Consolidated Communications Holdings, Inc.
Form 10-Q
November 02, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2012

or

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 000-51446

CONSOLIDATED COMMUNICATIONS HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	02-0636095 (IRS Employer Identification No.)
121 South 17th Street, Mattoon, Illinois (Address of principal executive offices)	61938-3987 (Zip Code)

(217) 235-3311

(Registrant s telephone number, including area code)

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.

Yes X No ____

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes X No ____

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ____ Accelerated filer X

Non-accelerated filer___ (Do not check if a smaller reporting company) Smaller reporting company ____

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes _____ No X

On October 23, 2012, the registrant had 39,917,265 shares of Common Stock outstanding.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CONSOLIDATED COMMUNICATIONS HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited; Amounts in thousands except per share amounts)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net revenues	$ 157,012	$ 92,548	$ 343,381	$ 280,612
Operating expense:				
Cost of services and products (exclusive of depreciation and amortization)	59,589	33,913	131,979	103,864
Selling, general and administrative expenses	35,568	21,148	75,092	60,994
Financing and other transaction costs	14,525	109	19,909	2,649
Depreciation and amortization	37,252	22,161	81,258	66,306
Operating income	10,078	15,217	35,143	46,799
Other income (expense):				
Interest expense, net of interest income	(20,624)	(13,447)	(52,117)	(37,783)
Investment income	8,229	6,403	21,457	19,417
Other, net	232	516	431	953
(Loss) income before income taxes	(2,085)	8,689	4,914	29,386
Income tax (benefit) expense	(1,895)	2,723	314	10,410
Net (loss) income	(190)	5,966	4,600	18,976
Less: net income attributable to noncontrolling interest	121	148	366	442
Net (loss) income attributable to common stockholders	$ (311)	$ 5,818	$ 4,234	$ 18,534
Net (loss) income per common share - basic and diluted	$ (0.01)	$ 0.19	$ 0.12	$ 0.61
Dividends declared per common share	$ 0.39	$ 0.38	$ 1.16	$ 1.16

See accompanying notes.

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CONSOLIDATED COMMUNICATIONS HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited; Amounts in thousands)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net (loss) income	$ (190)	$ 5,966	$ 4,600	$ 18,976
Change in prior service cost, net of tax of $36 and $(19) for the quarter ended September 30, 2012 and 2011, and $579 and $61 for nine months ended September 30, 2012 and 2011	60	(33)	957	102
Change in fair value of cash flow hedges, net of tax of $921 and $1,349 for the quarter ended September 30, 2012 and 2011, and $1,845 and $3,405 for nine months ended September 30, 2012 and 2011	1,577	2,314	3,161	5,872
Comprehensive income	1,447	8,247	8,718	24,950
Less: comprehensive income attributable to noncontrolling interest	121	148	366	442
Total comprehensive income attributable to common stockholders	$ 1,326	$ 8,099	$ 8,352	$ 24,508

See accompanying notes.

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CONSOLIDATED COMMUNICATIONS HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited; Amounts in thousands except share and per share amounts)

	September 30, 2012	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 24,775	$ 105,704
Accounts receivable, net	60,661	35,492
Income tax receivable	11,474	8,988
Deferred income taxes	10,202	4,825
Prepaid expenses and other current assets	9,335	6,170
Total current assets	116,447	161,179
Property, plant and equipment, net	876,115	339,197
Investments	102,860	98,069
Goodwill	629,967	520,562
Other intangible assets	63,574	70,158
Deferred debt issuance costs, net and other assets	13,767	4,904
Total assets	$ 1,802,730	$ 1,194,069
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 19,732	$ 13,673
Advance billings and customer deposits	29,068	20,324
Dividends payable	15,463	11,571
Accrued compensation	18,884	12,814
Accrued interest	11,690	237
Accrued expense	45,576	14,099
Current portion of long-term debt and capital lease obligations	9,029	8,992
Current portion of derivative liability	6,801	3,580
Total current liabilities	156,243	85,290
Long-term debt and capital lease obligations	1,202,059	875,719
Deferred income taxes	136,033	77,327
Pension and other postretirement obligations	133,246	93,754
Other long-term liabilities	11,382	14,167
Total liabilities	1,638,963	1,146,257
Commitments and contingencies		
Shareholders equity:		
Common stock, par value $0.01 per share; 100,000,000 shares authorized, 39,917,265 and 29,869,512, shares outstanding as of September 30, 2012 and December 31, 2011, respectively	399	299
Additional paid-in capital	191,223	79,852
Retained earnings	-	-
Accumulated other comprehensive loss, net	(33,715)	(37,833)

Noncontrolling interest		5,860		5,494
Total shareholders equity		163,767		47,812
Total liabilities and stockholders equity	$	1,802,730	$	1,194,069

See accompanying notes.

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CONSOLIDATED COMMUNICATIONS HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited; amounts in thousands)

	Nine months ended September 30,	
	2012	**2011**

See accompanying notes.

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CONSOLIDATED COMMUNICATIONS HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business and Basis of Accounting

Consolidated Communications Holdings, Inc. (the Company , we or our) is a holding company with operating subsidiaries (collectively Consolidated) that provide communications services to residential and business customers in Illinois, Texas, Pennsylvania, California, Kansas and Missouri.

In the opinion of management, the accompanying condensed consolidated balance sheets and related interim statements of operations, comprehensive income and cash flows include all adjustments, consisting only of normal recurring items, necessary for their fair presentation in conformity with accounting principles generally accepted in the United States (U.S. GAAP or GAAP) for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to such SEC rules and regulations and accounting principles applicable for interim periods. Events subsequent to the balance sheet date have been evaluated for inclusion in the accompanying condensed consolidated financial statements through the date of issuance. Management believes that the disclosures made are adequate to make the information presented not misleading. Interim results are not necessarily indicative of results for a full year. The information presented in this Form 10-Q should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and the accompanying notes to the financial statements (Notes) thereto included in our 2011 Annual Report on Form 10-K filed with the SEC.

SureWest Merger

On July 2, 2012, we completed the acquisition of SureWest Communications. SureWest Communications results of operations have been consolidated with our results following the acquisition date. For a more complete discussion of the transaction, refer to Note 2.

Reclassifications

Inventories have been reclassified from current assets to property, plant and equipment on the condensed consolidated balance sheets. Inventories consist primarily of network construction materials and supplies that when issued are capitalized as part of new customer installations and the construction of the network. The proportion of the items included in inventories that are capitalized to property, plant and equipment continues to increase as a result of the growth in the broadband services offered by the Company.

Property, Plant and Equipment

Property, plant and equipment consisted of the following:

(Amounts in thousands)		**September 30, 2012**		**December 31, 2011**	**Estimated Useful Lives**
Land and buildings	$	93,529	$	66,704	18-40 years
Network and outside plant facilities		1,397,113		897,140	3-50 years
Furniture, fixtures and equipment		93,451		73,185	3-15 years
Assets under capital lease		10,014		10,014	11 years
Total plant in service		1,594,107		1,047,043	
Less: accumulated depreciation and amortization		(752,878)		(721,527)	
Plant in service		841,229		325,516	
Construction in progress		24,630		6,530	
Construction inventory		10,256		7,151	
Totals	$	876,115	$	339,197	

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Construction inventory, which is stated at weighted average cost, consists primarily of network construction materials and supplies that when issued are predominately capitalized as part of new customer installations and the construction of the network.

Recently Issued Accounting Pronouncements

In July 2012, Financial Accounting Standards Board (FASB) issued the Accounting Standards Update No. 2012-02 (ASU 2012-02), *Testing Indefinite-Lived Intangible Assets for Impairment*. ASU 2012-02 permits an entity to perform an initial assessment of qualitative factors to determine whether it is more likely than not that a non-goodwill indefinite-lived intangible asset is impaired and thus whether it is necessary to calculate the asset s fair value for the purpose of comparing it with the asset s carrying amount. The amended guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted. We are currently evaluating the impact this update will have on our condensed consolidated financial statements.

Recently Adopted Accounting Pronouncements

Effective January 1, 2012, we adopted the FASB issued Accounting Standards Update No. 2011-04 (ASU 2011-04), *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (IFRS).* This pronouncement was issued to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and IFRS. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for Level 3 fair value measurements. The adoption of this standard did not have a material impact on our consolidated financial statements.

Effective January 1, 2012, we adopted the FASB issued Accounting Standards Update No. 2011-05 (ASU 2011-05), *Presentation of Comprehensive Income*. ASU 2011-05 requires an entity to either present components of net income and other comprehensive income in one continuous statement or in two separate but consecutive statements. Accordingly, we have presented net income and other comprehensive income in two consecutive statements.

2. MERGER WITH SUREWEST COMMUNICATIONS

On July 2, 2012, we completed the merger with SureWest Communications (SureWest), which resulted in the acquisition of 100% of all the outstanding shares of SureWest for $23.00 per share in a cash and stock transaction. SureWest provides telecommunication services in Northern California, primarily in the greater Sacramento region, and in the greater Kansas City, Kansas and Missouri areas. The total purchase price of $550.8 million consisted of cash and assumed debt of $402.4 million and 9,965,983 shares of the Company s common stock valued at the Company s opening stock price on July 2, 2012 of $14.89, which totaled $148.4 million.

The results of SureWest operations since July 2, 2012 are included in the Company s condensed consolidated statement of operations. The financial results of SureWest are included in the Telephone Operations segment. SureWest contributed $66.4 million in net revenues and recorded a net loss of $0.9 million for the period from July 2, 2012 through the period ended September 30, 2012, which includes $9.5 million in acquisition related costs. On July 2, 2012 as part of the purchase, the Company recorded accrued cash purchase price consideration of

approximately $8.3 million to be paid during the quarter ending December 31, 2012, which represents a noncash investing activity in the condensed consolidated statements of cash flows for the nine months ended September 30, 2012. In addition, at September 30, 2012 the Company has accrued change-in-control payments to former members of the SureWest management team of $8.7 million which are expected to be paid during the six months ended June 30, 2013. These payments were recognized in financing and other transaction costs in the condensed consolidated statement of operations during the quarter and nine months ended September 30, 2012 due to the close of the acquisition and the change or elimination of job duties.

The acquisition of SureWest has been accounted for using the acquisition method in accordance with the FASB s Accounting Standards Codification Topic 805, *Business Combinations*. Accordingly, the net assets acquired are recorded at their estimated fair values at July 2, 2012. These values are derived from a preliminary purchase price allocation, which is subject to change based on the final valuation of the acquired real and intangible assets and liabilities assumed. The primary areas of the preliminary purchase price allocation that are not yet finalized relate to the valuing of real and personal property, intangible assets and the final determination of goodwill. The Company expects to continue to obtain information to assist it in determining the fair values of the net assets

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acquired at the acquisition date during the measurement period. The following table summarizes the preliminary purchase price allocation.

		(In thousands)
Current assets	$	46,791
Property, plant and equipment		551,315
Goodwill		109,405
Other intangible assets		10,500
Other long-term assets		4,589
Total assets acquired		722,600
Current liabilities		51,350
Pension and other post-retirement obliations		55,653
Deferred income taxes		58,316
Other long-term liabilities		6,485
Total liabilities assumed		171,804
Net assets acquired	$	550,796

Included in the current assets acquired are cash of $17.1 million and trade receivables fair valued at approximately $21.6 million with a gross value of approximately $23.4 million. We believe that the estimated fair value of the trade receivables approximates the amount to be eventually collected. The acquired other intangible assets of approximately $10.5 million consists of the estimated fair values assigned to customer lists of $9.6 million and tradenames of $0.9 million. The customer list intangible asset is being amortized over the estimated useful life of 5 years. During the quarter and nine months ended September 30, 2012, we recorded amortization expense of approximately $0.5 million relating to the customer lists. Goodwill of $109.4 million and the tradenames are indefinite lived assets which are not subject to amortization; however, they are tested annually for impairment or more frequently when events or changes in circumstances indicate that the asset might be impaired. Goodwill will be tested annually for impairment at November 30. Goodwill is not deductible for income tax purposes.

Unaudited Pro Forma Results

The following unaudited pro forma information presents the results of operations of the Company as if the acquisition of SureWest occurred on January 1, 2011. The adjustments to arrive at the pro forma information below included additional depreciation and amortization expense for the fair value increases to property plant and equipment, software and customer relationships. Interest expense was increased to reflect the additional debt entered into to finance a portion of the acquisition price. Shares used to calculate the basic and diluted earnings per share were adjusted to reflect the additional shares of common stock issued to fund a portion of the acquisition price. The pro forma information below does not purport to present the actual results that would have resulted if the acquisition had in fact occurred at the beginning of the fiscal periods presented, nor does the information project results for any future period.

(In thousands, except share amounts)		**Quarter Ended September 30, 2011**		**Nine Months Ended September 30, 2012**		**2011**
Operating revenues	$	155,700	$	471,283	$	466,277
Income from operations	$	18,392	$	54,919	$	55,177
Net income	$	2,476	$	10,629	$	7,214
Less: income attributable to noncontrolling interest		148		366		442
Net income attributable to common stockholders	$	2,328	$	10,263	$	6,772

Basic and diluted earnings per common share:

Net income	$	0.06	$	0.26	$	0.17

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3. EARNINGS PER SHARE

The following illustrates the earnings allocation method as required by the FASB s authoritative guidance on the treatment of participating securities in the calculation of earnings per share which we utilize in the calculation of basic and diluted earnings per share.

(In thousands, except share amounts)	Quarter Ended September 30, 2012		Quarter Ended September 30, 2011		Nine Months Ended September 30, 2012		Nine Months Ended September 30, 2011	
Basic and Diluted Earnings Per Share using Two-class Method:								
Net (loss) income	$	(190)	$	5,966	$	4,600	$	18,976
Less: net income attributable to noncontrolling interest		121		148		366		442
Net (loss) income attributable to common shareholders before allocation of earnings to participating securities		(311)		5,818		4,234		18,534
Less: earnings allocated to participating securities				117		255		363
Net (loss) income attributable to common shareholders	$	(311)	$	5,701	$	3,979	$	18,171
Weighted-average number of common shares outstanding (1)		39,439		29,593		32,963		29,593
Net (loss) income per common share attributable to common stockholders - basic and diluted	$	(0.01)	$	0.19	$	0.12	$	0.61

(1)To the extent that restricted shares are anti-dilutive, they have been excluded from the calculation of diluted earnings per share in accordance with the applicable accounting guidance.

An additional 0.2 million and 0.4 million shares were not included in the computation of potentially dilutive securities at September 30, 2012 and 2011, because they were anti-dilutive.

4. INVESTMENTS

Our investments are as follows:

(In thousands)	September 30, 2012	December 31, 2011

Cash surrender value of life insurance policies	$	1,895	$	1,978
Cost method investments:				
GTE Mobilnet of South Texas Limited Partnership (2.34% interest)		21,450		21,450
Pittsburgh SMSA Limited Partnership (3.60% interest)		22,950		22,950
CoBank, ACB Stock		4,961		3,394
Other		115		15
Equity method investments:				
GTE Mobilnet of Texas RSA #17 Limited Partnership (17.02% interest)		19,142		19,422
Pennsylvania RSA 6(I) Limited Partnership (16.6725% interest)		7,424		7,063
Pennsylvania RSA 6(II) Limited Partnership (23.67% interest)		23,390		21,797
CVIN, LLC (13.61% interest)		1,533		-
Totals	$	102,860	$	98,069

Cost Method

We own 2.34% of GTE Mobilnet of South Texas Limited Partnership (the Mobilnet South Partnership). The principal activity of the Mobilnet South Partnership is providing cellular service in the Houston, Galveston, and Beaumont, Texas metropolitan areas. We also own 3.60% of Pittsburgh SMSA Limited Partnership (Pittsburgh SMSA), which provides cellular service in and around the Pittsburgh metropolitan area. Because of our limited influence over these partnerships, we use the cost method to account for both of these investments. It is not practicable to estimate fair value of these investments. We did not evaluate any of the investments for impairment as no factors indicating impairment existed during the year. For the three-month periods ended September 30, 2012 and 2011, we received cash distributions from these partnerships totaling $3.7 million and $2.7 million, respectively. For the nine months ended September 30, 2012 and 2011, we received cash distributions from these partnerships totaling $9.3 million and $7.7 million, respectively.

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CoBank, ACB (CoBank) is a cooperative bank owned by its customers. Annually, CoBank distributes patronage in the form of cash and stock in the cooperative based on the Company s outstanding loan balance with CoBank, which has traditionally been a significant lender in the Company s credit facility. The investment in CoBank represents the accumulation of the equity patronage paid by CoBank to the Company.

Equity Method

We own 17.02% of GTE Mobilnet of Texas RSA #17 Limited Partnership (RSA #17), 16.6725% of Pennsylvania RSA 6(I) Limited Partnership (RSA 6(I)), and 23.67% of Pennsylvania RSA 6(II) Limited Partnership (RSA 6(II)). RSA #17 provides cellular service to a limited rural area in Texas. RSA 6(I) and RSA 6(II) provide cellular service in and around our Pennsylvania service territory. Because we have significant influence over the operating and financial policies of these three entities, we account for the investments using the equity method. For the three months ended September 30, 2012 and 2011, we received cash distributions from these partnerships totaling $4.0 million and $4.2 million, respectively. For the nine months ended September 30, 2012 and 2011, we received cash distributions from these partnerships totaling $10.5 million and $11.9 million, respectively.

We have a 13.61% interest in Central Valley Independent Network, LLC (CVIN), a joint enterprise comprised of affiliates of several Independent Telephone Companies located in central and northern California. CVIN provides network services and oversees a broadband infrastructure project designed to expand and improve the availability of network services to counties in central California. During the quarter and nine months ended September 30, 2012, we did not receive any distributions from this partnership.

The combined unaudited results of operations and financial position of our three equity investments in the cellular limited partnerships are summarized below:

	Quarter Ended September 30,		Nine Months Ended September 30,	
(In thousands)	**2012**	**2011**	**2012**	**2011**
Total revenues	$ 75,317	$ 79,880	$ 221,207	$ 223,428
Income from operations	21,611	23,065	63,538	63,861
Net income before taxes	21,626	23,087	63,582	63,935
Net income	21,522	22,987	63,270	63,635

5. FAIR VALUE MEASUREMENTS

The Company s 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 an internal valuation model which relies 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 Level 2 within the fair value hierarchy. See Note 7 for further discussion regarding our interest rate swap agreements.

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The Company s interest rate swap assets and liabilities measured at fair value on a recurring basis subject to disclosure requirements at September 30, 2012 and December 31, 2011 were as follows:

	As of September 30, 2012			
(In thousands)	Total	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Current interest rate swap liabilities	$ (6,801)		$ (6,801)	
Long-term interest rate swap liabilities	(4,135)		(4,135)	
Totals	$ (10,936)	$	$ (10,936)	$

	As of December 31, 2011			
(In thousands)	Total	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Current interest rate swap liabilities	$ (3,580)		$ (3,580)	
Long-term interest rate swap liabilities	(12,401)		(12,401)	
Totals	$ (15,981)	$	$ (15,981)	$

The change in the fair value of the derivatives is primarily a result of a change in market expectations for future interest rates.

We have not elected the fair value option for any of our financial assets or liabilities. The carrying value of other financial instruments, including cash, accounts receivable, accounts payable and accrued liabilities approximate fair value due to their short maturities or variable-rate nature of the respective balances. The following table presents the other financial instruments that are not carried at fair value but which require fair value disclosure as of September 30, 2012 and December 31, 2011.

	As of September 30, 2012		As of December 31, 2011	
(In thousands)	Carrying Value	Fair Value	Carrying Value	Fair Value
Investments, equity basis	$ 51,489	n/a	$ 48,282	n/a
Investments, at cost	$ 49,476	n/a	$ 47,809	n/a
Long-term debt	$ 1,206,517	$ 1,206,517	$ 880,000	$ 880,000

The Company s investments at September 30, 2012 and December 31, 2011 accounted for under both the equity and cost methods consists primarily of minority positions in various cellular telephone limited partnerships. These investments are recorded using either the equity or cost methods. It is impracticable to determine fair value of these investments.

Our senior secured long-term debt of $908.4 million allows us to select a one month LIBOR repricing option, which we have elected. As such, the fair value of this debt approximates its carrying value. Based upon the inputs of the LIBOR based yield curve, which can be corroborated by observable market data, we have categorized the long-term debt as Level 2 within the fair value hierarchy.

In May 2012, we completed an offering of $300.0 million aggregate principal amount of 10.875% Senior Notes (Senior Notes). The fair value of this debt approximates its carrying value of $298.1 million, net of discount, at September 30, 2012. We have categorized the Senior Notes long-term debt as Level 2 within the fair value hierarchy. See Note 6 for a further discussion regarding our senior secured long-term debt.

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6. LONG-TERM DEBT

Long-term debt consists of the following:

(In thousands)	September 30, 2012	December 31, 2011
Senior secured credit facility - term loan	$ 873,400	$ 880,000
Senior secured credit facility - revolving loan	35,000	-
Senior notes - net of discount	298,117	-
Capital leases	4,571	4,711
	1,211,088	884,711
Less: current portion of long-term debt and capital leases	(9,029)	(8,992)
Total long-term debt	$ 1,202,059	$ 875,719

Credit Agreement

The Company, through certain of its wholly owned subsidiaries, has an outstanding credit agreement with several financial institutions, which consists of a $50.0 million revolving credit facility and an $873.4 million term loan facility. In addition, the Company has outstanding $300.0 million of Senior Notes. As of September 30, 2012, $35.0 million was outstanding under the revolving credit facility. Borrowings under the senior secured credit facility are secured by substantially all of the assets of the Company, with the exception of Illinois Consolidated Telephone Company and our majority-owned subsidiary, East Texas Fiber Line Incorporated. The Senior Notes are unsecured.

Our term loan credit facility is made up of two separate tranches, resulting in different maturity dates and interest rate margins for each term loan tranche. The first term loan tranche consists of $467.4 million aggregate principal amount, matures on December 31, 2014 and has an applicable margin (at our election) equal to either 2.50% for a LIBOR-based term loan or 1.50% for an alternative base rate loan. The second term loan tranche consists of $406.0 million aggregate principal amount, matures on December 31, 2017 and has an applicable margin (at our election) equal to either 3.75% for a LIBOR-based term loan or 2.75% for an alternative base rate term loan. The applicable margins for each of the term loan tranches are fixed for the duration of the loans. The amended term loan facility also requires $2.2 million in quarterly principal payments which began on March 31, 2012.

Our revolving credit facility has a maturity date of June 8, 2016 and an applicable margin (at our election) of between 2.75% and 3.50% for LIBOR-based borrowings and between 1.75% and 2.50% for alternative base rate borrowings, depending on our leverage ratio. Based on our leverage ratio at September 30, 2012, the borrowing margin for the next three month period ending December 31, 2012 will be at a weighted-average margin of 3.25% for a LIBOR-based loan or 2.25% for an alternative 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. During the quarter ended September 30, 2012, we borrowed $35.0 million of the revolving credit facility in connection with the acquisition of SureWest as described in Note 2. There were no borrowings or letters of credit outstanding under the revolving credit facility as of December 31, 2011.

The weighted-average interest rate incurred on our credit facilities during the three month periods ended September 30, 2012 and 2011, including amounts paid on our interest rate swap agreements and the applicable margin, was 6.49% and 5.73% per annum, respectively. Interest is payable at least quarterly.

The credit agreement contains various provisions and covenants, including, among other items, restrictions on the ability to pay dividends, incur additional indebtedness, issue capital stock, and commit to future capital expenditures. 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 September 30, 2012, we were in compliance with the credit agreement covenants.

In connection with the acquisition of SureWest, on February 5, 2012 the Company received committed financing for a total of $350.0 million to fund the cash portion of the anticipated transaction, to refinance SureWest s debt and to pay for certain transaction costs. The financing package included a $350.0 million Senior Unsecured Bridge Loan Facility (Bridge Facility). As anticipated, permanent financing for the SureWest acquisition was funded by our Senior Note offering, as described below. As a result, the $4.1 million commitment fee incurred for the Bridge Facility was capitalized as deferred debt issuance costs and was amortized over the expected life of the Bridge Facility, which was four months.

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Effective February 17, 2012, we amended our credit facility to provide us with the ability to escrow proceeds from a high-yield note offering prior to the closing of the SureWest acquisition and, until closing, exclude the debt from current leverage calculations. The amendment also permitted us additional flexibility for future high yield notes issuances with the same subsidiary guarantees required by our current credit facility, which enabled us to issue the Senior Notes described below. All other terms, coverage and leverage ratios of the credit facility were unchanged. In connection with the amendment, fees of $3.5 million were recognized as expense during the quarter ended March 31, 2012 while $1.2 million in fees were capitalized as deferred debt issuance costs and amortized over the remaining life of the term debt.

On May 30, 2012, we completed an offering of $300.0 million aggregate principal amount of 10.875% 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 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 to investors at a price equal to 99.345% of the principal amount thereof, for a yield to maturity of 11.00%. This discount will be amortized over the term of the Senior Notes. The proceeds of the sale of the Senior Notes were held in an escrow account prior to the closing of the SureWest transaction. Upon closing of the SureWest acquisition on July 2, 2012, Finance Co. merged with and into our wholly-owned subsidiary Consolidated Communications, Inc., which assumed the Senior Notes, and we and certain of our subsidiaries fully and unconditionally guaranteed the Senior Notes. Deferred debt issuance costs of $7.8 million incurred in connection with the issuance of the Senior Notes will be amortized over the term of the Senior Notes through June 2020.

A portion of the Senior Notes was sold to certain accredited investors consisting of the Company s Chairman of the Board of Directors (BOD) and certain other members of the BOD, including the Company s Chief Executive Officer (collectively related parties). The related parties purchased $10.8 million of the Senior Notes on same terms available to other investors, except that the related parties were not entitled to registration rights.

Capital Leases

The Company has four capital leases, all of which expire in 2021, for the lease of office, warehouse and tech center space. As of September 30, 2012, the present value of the minimum remaining lease commitments was approximately $4.6 million, of which $0.2 million is due and payable within the next 12 months. The leases will require total remaining rental payments to LATEL, a related party entity, of approximately $6.6 million and total remaining rental payments to Spruce of approximately $1.3 million over the term of the leases. These leases have total payments of $7.9 million on the remaining terms of the leases.

7. DERIVATIVE FINANCIAL INSTRUMENTS

In order to manage the risk associated with changes in interest rates, we have entered into interest rate swap agreements that 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 account for these transactions as cash flow hedges under the FASB s ASC Topic 815 (ASC 815), *Derivatives and Hedging*. The swaps are designated as cash flow hedges of our expected future interest payments. In a cash flow hedge, the effective portion of the change in the fair value of the hedging derivative is recorded in accumulated other comprehensive income (loss) (AOCI) and is subsequently reclassified into earnings during the same period in which the hedged item impacts earnings. The change in fair value of any ineffective portion of the hedging derivative is recognized immediately in earnings.

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The following interest rate swaps, all designated as cash flow hedges, were outstanding at September 30, 2012:

(In thousands)	Notional Amount	2012 Balance Sheet Location	Fair Value
Fixed to 3-month floating LIBOR	$ 230,000	Current portion of derivative liability	$ (3,657)
3-month floating LIBOR minus spread to 1-month floating LIBOR	230,000	Current portion of derivative liability	(77)
Fixed to 1-month floating LIBOR	100,000	Other long-term liabilities	(1,804)
Fixed to 1-month floating LIBOR	300,000	Current portion of derivative liability	(3,067)
Forward starting fixed to 1-month floating LIBOR	175,000	Other long-term liabilities	(2,331)
Total Fair Values			$ (10,936)

The following interest rate swaps, all designated as cash flow hedges, were outstanding at December 31, 2011:

(In thousands)	Notional Amount	2011 Balance Sheet Location	Fair Value
Fixed to 3-month floating LIBOR	$ 100,000	Current portion of long-term liabilites	$ (3,401)
Fixed to 3-month floating LIBOR	130,000	Other long-term liabilities	(6,053)
3-month floating LIBOR minus spread to 1-month floating LIBOR	100,000	Current portion of long-term liabilites	(179)
3-month floating LIBOR minus spread to 1-month floating LIBOR	130,000	Other long-term liabilities	(269)
Fixed to 1-month floating LIBOR	300,000	Other long-term liabilities	(5,343)
Forward starting fixed to 1- month floating LIBOR	200,000	Other long-term liabilities	(736)
Total Fair Va			