

Consolidated Communications Holdings, Inc.
Form 10-Q
May 02, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2014

or

TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 000-51446

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Yes _____ No X

On April 23, 2014, the registrant had 40,287,654 shares of Common Stock outstanding.

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CONSOLIDATED COMMUNICATIONS HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited; Amounts in thousands)

	Quarter Ended March 31,			
	2014		2013	
Net income	\$	8,422	\$	6,882
Pension and post-retirement obligations:				
Amortization of actuarial (gains) losses and prior service credit to earnings, net of tax		(136)		474
Derivative instruments designated as cash flow hedges:				
Change in fair value of derivatives, net of tax		-		(32)
Reclassification of realized loss to earnings, net of tax		408		2,290
Comprehensive income		8,694		9,614
Less: comprehensive income attributable to noncontrolling interest		98		99
Total comprehensive income attributable to common shareholders	\$	8,596	\$	9,515

See accompanying notes.

See accompanying notes.

2. DISCONTINUED OPERATIONS

In September 2013, we completed the sale of the assets and contractual rights of our Prison Services business for a total cash purchase price of \$2.5 million, which included the settlement of any pending legal matters. The financial results of the operations for Prison Services, which were previously reported in the Other Operations segment, have been reported as a discontinued operation in our condensed consolidated financial statements for all periods presented.

The following table summarizes the financial information for the Prison Services operations for the quarter ended March 31, 2013:

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<i>(In thousands)</i>	Quarter Ended March 31, 2013	
Operating revenues	\$	4,767
Operating expenses including depreciation and amortization		4,699
Income from operations		68
Income tax expense		44
Income from discontinued operations	\$	24

3. EARNINGS PER SHARE

The computation of basic and diluted earnings per share attributable to common shareholders computed using the two-class method is as follows:

<i>(In thousands, except per share amounts)</i>	Quarter Ended March 31,			
	2014		2013	
Income from continuing operations	\$	8,422	\$	6,858
Less: net income attributable to noncontrolling interest		98		99
Income attributable to common shareholders before allocation of earnings to participating securities		8,324		6,759
Less: earnings allocated to participating securities		153		132
Income from continuing operations attributable to common shareholders		8,171		6,627
Net income from discontinued operations		-		24
Net income attributable to common shareholders	\$	8,171	\$	6,651
Weighted-average number of common shares outstanding		39,877		39,755
Basic and diluted earnings per common share:				
Income from continuing operations	\$	0.20	\$	0.17
Income from discontinued operations, net of tax		0.00		0.00
Net income per common share attributable to common shareholders	\$	0.20	\$	0.17

Diluted earnings per common share attributable to common shareholders for the quarters ended March 31, 2014 and 2013, excludes 0.2 million shares of potential common shares that could be issued under our share-based compensation plan, because the inclusion of the potential common shares would have had an antidilutive effect.

4. INVESTMENTS

Our investments are as follows:

<i>(In thousands)</i>	March 31, 2014	December 31, 2013
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<i>(In thousands)</i>	March 31, 2014	December 31, 2013
Current assets	\$ 52,843	\$ 54,837
Non-current assets	88,635	87,968
Current liabilities	14,584	15,221
Non-current liabilities	2,166	1,786
Partnership equity	124,731	125,799

5. FAIR VALUE MEASUREMENTS

Our derivative instruments related to interest rate swap agreements are required to be measured at fair value on a recurring basis. The fair values of the interest rate swaps are determined using valuation models which rely on the expected London Interbank Offered Rate (LIBOR) based yield curve and estimates of counterparty and Consolidated's non-performance risk as the most significant inputs. Because each of these inputs are directly observable or can be corroborated by observable market data, we have categorized these interest rate swaps as

Long-term Debt

The fair value of our long-term debt was estimated using a discounted cash flow analyses based on incremental borrowing rates for similar types of borrowing arrangements. We have categorized the long-term debt as Level 2 within the fair value hierarchy.

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The weighted-average interest rate on outstanding borrowings under our credit facility was 4.24% and 4.23% at March 31, 2014 and December 31, 2013, respectively. Interest is payable at least quarterly.

Net proceeds from asset sales exceeding certain thresholds, to the extent not reinvested, are required to be used to repay loans outstanding under the Credit Agreement.

Credit Agreement Covenant Compliance

The Credit Agreement contains various provisions and covenants, including, among other items, restrictions on the ability to pay dividends, incur additional indebtedness, and issue capital stock. We have agreed to maintain

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<i>(In thousands)</i>	Notional Amount	2014 Balance Sheet Location	Fair Value
De-designated Hedges:			
Fixed to 1-month floating LIBOR	\$ 150,000	Other long-term liabilities	\$ (1,581)
Fixed to 1-month floating LIBOR	125,000	Current portion of derivative liability	(694)
Fixed to 1-month floating LIBOR (with floor)	50,000	Other long-term liabilities	(146)
Total Fair Values			\$ (2,421)

Share-Based Compensation

The following table summarizes total compensation costs recognized for share-based payments during the quarters ended March 31, 2014 and 2013:

		Quarter Ended March 31,		
<i>(In thousands)</i>		2014		2013
Restricted stock	\$	517	\$	456
Performance shares		267		200
Total	\$	784	\$	656

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Loss on cash flow hedges:

Interest rate derivatives	\$	(659)	\$	(3,641)	Interest expense
		251		1,351	Tax benefit
	\$	(408)	\$	(2,290)	Net of tax

(a) These items are included in the components of net periodic benefit cost for our pension and post-retirement benefit plans. See Note 9 for additional details.

9. PENSION PLAN AND OTHER POST-RETIREMENT BENEFITS

Defined Benefit Plans

We sponsor a qualified defined benefit pension plan (Retirement Plan) that is non-contributory covering certain of our hourly employees who fulfill minimum age and service requirements. Certain salaried employees are also covered by the Retirement Plan, although these benefits have previously been frozen. In April 2013, the

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Retirement Plan was amended for certain employees under collective bargaining agreements to among other things: (i) change the benefit formula to a cash balance account as of May 1, 2013 and (ii) freeze entrance into the Retirement Plan so that no person is eligible to become a participant on or following May 1, 2013. As of May 2013, all employees under collective bargaining agreements that include a defined benefit plan are on a cash balance plan.

In connection with our acquisition of SureWest, we assumed sponsorship in 2012 of a frozen non-contributory defined benefit pension plan (the SureWest Plan). The SureWest Plan covers certain eligible employees and benefits are based on years of service and the employee's average compensation during the five highest consecutive years of the last ten years of credited service. This plan has previously been frozen so that no person is eligible to become a new participant and all future benefit accruals for existing participants have ceased. As of January 1, 2014, the SureWest Plan was merged into and consolidated with the Retirement Plan.

We also have two non-qualified supplemental retirement plans (Supplemental Plans): the Restoration Plan, which we acquired as part of our North Pittsburgh Systems, Inc. (North Pittsburgh) and TXU Communications Venture Company (TXUCV) acquisitions, and a Supplemental Executive Retirement Plan (SERP), which we acquired as part of our acquisition of SureWest. The Supplemental Plans provide supplemental retirement benefits to certain former employees by providing for incremental pension payments to partially offset the reduction that would have been payable under the qualified defined benefit pension plans if it were not for limitations imposed by federal income tax regulations. Both plans have previously been frozen so that no person is eligible to become a new participant in the Supplemental Plans. These plans are unfunded and have no assets. The benefits paid under the Supplemental Plans are paid from the general operating funds of the Company.

The following table summarizes the components of net periodic pension cost for our defined benefit plans for the quarters ended March 31, 2014 and 2013:

	Quarter Ended	
	March 31,	
<i>(In thousands)</i>	2014	2013
Service cost	\$ 140	\$ 304
Interest cost	4,073	3,862
Expected return on plan assets	(5,777)	(5,151)
Net amortization loss	5	891
Prior service credit amortization	(115)	(71)
Net periodic pension benefit	\$ (1,674)	\$ (165)

Other Non-qualified Deferred Compensation Agreements

We also are liable for deferred compensation agreements with former members of the board of directors and certain other former employees of a subsidiary of TXUCV, which was acquired in 2004. The benefits are payable for up to the life of the participant or to the beneficiary upon the death of the participant and may begin as early as age 55. Participants accrue no new benefits as these plans had previously been frozen by TXUCV's predecessor company prior to our acquisition of TXUCV. Payments related to the deferred compensation agreements totaled approximately \$0.1 million for each of the quarters ended March 31, 2014 and 2013. The net present value of the remaining obligations was approximately \$1.7 million and \$1.8 million at March 31, 2014 and December 31, 2013, respectively, and is included in pension and post-retirement benefit obligations in the accompanying condensed consolidated balance sheets.

We also maintain 34 life insurance policies on certain of the participating former directors and employees. The excess of the cash surrender value of the remaining life insurance policies over the notes payable balances related to these policies is determined by an independent consultant, and totaled \$2.4 million at March 31, 2014 and \$2.2 million at December 31, 2013. These amounts are included in investments in the accompanying condensed consolidated balance sheets. Cash principal payments for the policies and any proceeds from the policies are classified as operating activities in the condensed consolidated statements of cash flows. We did not recognize any life insurance proceeds during the quarters ended March 31, 2014 and 2013.

Post-retirement Benefit Obligations

We sponsor a healthcare and life insurance plan (Post-retirement Plan) that provides post-retirement medical benefits and life insurance to certain groups of retired employees. Retirees share in the cost of healthcare benefits,

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making contributions that are adjusted periodically either based upon collective bargaining agreements or because total costs of the program have changed. Covered expenses for retiree health benefits are paid as they are incurred. Post-retirement life insurance benefits are fully insured. The Post-retirement Plan is unfunded and has no assets, and benefits are paid from the general operating funds of the Company.

In connection with the acquisition of SureWest in 2012, we acquired its post-retirement benefit plan which provides life insurance benefits and a stated reimbursement for Medicare supplemental insurance to certain eligible retired participants. This plan has previously been frozen so that no person is eligible to become a new participant. Employer contributions for retiree medical benefits are separately designated within the SureWest Plan pension trust for the sole purpose of providing payments of retiree medical benefits. The nature of the assets used to provide payment of retiree medical benefits is the same as that of the SureWest Plan.

	Quarter Ended			
	2014		2013	
<i>(In thousands)</i>		March 31,		
Service cost	\$	90	\$	232
Interest cost		355		391
Expected return on plan assets		(55)		(58)
Net amortization (gain) loss		(147)		-
Net prior service cost (credit) amortization		35		(45)
Net periodic postretirement benefit cost	\$	278	\$	520

Contributions

We expect to contribute approximately \$15.5 million to our pension plans and \$2.5 million to our other post-retirement plans in 2014. As of March 31, 2014, we have contributed \$2.7 million and \$0.7 million of the annual contribution to the pension plans and other post-retirement plans, respectively.

10. INCOME TAXES

We did not have any unrecognized tax benefits as of March 31, 2014 and December 31, 2013.

Our practice is to recognize interest and penalties related to income tax matters in interest expense and general and administrative expense, respectively. At March 31, 2014, we did not have a material liability for interest or penalties and had no material interest or penalty expense.

The periods subject to examination for our federal return are years 2010 through 2012. The periods subject to examination for our state returns are years 2005 through 2012. We are currently under examination by federal and state taxing authorities. We have received proposed assessments in connection with our federal examination for tax years ended December 31, 2010 and 2011. We are in the process of responding to the IRS and providing support for our tax position. We believe that our tax position will more likely than not be upheld based on the technical merits of our position. Accordingly, we have not made any adjustments to our unrecognized tax benefits for the proposed assessments. We do

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not expect any settlement or payment that may result from the audits to have a material effect on our results of operations or cash flows.

Our effective tax rate was 37.8% and 44.7% for the quarters ended March 31, 2014 and 2013, respectively. For the quarter ended March 31, 2013, the effective tax rate differed from the federal and state statutory rates primarily due to non-deductible compensation in relation to the acquisition of SureWest. Exclusive of this adjustment, our effective tax rate for the three months ended March 31, 2013 would have been approximately 37.0%.

On September 13, 2013, Treasury and the Internal Revenue Service issued final regulations regarding the deduction and capitalization of expenditures related to tangible property. The final regulations under Internal Revenue Code Sections 162, 167 and 263(a) apply to amounts paid to acquire, produce, or improve tangible property as well as dispositions of such property and are generally effective for tax years beginning on or after January 1, 2014. We have evaluated these regulations and we do not expect they will have a material adverse impact on our consolidated results of operations, cash flows or financial position.

2012. We were notified in January 2013 that SureWest did not submit the required certification to the California Public Utilities Commission (CPUC) in time to be

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included in its October 1, 2012, submission to the FCC. On January 24, 2013, we filed a certification with the CPUC and filed a petition with the FCC for a waiver of the filing deadline for the annual state certification. On February 19, 2013, the CPUC filed a certification with the FCC with respect to SureWest. On October 29, 2013, the Wireline Competition Bureau of the FCC denied our petition for a waiver of the annual certification deadline. On November 26, 2013, we applied for a review of the decision made by the FCC staff by the full Commission.

Management believes, based on the change in SureWest Telephone's USF filing status caused by the change in the ownership of SureWest Telephone, the lack of formal notice by the FCC regarding this change in filing status, the fact that SureWest Telephone had a previously-filed certification of compliance in effect with the FCC for the two quarters for which USF was withheld, and the FCC's past practice of granting waivers to accept late filings in similar situations, that the Company should prevail in its application to the Commission and receive USF funding for the period January 1, 2013, through June 30, 2013. However, due to the denial of our petition by the Wireline Competition Bureau and the uncertainty of the collectability of the previously recognized revenues, in December 2013, we reversed the \$3.0 million of previously recognized revenues of which \$1.1 million was recognized in the three months ended March 31, 2013, until such time that the Commission has the opportunity to reach a decision on our application for review.

We are from time to time involved in various other legal proceedings and regulatory actions arising out of our operations. We do not believe that any of these, individually or in the aggregate, will have a material adverse effect upon our business, operating results or financial condition.

12. CONDENSED CONSOLIDATING FINANCIAL INFORMATION

Consolidated Communications, Inc. is the primary obligor under the unsecured Senior Notes it issued on May 30, 2012. We and the following of our subsidiaries: Consolidated Communications Enterprise Services, Inc., Consolidated Communications Services Company, Consolidated Communications of Fort Bend Company, Consolidated Communications of Texas Company, Consolidated Communications of Pennsylvania Company, LLC, SureWest Communications, SureWest Long Distance, SureWest Telephone, SureWest TeleVideo, SureWest Kansas, Inc., SureWest Fiber Ventures, LLC, have jointly and severally guaranteed the Senior Notes. All of the subsidiary guarantors are our 100% direct or indirect wholly owned subsidiaries, and all guarantees are full, unconditional and joint and several with respect to principal, interest and liquidated damages, if any. As such, we present condensed consolidating balance sheets as of March 31, 2014 and December 31, 2013, and condensed consolidating statements of operations and cash flows for the quarters ended March 31, 2014 and 2013 for each of the Company (Parent), Consolidated Communications, Inc. (Subsidiary Issuer), guarantor subsidiaries and other non-guarantor subsidiaries with any consolidating adjustments. See Note 6 for more information regarding our Senior Notes.

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Total Consolidated Communications Holdings, Inc. shareholders equity							
Noncontrolling interest	-	-	4,603	-	-	4,603	
Total shareholders equity	141,608	1,126,932	231,839	138,894	(1,493,062)	146,211	
Total liabilities and shareholders equity	\$ 1,146,179	\$ 372,649	\$ 1,584,236	\$ 137,631	\$ (1,507,681)	\$ 1,733,014	

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Investment income	-	(37)	8,821	-	-	8,784
Equity in earnings of subsidiaries, net	20,300	18,393	276	-	(38,969)	-
Other, net	-	-	(98)	(9)	-	(107)
Income (loss) from continuing operations before income taxes	(1,254)	21,429	24,459	6,742	(38,969)	12,407
Income tax expense (benefit)	(8,037)	1,129	9,943	2,514	-	5,549
Income (loss) from continuing operations	6,783	20,300	14,516	4,228	(38,969)	6,858
Discontinued operations, net of tax	-	-	24	-	-	24
Net income (loss)	6,783	20,300	14,540	4,228	(38,969)	6,882
Less: net income attributable to noncontrolling interest	-	-	99	-	-	99
Net income (loss) attributable to Consolidated Communications Holdings, Inc.	\$ 6,783	\$ 20,300	\$ 14,441	\$ 4,228	\$ (38,969)	\$ 6,783
 Total comprehensive income (loss) attributable to common shareholders	 \$ 6,783	 \$ 22,558	 \$ 14,759	 \$ 4,384	 \$ (38,969)	 \$ 9,515

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The Securities and Exchange Commission (SEC) encourages companies to disclose forward-looking information so that investors can better understand a company's future prospects and make informed investment decisions. Certain statements in this Quarterly Report on Form 10-Q, including that which relates to the impact on future revenue sources, pending and future regulatory orders, continued expansion of the telecommunications network and expected changes in the sources of our revenue and cost structure resulting from our entrance into new communications markets, are forward-looking statements and are made pursuant to the safe harbor provisions of the Securities Litigation Reform Act of 1995. These forward-looking statements reflect, among other things, our current expectations, plans, strategies, and anticipated financial results. There are a number of risks, uncertainties, and conditions that may cause our actual results to differ materially from those expressed or implied by these forward-looking statements. Many of these circumstances are beyond our ability to control or predict. Moreover, forward-looking statements necessarily involve assumptions on our part. These forward-looking statements generally are identified by the words believe, expect, anticipate, estimate, project, intend, plan, should, may, will, would, will be, will continue or similar forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements of Consolidated Communications Holdings, Inc. and its subsidiaries (Consolidated, the Company, we, or our) to be different from those expressed or implied in the forward-looking statements. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements that appear throughout this report. A detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements is included in our 2013 Annual Report on Form 10-K filed with the SEC. Furthermore, forward-looking statements speak only as of the date they are made. Except as required under the federal securities laws or the rules and regulations of the Securities and Exchange Commission, we disclaim any intention or obligation to update or revise publicly any forward-looking statements. You should not place undue reliance on forward-looking statements. Management's Discussion and Analysis (MD&A) should be read in conjunction with our unaudited condensed consolidated financial statements and accompanying notes to the financial statements (Notes) as of and for the three months ended March 31, 2014 included in Item 1 of this Quarterly Report on Form 10-Q.

Throughout this MD&A, we refer to measures that are not a measure of financial performance in accordance with United States generally accepted accounting principles (US GAAP or GAAP). We believe the use of these non-GAAP measures on a consolidated and segment basis provides the reader with additional information that is useful in understanding our operating results and trends. These measures should be viewed in addition to, rather than as a substitute for, those measures prepared in accordance with GAAP. See the Non-GAAP Measures section below for a more detailed discussion on the use and calculation of these measures.

Overview

We are an established telecommunications services company providing a wide range of telecommunications services to residential and business customers in Illinois, Texas, Pennsylvania, California, Kansas and Missouri. We offer a wide range of telecommunications services, including local and long-distance service, high-speed broadband Internet access, video services, digital telephone service (VOIP), custom calling features, private line services, carrier grade access services, network capacity services over our regional fiber optic networks, directory publishing, Competitive Local Exchange Carrier (CLEC) services and equipment sales.

We generate the majority of our consolidated operating revenues primarily from subscriptions to our voice, video and data services (broadband services) to residential and business customers. Revenues decreased \$1.9 million during the quarter ended March 31, 2014 compared to the same period in 2013, primarily driven by a \$2.9 million decrease in network access revenues and \$0.4 million in local calling services, partially offset by an increase of \$1.9 million in broadband revenues. We expect our broadband service revenues to continue to grow as consumer and business demands for data based services increase.

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We market our services to residential and business customers, either individually or as a bundled package. Our triple play bundle includes our voice, video and data services. As of March 31, 2014, our video service was available to approximately 533 thousand homes in the markets we serve, with an approximate 21% penetration rate. As of March 31, 2014, we had approximately 111 thousand video subscribers, a 3% increase from the same period in 2013. During 2013, we launched TV Everywhere which allows our subscribers to watch their favorite programs at home or away on a computer, smartphone or tablet. Data and Internet connections continue to

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increase as a result of enhanced product and service offerings, such as our consumer VOIP service and data speeds of up to 50 Mbps, depending on the geographic market availability. As of March 31, 2014, approximately 31% of the homes in the areas we serve subscribe to our data service. Our voice services provide local and long-distance calling and other features, such as hosted voice services using cloud network servers, a business directory listing and the added capacity for multiple phone lines to be made available to our business voice customers. For our small to medium sized business customers, we also offer Metro Ethernet network services and wireless backhaul services.

The decrease in local calling services revenue during the quarter ended March 31, 2014 was due in part to an anticipated industry-wide trend of a decline in access lines and related use of services. Many consumers are choosing to subscribe to alternative communications services and competition for these subscribers continues to increase. Progressively, consumers are utilizing over-the-top services to download and watch television shows of interest to them on their computers. Competition from wireless providers, CLECs and in some cases cable television providers has increased in recent years in the markets we serve. We have been able to mitigate some of the access line losses through marketing initiatives and product offerings, such as our VOIP service.

As discussed in the *Regulatory Matters* section below, our operating revenues are also impacted by legislative or regulatory changes at the federal and state levels, which could reduce or eliminate the current subsidies revenue we receive. A number of proceedings and recent orders relate to universal service reform, intercarrier compensation and network access charges. There are various ongoing legal challenges to the orders that have been issued. As a result, it is not yet possible to determine fully the impact of the regulatory changes on our operations.

Significant Recent Developments

Segment Reporting

Historically, we have classified our operations into two separate reportable business segments: Telephone Operations and Other Operations. Our Telephone Operations consisted of a wide range of telecommunications services to residential and business customers, including local and long-distance service, high-speed broadband Internet access, video services, VOIP services, custom calling features, private line services, carrier access services, network capacity services over a regional fiber optic network, mobile services and directory publishing. Our Other Operations segment operated two complementary non-core businesses including telephone services to state and county correctional facilities (*Prison Services*) and equipment sales. As discussed below, our contract to provide telephone services to correctional facilities operated by the Illinois Department of Corrections was not renewed and the process of transitioning these services to another service provider was completed during the quarter ended March 31, 2013. The remaining *Prison Services* assets and operations were classified as discontinued operations during the quarter ended June 30, 2013 and subsequently sold during the quarter ended September 30, 2013, as discussed below. *Prison Services* comprised nearly all of the *Other Operations* segment revenue and results of operations. Consequently, with the cessation of our *Prison Services* business and based on the segment accounting guidance, we concluded that we operate as one segment as of the quarter ended June 30, 2013. As required by the authoritative guidance for segment presentation, segment results of operations have been retrospectively adjusted to reflect this change for all periods presented.

Prison Services Contract

We previously provided telephone service to inmates incarcerated at facilities operated by the Illinois Department of Corrections. On June 27, 2012, the Illinois Department of Central Management Services announced its intent to replace us as the provider of those services with a

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competitor. Although we challenged our competitor's bid and the State's decision to accept that bid in a variety of different forums, during the quarter ended March 31, 2013, the process of transitioning these services to another service provider was completed. All related assets have been assessed for recoverability in light of this change and we determined that no impairment was necessary.

Discontinued Operations

On September 13, 2013, we completed the sale of the assets and contractual rights used to provide communications services to thirteen county jails located in Illinois. The sale was completed for an aggregate purchase price of \$2.5 million, resulting in a gain of \$1.3 million, net of tax. The financial results of the operations for Prison Services, which were previously reported in the Other Operations segment, have been reported as discontinued operations in our condensed consolidated financial statements for all periods presented.

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Results of Operations

The following tables reflect our financial results on a consolidated basis and key operating metrics as of and for the quarters ended March 31, 2014 and 2013.

Financial Data

<i>(In millions, except for percentages)</i>	2014	2013	Quarter Ended March 31,	
			\$	%
			Change	Change
Operating Revenues				
Local calling services	\$ 26.2	\$ 26.6	\$ (0.4)	(2) %
Network access services	26.8	29.7	(2.9)	(10)
Video, Data and Internet services	68.2	66.3	1.9	3
Subsidies	13.1	13.4	(0.3)	(2)
Long-distance services	4.8	4.9	(0.1)	(2)
Other services	10.5	10.6	(0.1)	(1)
Total operating revenue	149.6	151.5	(1.9)	(1)
Expenses				
Cost of services and products	55.3	55.0	0.3	1
Selling, general and administrative costs	32.9	33.4	(0.5)	(1)
Depreciation and amortization	35.5	34.8	0.7	2
Total operating expenses	123.7	123.2	0.5	0
Income from operations	25.9	28.3	(2.4)	(8)
Interest expense, net	(19.8)	(24.6)	4.8	20
Other income	7.4	8.7	(1.3)	(15)
Income tax expense	5.1	5.5	(0.4)	(7)
Income from continuing operations	8.4	6.9	1.5	22
Income from discontinued operations, net of tax	-	-	-	0
Net income attributable to noncontrolling interest	0.1	0.1	-	0
Net income attributable to common shareholders	\$ 8.3	\$ 6.8	\$ 1.5	22
Adjusted EBITDA (1)	\$ 71.1	\$ 73.5	\$ (2.4)	(3) %

(1)A non-GAAP measure. See the Non-GAAP Measures section below for additional information and reconciliation to the most directly comparable GAAP measure.

Key Operating Statistics

	2014	2013	As of March 31,	
			Change	% Change
IILEC access lines				
Residential	145,814	152,644	(6,830)	(4) %
Business	108,247	113,211	(4,964)	(4)

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Video, data and Internet revenue increased \$1.9 million during the quarter ended March 31, 2014, compared to the same period in 2013, primarily due to the continued growth in data and Internet connections and video connections, which each increased 3% as of March 31, 2014. We expect video, data and Internet service revenue to continue to grow and comprise a greater percentage of consolidated operating revenues as a result of growth in commercial services and Metro Ethernet revenue and as a result of the rising consumer demand for data based services. However, the revenue growth was tempered by a decrease in voice revenue primarily for residential digital phone services due to a 4% decline in voice connections as more consumers begin to rely exclusively on wireless service.

Subsidies

We receive federal and state subsidies, which are designed to promote widely available, quality telephone service at affordable prices in rural areas. Subsidy revenues decreased \$0.3 million during the quarter ended March 31, 2014, compared to the same period in 2013 primarily as a result of the reduction in state funding support for our Texas ILEC effective January 1, 2014. See the *Regulatory Matters* section below for a further discussion of the subsidies we receive.

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Long-Distance Services

We offer a variety of long-distance calling plans, including unlimited flat-rate calling plans, to residential and business customers. Long-distance services revenue decreased \$0.1 million during the quarter ended March 31, 2014, compared to the same period in 2013 primarily due to the decline in access lines as described above and the shift in customers moving to unlimited long-distance plans.

Other Services

Other services includes revenues from telephone directory publishing, wholesale transport services, billing and collection services, inside wiring service and maintenance and equipment sales. Other services revenue decreased \$0.1 million during the quarter ended March 31, 2014, compared to the same period in 2013. The changes in other services revenue was primarily due to a decline in directory publishing revenues, which was offset in part by an increase in transport services and equipment sales.

Operating Expenses

Cost of Services and Products

Cost of services and products increased \$0.3 million during the quarter ended March 31, 2014, compared to the same period in 2013 primarily due to higher costs associated with providing video programming. Video programming costs continued to increase due to the growth in video connections and an increase in costs per program channel. However, the increase in video programming costs was partially offset by a reduction in federal universal service fund (USF) expense in the current quarter due to the recovery of USF fees related to the 2013 service period as a result of a reduction in the estimated revenue base. Employee costs also decreased due to a reduction in headcount as a result of integration and cost reduction efforts in 2013 as well as a reduction in pension expense in the current year.

Selling, General and Administrative Costs

Selling, general and administrative costs decreased \$0.5 million during the quarter ended March 31, 2014, compared to the same period in 2013 primarily due to a decrease in professional fees for audit and legal services and a decline in pension costs in the current year. These savings were offset in part by changes in bad debt expense due to a reduction in expense in the prior year period.

Depreciation and Amortization

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Depreciation and amortization expense increased \$0.7 million during the quarter ended March 31, 2014, compared to the same period in 2013, which was primarily associated with ongoing capital expenditures related to network enhancements and success based capital projects for consumer and commercial services.

Reclassifications

Certain amounts in our 2013 condensed consolidated financial statements have been reclassified to conform to the presentation of our 2014 condensed consolidated financial statements, which consists of the effects of reclassifications of Prison Services as a discontinued operation and the retrospective adjustments to report operating results as a single segment.

Regulatory Matters

Our revenues are subject to broad Federal and/or state regulation, which include such telecommunications services as local telephone service, network access service and toll service and are derived from various sources, including:

- business and residential subscribers of basic exchange services;

- surcharges mandated by state commissions;

- long distance carriers, for network access service;

- competitive access providers and commercial enterprises for network access service; and

- support payments from federal or state programs.

The telecommunications industry is subject to extensive federal, state and local regulation. Under the Telecommunications Act of 1996, federal and state regulators share responsibility for implementing and enforcing statutes and regulations designed to encourage competition and to preserve and advance widely available, quality telephone service at affordable prices.

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At the federal level, the FCC generally exercises jurisdiction over facilities and services of local exchange carriers, such as our rural telephone companies, to the extent they are used to provide, originate, or terminate interstate or international communications. The FCC has the authority to condition, modify, cancel, terminate, or revoke our operating authority for failure to comply with applicable federal laws or FCC rules, regulations and policies. Fines or penalties also may be imposed for any of these violations.

State regulatory commissions generally exercise jurisdiction over carriers' facilities and services to the extent they are used to provide, originate, or terminate intrastate communications. In particular, state regulatory agencies have substantial oversight over interconnection and network access by competitors of our rural telephone companies. In addition, municipalities and other local government agencies regulate the public rights-of-way necessary to install and operate networks. State regulators can sanction our rural telephone companies or revoke our certifications if we violate relevant laws or regulations.

FCC Matters

In general, telecommunications service in rural areas is more costly to provide than service in urban areas. The lower customer density means that switching and other facilities serve fewer customers and loops are typically longer, requiring greater expenditures per customer to build and maintain. By supporting the high cost of operations in rural markets, Federal Universal Service Fund subsidies promote widely available, quality telephone service at affordable prices in rural areas. Revenues from the Universal Service Funds decreased \$0.4 million during the quarter ended March 31, 2014, compared to the same period in 2013. The decrease in the Universal Service subsidies received during the quarter ended March 31, 2014 was primarily due to the impact of Senate Bill 583 (SB 583) discussed in the State Matters section below, which resulted in a \$0.6 million decrease in the Texas Universal Service Fund subsidies. This decrease is offset in part by a \$0.3 million increase in federal high-cost support subsidies, from which we received \$8.5 million in the quarter ended March 31, 2014 as compared to \$8.2 million recognized in the same period in 2013. Included in the \$8.2 million in federal subsidies recorded in the prior year was \$1.1 million in revenue that was recognized in anticipation of FCC approval of our petition for a waiver of the filing deadline for the annual state certification required for eligible telecommunications carriers (ETC) who receive high-cost support. As discussed below, the petition was denied and the \$1.1 million was included in the reversal of previously recognized revenues in December 2013.

In order for ETCs to receive high-cost support, the USF/ICC Transformation Order requires states to certify on an annual basis that USF support is used only for the provision, maintenance, and upgrading of facilities and services for which the support is intended . States, in turn, require that ETCs file certifications with them as the basis for the state filings with the FCC. Failure to meet the annual data and certification deadlines can result in reduced support to the ETC based on the length of the delay in certification. For the calendar year 2013, the California state certification was due to be filed with the FCC on or before October 1, 2012. We were notified in January 2013 that SureWest Communications (SureWest) did not submit the required certification to the California Public Utilities Commission (CPUC) in time to be included in its October 1, 2012, submission to the FCC. On January 24, 2013, we filed a certification with the CPUC and filed a petition with the FCC for a waiver of the filing deadline for the annual state certification. On February 19, 2013, the CPUC filed a certification with the FCC with respect to SureWest. On October 29, 2013, the Wireline Competition Bureau of the FCC denied our petition for a waiver of the annual certification deadline. On November 26, 2013, we applied for a review of the decision made by the FCC staff by the full Commission. Management believes, based on the change in SureWest Telephone's USF filing status caused by the change in the ownership of SureWest Telephone, the lack of formal notice by the FCC regarding this change in filing status, the fact that SureWest Telephone had a previously-filed certification of compliance in effect with the FCC for the two quarters for which USF was withheld, and the FCC's past practice of granting waivers to accept late filings in similar situations, that the Company should prevail in its application to the Commission and receive USF funding for the period January 1, 2013, through June 30, 2013. However, due to the denial of our petition by the Wireline Competition Bureau and the uncertainty of the collectability of the previously recognized revenues, in December 2013 we reversed the \$3.0 million of previously recognized revenues until such time that the Commission has the opportunity to reach a decision on our application for review.

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Historically, under FCC rules governing rate making, our California ILEC was required to establish rates for its interstate telecommunications services based on projected demand usage for the various services. We projected our earnings through the use of annual cost separation studies, which utilized estimated total cost information and projected demand usage. Carriers were required to follow FCC rules in the preparation of these annual studies. We determined actual earnings from our interstate rates as actual volumes and costs became known. In March

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2013, we filed a waiver with the FCC to convert our California ILEC from a rate of return to a price cap company. The FCC granted the waiver with an effective date of our annual interstate access tariff filing of July 2, 2013. We expect certain adjustments to take place over the next twenty-four months as a result of exiting the National Exchange Carrier Association (NECA) pool; however, we do not anticipate that they will be material to our condensed consolidated financial statements or results of operations.

An order adopted by the FCC in 2011 (the Order) may significantly impact the amount of support revenue we receive from the USF/Connect America Fund (CAF) and ICC. The Order reformed core parts of the USF, broadly recast the existing ICC scheme and established the CAF to replace support revenues provided by the current USF and redirected support from voice services to broadband services. In 2012, the first phase of the CAF was implemented, freezing USF support to a price cap holding company until the FCC implements a broadband cost model to shift support from voice service to broadband. Initially, the second phase was anticipated to be implemented July 1, 2013. It is now anticipated that implementation will likely occur no sooner than January 2015. We anticipate that our revenues will be significantly impacted when the broadband cost model is implemented. The Order also modifies the methodology used for ICC for traffic exchanged between carriers. The initial phase of ICC reform was effective on July 1, 2012, beginning the transition of our terminating switched access rates to bill-and-keep over a seven year period. As a result of implementing the provisions of the Order, our network access revenues decreased approximately \$0.5 million in the quarter ended March 31, 2014 compared to the same period in 2013.

On April 23, 2014, the FCC approved a report and order addressing the implementation of the CAF Phase 2, transition and auction processes for price cap companies and the local rate benchmark. They also issued a Further Notice of Proposed Rulemaking proposing to increase the download speed requirement from 4 Mbps to 10 Mbps as well as the transition for companies that receive CAF Phase 1 frozen funding but do not elect CAF Phase 2 funding. The details of the order have not been published at the date of this filing and it is not yet possible to determine fully the impact of the order on our operations. We will continue to monitor this matter.

State Matters

California

In an ongoing proceeding relating to the New Regulatory Framework, the CPUC adopted Decision 06-08-030 in 2006, which grants carriers broader pricing freedom in the provision of telecommunications services, bundling of services, promotions and customer contracts. This decision adopted a new regulatory framework, the Uniform Regulatory Framework (URF), which among other things (i) eliminates price regulation and allows full pricing flexibility for all new and retail services, (ii) allows new forms of bundles and promotional packages of telecommunication services, (iii) allocates all gains and losses from the sale of assets to shareholders and (iv) eliminates almost all elements of rate of return regulation, including the calculation of shareable earnings. On December 31, 2010, the CPUC issued a ruling to initiate a new proceeding to assess whether, or to what extent, the level of competition in the telecommunications industry is sufficient to control prices for the four largest ILECs in the state. Subsequently, the CPUC issued a ruling temporarily deferring the proceeding. The status on when the CPUC may open this proceeding is unclear and on hold at this time. The CPUC 's actions in this and future proceedings could lead to new rules and an increase in government regulation. We will continue to monitor this matter.

Pennsylvania

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In 2011, the Pennsylvania Public Utilities Commission (PAPUC) issued an intrastate access reform order reducing intrastate access rates to interstate levels in a three-step process, which began in March 2012. With the release of the FCC order in November 2011, the PAPUC temporarily issued a stay. A final stay was issued in 2012 to implement the FCC ordered intrastate access rate changes. The PAPUC had indicated that it would address state universal funding in 2013, but delayed conducting a proceeding pending any state legislative activity that may occur in the 2014 legislative session. We will continue to monitor this matter.

Texas

The Texas Public Utilities Regulatory Act (PURA) directs the Public Utilities Commission of Texas (PUCT) to adopt and enforce rules requiring local exchange carriers to contribute to a state universal service fund that helps telecommunications providers offer basic local telecommunications service at reasonable rates in high cost rural areas. The Texas Universal Service Fund is also used to reimburse telecommunications providers for revenues lost by providing lifeline service. Our Texas rural telephone companies receive disbursements from this

Other Income and Expense, Net

Interest expense, net of interest income, decreased \$4.8 million during the quarter ended March 31, 2014, compared to the same period in 2013 primarily due to a reduction in interest expense related to our interest rate swap agreements as a result of the maturity of several agreements during 2013. Interest rates on outstanding borrowings under our Credit Agreement also declined due to the amendment of our Credit Agreement in December 2013, as described in the Liquidity and Capital Resources section below.

Investment income decreased \$0.5 million during the quarter ended March 31, 2014, compared to the same period in 2013, primarily due to lower earnings from our wireless partnership interests. Other, net decreased \$0.8 million during the quarter ended March 31, 2014, compared to the same period in 2013, primarily due to the sale of an office facility and other related assets in Pennsylvania.

Table of Contents*Income Taxes*

Income taxes decreased \$0.4 million during the quarter ended March 31, 2014, compared to the same period in 2013. Our effective rate was 37.8% and 44.7% for the quarters ended March 31, 2014 and 2013, respectively. For the quarter ended March 31, 2013, the effective tax rate differed from the federal and state statutory rates primarily due to non-deductible compensation in relation to the acquisition of SureWest. Exclusive of this adjustment, our effective tax rate for the three months ended March 31, 2013 would have been approximately 37.0%.

Non-GAAP Measures

In addition to the results reported in accordance with US GAAP, we also use certain non-GAAP measures such as EBITDA and adjusted EBITDA to evaluate operating performance and to facilitate the comparison of our historical results and trends. These financial measures are not a measure of financial performance under US GAAP and should not be considered in isolation or as a substitute for net income as a measure of performance and net cash provided by operating activities as a measure of liquidity. They are not, on their own, necessarily indicative of cash available to fund cash needs as determined in accordance with GAAP. The calculation of these non-GAAP measures may not be comparable to similarly titled measures used by other companies. Reconciliations of these non-GAAP measures to the most directly comparable financial measures presented in accordance with GAAP are provided below.

EBITDA is defined as net earnings before interest expense, income taxes, and depreciation and amortization. Adjusted EBITDA is comprised of EBITDA, adjusted for certain items as permitted or required under our credit facility as described in the reconciliations below. These measures are a common measure of operating performance in the telecommunications industry and are useful, with other data, as a means to evaluate our ability to fund our estimated uses of cash.

The following table is a reconciliation of net cash provided by operating activities to adjusted EBITDA for the quarters ended March 31, 2014 and 2013:

<i>(In thousands)</i>	Quarter Ended	
	2014	March 31,
		2013
Net cash provided by operating activities from continuing operations	\$ 48,394	\$ 37,723
Adjustments:		
Non-cash, stock-based compensation	(784)	(656)
Other adjustments, net	(2,750)	(2,169)
Changes in operating assets and liabilities	(896)	6,801
Interest expense, net	19,831	24,600
Income taxes	5,122	5,549
EBITDA	68,917	71,848
Adjustments to EBITDA:		
Other, net (1)	(7,717)	(7,084)
Investment distributions (2)	9,086	8,101
Non-cash, stock-based compensation (3)	784	656

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Adjusted EBITDA	\$	71,070	\$	73,521
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(1) Other, net includes the equity earnings from our investments, dividend income, income attributable to noncontrolling interests in subsidiaries, transaction related costs including severance and certain other miscellaneous items.

(2) Includes all cash dividends and other cash distributions received from our investments.

(3) Represents compensation expenses in connection with the issuance of stock awards, which, because of the non-cash nature of these expenses, are excluded from adjusted EBITDA.

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Liquidity and Capital Resources

Outlook and Overview

Our operating requirements have historically been funded from cash flows generated from our business and borrowings under our credit facilities. We expect that our future operating requirements will continue to be funded from cash flows from operating activities, existing cash and cash equivalents, and, if needed, from borrowings under our revolving credit facility and our ability to obtain future external financing. We anticipate that we will continue to use a substantial portion of our cash flow to fund capital expenditures, meet scheduled payments of long-term debt, make dividend payments and to invest in future business opportunities.

The following table summarizes our cash flows:

<i>(In thousands)</i>	Three Months Ended March 31,	
	2014	2013
Cash flows provided by (used in):		
Operating activities:		
Continuing operations	\$ 48,394	\$ 37,723
Discontinued operations	-	(1,531)
Investing activities:		
Continuing operations	(24,164)	(27,569)
Discontinued operations	-	(11)
Financing activities:		
Continuing operations	(22,952)	(17,842)
Increase (decrease) in cash and cash equivalents	\$ 1,278	\$ (9,230)

Cash Flows Provided by Operating Activities

Net cash provided by operating activities from continuing operations was \$48.4 million during the three-month period ended March 31, 2014, an increase of \$10.7 million compared to the same period in 2013. Cash provided by operating activities increased primarily as a result of the timing in payments to suppliers and the payment of accrued transaction costs in 2013. We also received additional cash distributions from our wireless partnerships in 2014. These increases were offset in part by an increase in accounts receivable and an increase in contributions to our pension plans in 2014.

Cash Flows Used In Investing Activities

Net cash used in investing activities was \$24.2 million during the three-month period ended March 31, 2014, a decrease of \$3.4 million compared to the same period in 2013 and consisted primarily of cash used for capital expenditures.

Capital Expenditures

Capital expenditures continue to be our primary recurring investing activity and were \$25.4 million during the three-month period ended March 31, 2014, a decrease of \$2.1 million compared to the same period in 2013. Capital expenditures for the remainder of 2014 are expected to be \$72.0 million to \$78.0 million of which approximately 60% is planned for success-based capital projects for residential and commercial initiatives. Capital expenditures for the remainder of 2014 and subsequent years will depend on various factors, including competition, changes in technology, regulatory changes and the timing in the deployment of new services. We expect to continue to invest in existing and new services in order to retain and acquire more customers through a broader set of products.

Cash Flows Provided by Financing Activities

Net cash provided by financing activities consists primarily of our proceeds and principal payments on long-term borrowings and the payment of dividends.

Long-term Debt

Credit Agreement

In December 2013, the Company, through certain of its wholly owned subsidiaries, entered into a Second Amended and Restated Credit Agreement with various financial institutions (the "Credit Agreement") to replace

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the Company's previously amended credit agreement. The Credit Agreement consists of a \$75.0 million revolving credit facility and initial term loans in the aggregate amount of \$910.0 million ("Term 4"). The proceeds from the Credit Agreement were used to repay the outstanding term loans from the previous agreement in its entirety. The Credit Agreement also includes an incremental term loan facility which provides the ability to borrow up to \$300.0 million of incremental term loans subject to certain terms and conditions. Borrowings under the senior secured credit facility are secured by substantially all of the assets of the Company and its subsidiaries, with the exception of Illinois Consolidated Telephone Company and our majority-owned subsidiary, East Texas Fiber Line Incorporated.

The Term 4 loan was issued in an original aggregate principal amount of \$910.0 million with a maturity date of December 23, 2020, but is subject to earlier maturity on December 31, 2019 if the Company's unsecured Senior Notes due in 2020 ("Senior Notes") are not repaid or redeemed in full by December 31, 2019. The Term 4 loan contains an original issuance discount of \$4.6 million, which is being amortized over the term of the loan. The Term 4 loan requires quarterly principal payments of \$2.3 million, which commenced March 31, 2014, and has an interest rate of the London Interbank Offered Rate ("LIBOR") plus 3.25% subject to a 1.00% LIBOR floor.

Our revolving credit facility has a maturity date of December 23, 2018 and an applicable margin (at our election) of between 2.50% and 3.25% for LIBOR-based borrowings or between 1.50% and 2.25% for alternate base rate borrowings, depending on our leverage ratio. Based on our leverage ratio at March 31, 2014, the borrowing margin for the next three month period ending June 30, 2014 will be at a weighted-average margin of 3.00% for a LIBOR-based loan or 2.00% for an alternate base rate loan. The applicable borrowing margin for the revolving credit facility is adjusted quarterly to reflect the leverage ratio from the prior quarter-end. As of March 31, 2014 and December 31, 2013, borrowings of \$8.0 million and \$13.0 million were outstanding under the revolving credit facility, respectively. A stand-by letter of credit of \$0.9 million, issued in connection with the Company's insurance coverage, was outstanding under our revolving credit facility as of March 31, 2014. The stand-by letter of credit is renewable annually and reduces the borrowing availability under the revolving credit facility.

The weighted-average interest rate on outstanding borrowings under our credit facility was 4.24% and 4.23% at March 31, 2014 and December 31, 2013, respectively. Interest is payable at least quarterly.

Net proceeds from asset sales exceeding certain thresholds, to the extent not reinvested, are required to be used to repay loans outstanding under the Credit Agreement.

Credit Agreement Covenant Compliance

The Credit Agreement contains various provisions and covenants, including, among other items, restrictions on the ability to pay dividends, incur additional indebtedness, and issue capital stock. We have agreed to maintain certain financial ratios, including interest coverage and total net leverage ratios, all as defined in the Credit Agreement. As of March 31, 2014, we were in compliance with the Credit Agreement covenants.

In general, our Credit Agreement restricts our ability to pay dividends to the amount of our Available Cash as defined in our Credit Agreement. As of March 31, 2014, and including the \$15.6 million dividend declared in February 2014 and paid on May 1, 2014, we had \$215.6 million in dividend availability under the credit facility covenant.

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Under our Credit Agreement, if our total net leverage ratio (as defined in the Credit Agreement), as of the end of any fiscal quarter, is greater than 5.10:1.00, we will be required to suspend dividends on our common stock unless otherwise permitted by an exception for dividends that may be paid from the portion of proceeds of any sale of equity not used to fund acquisitions, or make other investments. During any dividend suspension period, we will be required to repay debt in an amount equal to 50.0% of any increase in Available Cash, among other things. In addition, we will not be permitted to pay dividends if an event of default under the Credit Agreement has occurred and is continuing. Among other things, it will be an event of default if our total net leverage ratio and interest coverage ratio as of the end of any fiscal quarter is greater than 5.25:1.00 and less than 2.25:1.00, respectively. As of March 31, 2014, our total net leverage ratio under the Credit Agreement was 4.27:1.00, and our interest coverage ratio was 3.52:1.00.

Senior Notes

On May 30, 2012, we completed an offering of \$300.0 million aggregate principal amount of 10.875% unsecured Senior Notes, due 2020 through our wholly-owned subsidiary, Consolidated Communications Finance Co. (Finance Co.) for the acquisition of SureWest. The Senior Notes will mature on

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June 1, 2020 and earn interest at a rate of 10.875% per year, payable semi-annually in arrears on June 1 and December 1 of each year, commencing on December 1, 2012. The Senior Notes were sold in the United States to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933 (the Securities Act) and outside the United States in compliance with Regulation S under the Securities Act. In addition, some of the Senior Notes were sold to certain accredited investors (as defined in Rule 501 under the Securities Act). The Senior Notes were sold to investors at a price equal to 99.345% of the principal amount thereof, for a yield to maturity of 11.00%. This discount is being amortized over the term of the Senior Notes. Upon closing of the SureWest acquisition on July 2, 2012, Finance Co. merged with and into our wholly-owned subsidiary Consolidated Communications, Inc., (CCI) which assumed the Senior Notes, and we and certain of our subsidiaries fully and unconditionally guaranteed the Senior Notes. On August 3, 2012, SureWest and its subsidiaries guaranteed the Senior Notes.

In 2013, we completed an exchange offer to issue registered notes (Exchange Notes) for \$287.3 million of the original Senior Notes. The terms of the Exchange Notes are substantially identical to the Senior Notes, except that the Exchange Notes are registered under the Securities Act and the transfer restrictions and registration rights applicable to the Senior Notes do not apply to the Exchange Notes. The exchange offer did not impact the aggregate principal amount or the remaining terms of the Senior Notes outstanding.

Senior Notes Covenant Compliance

The indenture governing the Senior Notes contains customary covenants for high yield notes, which limits CCI's and its restricted subsidiaries ability to: incur debt or issue certain preferred stock; pay dividends or make other distributions on capital stock or prepay subordinated indebtedness; purchase or redeem any equity interests; make investments; create liens; sell assets; enter into agreements that restrict dividends or other payments by restricted subsidiaries; consolidate, merge or transfer all or substantially all of its assets; engage in transactions with its affiliates; or enter into any sale and leaseback transactions.

Among other matters, the Senior Notes indenture provides that CCI may not pay dividends or make other restricted payments to the Company if its total net leverage ratio is 4.25:1.00 or greater. This ratio is calculated differently than the comparable ratio under the Credit Agreement; among other differences, it takes into account on a pro forma basis synergies expected to be achieved as a result of the SureWest acquisition but not yet reflected in historical results. At March 31, 2014, this ratio was 4.23:1.00. If this ratio is met, dividends and other restricted payments may be made from cumulative consolidated cash flow since the date the Senior Notes were issued, less 1.75 times fixed charges, less dividends and other restricted payments made since the date the Senior Notes were issued. Dividends may be paid and other restricted payments may also be made from a basket of \$50.0 million, none of which has been used to date, and pursuant to other exceptions identified in the Senior Notes indenture. Since dividends of \$124.1 million have been paid since May 30, 2012, at March 31, 2014 there was \$178.6 million of the \$302.7 million of cumulative consolidated cash flow since May 30, 2012 available to pay dividends.

On March 19, 2014, CCI commenced a solicitation of consents from the eligible holders of the Senior Notes in order to amend the indenture governing the Senior Notes to (i) modify CCI's Consolidated Leverage Ratio (as defined in the indenture governing the Senior Notes) level required before CCI (subject to certain other conditions specified in the indenture) can make Restricted Payments (as defined in the indenture) otherwise available under the consolidated cash flow builder basket from 4.25:1.00 to 4.50:1.00 and (ii) modify the size of a permitted lien basket for liens securing Indebtedness (as defined in the indenture) by amending the multiplier for CCI's Consolidated Cash Flow (as defined in the indenture) in the calculation of such permitted lien basket from 2.50 to 2.75. On April 1, 2014, the required consent of the holders of the Senior Notes was obtained and the consent solicitation expired, and we entered into a supplemental indenture effecting the proposed amendments as provided in the consent solicitation. The amendment to the indenture with respect to modifying the size of a permitted lien basket for liens securing Indebtedness modified such provision in the indenture so that it would be the same as the equivalent provision in our Credit Agreement. In connection with entering into the supplemental indenture, we paid consent fees of approximately \$2.5 million, during the second quarter ended June 30, 2014, to the holders of the Senior Notes who validly consented to the proposed amendment. The consent fees will be capitalized as deferred debt issuance costs and amortized over the term of the Senior Notes.

Capital Leases

As of March 31, 2014, we had seven capital leases which expire between 2015 and 2021. As of March 31, 2014, the present value of the minimum remaining lease commitments was approximately \$5.0 million, of which \$0.7

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million was due and payable within the next twelve months. The leases require total remaining rental payments of \$7.5 million as of March 31, 2014, of which \$5.6 million will be paid to LATEL LLC, a related party entity.

Dividends

We paid \$15.5 million and \$15.4 million in dividend payments to shareholders during the quarters ended March 31, 2014 and 2013, respectively. In February 2014, our board of directors declared its next quarterly dividend of \$0.38738 per common share, which is payable on May 1, 2014 to stockholders of record at the close of business on April 15, 2014. Our current annual dividend rate is approximately \$1.55 per share.

The cash required to fund dividend payments is in addition to our other expected cash needs, which we expect to fund with cash flows from our operations. In addition, we expect we will have sufficient availability under our revolving credit facility to fund dividend payments in addition to any expected fluctuations in working capital and other cash needs, although we do not intend to borrow under this facility to pay dividends.

We believe that our dividend policy will limit, but not preclude, our ability to grow. If we continue paying dividends at the level currently anticipated under our dividend policy, we may not retain a sufficient amount of cash, and may need to seek refinancing to fund a material expansion of our business, including any significant acquisitions or to pursue growth opportunities requiring capital expenditures significantly beyond our current expectations. In addition, because we expect a significant portion of cash available will be distributed to holders of common stock under our dividend policy, our ability to pursue any material expansion of our business will depend more than it otherwise would on our ability to obtain third-party financing.

Sufficiency of Cash Resources

The following table sets forth selected information regarding our financial condition.

	March 31,	December 31,
<i>(In thousands, except for ratio)</i>	2014	2013
Cash and cash equivalents	\$ 6,829	\$ 5,551
Working capital (deficit)	(34,844)	(29,979)
Current ratio	0.71	0.75

Our most significant uses of funds in the remainder of 2014 are expected to be for: (i) dividend payments of approximately \$47.0 million; (ii) interest payments on our indebtedness of between \$62.0 million and \$65.0 million and principal payments on debt of \$6.8 million; (iii) capital expenditures of between \$72.0 million and \$78.0 million and (iv) pension and other post-retirement obligations of \$14.6 million. However, in the future our ability to use cash may be limited by our other expected uses of cash, including our dividend policy, and our ability to incur additional debt will be limited by our existing and future debt agreements.

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We believe that cash flows from operating activities, together with our existing cash and borrowings available under our revolving credit facility will be sufficient for at least the next twelve months to fund our current anticipated uses of cash. After that, our ability to fund these expected uses of cash and to comply with the financial covenants under our debt agreements will depend on the results of future operations, performance and cash flow. Our ability to fund these expected uses from the results of future operations will be subject to prevailing economic conditions and to financial, business, regulatory, legislative and other factors, many of which are beyond our control.

We may be unable to access the cash flows of our subsidiaries since certain of our subsidiaries are parties to credit or other borrowing agreements, or subject to statutory or regulatory restrictions, that restrict the payment of dividends or making intercompany loans and investments, and those subsidiaries are likely to continue to be subject to such restrictions and prohibitions for the foreseeable future. In addition, future agreements that our subsidiaries may enter into governing the terms of indebtedness may restrict our subsidiaries' ability to pay dividends or advance cash in any other manner to us.

To the extent that our business plans or projections change or prove to be inaccurate, we may require additional financing or require financing sooner than we currently anticipate. Sources of additional financing may include commercial bank borrowings, other strategic debt financing, sales of nonstrategic assets, vendor financing or the private or public sales of equity and debt securities. There can be no assurance that we will be able to generate sufficient cash flows from operations in the future, that anticipated revenue growth will be realized, or that future borrowings or equity issuances will be available in amounts sufficient to provide adequate sources of cash to fund our expected uses of cash. Failure to obtain adequate financing, if necessary, could require us to significantly

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reduce our operations or level of capital expenditures which could have a material adverse effect on our financial condition and the results of operations.

Surety Bonds

In the ordinary course of business, we enter into surety, performance, and similar bonds as required by certain jurisdictions in which we provide services. As of March 31, 2014, we had approximately \$2.8 million of these bonds outstanding.

Defined Benefit Pension Plans

As required, we contribute to qualified defined pension plans and non-qualified supplemental retirement plans (collectively the Pension Plans) and other post-retirement benefit plans, which provide retirement benefits to certain eligible employees. Contributions are intended to provide for benefits attributed to service to date. Our funding policy is to contribute annually an actuarially determined amount consistent with applicable federal income tax regulations.

The costs of maintaining our Pension Plans and future funding requirements are affected by several factors including the expected return on investment of the assets held by the Pension Plan, changes in the discount rate used to calculate pension expense and the amortization of unrecognized gains and losses. Returns generated on Plan assets have historically funded a significant portion of the benefits paid under the Pension Plans. We estimate the long-term rate of return of Plan assets will be 8.0%. The Pension Plans invest in marketable equity securities which are exposed to changes in the financial markets. If the financial markets experience a downturn and returns fall below our estimate, we could be required to make a material contribution to the Pension Plan, which could adversely affect our cash flows from operations.

In 2014, we expect to make contributions totaling approximately \$15.5 million to our pension plans and \$2.5 million to our other post-retirement plans. As of March 31, 2014, we have contributed \$2.7 million and \$0.7 million to our pension plans and our other post-retirement plans, respectively. Our contribution amounts meet the minimum funding requirements as set forth in employee benefit and tax laws. See Note 9 for a more detailed discussion regarding our pension and other post-retirement plans.

Income Taxes

The timing of cash payments for income taxes, which is governed by the Internal Revenue Service and other taxing jurisdictions, will differ from the timing of recording tax expense and deferred income taxes, which are reported in accordance with GAAP. For example, tax laws in effect regarding accelerated or bonus depreciation for tax reporting resulted in less cash payments than the GAAP tax expense. Acceleration of tax deductions could eventually result in situations where cash payments will exceed GAAP tax expense.

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It is more likely than not that the benefit from approximately \$1.5 million in federal NOL carryforwards that are subject to separate return limitation year restrictions will not be realized. This loss carryover can only be used against consolidated taxable income to the extent of a single member's contribution to consolidated taxable income. The amount considered realizable, however, could be adjusted if estimates of future taxable income for the single member during the carryforward period are increased. The amount of estimated future taxable income is expected to allow for the full utilization of the remaining net operating loss carryforwards.

Historically, pre-tax earnings for financial reporting purposes have exceeded the amount of taxable income reported for income tax purposes. This has primarily occurred due to the acceleration of depreciation deductions for income tax reporting purposes.

Regulatory Matters

As discussed in the Regulatory Matters section above, an order adopted by the FCC may significantly impact the amount of support revenue we receive from USF/CAF and ICC. The Order seeks to reform the current USF system by redirecting support from voice services to broadband services. Although the broadband cost model for this reform is still being developed, we anticipate that our revenues will be significantly impacted when it is implemented. The initial phase of ICC reform decreased our network access revenues \$0.5 million during the quarter ended March 31, 2014 compared to the same period in 2013. We anticipate network access revenues will continue to decline as a result of the Order through 2018 by as much as \$1.2 million in the remainder of 2014 and \$1.0 million, \$1.1 million, \$2.4 million and \$1.8 million in 2015, 2016, 2017 and 2018, respectively.

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In accordance with the provisions of SB 583, as discussed above in the Regulatory Matters section, our annual \$1.4 million Texas HCAF was eliminated, effective January 1, 2014. In addition, the terms of the settlement agreement reached with the PUCT in August 2013 returned our HCF support funding to a per line basis as of January 2014, and will reduce our HCF draw by approximately \$1.2 million annually, or approximately \$4.8 million in total, over a 4 year period beginning June 1, 2014 through 2017. However, where market conditions allow, we have the ability to offset this reduction with increases to residential rates, for which the Company initiated a filing in April 2014.

Critical Accounting Estimates

Our condensed consolidated financial statements and accompanying notes are prepared in accordance with GAAP. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. These estimates and assumptions are affected by management's application of accounting policies. Our judgments are based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making estimates about the carrying values of assets and liabilities that are not readily apparent from other sources. For a full discussion of our accounting estimates and assumptions that we have identified as critical in the preparation of our condensed consolidated financial statements, refer to our 2013 Annual Report on Form 10-K.

Recent Accounting Pronouncements

In April 2014, the Financial Accounting Standards Board (FASB) issued the Accounting Standards Update No. 2014-08 (ASU 2014-08), *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*. ASU 2014-08 revises the definition of a discontinued operation to limit the circumstances under which a disposal or classification as held for sale qualifies for presentation as a discontinued operation. Amendments in this ASU require expanded disclosures concerning a discontinued operation and the disposal of an individually-material component of an entity not qualifying as a discontinued operation. ASU 2014-08 is effective for annual and interim periods beginning on or after December 15, 2014 and should be applied prospectively, with early adoption permitted. We are currently evaluating the impact this update will have on our condensed consolidated financial statements.

Effective January 1, 2014, we adopted Accounting Standards Update No. 2013-11 (ASU 2013-11), *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. ASU 2013-11 provides guidance concerning the balance sheet presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss or a tax credit carryforward is present. The adoption of this standard did not have a material impact on our condensed consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our exposure to market risk is primarily related to the impact of interest rate fluctuations on our debt obligations. Market risk is the potential loss arising from adverse changes in market interest rates on our variable rate obligations. In order to manage the volatility relating to changes in interest rates, we utilize derivative financial instruments such as interest rate swaps to maintain a mix of fixed and variable rate debt. We do not use derivatives for trading or speculative purposes. Our interest rate swap agreements effectively convert a portion of our floating-rate debt to a fixed-rate basis, thereby reducing the impact of interest rate changes on future cash interest payments. We calculate the potential change in interest expense caused by changes in market interest rates by determining the effect of the hypothetical rate increase on the portion of our variable rate debt that is not subject to a variable rate floor or hedged through the interest rate swap agreements.

At March 31, 2014, the majority of our variable rate debt was subject to a 1.00% London Interbank Offered Rate (LIBOR) floor thereby reducing the impact of fluctuations in interest rates. As of March 31, 2014, LIBOR was well below the 1.00% floor. Based on our variable rate debt outstanding at March 31, 2014 that is not subject to a variable rate floor, a 1.0% change in market interest rates would not have a significant impact to annual interest expense.

As of March 31, 2014, the fair value of our interest rate swap agreements amounted to a net liability of \$2.4 million. Pretax deferred losses related to our interest rate swap agreements included in accumulated other comprehensive loss (AOCI) was \$2.0 million at March 31, 2014.

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Item 4. Controls and Procedures

We maintain disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (Exchange Act) that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in SEC rules and forms; and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. In connection with the filing of this Form 10-Q, management evaluated, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of the design to provide reasonable assurance of achieving their objectives and operation of our disclosure controls and procedures as of March 31, 2014. Based upon that evaluation and subject to the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective as of March 31, 2014.

Change in internal control over financial reporting

Based upon the evaluation performed by our management, which was conducted with the participation of our Chief Executive Officer and Chief Financial Officer, there has been no change in our internal control over financial reporting during the quarter ended March 31, 2014 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

In connection with management 's annual assessment of the overall effectiveness of our internal controls over financial reporting included in our Form 10-K for the year ended December 31, 2013, management based its assessment on the framework set forth in *Internal Control-Integrated Framework* (1992) issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. On May 14, 2013, COSO issued an updated framework, referred to as the 2013 COSO framework. COSO has indicated that after December 15, 2014, it will consider the 1992 framework to have been superseded. We have reviewed the COSO 2013 framework and will integrate the changes into the Company 's internal controls over financial reporting during 2014. We expect that management 's assessment of the overall effectiveness of our internal controls over financial reporting for the year ending December 31, 2014 will be based on the 2013 COSO framework and that the change will not be significant to our overall control structure over financial reporting.

Limitations on the effectiveness of controls

We are responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control systems are designed to provide reasonable assurance to the Company 's management, Board of Directors and Audit Committee regarding the reliability of financial reporting and the preparation of published financial statements in accordance with generally accepted accounting principles.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On April 15, 2008, Salsgiver Inc., a Pennsylvania-based telecommunications company, and certain of its affiliates (Salsgiver) filed a lawsuit against us and our subsidiaries North Pittsburgh Telephone Company and North Pittsburgh Systems Inc. in the Court of Common Pleas of Allegheny County, Pennsylvania alleging that we have prevented Salsgiver from connecting their fiber optic cables to our utility poles. Salsgiver seeks compensatory and punitive damages as the result of alleged lost projected profits, damage to its business reputation, and other costs. Salsgiver originally claimed to have sustained losses of approximately \$125 million. We believe that these claims are without merit and that the alleged damages are completely unfounded. Discovery concluded and Consolidated filed a motion for summary judgment on June 18, 2012 and the court heard oral arguments on August 30, 2012. On February 12, 2013, the court, in part, granted our motion. The court ruled that Salsgiver could not recover prejudgment interest and could not use as a basis of liability any actions prior to April 14, 2006. In September 2013, in order to avoid the distraction and uncertainty of further litigation, we reached an agreement in principle (the Agreement) with Salsgiver, Inc. In accordance with the terms of the Agreement, we will pay Salsgiver approximately \$0.9 million in cash and grant approximately \$0.3 million in credits that may be used for make-ready charges (the Credits). The Credits will be available for services performed in connection with the pole attachment applications within five years of the execution of the agreement. We had previously recorded approximately \$0.4 million in 2011 in anticipation of the settlement of this case. During the quarter ended September 30, 2013, per the terms of the agreement we recorded an additional \$0.9 million, which included estimated legal fees. The agreement is contingent on appropriate documentation and there is no assurance that the agreement will be finalized.

Two of our subsidiaries, Consolidated Communications of Pennsylvania Company LLC (CCPA) and Consolidated Communications Enterprise Services Inc. (CCES), have, at various times, received assessment notices from the Commonwealth of Pennsylvania Department of Revenue (DOR) increasing the amounts owed for Pennsylvania Gross Receipt Taxes, and/or have had audits performed for the tax years of 2008, 2009, and 2010. For the calendar years for which we received both additional assessment notices and audit actions, those issues have been combined by the DOR into a single Docket for each year. For the CCES subsidiary, the total additional tax liability calculated by the auditors for calendar years 2008, 2009, and 2010 is approximately \$1.9 million. As of March 2013, all three of these cases have been appealed, and have received continuance pending the outcome of present litigation in the Commonwealth of Pennsylvania (Verizon Pennsylvania, Inc. v. Commonwealth, Docket No. 266 F.R. 2008). For the CCPA subsidiary, the total additional tax liability calculated by the auditors for calendar years 2008, 2009, and 2010 is approximately \$2.0 million. As of December 2013 the cases for calendar years 2009 and 2010 have been appealed, and have received continuance pending the outcome of present litigation in the Commonwealth of Pennsylvania (Verizon Pennsylvania, Inc. v. Commonwealth, Docket No. 266 F.R. 2008). The calendar year 2008 audit result was appealed to the Board of Finance and Revenue on March 19, 2014. We anticipate that the 2008 case will be continued pending the outcome of the Verizon litigation as well. The Gross Receipts Tax issues in the Verizon Pennsylvania case are substantially the same as those presently facing CCPA and CCES. In addition, there are numerous telecommunications carriers with Gross Receipts Tax matters dealing with the same issues that are in various stages of appeal before the Board of Finance and Revenue and the Commonwealth Court. Those appeals by other similarly situated telecommunications carriers have been continued until resolution of the Verizon Pennsylvania case. We believe that these assessments and the positions taken by the Commonwealth of Pennsylvania are without substantial merit. We do not believe that the outcome of these claims will have a material adverse impact on our financial results

On January 18, 2012, we filed a petition with the U.S. Court of Appeals for the District of Columbia Circuit to review the Federal Communications Commission s (FCC) Order issued November 18, 2011 that reformed intercarrier compensation and core parts of the Universal Service Fund. We are appealing five core issues in the November 18, 2011 FCC Order. This matter was heard by the U.S. Court of Appeals for the Tenth Circuit on November 19, 2013; however a decision is not expected before the third quarter of 2014.

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We are from time to time involved in various other legal proceedings and regulatory actions arising out of our operations. We do not believe that any of these, individually or in the aggregate, will have a material adverse effect upon our business, operating results or financial condition.

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Item 6. Exhibits

(a) Exhibits

31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	The following financial information from Consolidated Communications Holdings, Inc. Quarterly Report on Form 10-Q for the quarter ended March 31, 2014, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Statements of Income, (ii) Condensed Consolidated Statements of Comprehensive Income, (iii) Condensed Consolidated Balance Sheets, (iv) Condensed Consolidated Statements of Cash Flows, and (v) Notes to Unaudited Condensed Consolidated Financial Statements

