Alameda County Industries

Long Term Adjustments to Existing Franchise Agreements with the Cities of San Leandro and Alameda Related to "Living Wage" Adjustments & MRF Improvements

Executive Summary

As has been discussed with staff of the Cities of San Leandro and Alameda (the "Cities"), the passage of a "Living Wage" ordinance (the "San Leandro Ordinance") and similar actions or intentions expressed by other municipal leaders in Alameda County, have resulted in an increase in the number of union employees which, not surprisingly, have also had a material adverse effect on the financial health of Alameda County Industries ("ACI" or, the "Company"). While an interim solution to the problem was reached with the City of San Leandro thru June 30, 2015, a permanent solution will be required..

As you are aware, pursuant to an agreement with the City of San Leandro, ACI significantly increased wages as of December 1, 2014 for employees at its Material Recovery Facility ("MRF") in accordance with the San Leandro Ordinance. Per agreement with that city, San Leandro provided a cash loan to be paid back from future rate adjustments, and implemented a small rate adjustment already provided for in its franchise agreement, the combination of which will allow the Company to have sufficient resources to operate through mid-year without material consequences related to meeting its bank financial covenants given its greatly increased costs (although waivers by the bank of certain covenants will still be required). But those adjustments and the bank waivers were only temporary in nature.

The purpose of this memo and the accompanying material, therefore, is to propose the basis for a permanent solution which will allow the increased unionization of the Company's workforce while at the same time, ultimately encouraging maximum efficiency and thereby keep the costs to the solid waste ratepayers as low as possible.

This memo and the accompanying material will provide details of the financial impact of the new wage and benefit scales, discuss estimated rate increases which would be required to allow the Company to continue to operate the MRF in accordance with living and prevailing wage requirements, and what the Company believes is the long term plan best suited to keeping rates as low as possible while increasing efficiencies and resulting diversion of recyclable material. This discussion will necessarily be based on certain financial ratios and covenants which the Company's bank imposes on the Company to ensure its ability to repay debt. (Such covenants are standard for any banking relationship in this industry and others.)

The Financial Impact of "Living" or "Prevailing" Wage Requirements

Current operations at the Materials Recovery Facility serving Alameda and San Leandro require ACI to maintain two full shifts of employees as well as a limited third shift for ongoing maintenance. While ACI was paying a temp agency a burdened rate of $13.91 an hour with the adoption of the living wage and transferring the workers to full time employees of ACI the fully burdened rate has increased to $17.83 a 28 percent increase in costs. With the adoption of the letter of Understanding between ACI and Local 6 Health and Welfare will be provided to the Material Recovery Facility Employees further increasing costs.

Following in Figure 1 is a projection of the major components of a cash flow/income statement for ACI as well as a calculation of the most important of the two major financial covenants used by banks that lend to our industry. This covenant is known as the "Fixed Charge Covenant" or "FCC" and is simply a measure of how much cash a company has at any given period as compared to its obligation to pay principal and interest on its loans due during that period. Obviously, a company with only a 1:1 ratio would be seen as a significant risk to the bank since the slightest upset would make such a company unable to pay its debts (and below that, such payment would be impossible). So, banks typically require that a company maintain cash positions at least 120% greater than all its “Fixed Charges”. The calculation is expressed as “EBITDA” (“**E**arnings **B**efore **I**nterest, **T**axes, **D**epreciation & **A**mortization”) *less* distributions to owners (to enable them to pay subchapter S taxes) *divided by* principal and interest payments.

These numbers include the 4.01% rate increase already granted by the City of San Leandro as well as the new labor costs as of December 1, 2014.

Figure 1

ALAMEDA COUNTY INDUSTRIES
TWO LABOR SHIFTS WITHOUT REVENUE RATE INCREASES
FINANCIAL STATEMENT COVENANTS
YEARS ENDING JUNE 30, 2015 THROUGH JUNE 30, 2020

	2015	2016	2017	2018	2019	2020
Net Income	$ (277,293)	$ (1,853,881)	$ (1,765,802)	$ (1,640,630)	$ (1,700,357)	$ (1,239,795)
Depreciation	2,980,158	2,887,141	2,726,049	2,562,513	2,487,614	1,876,944
Amortization	51,955	42,988	42,988	42,583	40,363	29,110
Interest expense	465,326	432,421	339,220	245,973	182,855	142,744
Income taxes	29,065	48,336	53,912	58,078	60,555	72,017
EBITDA	$ 3,249,211	$ 1,557,005	$ 1,396,368	$ 1,268,517	$ 1,071,030	$ 881,020
Principal payments	2,384,637	3,585,463	3,580,020	2,385,982	1,543,989	1,470,000
City of San Leandro principal payments	-	73,977	100,811	103,355	105,963	108,637
Interest expense	465,326	432,421	339,220	245,973	182,855	142,744
Distributions	-		-	-	-	-
FIXED CHARGES	2,849,963	4,091,861	4,020,051	2,735,311	1,832,807	1,721,381
FIXED CHARGE COVERAGE RATIO	**1.14**	**0.38**	**0.35**	**0.46**	**0.58**	**0.51**

As you can see, the Company is projected to be barely able to pay its debt service this year and will be in violation of the Fixed Charge Covenant Ratio. However the company, will not be able to make future payments unless further rate adjustments are made and, in fact, the Company would not be even close to being able to pay its bills. The bank would quickly declare a default and it is hard to foresee any other result than liquidation. There is a sense of urgency here in that the bank credit facility expires in June of this year. With that being said the company will need to be able to show the bank financial projections sufficient to meet fixed charge coverage ratios. This will require commitments from the cities of adequate rate increases as outlined in Option Three as well as restructuring of debt with the bank. Figure 2 shows the companies profit and loss for the last three years.

Figure 2

Alameda County Industries, Inc. Profit and Loss Statement			
Year	**2012**	**2013**	**2014**
Revenues	35,074,560	37,560,402	40,028,058
Expenses	33,447,698	35,376,569	39,035,987
Net Income	1,626,862	2,183,833	992,071
Net Income Percentage	5%	6%	2%

In contrast to the net income losses shown in Figure 1 above during the prior three years the company showed a modest profit and with the exception of 2014 the company made its banking covenants which in turn allowed the company to previously borrow funds in 2012 to purchase a new clean fuel vehicle fleet for service in Alameda. The Waste and Recycling Industry is a capital intensive business which requires capital for Trucks, Containers heavy machinery and processing equipment and it is critical that companies have the ability to borrow and access to capital.

Summary and Solution Option 3

Alameda County Industries appreciates the support of the City of San Leandro in implementing the interim solution described and hopes it will have the support of Alameda in a permanent solution which will allow the payment to our MRF employees of the new wage scales as agreed to in the L.O.U. with Local 6 while keeping the Company in compliance with its bank covenants. We are confident that the adoption of ***Option #3 (7.7% Increase)*** with the rate smoothing attributes as outlined in the staff report will provide sufficient rate increases now and in the future for the company to re-negotiate its debt and continue providing service to Alameda as well as pay future wage increases so the workers meet there 2019 goals. In the long run, we believe the benefits to the Company and the cities it serves will be significant in allowing the cities access to--and through rate regulation--control over a MRF facility whose employees can aspire to a well-paid career. Given the costs of similar facilities located in the Bay Area, we believe this can be achieved while still keeping rates competitive and we look forward to working with you in accomplishing those goals.