Consolidated Communications Holdings, Inc.
Form 10-Q
November 09, 2006

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Quarter Ended September 30, 2006

or

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Transition Period from ____________________ to ____________________

Commission File Number 000-51446
CONSOLIDATED COMMUNICATIONS HOLDINGS, INC.
(Exact name of registrant as specified in its charter)

Delaware	**02-0636095**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

121 South 17th Street
Mattoon, Illinois 61938-3987
(Address of principal executive offices)
Registrant s telephone number, including area code: (217) 235-3311

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yesþ Noo

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).
Large Accelerated Filer o Accelerated Filer o Non-accelerated Filer þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

The number of shares of the registrant s common stock, $.01 par value, outstanding as of November 1, 2006 was 26,003,826.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

Consolidated Communications Holdings, Inc.
Condensed Consolidated Statements of Income
(Dollars in thousands, except per share amounts)
(Unaudited)

	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Revenues	$ 80,323	$ 82,168	$ 239,089	$ 240,204
Operating expenses:				
Cost of services and products (exclusive of depreciation and amortization shown separately below)	24,140	25,953	72,764	74,723
Selling, general and administrative expenses	23,764	32,419	70,947	75,517
Depreciation and amortization	16,961	16,920	50,876	50,852
Income from operations	15,458	6,876	44,502	39,112
Other income (expense):				
Interest income	239	361	854	892
Interest expense	(11,414)	(20,175)	(32,195)	(43,704)
Investment income	1,709	1,313	4,692	2,265
Minority interest	(203)	(85)	(499)	(433)
Other, net	139	215	186	3,204
Income (loss) before income taxes	5,928	(11,495)	17,540	1,336
Income tax expense (benefit)	3,913	(1,270)	3,752	3,701
Net income (loss)	2,015	(10,225)	13,788	(2,365)
Dividends on redeemable preferred shares		(1,142)		(10,263)
Net income (loss) applicable to common stockholders	$ 2,015	$ (11,367)	$ 13,788	$ (12,628)
Net income (loss) per common share - Basic	$ 0.08	$ (0.49)	$ 0.48	$ (0.90)
Diluted	$ 0.07	$ (0.49)	$ 0.48	$ (0.90)
Cash dividends declared per common share	$ 0.39	$ 0.41	$ 1.16	$ 0.41

See accompanying notes

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Consolidated Communications Holdings, Inc.
Condensed Consolidated Balance Sheets
(Dollars in thousands, except share and per share amounts)

	September 30, 2006 (unaudited)	2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 19,898	$ 31,409
Accounts receivable, net of allowance of $2,277 and $2,825, respectively	37,017	35,503
Inventories	4,048	3,420
Deferred income taxes	3,111	3,111
Prepaid expenses and other current assets	8,541	5,592
Total current assets	72,615	79,035
Property, plant and equipment, net	319,287	335,088
Intangibles and other assets:		
Investments	39,191	44,056
Goodwill	316,281	314,243
Customer lists, net	124,807	135,515
Tradenames	14,546	14,546
Deferred financing costs and other assets	20,999	23,467
Total assets	$ 907,726	$ 945,950
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 7,774	$ 11,743
Advance billings and customer deposits	16,880	14,203
Dividends payable	10,038	11,537
Accrued expenses	29,645	30,376
Total current liabilities	64,337	67,859
Long-term debt	594,000	555,000
Deferred income taxes	65,583	66,228
Pension and postretirement benefit obligations	54,077	53,185
Other liabilities	1,266	1,476
Total liabilities	779,263	743,748
Minority interest	3,473	2,974
Stockholders equity		
Common stock, $0.01 par value, 100,000,000 shares, authorized, 26,006,472 and 29,775,010 issued and outstanding, respectively	260	297
Additional paid in capital	199,338	254,162
Accumulated deficit	(76,796)	(57,533)
Accumulated other comprehensive income	2,188	2,302

Total stockholders equity	124,990	199,228
Total liabilities and stockholders equity	$ 907,726	$ 945,950

See accompanying notes

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Consolidated Communications Holdings, Inc.
Consolidated Statements of Cash Flows
(Dollars in thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2006	**2005**
OPERATING ACTIVITIES		
Net income (loss)	$ 13,788	$ (2,365)
Adjustments to reconcile net income (loss) to cash provided by operating activities:		
Depreciation and amortization	50,876	50,852
Provision for uncollectible accounts	3,666	3,548
Deferred income tax	(645)	4,083
Pension curtailment gain		(7,880)
Partnership income	(4,407)	(1,076)
Non-cash stock compensation	1,875	7,244
Minority interest in net income of subsidiary	499	433
Amortization of deferred financing costs	2,437	4,525
Changes in operating assets and liabilities:		
Accounts receivable	(5,180)	(7,449)
Inventories	(628)	422
Other assets	(1,377)	(5,296)
Accounts payable	(3,969)	66
Accrued expenses and other liabilities	2,628	(36)
Net cash provided by operating activities	59,563	47,071
INVESTING ACTIVITIES		
Proceeds from sale of investments	5,921	
Proceeds from sale of land	590	
Capital expenditures	(25,037)	(21,596)
Net cash used in investing activities	(18,526)	(21,596)
FINANCING ACTIVITIES		
Proceeds from issuance of stock		67,798
Proceeds from long-term obligations	39,000	5,688
Payments made on long-term obligations		(75,109)
Payment of deferred financing costs	(262)	(4,737)
Purchase of treasury shares	(56,736)	(12)
Distribution to preferred shareholders		(37,500)
Dividends on common stock	(34,550)	
Net cash used in financing activities	(52,548)	(43,872)
Net decrease in cash and cash equivalents	(11,511)	(18,397)
Cash and cash equivalents at beginning of period	31,409	52,084

Cash and cash equivalents at end of period	$	19,898	$	33,687

See accompanying notes

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Consolidated Communications Holdings, Inc.
Condensed Consolidated Statement of Changes in Stockholders Equity
Nine Months Ended September 30, 2006
(Dollars in thousands, except share amounts)
(Unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total
Balance, January 1, 2006	**29,775,010**	**$ 297**	**$ 254,162**	**$ (57,533)**	**$ 2,302**	**$ 199,228**
Net income				13,788		13,788
Dividends on common stock				(33,051)		(33,051)
Shares issued under employee plan, net of forfeitures	13,841					
Non-cash stock compensation			1,875			1,875
Purchase and retirement of common stock	(3,782,379)	(37)	(56,699)			(56,736)
Unrealized gain on marketable securities, net of $34 of tax					49	49
Change in fair value of cash flow hedges, net of ($139) of tax					(163)	(163)
Balance, September 30, 2006	**26,006,472**	**$ 260**	**$ 199,338**	**$ (76,796)**	**$ 2,188**	**$ 124,990**

See accompanying notes

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CONSOLIDATED COMMUNICATIONS HOLDINGS, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Three and nine months ended September 30, 2006 and 2005
(Dollars in thousands, except share and per share amounts)

1. Description of Business

Consolidated Communications Holdings, Inc. and its wholly owned subsidiaries (the Company) operate under the name Consolidated Communications. The Company is an established rural local exchange company (RLEC) providing communications services to residential and business customers in Illinois and Texas. With approximately 235,983 local access lines, 49,360 digital subscriber lines (DSL) and 5,638 Internet protocol television (IPTV) lines, Consolidated Communications offers a wide range of telecommunications services, including local dial tone, custom calling features, private line services, long distance, dial-up and high-speed Internet access, IPTV, inside wiring service and maintenance, carrier access, billing and collection services, telephone directory publishing and wholesale transport services on a fiber optic network in Texas. The Company also operates a number of complementary businesses, including telephone services to county jails and state prisons, operator services, equipment sales and telemarketing and order fulfillment services.

2. Initial Public Offering

On July 27, 2005, the Company completed the initial public offering of its common stock (the IPO). The IPO consisted of the sale of 6,000,000 shares of common stock newly issued by the Company and 9,666,666 shares of common stock sold by certain selling stockholders. The shares of common stock were sold at an initial public offering price of $13.00 per share resulting in net proceeds, after deduction of offering costs, to the Company of $67,589. The Company did not receive any proceeds from the sale of common stock by the selling stockholders.

On July 29, 2005, the underwriters notified the Company of their intention to fully exercise their option to purchase an additional 2,350,000 shares of the Company s common stock from the selling stockholders at the initial public offering price of $13.00 per share, less the underwriters discount. The sale of the over-allotment shares closed on August 2, 2005. The Company did not receive any proceeds from the sale of the over-allotment shares by the selling stockholders.

3. Presentation of Interim Financial Statements

These unaudited interim condensed consolidated financial statements include the accounts of Consolidated Communications Holdings, Inc. and its wholly owned subsidiaries and subsidiaries in which it has a controlling financial interest. All material intercompany balances and transactions have been eliminated in consolidation. These interim statements have been prepared in accordance with Securities and Exchange Commission (SEC) guidelines and do not include all of the information and footnotes required by U.S. generally accepted accounting principles (GAAP) for complete financial statements. These interim financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair presentation of its financial position and results of operations for the interim periods. All such adjustments are of a normal recurring nature. Interim results are not necessarily indicative of the results that may be expected for the entire year. These interim financial statements should be read in conjunction with the financial statements and related notes for the year ended December 31, 2005, which were included in our annual report on Form 10-K previously filed with the SEC.

4. Recent Accounting Pronouncements

In February 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 155, *Accounting for Certain Hybrid Instruments* (SFAS 155). SFAS 155 is an amendment of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133) and SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SFAS 140) and allows financial instruments that have embedded derivatives to be accounted for as a whole

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(eliminating the need to bifurcate the derivative from its host) if the holder elects to account for the whole instrument on a fair value basis. SFAS 155 is effective for an entity s first fiscal year that begins after September 15, 2006. The Company is currently evaluating the effect that the adoption of SFAS 155 will have on the financial condition or results of operations of the Company but does not expect it to have a material impact.

In June 2006, FASB issued Financial Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company s financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on description, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company is required to adopt FIN 48 effective January 1, 2007 and is currently evaluating the impact of adopting FIN 48 on its future results of operations and financial condition.

In September 2006, FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The Company is required to adopt SFAS 157 effective January 1, 2008 and is currently evaluating the impact of adopting SFAS 157 on its future results of operations and financial condition.

In September 2006, FASB issued Statement of Financial Accounting Standards No. 158, "*Employers Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS 158). SFAS 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. SFAS 158 also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position. The Company is required to adopt SFAS 158 effective as December 31, 2006; however, the requirement to measure plan assets and benefit obligations as of the date of the Company s fiscal year end is required to be effective as of December 31, 2008. The Company is currently evaluating the impact of adopting SFAS 158 on its future results of operations and financial condition.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulleting (SAB) No. 108, *Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements* . SAB No. 108 provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of assessing materiality. SAB No. 108 is effective for fiscal years ending after November 15, 2006. The Company is currently evaluating the impact of adopting SAB No. 108 on its future results of operations and financial condition upon its adoption on January 1, 2007.

5. Goodwill and Customer Lists

The following table summarizes the carrying value of goodwill by segment:

	Telephone Operations	Other Operations	Total
Balance at December 31, 2005	$ 305,289	$ 8,954	$ 314,243
Adjustment for change in estimate of tax basis of acquired assets	2,038		2,038
Balance at September 30, 2006	$ 307,327	$ 8,954	$ 316,281

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The Company s customer lists consist of an established core base of customers that subscribe to its services. The carrying amount of customer lists is as follows:

	September 30, 2006	December 31, 2005
Gross carrying amount	$ 167,633	$ 167,633
Less: accumulated amortization	(42,826)	(32,118)
Net carrying amount	$ 124,807	$ 135,515

The aggregate amortization expense associated with customer lists was $3,567 and $3,569 for the three months ended September 30, 2006 and 2005, respectively, and was $10,708 for both the nine months ended September 30, 2006 and 2005. Customer lists are being amortized using a weighted average life of 11.7 years.

6. Summarized Financial Information for Significant Investments

The Company has a 17.02% ownership of GTE Mobilnet of Texas RSA #17 Limited Partnership (the Mobilnet RSA Partnership). The principal activity of the Mobilnet RSA Partnership is providing cellular service to a limited rural area in Texas. The Company accounts for this investment on the equity basis. Unaudited summarized financial information for the Mobilnet RSA Partnership was as follows:

For the three months ended September 30, 2005:

Total revenues	$ 10,537
Income from operations	2,420
Income before income taxes	2,506
Net income	2,506

For the nine months ended September 30, 2005:

Total revenues	$ 29,520
Income from operations	7,113
Income before income taxes	7,332
Net income	7,332

As of September 30, 2005:

Current assets	$ 10,685
Non-current assets	25,626
Current liabilities	1,775
Non-current liabilities	
Partnership equity	34,536

The 2006 summarized financial information for the Mobilnet RSA Partnership is not presented since it did not meet the Company s threshold of materiality.

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7. Pension Costs and Other Postretirement Benefits

The Company has several defined benefit pension plans covering substantially all of its hourly employees and certain salaried employees, primarily those located in Texas. The plans provide retirement benefits based on years of service and earnings. The pension plans are generally noncontributory. The Company s funding policy is to contribute amounts sufficient to meet the minimum funding requirements as set forth in employee benefit and tax laws.

The Company currently provides other postretirement benefits (Other Benefits) consisting of health care and life insurance benefits for certain groups of retired employees. Retirees share in the cost of health care benefits. Retiree contributions for health care benefits are adjusted periodically based upon collective bargaining agreements for former hourly employees and as total costs of the program change for former salaried employees. The Company s funding policy for retiree health benefits is generally to pay covered expenses as they are incurred. Postretirement life insurance benefits are fully insured.

The following tables present the components of net periodic benefit cost:

	Pension Benefits		Other Benefits	
	2006	2005	2006	2005
Three months ended September 30,				
Service cost	$ 545	$ 748	$ 188	$ 146
Interest cost	2,046	2,517	386	334
Expected return on plan assets	(1,914)	(2,773)	(10)	
Other, net	(227)	11	(212)	(214)
Net periodic benefit cost	$ 450	$ 503	$ 352	$ 266
Nine months ended September 30,				
Service cost	$ 1,565	$ 2,824	$ 562	$ 697
Interest cost	5,413	7,662	1,159	1,226
Expected return on plan assets	(5,719)	(8,376)		
Curtailment gain				(7,880)
Other, net	92	37	(666)	(360)
Net periodic benefit cost	$ 1,351	$ 2,147	$ 1,055	$ (6,317)

Effective as of April 30, 2005, the Company s Board of Directors authorized amendments to several of the Company s benefit plans. The Consolidated Communications Texas Retirement Plan was amended to freeze benefit accruals for all participants other than union participants and grandfathered participants. The rate of accrual for grandfathered participants in this plan was reduced. A grandfathered participant is defined as a participant age 50 or older with 20 or more years of service as of April 30, 2005. The Consolidated Communications Texas Retiree Medical and Life Plan was amended to freeze the Company subsidy for premium coverage as of April 30, 2005 for all existing retiree participants. This plan was also amended to limit future coverage to a select group of future retires who attain at least age 55 and 15 years of service, but with no Company subsidy. The amendments to the Retiree Medical and Life Plan resulted in a $7,880 curtailment gain that was included in general and administrative expenses during the quarter ended September 30, 2005.

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7. Long-Term Debt and Common Stock Repurchase

Long-term debt consists of the following:

	September 30, 2006	December 31, 2005
Senior Secured Credit Facility		
Revolving loan	$	$
Term loan D	464,000	425,000
Senior notes	130,000	130,000
	594,000	555,000
Less: current portion		
	$ 594,000	$ 555,000

On July 28, 2006, the Company entered into Amendment No. 4 to its credit facilities which provides for, among other things, the following: (1) an increase in the size of the term D loan available by up to $45,000 (subject to certain adjustments); (2) an increase in the applicable margin on the entire amount of term D loans outstanding from 175 basis points to 200 basis points; (3) an amendment to the definition of cumulative available cash to exclude the impact of its repurchase of shares of its common stock pursuant to the Stock Repurchase Agreement, dated July 13, 2006, by and among us and Providence Equity Partners IV L.P. and Providence Equity Operating Partners IV L.P. (the Share Repurchase); (4) an amendment to the definition of consolidated EBITDA to add back certain one-time expenses related to the Share Repurchase, severance, billing integration and compliance with the Sarbanes-Oxley Act of 2002; and (5) a reduction by $1,500 of the quarterly amount of restricted payments (as defined in the credit agreement) that the Company may pay out of cumulative available cash without triggering mandatory loan prepayments.

During July 2006, the Company completed the Share Repurchase of approximately 3.8 million shares of its common stock for approximately $56,736, or $15.00 per share. The transaction closed on July 28, 2006. With this transaction, Providence Equity sold its entire position in the Company, which, prior to the transaction, totaled approximately 12.7 percent of the Company s outstanding shares of common stock. This was a private transaction and did not decrease the Company s publicly traded shares. The Company financed this repurchase using approximately $17,736 of cash on hand and $39,000 of additional term-loan borrowings.

8. Derivative Instruments

The Company maintains interest rate swap agreements that effectively convert a portion of its floating-rate debt to a fixed-rate basis, thus reducing the impact of interest rate changes on future interest expense. At September 30, 2006, the Company had interest rate swap agreements covering $355,590 in aggregate principal amount of its variable rate debt at fixed LIBOR rates ranging from 3.0% to 4.8%. The swap agreements expire on various dates ranging from December 31, 2006 to September 30, 2011. On July 11, 2006, the Company entered into an agreement to hedge $50,000 of variable rate debt swaps that will be effective as of December 29, 2006 and replace swap agreements covering that same amount of variable rate debt that expire on December 31, 2006. The new agreement carries a rate of 5.5% and expires on December 31, 2008.

The fair value of the Company s derivative instruments, comprised solely of its interest rate swaps, amounted to an asset of $3,815 and $4,117 at September 30, 2006 and December 31, 2005, respectively. The fair value is included in Other Assets. The Company recognized a net reduction of $73 and a net increase of $46 in interest expense during the three months ended September 30, 2006 and 2005, respectively, related to its derivative instruments and recognized a net reduction of $220 and net increase of $96 during the nine months ended September 30, 2006 and 2005, respectively. The change in the market value of derivative instruments, net of related tax effect, is recorded in Other Comprehensive Income. The Company recognized comprehensive (loss)/income of ($4,287) and $855 during the three months ended September 30, 2006 and 2005, respectively, and comprehensive (loss)/income of ($163) and $1,764 during the nine months ended September 30, 2006 and 2005, respectively.

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9. Restricted Share Plan

The following table summarizes restricted stock activity:

Restricted shares outstanding, December 31, 2005	422,065
Shares granted	18,000
Shares vested	
Shares forfeited or retired	(4,320)
Restricted shares outstanding, September 30, 2006	435,745

The Company recognized non-cash compensation expense associated with the restricted shares totaling $625 and $7,244 for the three months ended September 30, 2006 and 2005, respectively, and $1,875 and $7,244 for the nine months ended September 30, 2006 and 2005, respectively. The non-cash compensation expense is included in Selling, General and Administrative Expenses in the accompanying statement of income.

10. Life Insurance Proceeds

In June 2005, the Company recognized $2,800 of net proceeds in other income from the receipt of key man life insurance proceeds relating to the passing of a former employee.

11. Legal proceedings

In September 2006, the Company incurred $500 of charges to settle a dispute over the termination of a 2001 lease on an office building no longer utilized by the Company.

During 2005, the Company incurred total charges of approximately $3,100 to settle a dispute with a former consultant to the Company. Approximately $400 of the charges were recognized during the first half of 2005 and the remaining $2,700 were recognized during the Company s third quarter ended September 30, 2005.

12. Income Taxes

The following table sets forth the computation of our effective tax rate by period:

	Three Months Ended September 30,	Nine Months Ended September 30,
	2006	