REDACTED

EXHIBIT
#5
DT 16-872

STATE OF NEW HAMPSHIRE

BEFORE THE

PUBLIC UTILITIES COMMISSION

DT 16-872

CONSOLIDATED COMMUNICATIONS HOLDINGS, INC. and FAIRPOINT COMMUNICATIONS, INC.

Joint Petition for Findings in Furtherance of the Acquisition of FairPoint Communications, Inc. and its New Hampshire Operating Subsidiaries by Consolidated Communications Holdings, Inc.

PREFILED DIRECT TESTIMONY OF

STEVEN CHILDERS

ON BEHALF OF

CONSOLIDATED COMMUNICATIONS HOLDINGS, INC.

January 17, 2017

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Steven Childers. My business address is 121 S. 17th Street, Mattoon, Illinois 61938.

Q. By whom are you employed and what position do you hold?

A. I am employed by Consolidated Communications, Inc. ("CCI"), a wholly-owned subsidiary of Consolidated Communications Holdings, Inc. ("Consolidated"). I hold the position of Chief Financial Officer.

Q. Please describe your professional and educational background.

A. I have a diversified background in finance, accounting and operations. I started with CCI in 1986 and was named Chief Financial Officer in 2004, with responsibilities for all accounting, finance, investor relations, treasury, tax and regulatory functions. Prior to my current role, I served as the Director of Accounting and as President of the former Consolidated Market Response.

I served in a number of executive and operational roles with McLeodUSA during the time of the merger with CCI, from 1997 through 2002, including running customer service and leading the company's Business Process Teams to implement revenue assurance processes and controls.

I am a member of the Lake Land College Foundation Board of Directors, serving on the executive committee and as the chairman of the audit committee. I also serve on the School of Business Advisory Board of Eastern Illinois University.

I hold a bachelor's degree in Business from Eastern Illinois University.

Q. What are your duties as Chief Financial Officer?

A. My primary responsibilities as CFO for Consolidated are to manage external financial reporting, including ensuring compliance with all Sarbanes Oxley requirements, leading investor relations and communication, as well as the treasury, insurance, tax and financial planning functions for the company. I have significant involvement in Consolidated's evaluation of all M&A opportunities, as well as any related diligence and integration activities. I proactively manage capital structure, and lead financing (equity or debt) efforts on a stand-alone basis or acquisition-related.

Q. Have you previously testified before the New Hampshire Public Utilities Commission ("the Commission") or another state public utility commission?

A. I have not previously testified before the New Hampshire Public Utilities Commission, but I have testified before the Indiana Public Utilities Commission.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to demonstrate that Consolidated possesses the financial capabilities to maintain FairPoint Communications, Inc.'s ("FairPoint's") obligations as an incumbent local exchange carrier ("ILEC") in New Hampshire. My testimony describes: Consolidated's financial soundness; the proposed transaction in which Consolidate will acquire FairPoint; and the financial impact of the transaction on Consolidated.

II. CONSOLIDATED'S FINANCIAL SOUNDNESS

Q. Please describe Consolidated's financial and operating results for the last five years.

A. We would characterize our financial and operating results for the last five years as being very consistent and very solid on a stand-alone basis and especially good as compared to our peer group. For 2012, we reported revenues of $477.9 million and adjusted EBITDA[1] of $231.9 million. Given our focus on our organic growth strategy, as well as our acquisition strategy, in 2016, we estimate that revenue will be approximately $743.0 million and adjusted EBITDA will be approximately $306.0 million. While the clear trend over the last five years has been positive, I would note that estimates for revenue and adjusted EBITDA for 2016 are down slightly from our 2015 numbers. This is due to Consolidated's strategic decision to sell several non-core businesses, as well as due to losses in voice and video revenues, and anticipated reductions in subsidy and network access revenue.

Part of the growth in revenue and adjusted EBITDA seen over the last five years is due to our acquisitions of SureWest (closed July, 2012) and Enventis (closed October, 2014). Our organic growth strategy is focused on growing broadband and business services for both enterprise and carrier/wholesale customer channels. Over 89% of our addressable homes can get 20 Mbps of broadband speed, while 42% can get 100 Mbps, and we can deliver a 1 Gig consumer product in all our markets. Currently, over 75% of our addressable homes can get Internet Protocol television ("IPTV") directly from Consolidated.

We have continued to invest 16-17% of our revenue back into the business with a focus on providing our residential customers with faster speeds of broadband, enhanced streaming capabilities for video and, when we can generate adequate returns for green field opportunities, to build fiber directly to the home. For business and carrier channels, we strive to provide enhanced services and fiber extensions of our network on behalf of our major customers.

---

[1] Earnings before interest, tax, depreciation and amortization.

We are in a period of revenue transformation - consistent with industry trends - as we manage the erosion in our legacy voice services (including access) and reduced subsidy revenues due to the implementation of the Connect America Funding ("CAF") plan for high cost support. Consolidated has continued to be successful by focusing on stabilizing revenues through consistent execution of our organic growth strategy, differentiating ourselves from our competition based on quality of product and quality of service, while continuing our disciplined approach to growing the business and diversifying our revenue streams through acquisitions. In their respective testimonies, Mr. Shultz and Mr. Waggoner provide more detail about Consolidated's experience and proven track record of successfully integrating recently acquired companies.

We also have five limited partnerships with Verizon Wireless that produce $33 to $35 million in cash distributions that we have used to support our key strategic objectives and to invest in the business.

Q. From Consolidated's perspective what are the key indicators of Consolidated's financial health?

A. We are focused on growing and sustaining free cash flow, *i.e.*, cash generated after expenditures to maintain or expand our asset base. To that end, we measure our financial health by the diversity of revenue and strive for over 80% of our revenue mix to come from strategic revenues (i.e. consumer broadband, commercial and carrier), consistently investing 16-17% of revenue back into the business to promote broadband speeds and enhanced services, maintaining a payout ratio with respect to our dividend of 65-70% of free cash flow (as defined in our credit agreement), and improving leverage. Due to a recent refinancing, we have no debt maturities until 2022 and our average cost of debt is approximately 5%.

Q. What is Consolidated's credit rating?

A. Consolidated is rated by two of the three agencies: Moody's rating for debt is Ba3 and for bonds is B3; S&P ratings for debt is BB and for bonds is B-.

Q. How does the Company's credit rating compare to other investor-owned utilities?

A. As indicated in the table below, Consolidated is rated favorably compared to its peer companies and is rated higher than FairPoint. This Transaction will not negatively impact our ratings.

Secured Debt Rating:

Company	**Moody's**	**S&P**	**Fitch**
Consolidated	Ba3	BB	
FairPoint	B2	B	
Windstream	B1	BB	BB
Frontier	Ba3	BB	BB+

III. <u>THE PROPOSED TRANSACTION</u>

Q. Please describe the proposed transaction in which Consolidated will acquire FairPoint.

A. Consolidated and FairPoint have entered into an Agreement and Plan of Merger dated December 3, 2016 ("Merger Agreement"), which was submitted to the Commission as

Attachment 2 to the Joint Petition that was filed in this docket on December 29, 2016. Pursuant to the terms of the Merger Agreement, Consolidated will acquire all of the outstanding equity interests in FairPoint in exchange for Consolidated stock valued at approximately $1.5 billion (the "Transaction"). Post-close, Consolidated shareholders will own 71.3% of the combined company and FairPoint shareholders will own 28.7%. One director from the FairPoint Board of Directors will join the Board of Directors of Consolidated, which will expand from 8 to 9 directors.

Under the Merger Agreement, Falcon Merger Sub, Inc. ("Merger Sub"), a corporation wholly owned by Consolidated and formed for purposes of the Transaction, will merge with and into FairPoint, whereupon Merger Sub will cease to exist and FairPoint will remain as the surviving corporation. Upon completion of the Transaction, Consolidated will contribute all of the equity interest in FairPoint to CCI, so that FairPoint will be a direct, wholly-owned subsidiary of CCI.

Q. Please describe the Transaction structure.

A. This is an all-stock transaction. The Transaction is structured as an exchange of stock, so there will be no borrowing to acquire FairPoint's stock. However, Consolidated will incur new debt largely to refinance FairPoint's existing debt. Cash is not a component of the consideration other than for the customary settlement of fractional shares.

Q. What is the fixed exchange ratio for the Transaction?

A. The fixed ratio is .73, which implies a 17% premium to the 30 day average exchange ratio for FairPoint on a stand-alone basis.

Q. What is the total value of the Transaction?

A. The total value of the Transaction is $1.5B, which includes repayment of FairPoint's existing total debt of approximately $916M at signing.

Q. How will the Transaction be financed?

A. At signing, Consolidated's wholly-owned subsidiary CCI had secured underwritten debt financing - the Incremental Term Loans described below - from Morgan Stanley Senior Funding, Inc., MUFG, TD Securities (USA) LLC, The Toronto-Dominion Bank, New York Branch, and Mizuho Bank, Ltd. (the "Lenders") to finance the redemption or repayment of the outstanding long-term debt of FairPoint, currently approximately $916 million, and to pay costs associated with the Transaction. FairPoint's existing indebtedness consists of: (a) approximately $617.6 million term loan due 2019 with a weighted average rate of 7.50% ("FairPoint Term Loan"), and (b) 8.75% notes due 2019 in an aggregate amount of $300 million ("FairPoint Notes").

Q. Please describe the financing Consolidated has secured.

A. On October 5, 2016, CCI entered into a Third Amended and Restated Credit Agreement, which was subsequently amended by Amendment No. 1, dated as of December 14, 2016 and Amendment No. 2, dated as of December 21, 2016 (the "Credit Agreement"). The Credit Agreement consists of the following credit facilities: (1) an initial term loan of $900 million (the "Initial Term Loan"); (2) incremental term loan commitments of $935 million ("Incremental Term Loans" and together with the Initial Term Loan, the "Term Loans"); and (3) a revolving loan facility in an aggregate amount of up to $110 million (the "Revolver" and together with the Term Loans, the "Credit Facilities"). Amendment No. 2 added the Incremental Term Loans for purposes of the Transaction. A copy of Amendment No. 2 is attached as **Attachment SLC -1.**

It is important to note, with the financing secure, Consolidated will have to pay accrued interest on the incremental term loan commitments of $4M or more per month, which will start accruing mid-January.

Q. Does the Transaction involve a pledge of FairPoint assets?

A. Yes, it does involve a pledge of FairPoint assets, as well as the FairPoint stock. By pledging both, Consolidated received a more favorable interest rate which, in turn, reduces the combined company's cost of debt and helps to produce a stronger balance sheet for the combined company.

As described in my testimony and that of Mr. Shultz, the combined company results in significant scale increase. In this transaction, as of December 5, 2016, Consolidated's enterprise capitalization increases from $2.5 billion to an estimated $4.0 billion post-close. FairPoint assets will therefore become part of a much stronger balance sheet. Additionally, the combined company improves purchasing power, increases in market diversity, and adds fiber based assets all of which will help deliver new products and services, as well as allows for improvements to the fiber network and service quality.

IV. <u>THE TRANSACTION'S FINANCIAL IMPACT ON CONSOLIDATED</u>

Q. What steps has Consolidated taken to evaluate the financial status of FairPoint and its subsidiaries?

A. As we do with all acquisitions, we did substantial due diligence on FairPoint's operating and financial historical results and management projections of future results. We spent substantial time meeting with the FairPoint senior management team to discuss results, IT and network infrastructure, customer service, personnel and labor agreements, as well as the regulatory environment in each state in which FairPoint operates. Also as part of our diligence efforts we worked closely with the FairPoint management team to review and stress-test their business plan and long term model.

In addition, we also toured the key markets in the Northern New England properties with and without FairPoint management. We hired Morgan Stanley as an investment banking firm due to the strong level of involvement and expertise in similar industry transactions. We also performed extensive analysis with Ernst & Young on potential limitations or restrictions regarding $300 million in Federal net operating losses.

Q. From a financial point of view, what are the key areas of focus to demonstrate the expected financial benefits of this Transaction?

A. Our investors, our Board and our management team measure the financial success of this Transaction primarily based on the impact to free cash flow. Specifically, Consolidated anticipates the following financial benefits for the combined company:

a) Realigning Revenue Curve - We will be focused on how quickly we can bend the revenue curve for FairPoint which has been losing revenue at the rate of 4 to 5% a year.

b) Realizing Operating Cost Efficiencies - We will be focused on meeting and exceeding our timelines for integration and achieving operating cost efficiencies.

c) Improving EBITDA margins - We will measure operating efficiency by EBITDA margin percent (Adjusted EBITDA/Revenue). EBITDA margin percentages for Consolidated on a standalone basis have been approximately 42%. Adjusted for the sale of our IT/Equipment business in December, the Consolidated EBITDA margin would be approximately 42%. FairPoint EBITDA margins have historically run in the range of approximately 29-30%.

At close, we would expect EBITDA margins to be roughly 35%. Over time, based on improving revenue trends, expanding product margins, improving churn through higher quality service and improving the cost structure, we would expect EBITDA margins to approach 42 or 43%.

d) Increased Investment in the Business - To advance broadband products and network expansion we will continue to invest 15 to 16% of revenue back into the business as a capital expenditure.

e) Improved Net Debt Leverage and Cost of Debt- At closing of the Transaction, our net debt leverage is expected to be 3.8x (giving effect to full run rate synergies) and our target for leverage is now 3.5x.

In addition, as mentioned earlier, the financial benefits of this Transaction are also enhanced by reducing cash taxes in the short term by the utilization of the $300 million in Federal net operating losses and the ability to significantly improve the cost of debt as the FairPoint debt is refinanced.

f) Encouraging Investment in Consolidated - We expect to see significant improvement in our dividend payout ratio and expect it to be significantly lower than our current target of 65-70% of free cash flow (as defined in our credit agreement).

Q. Please describe the financial model and pro forma financial projections Consolidated has developed for this acquisition.

A. During our diligence work, we worked closely with the FairPoint management team to diligence- and stress-test their 2017 budget and long term model. We believe our model is conservative and the financial benefits of this Transaction are compelling for all stakeholders.

<u>REDACTED</u>

In our model, on a pro forma basis, revenues are expected to decline modestly from year end 2016 through 2022. We currently estimate 2016 pro forma revenue to be roughly [redacted] million, which is normalized for the sale of Enterprise Integration Services, Inc. ("EIS") on 12/6/16, and is expected to be [redacted] million for 2022. This represents a negative Compound Annual Growth Rate ("CAGR") of .6% for the model period. An overview of Consolidated's financial projections for the combined company is provided in **CONFIDENTIAL Attachment SLC-2.**

It should be noted that the revenue loss rate will be higher in the first year or two after close. We do not anticipate any material changes to the FairPoint revenue trends of a roughly 4% annualized loss for 2017, as we do not expect to close until mid-year 2017. Once the transaction closes, we believe it will take us six to nine months to have any meaningful impact on the trend line. For the legacy Consolidated business, we will continue to be focused on our organic growth strategy by targeting over 80% of revenue to come from consumer broadband, commercial and carrier customer channels. However, we are scheduled to have two more CAF II step downs in 2017 and 2018, and each step down yields a loss of high cost support of approximately $ 6 million per year. We also are in transition moving away from a linear subscription video service to facilitating more streaming or Over the Top ("OTT") capabilities for our consumer customers by offering higher broadband speeds.

With our focus on consumer broadband and growing our commercial and carrier channels by 3.5% to 4% per year, we expect to see legacy Consolidated revenues stabilize in 2019. To be

REDACTED

conservative, we are modeling declines of less than one half of one percent in the out years of the model.

On the FairPoint side, we believe growing carrier, commercial and consumer broadband channels will bring a stronger focus on targeted capital deployment and we will be able to leverage the improvement that FairPoint has started to demonstrate in their results by more quickly deploying advanced products and with a more consultative, solution-focused approach to sales and customer retention. We expect the revenue trends for legacy FairPoint to improve from a loss rate of 4% in 2016 to around [redacted] by 2022.

By constantly striving to improve the quality of service and reducing churn, we expect to see product margin expansion, and combined with improving the overall cost structure due to scale, integration and synergy achievement, we expect to improve pro forma EBITDA margins from roughly [redacted] at close to at least [redacted] by 2019.

We will continue to invest approximately 15% of revenue back into the business and based on the quality of the networks, we expect at least two thirds of our capital expenditure spending to be success based, and our target Internal Rate of Return is 25% for each project.

Q. Based on the projected financial profile of the combined company, as reflected in CONFIDENTIAL Attachment SLC-2, do you expect that Consolidated will be a financially sound company after this Transaction is complete?

A. Yes. In addition to the Transaction rationale as previously discussed, this combination doubles our size, adds over 20,000 route fiber miles, significantly improves our payout ratio with respect to our dividend, meaningfully deleverages our balance sheet and we will be investing

15-16% of our revenue back into the business to drive business and broadband growth. The market has reacted very well to this transaction as our equity is still trading at a premium to our peer group and we were able to secure the FairPoint financing at very attractive rates and terms. The cost of debt for the combined company is significantly better than FairPoint's on a stand-alone basis.

Q. Please describe any cost savings or "synergies" associated with the Transaction, how they were determined, and the timeframe over which they will be realized.

A. We anticipate a net $55M in total synergies in the first two to three years from closing, based on the pace of integration. This was developed based on analysis of FairPoint's network, IT infrastructure, and organization structure. $10M of the total is related to network optimization, volume purchasing efficiencies and public company cost savings. $45M represents the elimination of overlapping executive and corporate functions, and the expected efficiencies of corporate, network optimization and IT savings. The total synergy amount is over the entire combined company, not just FairPoint.

Q. Based on your knowledge, expertise, and experience, and your analysis of this Transaction, is it your expectation that the merger will create a stronger company financially?

A. Yes it will. The combined company will have scale, improved purchasing power, increased market diversity and fiber based assets all of which will help deliver new products and services, as well as improve and expand the fiber network and service quality. The business combination of FairPoint and Consolidated provides each company with significantly increased scale as demonstrated by the following pro forma metrics for the new company: (1) it will have over 35,000 fiber route miles, making it a top ten fiber provider in the United States; (2) it will do business in 24 states; (3) it will support over 8,500 on-net buildings and 2,400 fiber connected towers; and (4) it will serve over 1.6 million customer connections with 4,400 employees. Also, as measured on a pro forma basis for the last twelve months as of September 30, 2016, revenue is projected to be approximately $1.6 billion, and adjusted EBITDA will also double to over $600 million, giving effect to the expected $55 million in run rate cost synergies.

As demonstrated by the amount of consolidation that has recently been announced in the telecom sector, we believe scale matters. The proposed acquisition will make both companies more competitive from a service and product perspective and better capitalized to deploy broadband and expand our network footprint to support our consumer, commercial and carrier customer channels.

The Transaction is meaningfully accretive to cash flow given the opportunity to improve revenue trends, improve operating cost structure while enhancing quality of service, as well as minimizing, in the short term, cash income taxes by utilizing approximately $300 million in Federal net operating losses. Also, we will improve cash flow of the combined company, at close, based on our financing efforts in December that will result in significantly better terms and reduced interest costs for the FairPoint debt.

The combined company will be better positioned to continue Consolidated's demonstrated commitment to financial and operational stability in all the markets it serves. When systems and network integration is completed, the combined company will be a significant platform and infrastructure that will facilitate future mergers or acquisitions. In my professional opinion this transaction is financially positive for both companies.

V. CONSOLIDATED'S FINANCIAL CAPABILITIES TO MAINTAIN FAIRPOINT'S ILEC OBLIGATIONS

Q. Based on your knowledge, expertise and experience with other transactions such as the one at issue in this docket, does Consolidated have the financial capabilities to maintain FairPoint's ILEC obligations under New Hampshire RSAs 362:8 and 374:22-p?

A. Yes. My testimony above indicates that Consolidated has the financial capabilities to own and operate an ILEC such as FairPoint, and to maintain FairPoint's ILEC obligations in New Hampshire. The testimony of Michael C. Reed submitted on behalf of FairPoint in this docket indicates that FairPoint's New Hampshire companies are currently meeting their ILEC obligations under the above-referenced statutes. The acquisition of FairPoint by Consolidated will not affect FairPoint's continuing ability to meet its ILEC obligations in New Hampshire.

As my testimony indicates, because the Transaction will produce a financially stronger combined company post-closing, Consolidated will be able to meet the New Hampshire ILEC obligations that FairPoint is now meeting.

Q. Does this conclude your prefiled direct testimony?

A. Yes.

1666075_1