

Mr. Jim Rule
Chief Administrative Officer
City of Greater Sudbury
Tom Davies Square, 200 Brady Street
Sudbury, Ontario P3A 5P3

June 6, 2001

Dear Mr. Rule

The Station Telecommunications Project

INTRODUCTION

Please let this letter serve as an addendum to our report dated June 1, 2001 concerning the Station Telecommunications Project (the "Station").

As noted in our earlier report, our review has left us with significant concerns over the Station's viability from a financial standpoint. This conclusion was based on our analysis of the likely financial performance of the Station based on a total market area of 3,000 homes.

As requested, we have expanded our analysis to consider alternate scenarios that would be reflective of the intent to expand the Station throughout the City. Accordingly, we have reviewed the projected financial performance of the Station under three scenarios:

- Deployment to 10,000 households within the City
- Deployment to 30,000 households within the City
- Deployment to 62,000 households within the City, representing 100% of all households in the municipality

While the underlying assumptions supporting our analysis have changed, we continue to question the financial viability of the Station, regardless of the size of the market area. In addition, we note that an expansion of the Station's market area could result in significant increases in both the capital costs of the required infrastructure and the City's investment in the project.

Our comments concerning our additional analysis follow.

ANALYSIS OF ALTERNATIVE SCENARIOS

As a result of our discussions with the proponents of the Station, we understand that the original vision of the Station was to deploy a pilot project in the former Town of Capreol and ten multi-residential properties in the former City of Sudbury. Following this initial pilot project, the underlying infrastructure supporting the Station would be expanded to other portions of the City. This capital expenditure is intended to be financed by the profits generated by the Station.

Analysis of projected operating results

Based on the results of our analysis, it appears that any increase in the Station's market area would not result in a corresponding increase in operating profits. Our analysis indicates that the Station would continue to be challenged from a financial standpoint, regardless of its total market area.

Projected customers

As noted in our earlier report, we have based our financial analysis on industry penetration rates and other indicators for the services to be offered by the Station. Based on our research, we have determined that the potential market for the services to be offered is relatively low, and expect this to be consistent if the Station's market area were expanded.

Based on our analysis, we have determined the customer levels for the Station, based on the expanded market areas, to be as follows:

Projected customer levels assuming varying market sizes

	Number of homes serviced			
	3,000	10,000	30,000	62,000
Internet customers	1,096	1,096	3,288	6,796
Video on demand customers	700	700	2,100	4,340
Alarm monitoring customers	–	–	–	–

Projected revenues

As outlined in our earlier report, we have assumed that the Station would generate approximately \$697,000 in revenues over a three year period, based on a deployment to 3,000 homes. If an expanded market area is assumed, the total revenue to be earned by the Station would increase accordingly.

Based on our estimates of customer levels for each of the scenarios reviewed, we have estimated that the total revenues that could be earned by the Station over a three year period would be in the range of \$1.8 million to \$10.4 million, as follows:

Projected revenues earned over a three year period assuming varying market sizes

	Number of homes serviced			
	3,000	10,000	30,000	62,000
Internet service	\$ 446,000	1,484,000	4,452,000	9,202,000
Video on demand	18,000	63,000	189,000	390,000
Alarm monitoring	–	–	–	–
Local business advertising	204,000	204,000	204,000	204,000
E-commerce commission	9,000	32,000	96,000	198,000
National business advertising	20,000	68,000	204,000	422,000
Total projected revenue	\$ 697,000	1,851,000	5,145,000	10,416,000

Projected expenditures

Based on the assumption that the Station's market area and customer base will increase in the future, the projected operating costs to be incurred by the Station will rise as well. As a result, any increase in the Station's market area will likely result in operating losses as we anticipate expenditures will continue to exceed the higher revenues.

Projected operating results over a three year projection period

	Number of homes serviced			
	3,000	10,000	30,000	62,000
Total projected revenue	\$ 697,000	1,851,000	5,145,000	10,416,000
Total projected operating costs	1,342,000	3,035,000	8,817,000	14,510,000
Projected deficit	(645,000)	(1,184,000)	(3,672,000)	(4,094,000)
Average annual operating loss	\$ (215,000)	(395,000)	(1,224,000)	(1,365,000)

Required capital expenditures and municipal investment

In addition to our concerns over the financial viability of the Station, we also note that any expansion of the Station's market area could be accompanied by significant increases in the amount of capital spending associated with the project.

As a result of our review, we note that the business case estimates the average cost of installing the infrastructure necessary for the Station to be approximately \$1,641 per household, as follows:

Estimated per household cost of infrastructure

	Total Cost	Cost per Household
Switching equipment (net of private sector discounts)	\$ 3,309,000	1,103.00
Fibre optic cable (to connect households to existing fibre optic network)	379,000	126.00
Fibre to home equipment	875,000	292.00
Installation costs	359,000	120.00
Total costs	\$ 4,922,000	1,641.00

In addition to this amount, approximately \$812,000 of expenses will also be incurred for computer servers, software development and other items. However, we do not anticipate significant increases in these costs as the market area of the Station is expanded due to the fact that the capacity of these systems should be sufficient to handle the projected customer base.

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In light of the above, we estimate that any expansion in the Station's market area can only be accomplished through capital spending equal to \$1,641 per additional household serviced. As a result, the projected capital costs associated with the Station under the scenarios considered will likely be in the range of \$17 million to \$102 million, as follows:

Estimated capital costs associated with expanded market areas

	Number of homes serviced			
	3,000	10,000	30,000	62,000
Projected capital cost per home	\$ 1,641.00	\$1,641.00	\$1,641.00	\$1,641.00
Total projected capital cost before computer components	4,922,000	16,410,000	49,230,000	101,742,000
Estimated cost of computer components	812,000	812,000	812,000	812,000
Total projected capital cost	\$ 5,734,000	17,222,000	50,042,000	102,554,000

We trust the above is satisfactory for your purposes. Should you have any questions or require further information, please do not hesitate to contact us at your convenience.

Yours very truly

James G. Corless, FCA

Oscar A. Poloni, CA, CBV

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