

March 14, 2011

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To: Council as the QNet Shareholder

From: General Manager, QNet on behalf of the QNet Board of Directors

Subject: **QNet 2010/2011 Annual General Meeting Report**

For: **Council as the QNet Shareholder**

Recommendation:

That the QNet shareholder receive the Coquitlam Optical Network Corporation (QNet) Annual General Meeting Report – including the 2010 Audited Financial Reports and Status Update – noting that consideration of this report fulfills the 2010/2011 Annual General Meeting requirements.

Report Purpose:

The purpose of this report is to receive the 2010 Audited Financial Reports and Status Update; and to hold the QNet Shareholder Annual General Meeting as required under the QNet corporate charter.

Strategic Goal:

The initiatives outlined in this report help to meet the strategic goal of enhancing sustainability of city services and infrastructure; expands local jobs, local prosperity and supports the City's corporate objectives of innovating to meet changing needs and continually enhancing economic opportunity.

Executive Summary:

While QNet revenue was lower than expected in 2010 costs were managed to offset the deficit resulting in a budget variance of \$(6,817). The lower than expected revenue was primarily due to:

- Long approval processes for building access
- Service disruption in Pacific Reach due to the Gateway project
- Staffing and technology issues at Uniserve

Key accomplishments for QNet as of March, 2011 include:

- Connected 7 new sites to the network for a total of 12 connected buildings
- Secured 8 fibre leases from Bell Canada, Rogers Wireless, Uniserve Communications and the District of Maple Ridge worth \$55,000 in annual recurring revenue
- Issued service orders for 22 new fibre leases (most of which are expected to be executed over the course of 2011) worth \$158,000 in annual recurring revenue
- Presented a formal proposal to School District 43 to connect approximately 70 tri-city schools via fibre using QNet (the proposal has been approved by SD43 Trustees and the project is expected to begin by 2012 and be completed by 2016)
- Set up the technology, business processes, legal instruments and marketing materials to begin leasing excess capacity at the new Poirier co-location facility (expected to begin generating additional revenue for QNet starting in 2012)
- Conducted feasibility studies with Rogers Wireless for several new cellular transmission facilities in Coquitlam which have the potential to generate additional revenue for QNet and the City in future years while improving cellular coverage in the most responsible manner possible
- Received a 2010 Community Excellence Award from UBCM, Honourable Mention in the Best Practices General category

Using conservative estimates based on current sales and work in progress, the QNet financial plan has been updated resulting in the following 30 year financial forecast:

| | |
|---|----------------------|
| - First Year of Positive Revenue over Expenses: | 2012 |
| - First Year of Profit Excluding Interest and Depreciation: | 2014 |
| - Last Year of Repayment of City Loan: | 2029 |
| - Total Financing Required (as per original plan): | \$5.1 million |
| - Total Cost of Financing (interest paid on loan): | \$4.5 million |
| - Total 30 Year Profits: | \$12 million |
| - Annual Profit in 2037: | \$1.5 million |

Background:

The QNet Business Plan approved by Council in 2008 included three key strategies:

1. Leverage the excess fibre optic capacity of Coquitlam's core fibre optic network
2. Use the fibre optic network as a platform to improve wireless services in the City
3. Enhance access to competitive high speed services for Coquitlam businesses and residents by connecting businesses and residential multi-dwelling units (MDUs) to the network (i.e. fibre-to-the-premises)

The QNet Business Plan also established three goals which would guide the corporation and its Board members. In addition, the City of Coquitlam has some corresponding business and economic development aspirations which are closely aligned to QNet:

QNet Goal 1: Enable the transformation of telecommunications services in Coquitlam to an open, market driven, competitive environment.

With the launch of Uniserve services in January of this year, Coquitlam is now one of the few communities in Canada with truly competitive high speed Internet and telephone services. Uniserve expects to be providing competitive services in approximately 30 businesses and MDUs in Coquitlam over the next 12 to 18 months. Uniserve's competitive pricing starting at just \$9.95 per month is well structured for residential, home-based/small business and large business customers. This enhances Coquitlam's ability to expand local jobs and facilitates people's ability to work from home (i.e. virtual workplace). This in turn helps to reduce commuter traffic while enhancing the quality of life for Coquitlam families and residents.

As an indicator of the business and economic development opportunities enhanced by QNet, NCIX (a major technology supplier in BC) recently opened a retail store in the Levo 1 building on Atlantic Avenue. Prior to establishing their Coquitlam store, NCIX contacted QNet to ensure that Levo 1 was connected to our network and to find out which companies were offering competitive high speed services over QNet fibre.

QNet Goal 2: Enhance the telecom capabilities of the City and community.

With the initial deployment of fibre optics in 2003, the City was able to reduce operating costs for telecom services by \$302,000 per year. Additional savings of \$55,000 per year were realized in 2009 as a result of the competitive telecom services enabled by QNet. Access to competitive services also enabled the City to improve its Internet connection speed by approximately 1000%. School District 43 also hopes to realize significant improvements in ICT in partnership with QNet.

The City utilizes QNet infrastructure, technology, facilities and technical expertise at no cost. Conversely, QNet relies on the City for services such as accounting, legal advice and engineering support. This symbiotic relationship is highly beneficial to both parties.

QNet Goal 3: Provide a framework for the managed deployment of telecom infrastructure.

Increased competition in the wireless sector and the possibility that the federal government may allow more foreign telecom companies to operate in Canada has caused widespread concern among members of the Canadian Federation of Municipalities about the impact of new telecom infrastructure construction on municipal rights-of-way.

Initially Rogers Wireless approached the City with plans to build their own fibre optic network in Coquitlam. However, once Rogers became aware of QNet, they abandoned those plans and are now QNet's largest fibre leasing customer. It is clear that the best way to protect rights-of-way from new infrastructure projects is to provide a better, lower cost alternative. In this regard Coquitlam is one of the few municipalities in Canada that see increasing telecom demand as an opportunity rather than a concern.

By assisting cellular companies with finding appropriate sites for locating new wireless transmission facilities, QNet is helping to improve wireless coverage in Coquitlam in a managed and publicly responsible manner while creating opportunities for revenue generation for both QNet and the City.

2010 Final Trimester Report

As per the attached audited financial statements for 2010, QNet's final trimester report is as follows:

Building Connections

| | 2010 Budget | Actual | Variance |
|---------------------------|--------------------|---------------|-----------------|
| Fibre Connected Buildings | 8 | 12 | 4 |

Revenue & Expenses

| | 2010 Budget | Actual | Variance |
|---------------------|--------------------|---------------|-----------------|
| One Time Revenue | \$ 3,200 | \$ 1,600 | \$ (1,600) |
| Recurring Revenue | 71,400 | 30,600 | (39,200) |
| Operating Costs | (252,358) | (218,375) | <u>33,983</u> |
| Total 2010 Variance | | | \$ (6,817) |

Capital Expenditures

The following capital project expenditures were incurred in 2010 as per the QNet Business Plan:

| | |
|--|-----------------|
| Building Connections (Cost of Sales): | \$(234,010) |
| United Blvd Arterial (King Edward to Schooner): | (188,031) |
| Poirier COLO Equipment: | (225,859) |
| Minor Projects and Equipment: | <u>(16,397)</u> |
| Total 2010 Capital Expenditures | \$ (664,297) |
| Total financing including principal and interest due to the City at the end of 2010: | \$2,287,621 |

2011 Budget

As per the updated 30 year financial plan, QNet's 2011 budget and planned expenditures are as follows:

Building Connections

| | 2010 Budget | 2010 Actual | 2011 Budget |
|---------------------------|--------------------|--------------------|--------------------|
| Fibre Connected Buildings | 8 | 12 | 20 |

Revenue & Expenses

| | 2010 Budget | 2010 Actual | 2011 Budget |
|-------------------|--------------------|--------------------|--------------------|
| One Time Revenue | \$ 3,200 | \$ 1,600 | \$ 14,400 |
| Recurring Revenue | 71,400 | 30,600 | 74,300* |
| Operating Costs | (252,358) | (218,375) | (275,067) |

* Most new 2011 leases are expected to become active in the latter part of the year so first year revenue is estimated at 25% of the full year value. The revenue base for 2012 (excluding new leases) is forecast at \$180,000.

Capital Expenditures

| | |
|--|-------------------|
| Poirier Co-location Facility: | \$ (932,876) |
| Poirier Co-location Equipment (UPS): | (81,040) |
| Building Connections (Cost of Sales): | (378,024) |
| Fibre Connection to BC Internet Exchange: | (250,000) |
| Arterial Fibre Builds as per Business Plan | (202,000) |
| Minor Equipment | <u>(10,000)</u> |
| Total 2011 Capital Projects | \$(1,853,940) |

Annual General Meeting

The Coquitlam Optical Network Corporation is a wholly owned municipal corporation of the City of Coquitlam and as such, Coquitlam City Council represents the sole shareholder of the company.

A Board of Directors has been established by the QNet Shareholder and is made up of the following individuals:

- Peter Steblin, City Manager and Chair of QNet Board
- John DuMont, Deputy City Manager
- Bill Susak, General Manager Engineering & Public Works
- Jim McIntyre, General Manager Planning & Development
- Mark Zaborniak, Manager Design & Construction
- Wayne Beggs, Manager Economic Development

The Board of Directors have appointed three officers of the company:

- Peter Steblin, QNet Board Chair
- Rick Adams, Manager Information Communications Technology and General Manager, QNet
- Sheena MacLeod, Manager Financial Services and Treasurer, QNet

Under section 10.1 of the articles of incorporation, “unless an annual general meeting is deferred or waived in accordance with the *Business Corporations Act*, the Company must hold its first annual general meeting within 18 months after the date in which it was incorporated or otherwise recognized, and after that must hold an annual general meeting at least once in each calendar year and not more than 15 months after the last annual reference date at such time and place as may be determined by the directors.”

The Shareholder may agree to all business that is required to be transacted at that annual general meeting, in which case the annual general meeting can be deemed to have been held. The normal business to be discussed at the annual general meeting is:

- a) business related to the conduct or voting at the meeting;
- b) consideration of any financial statement of the company presented to the meeting;
- c) consideration of any reports of the directors or auditor;
- d) the setting or changing of the number of directors;
- e) the election or appointment of directors;
- f) the appointment of an auditor;
- g) the setting of the remuneration of an auditor;
- h) business arising out of a report of the directors not requiring the passing of a special resolution or an exceptional resolution;

- i) any other business, which under the Articles or the *Business Corporations Act*, may be transacted at a meeting of shareholders without prior notice of the business being given to the shareholders.

With the exception of the financial report and status update provided herein and the audited financial statements for 2010, the QNet Board of Directors has no normal or special business to bring before the Shareholder at this annual general meeting. In that respect, the Directors ask that the Shareholder deem that the 2010/2011 annual general meeting of the Coquitlam Optical Network Corporation has been held as per the Articles of Incorporation.

Financial Implications:

Based on 2010 financial results and the updated 30 year financial plan, there are no anticipated changes in QNet's start-up financing requirements of \$5.1 million as per the QNet Business Plan approved by Council in 2008.

Conclusion:

Despite a longer than expected start-up phase further impacted by the economic downturn and service interruptions in Pacific Reach, QNet sales are ramping up providing a solid financial base for the company. With the experience gained from two full years of operation, the 2011 update of the 30 year financial plan represents a realistic, if somewhat conservative, financial forecast for the company. This provides a firm foundation for the City to realize the anticipated benefits of QNet.



Rick Adams

Attachments:

2010 Audited Financial Statements

This report was prepared by Rick Adams and reviewed by the QNet Board of Directors.

Financial Statements of

**COQUITLAM OPTICAL NETWORK
CORPORATION (QNET)**

Year ended December 31, 2010



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INDEPENDENT AUDITORS' REPORT

To the Shareholder

We have audited the accompanying financial statements of the Coquitlam Optical Network Corporation (QNET) (the "Company"), which comprise the balance sheet as at December 31, 2010 and the statements of operations and deficit and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian public sector accounting standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform an audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2010, and the results of its operations and its cash flows for the year then ended in accordance with Canadian public sector accounting standards.

Chartered Accountants

Burnaby, Canada

March 10, 2011

COQUITLAM OPTICAL NETWORK CORPORATION (QNET)

Statement of Operations and Deficit

Year ended December 31, 2010, with comparative figures for 2009

| | 2010 | 2009 |
|------------------------------|---------------------|---------------------|
| Revenue: | | |
| Professional consulting fees | \$ - | \$ 60,000 |
| Lease revenue | 32,200 | 28,400 |
| Installation fees | 1,600 | 1,600 |
| | <u>33,800</u> | <u>90,000</u> |
| Operating expenses: | | |
| General and administrative | 218,376 | 254,634 |
| Amortization | 57,443 | 36,308 |
| Bad debts | - | 25,200 |
| | <u>275,819</u> | <u>316,142</u> |
| Loss before other item | (242,019) | (226,142) |
| Other expense: | | |
| Interest (note 4) | 29,191 | 20,948 |
| Loss for the year | (271,210) | (247,090) |
| Deficit, beginning of year | (566,032) | (318,942) |
| Deficit, end of year | <u>\$ (837,242)</u> | <u>\$ (566,032)</u> |

See accompanying notes to financial statements.

COQUITLAM OPTICAL NETWORK CORPORATION (QNET)

Statement of Cash Flows

Year ended December 31, 2010, with comparative figures for 2009

| | 2010 | 2009 |
|--|--------------|--------------|
| Cash provided by (used in): | | |
| Operations: | | |
| Loss for the year | \$ (271,210) | \$ (247,090) |
| Amortization of property and equipment, a non-cash item | 57,443 | 36,308 |
| Net change in non-cash operating working capital balances: | | |
| Accounts receivable | (80,523) | (33,280) |
| Accounts payable and accrued liabilities | 191,265 | (4,855) |
| | (103,025) | (248,917) |
| Financing: | | |
| Increase in due to City of Coquitlam | 708,317 | 770,566 |
| Investments: | | |
| Purchase of property and equipment | (664,297) | (457,881) |
| Increase (decrease) in cash | (59,005) | 63,768 |
| Cash, beginning of year | 63,768 | - |
| Cash, end of year | \$ 4,763 | \$ 63,768 |

See accompanying notes to financial statements.

COQUITLAM OPTICAL NETWORK CORPORATION (QNET)

Notes to Financial Statements

Year ended December 31, 2010

1. Operations:

Coquitlam Optical Network Corporation (QNet) (the "Company") was incorporated on November 12, 2008 under the British Columbia Business Corporations Act. The Company's business involves providing open access to optical fibre networks. It is a wholly municipal-owned subsidiary of the City of Coquitlam and operates its business within the City of Coquitlam municipality boundaries. The Company is a local government corporation and is exempt from income taxes.

2. Significant accounting policies:

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles and reflect the following significant accounting policies:

(a) Revenue recognition:

The Company recognizes revenue when services are provided to customers, price is fixed or determinable, and collectibility is reasonably assured.

(b) Property and equipment:

Property and equipment are carried at cost less accumulated amortization and are amortized on a straight-line basis over their estimated useful lives as follows:

| Asset | Rate |
|---------------------------|-----------------|
| Software | 8 years |
| Data centre equipment | 5 - 25 years |
| Building entrance - civil | 85 years |
| Building entrance - fibre | 25 years |
| Arterial fibre - civil | 85 years |
| Arterial fibre - fibre | 25 years |
| Buildings | 50 years |
| Construction-in-progress | no amortization |

(c) Impairment of long-lived assets:

Long-lived assets, consisting of property and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability is measured by a comparison of the carrying amount to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of the asset exceeds its estimated future cash flows, an impairment loss is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset.

COQUITLAM OPTICAL NETWORK CORPORATION (QNET)

Notes to Financial Statements (continued)

Year ended December 31, 2010

2. Significant accounting policies (continued):

(d) Use of estimates:

The preparation of financial statements requires management to make estimates and assumptions that could affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Significant areas requiring the use of management estimates relate to the determination of allowance for doubtful accounts, useful lives for amortization of property and equipment, and provisions for contingencies. Actual results may ultimately differ from these estimates.

(e) Capital disclosures:

CICA Handbook Section 1535, *Capital Disclosures*, requires quantitative disclosure about what is regarded as capital and disclosure of information with respect to the objectives, policies and processes used by the Company to manage capital. These disclosures are included in note 7 to the financial statements.

(f) Future accounting changes:

Accounting framework:

The Public Sector Accounting Boards recently approved changes to the scope of public sector accounting standards. These amendments require that government business enterprises adopt International Financial Reporting Standards ("IFRS") for periods beginning on or after January 1, 2011. Government organizations that are not considered to be business enterprises are either government not-for-profit organizations or other government organizations. Other government organizations will have a choice of whether to adopt IFRS or Public Sector Accounting Standards ("PSAB").

Under the new framework, the Company is classified as an other government organization as at January 1, 2011. The Company has decided to adopt PSAB and is in the process of determining the impact to its financial statements.

COQUITLAM OPTICAL NETWORK CORPORATION (QNET)

Notes to Financial Statements (continued)

Year ended December 31, 2010

3. Property and equipment:

| | | | 2010 | 2009 |
|---------------------------|--------------|-----------------------------|-------------------|-------------------|
| | Cost | Accumulated amortization | Net book value | Net book value |
| Software | \$ 84,050 | \$ 28,304 | \$ 55,746 | \$ 60,068 |
| Data centre equipment | 446,301 | 55,549 | 390,752 | 194,941 |
| Building entrance - fibre | 135,887 | 3,846 | 132,041 | 6,997 |
| Building entrance- civil | 179,474 | 1,208 | 178,266 | - |
| Arterial fibre - civil | 637,286 | 13,183 | 624,103 | 620,001 |
| Arterial fibre - fibre | 55,413 | 2,846 | 52,567 | 43,232 |
| Construction in progress | 116,653 | - | 116,653 | 18,035 |
| | \$ 1,655,064 | \$ 104,936 | \$ 1,550,128 | \$ 943,274 |

4. Due to City of Coquitlam:

The amount due to City of Coquitlam of \$2,287,621 (2009 - \$1,579,304) is related to funding from the City for the purchase of property and equipment, and operating expenses of the Company. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration negotiated and agreed to by the related parties.

Amounts due to related parties are unsecured, bear interest at 1.55% (2009 - 1.77%) and have no set terms of repayment.

5. Related party transactions:

During the year, certain employees of the City of Coquitlam performed administrative services for the Company, including purchasing, accounting, clerical and other operational-type services. The Company was not charged by the City of Coquitlam for these services for the year ended December 31, 2010 (2009 - nil). Management costs and direct infrastructure services related to the Company were charged from the City of Coquitlam and are shown as expenses in the financial statements.

6. Economic dependence:

The Company's operations are currently wholly funded by the City of Coquitlam and accordingly, future operations of the Company are dependent upon the continued financial support of the City of Coquitlam for the foreseeable future.

COQUITLAM OPTICAL NETWORK CORPORATION (QNET)

Notes to Financial Statements (continued)

Year ended December 31, 2010

7. Capital management:

The Company's capital currently consists of its share capital. As the Company is expected to begin to earn a profit in 2013, future capital will consist of its retained earnings and share capital. The Company's objective when managing capital is to safeguard its assets and to ensure that adequate capital is managed for future requirements.

8. Financial instruments:

(a) Fair values:

The fair values of certain of the Company's financial instruments, including cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities approximate their carrying values due to their short maturities.

The fair value of amounts due to City of Coquitlam is not practical to determine due to the related party nature and terms of the balances and the limited amount of comparable market information available.

(b) Credit risk:

The majority of the Company's activities are concentrated in the telecommunications industry. To reduce credit risk, management performs ongoing credit evaluations of its customers' financial condition. The Company maintains reserves for credit losses.

(c) Interest rate risk:

The Company is exposed to interest rate risk on the amount due to City of Coquitlam as the instrument bears interest at a floating rate.

9. Comparative figures:

Certain comparative figures have been reclassified to conform with the financial statement presentation adopted in the current year.