



CORPORATE BUSINESS IMPROVEMENT
INITIATIVES – IDEAS – IMPROVEMENTS

Review of September 4, 2015 Letter from
UKnight Interactive

For UKnight Committee

Matthew A. St. John, Director, Insurance Marketing

Corporate Business Improvement Report
November 2015

A review of UKnight Interactive Letter of September 4, 2015, offering financial involvement with their business to The Supreme Council.

EXECUTIVE SUMMARY

There is significant value in Councils and Agents having a consistent web presence

1. A high standard, professional, interconnected web presence, guided by the Supreme Council's on-going backing and support
 - a. To foster Insurance agent "look ups", and our insurance program
 - b. To facilitate our Parish level fraternal activity; among councils and members, sharing information and calendar events

UKnight provides this web presence and offers sponsorship to Supreme to expand reach

2. UK's template is easy to use and create your own web presence
3. UK requires human resources, time and money to expand
 - a. UK is established and operating
 - b. Current penetration in the Order: 5-13% *per consultant Ian Kinkade- June 2015*
4. Current fees to councils and agents are "below market", *per Ian Kinkade*

Significant drawbacks

5. Costs, Order wide are **\$17M** over 6 years projected, paid to UK
6. UK's "Market Center" is "market-wide" open to unrestricted commercial advertising
7. Committing to UK now, prohibits switching later to a more "aligned" alternative
8. Supreme does not control members, councils, and agents' internet social media web presence
9. Errors in math and formulas, with inconsistencies in reporting were discovered within UK's financial presentation- *see page two*

Alternative

The Supreme Council provides the Order a web-presence

Benefits

1. Guidance and control are unimpeded, Supreme Councils' ethics prevail
2. Costs are a fraction of what the Order would spend with UK
3. K of C survey reveals Councils and agents are reluctant to commit until Supreme Council makes endorsement
4. Discovering alternatives to UK may be significant opportunities

Drawbacks

5. Time frame to develop acceptable alternative is unknown
6. Unknown if resources are available with necessary skill sets

REVIEW

Corporate Business Improvement reviewed the September 4, 2015 letter from UKnight Interactive (UK) at the request of Matthew St. John, Director of Insurance Marketing for our comments, questions and concerns on Plan 2, described in this letter.

UK offers to establish a relationship with the supreme council through financial investment or involvement. UK is a private business that offers website templates specifically designed for, and whose market is, our Order (State Councils, Districts, Chapters, Councils Assemblies, Circles).

We outline below our insights, our observations, what we see beneath the data and the questions raised from our analysis. In addition, we evaluated UK's "Firm Valuation" calculation to attain a deeper sense of this communication.

No other proposal described as a Social Media Site for K of C members was presented to CBI for comparison or cost benefit analysis.

Insights & Observations

There are five Plans to consider, all with different levels of funding, plus a weak interest to sell their business.

From CBI's perspective, there is significant value in Councils and Agents having a consistent "web presence". The Order would greatly benefit by consistent looking web pages among our councils and agents that employ a standard professional image with easy to use templates for site creation and that connects or links with other segments of our Order, which is governed by Supreme Council policies. For numerous reasons this is a worthy objective and one that deserves a high priority.

UK is an ongoing concern, currently offering templates for web creation, linking connections and other features that appear to meet the Orders' practical needs. Their willingness for Supremes' involvement is evident by their offering 5 separate Plans of operation, all focused on what they consider the Supreme Council's desire to ramp-up the Order's web presence (accelerated adoption), financial stability, technical support and capacity. In addition, UK's letter suggests a weak interest on selling their business while: 1) retaining a perpetual license and 2) maintaining their current agreement with List Interactive Ltd to operate "Market Center."

UK's financial worksheets project a 5% annual growth rate for Councils, GA's and FA's. *Growing at this rate, UK requires funding to support an increase in staff for marketing, sales support, customer support, plus developers for testing and infrastructure changes.* In addition:

- Their financial Plans do not reflect this significant increase in staffing levels (Admin expense)- *Ian Kinkade mirrors this observation albeit from different financial projections, see his June 16, 2015 report page 9*
- A 5% growth rate across these sectors is significantly higher than our historical trend- *New Council Development (NCD) averages 2.3% (gross increase) over the last 15 years (see report in Appendix), GA's have remained consistent at 135 +/- and FA average a steady 1,347 over the past 5 years*

- However, we believe the growth rate of 5% is attainable for new councils based the report of NCD's achievements and trends observed and tracked since 2000, *a report shows annual growth of 40%, 21%, and 17% in the highest 3 years over the past 15*

UK claims a “comparable service” is significantly higher than what they charge. CBI has not verified this however; Ian Kinkade verifies this statement *on pg. 6 of his June 16, report.*

We also note:

- UK's projections reflect \$300 annual subscription fee for Councils, however, their website currently charges councils just \$150 per year- a *100% price increase used for projections over figures currently advertised on their web site*
- We uncovered inconsistencies and inaccuracies sprinkled throughout this September 4, 2015 letter and accompanying spreadsheets

Beneath the Data

UK's product and services are unique and come with a big price tag to the Order. We read the combined projected payments from supreme, local councils, agents and agencies totals **\$17.4M in cash outlay** during the **first 6 years** under **Plan 2**. We also see:

- UK's worksheet “Summary,” an analysis summarizing all Plans, is not reflective of detail stated in their Plans; significant costs were left out - *this prompted us to create our own summary report “Plan Comparison Summary” using figures from their Plans*
- Plan 2 requires an additional payment of \$250K over Plan 1, and provides the Supreme Council with “3 % equity” in UK's business in “year two,” this appears to calculate into a company value of \$8.3M,- *in contrast to UK's claimed value of \$21.M calculated on their “Firm Valuation” worksheet*
- UK estimates the value of their business on their “Firm Valuation” worksheet. This “Enterprise Value” is calculated by projecting the present value (discounted at 12%) of their “free cash flows” over six years, added to the present value of their “Terminal Value”
 - The Terminal Value calculation used by UK applied the popular “Gordon Growth Model”. *This method anticipates continual growth at an assumed constant rate in perpetuity*
 - ***Per UK, their Enterprise Value is \$21.4M, using a 5% growth rate***
 - ***CBI calculated UK's Enterprise Value at \$17.6M using 3% growth rate***
 - *Both Enterprise Value calculations use figures from the “Revenue Model” that **do not include \$3M of costs** of “Other Administrative and Marketing Costs” **which is included Plans 1-5***
 - *UK's Enterprise Value, re-calculated **without math/formula errors** increases in value by \$2M (from \$21.4M to \$23.4M)*

- We discovered Formula errors or, the formulas were modified by design to achieve a desired outcome

Questions Raised

UK recognizes “control” is one of our top considerations of discussion and they suggest this “can be addressed contractually,” however, the limits of control by this method must be considered. Supreme currently has an inherent risk by two unrelated organizations, UKnight Interactive and List Interactive, Ltd, (*Leonard S. Labriola founder*) currently holding identifying records of a large (and growing) group of members, councils, agents and agencies. The September 4 letter briefly mentions their “Market Center”, yet this may be a significant ingredient in Supremes’ involvement. CBI’s review reveals:

- The company, “List Interactive Ltd.” currently operates and manages this Market Center and UK wants them to remain in this role if UK is acquired by Supreme -*see last page of September 4, letter, appendix has full description of UK’s Market Center*
- Market Center Revenue (List Interactive Ltd.) projects \$3.1M in advertisement revenue from 2016 -2020 in the June 16, 2015 report, however **these revenues are missing from the September 4 projections and valuation**

Alternative

The Supreme Council provides the Order a web-presence. CBI believes Supreme can offer a web presence equal or better than UK’s product and service. The benefits of this are numerous however; most important is the control of the Order’s presence in social media, which demands our highest attention and guidance.

Benefits

- Guidance and control are unimpeded, Supreme Councils’ ethics prevail
- Costs are a fraction of what the Order would spend with UK
- K of C survey reveals Councils and agents are reluctant to commit until Supreme Council makes endorsement
- Discovering alternatives to UK may be significant opportunities

Drawbacks

- Time frame to develop acceptable alternative is unknown
- Unknown if resources are available with necessary skill sets

APPENDIX

Market Center

The “UKnight Marketing Center” purpose and function as described on the web site follows.

“The purpose of the UKnight Market Center is to extend the fraternal relationships shared by brother Knights to the marketplace, and to use the power of this market center to provide financial support for your council. Use the Business Categories below to help find a business or service you are interested. All of these businesses have provided financial support to their council.”

“This UKnight Market Center contains information relating to business listings. Third parties (independent advertisers) have posted this information. It is provided solely as a convenience to the users of this website. The Knights of Columbus and/or UKnight Interactive do not endorse, support, represent or guarantee the truthfulness, accuracy or reliability of any information posted or provided in the business listings. The users of this website acknowledge that any reliance on material relating to such business listings will be at user's own risk.”

In the June 16, 2015 report, Ian Kinkade describes the Market Center in more clarity:

“UKnight offers the ability to include advertising on the individual sites and share the income with the particular site. This service is called “Market Center” and provides the Councils with a source of income that they can use to pay for the site or utilize with the promotion of the order.

UKnight has commenced this service and plan to staff a Market Center to assist with contracts, clear the Ads for appropriateness (posting guidelines are stated in the K of C By-laws) before they are posted and to ensure that they are being posted to a schedule. Support materials have been produced to explain the program and how it is implements.” – see UK’s website.

Errors Noted

Plans 1, 2, 3, 4, 5 - Year 2016 “Tech Total On-Going Technology Development” costs stated at \$345k, calculated actually is \$369K, error understating expenses by \$24,000

Plans 2, 3, 4, 5 - Years 2015 - 2025 “Total On-Going Technology Development”, missing the cost of “Managed Infrastructure Cost- Rack Space”, total cumulative error understating expenses by \$475,332

Summary – Plan 1, “Total Ongoing Fee Estimated”, stated at \$15,000, (current year only) actual “Total” cumulative revenue for UK and expense to Supreme Council for all years of Plan is, \$2,489,332, understating expense to Supreme Council by \$2,474,332

Plan 2, “Total Ongoing Fee Estimated”, stated at \$105,000, (current year only) actual “Total” cumulative revenue for UK and expense to Supreme Council for all years of Plan is, \$2,489,332, understating expense to Supreme Council by \$2,391,332

Plans 3, 4, 5, “Total Ongoing Fee Estimated”, stated at \$0 for all Plans, resulting in the understatement of expense to the Supreme Council for Plans 3 and 4 of \$2,466,832, and \$2,225,857 for Plan 5.

Firm Valuation

Inconsistency – Valuation calculation used a lower expense for Administration and Overhead than Plans, lowering expense figure used in Firm Valuation by \$3,839,155 (average of Plans)

Formula error- “Discount Period” in year 2018 calculated with 3.5 periods should be 2.5 periods, this error continued for 3 projected years, 2019, 2020, and 2021

Formula error- “Terminal Valuation Calculation, Discount Factor” added a 1 to the “Discount Period” in error according CBI’s interpretation of the GORDON GROWTH MODEL, resulting in decreasing the Enterprise Value by \$1,854,000

UKnight Interactive
Enterprise Value

	Projected						
	Fiscal Years Ending December 31						
	2015	2016	2017	2018	2019	2020	2021
Total Revenue	\$ -	\$ 1,986	\$ 2,107	\$ 2,580	\$ 3,204	\$ 3,447	\$ 3,619
Revenue % Growth		0.00%	6.13%	22.44%	24.18%	7.57%	5.00%
Total Cost of Revenues	\$ -	\$ 397	\$ 504	\$ 452	\$ 466	\$ 480	\$ 494
Cost of Revenues % Growth		0.00%	26.93%	-10.29%	3.00%	3.00%	3.00%
Contribution (Gross Profit)	\$ -	\$ 1,589	\$ 1,603	\$ 2,128	\$ 2,739	\$ 2,967	\$ 3,125
Contribution Margin	0.00%	80.01%	76.09%	82.48%	85.47%	86.08%	86.35%
Contribution % Growth		0.00%	0.94%	32.72%	28.68%	8.34%	5.32%
Total Operating Expenses	\$ -	\$ 491	\$ 506	\$ 521	\$ 537	\$ 553	\$ 569
Operating Expense Growth		0.00%	3.00%	3.00%	3.00%	3.00%	3.00%
EBITDA	\$ -	\$ 1,098	\$ 1,098	\$ 1,607	\$ 2,202	\$ 2,414	\$ 2,556
EBITDA Margin	0.00%	55.28%	52.09%	62.29%	68.72%	70.05%	70.62%
EBITDA % Growth		0.00%	0.01%	46.42%	37.01%	9.64%	5.86%
Less: Depreciation	\$ -	\$ -	\$ 164	\$ 197	\$ 233	\$ 109	\$ 120
EBIT	\$ -	\$ 1,098	\$ 934	\$ 1,410	\$ 1,969	\$ 2,305	\$ 2,436
Less: Estimated Taxes ⁽¹⁾	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Net Operating Profit After Tax (NOPAT)	\$ -	\$ 1,098	\$ 934	\$ 1,410	\$ 1,969	\$ 2,305	\$ 2,436
Cash Flow Adjustments							
Plus: Depreciation	\$ -	\$ -	\$ 164	\$ 197	\$ 233	\$ 109	\$ 120
Less: Capital Expenditures	\$ -	\$ 498	\$ 100	\$ 110	\$ 121	\$ 133	\$ 146
Free Cash Flow	\$ -	\$ 600	\$ 998	\$ 1,497	\$ 2,081	\$ 2,281	\$ 2,409
Discount Period		0.50	1.50	3.50	4.50	5.50	6.50
Present Value Factor (WACC)		0.9449x	0.8437x	0.6726x	0.6005x	0.5362x	0.4787x
Present Value of Fee Cash Flow	\$ -	\$ 567	\$ 842	\$ 1,007	\$ 1,250	\$ 1,223	\$ 1,153
Valuation							
Present Value of Free Cash Flow Over Period	\$ 6,042						
Present Value of Terminal Value ⁽²⁾	\$ 15,448						
Enterprise Value	\$ 21,490						

Terminal Value Calculation	
Terminal Free Cash Flow	\$ 2,530
Terminal Growth Rate	5.00%
Estimated Terminal Value ⁽²⁾	\$ 36,141
Discount Factor	0.4274x
Present Value of Terminal Value	\$ 15,448

(1) SBA Office of Advocacy, Effective Federal Income Tax Rates Faced by Small Businesses in the United States
(2) Terminal value is calculated assuming a 5.0 percent terminal growth rate, consistent with conservative projections

NCD FIGURES

	15	14	13	12	11	10	09	08	07	06	05	04	03	02	01	00	Total
July	19	16	23	13	10	19	11	13	12	8	6	14	8	9	7	12	12
Aug.	31	11	17	7	20	13	12	11	9	18	12	14	7	8	10	17	24
Sept.	51	11	18	14	34	17	10	33	14	12	13	16	8	8	6	23	40
Oct.	67	30	19	20	54	16	18	51	15	16	17	17	13	15	12	35	56
Nov.	67	15	21	18	72	19	26	77	15	21	18	22	12	16	14	49	71
Dec.	67	19	12	21	27	30	35	23	19	17	20	86	15	19	16	65	90
Jan.	67	24	22	11	11	12	22	15	18	16	18	25	18	15	13	9	99
Feb.	67	23	15	11	123	19	18	107	17	20	19	24	18	12	20	98	123
Mar.	67	26	34	19	142	20	34	22	24	26	34	29	20	23	28	126	140
Apr.	67	26	34	26	168	13	29	27	32	22	26	36	27	18	30	156	163
May	67	22	15	33	201	16	30	25	30	40	29	24	33	25	26	182	186
June	67	33	35	28	229	22	41	34	39	34	37	47	30	28	42	31	217
Highest Month																	
Code:	Highest Total																
	Lowest Month																
	-5.2%	17.9%	11.2%	-10.8%	-19.2%	20.7%	-2.9%	-2.4%	0.4%	-15.0%	40.2%	6.6%	-12.5%	3.2%	2.3%	Yearly Change Average	
	18.0%	24.4%	5.5%	-5.1%	6.5%	31.8%	9.2%	12.4%	15.2%	14.7%	-3.7%	-9.7%	3.2%	11.3%	Cumulative Change Average		

Source: NCD

Plan Comparison Summary

2015 - 2025

Figures from UK's PLANS - NOT MODIFIED

	<u>Plan 1</u>	<u>Plan 2</u>	<u>Plan 3</u>	<u>Plan 4</u>	<u>Plan 5</u>
Funding					
Supreme Council amount:					
<u>Set Up cost</u> - first year	\$ 250,000	\$ 250,000	\$ 250,000	\$ 500,000	\$ 500,000
- second year		\$ 250,000	\$ 250,000		
<u>Subscription</u> for Agents - first year		\$ 1,000,000	\$ 1,000,000	\$ 1,000,000	\$ 1,000,000
- second year				-	\$ 1,000,000
<u>Subscription</u> for Councils - first year			\$ 1,000,000	\$ 1,000,000	\$ 1,000,000
- second year				-	\$ 1,000,000
<u>Access Fees</u> for Councils- ongoing	\$ 2,489,332	\$ 2,496,832	\$ 2,466,832	\$ 2,466,832	\$ 2,225,857
Total Funding	\$ 2,739,332	\$ 2,996,832	\$ 3,966,832	\$ 4,966,832	\$ 6,725,857
EQUITY	0%	3%	12.5%	22.5%	25.0%
Revenue					
Council Subscriptions:					
Annual Fee \$300 / up to 15,513 councils	\$ 24,893,324	\$ 24,968,324	\$ 24,668,324	\$ 24,668,324	\$ 22,258,574
General Agents Subscriptions:					
Annual Fee \$300 / from 100 -205 GA's	\$ 513,085	\$ 513,085	\$ 513,085	\$ 473,485	\$ 339,000
Field Agent Subscriptions:					
Annual Fee \$300 / from 500 - 2,048 FA's	\$ 5,055,845	\$ 5,055,845	\$ 5,055,845	\$ 4,659,845	\$ 3,307,800
Total Revenue	\$ 33,201,586	\$ 33,534,086	\$ 34,204,086	\$ 34,768,486	\$ 32,631,231
Loan / Funding Repayment - over 8 years				\$ (2,000,000)	
Total Funding & Revenue	\$ 33,201,586	\$ 33,534,086	\$ 34,204,086	\$ 34,768,486	\$ 30,631,231

Free Cash Flow Forecast and Enterprise Value Calculation- CBI

Night Interactive Free Cash Flows Forecast

(\$000)

Projections

Fiscal Years Ending December 31

	2015	2016	2017	2018	2019	2020	2021	Totals
		YR-1	YR-2	YR-3	YR-4	YR-5	YR-6	
KNIGHTS OF COLUMBUS CALCULATION								
Growth Rate at 3%								
Free Revenue- from Revenue Model *	\$ -	\$ 1,486	\$ 2,099	\$ 2,562	\$ 3,176	\$ 3,191	\$ 3,287	15,801
<i>Only change: excluding \$500,000 from Supreme</i>			41.27%	22.08%	23.96%	0.49%	3.00%	Annual Change
Operating Costs - from Revenue Model	\$ -	\$ 888	\$ 1,010	\$ 973	\$ 1,002	\$ 1,032	\$ 1,063	5,968
Free Cash Flow	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	-
Investment - from UK	\$ -	\$ 498	\$ 100	\$ 110	\$ 121	\$ 133	\$ 146	1,108
Investment: Capital Expenditures	\$ -	\$ -	\$ (164)	\$ (197)	\$ (233)	\$ (109)	\$ (120)	
Investment: Depreciation	\$ -	\$ 498	\$ (64)	\$ (87)	\$ (112)	\$ 24	\$ 26	284
Change in Working Capital*	\$ -	\$ 598	\$ 1,089	\$ 1,589	\$ 2,174	\$ 2,159	\$ 2,224	
Free Cash Flow	\$ (498)	\$ 662	\$ 1,176	\$ 1,702	\$ 2,150	\$ 2,150	\$ 2,133	7,325
Discount Period		0.50	1.50	2.50	3.50	4.50	5.50	
Discount Value per UK		0.9449x	0.8437x	0.7533x	0.6726x	0.6005x	0.5362x	
Present Value of Free Cash Flow	\$ (470)	\$ 558	\$ 886	\$ 1,144	\$ 1,291	\$ 1,291	\$ 1,144	4,553

Night Interactive Enterprise Value

Present Value of Free Cash Flow Over Period	\$ 4,553
Present Value of Terminal Value	\$ 13,088
Enterprise Value	\$ 17,642

Terminal Value Calculation	
Terminal Free Cash Flow	\$ 2,197
Terminal Growth Rate	3.00%
Estimated Terminal Value ⁽²⁾	\$ 24,411
Discount Factor	0.5362x
Present Value of Terminal Value	\$ 13,088

Reduced Revenue by Supreme Council investment of \$500,000, as this is not cash from operations
Missing impact of fluctuating receivables and payables