EXHIBIT
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DT 16-872

STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

CONSOLIDATED COMMUNICATIONS HOLDINGS, 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.

DOCKET NO. DT 16-872

DIRECT TESTIMONY OF
RANDALL VICKROY
OF THE LIBERTY CONSULTING GROUP
ON BEHALF OF
COMMISSION STAFF

[REDACTED]

APRIL 19, 2017
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Contents

I. INTRODUCTION

Q. Please identify yourself for the record.

A. My name is Randall Vickroy. I am a senior consultant for The Liberty Consulting Group ("Liberty"). My Liberty business address is 279 North Zinns Mill Road, Suite H, Lebanon, Pennsylvania 17042.

Q. Please describe your background and experience.

A. I have spent my entire career in utility corporate finance, with extensive hands-on experience with the financial management, credit rating issues, and transaction financing issues, such as those this docket raises. I spent 12 years at Public Service Company of Colorado, a major Mountain States electric and gas utility. I began as a financial analyst in the corporate finance and planning department, and then became financial supervisor, director of analysis, business development manager, and assistant to the chief financial officer. My responsibilities included financial planning, capital acquisition, capital spending analysis and allocation, treasury operations, securitization financing, project financing, mergers and acquisitions, cash management, and investor relations.

I have been consulting since 1991 on corporate finance, planning, and business issues in the electric, natural gas, and telecommunications industries. During that time, I have provided consulting services to utility regulatory commissions and to companies in over 30 states and in three foreign countries. I received a Bachelor of Arts from Monmouth College with a major in business administration and a Masters of Business Administration degree from the University of Denver with an emphasis in finance.

I have managed the issuance of first mortgage bonds, common equity, pollution control bonds, leveraged leases, medium-term notes and commercial paper, and arranged credit facilities. I established at Public Service Company of Colorado financing facilities unique in the utility industry in the 1980s, including accounts receivable and inventory securitization, equipment financing through a revolving master lease, a medium-term note facility, and a customer financing facility through a commercial bank. I have been addressing utility financial issues for Liberty for about 25 years. More information regarding my background, qualifications, and professional experience is contained in Appendix LCG-1 filed with the direct testimony of John Antonuk and Dr. Charles King in this proceeding.

I began working on financial issues for Liberty in 1992 examining Public Service Electric & Gas for the New Jersey Board of Public Utilities. I have performed for Liberty the following utility merger/acquisition or credit risk/financial transaction projects, mostly for utility regulatory commissions:

- FairPoint Northern New England acquisition from Verizon for Commission Staff.
- Oncor acquisition by NextEra Energy for the Staff of the Public Utility Commission of Texas.
- TXU acquisition by Energy Future Holdings for the AARP.
- Duke Energy Carolinas for the North Carolina Utilities Commission Staff (two engagements).
- Delmarva Power/Pepco Holdings for the Delaware Public Service Commission (two engagements).
- PSE&G for the New Jersey Board of Public Utilities.
- Nova Scotia Power/Emera for the Nova Scotia Utilities Board.
- ETG/AGL Holdings for the New Jersey Board of Public Utilities.

- NUI Utilities/NUI for the New Jersey Board of Public Utilities.
- Virginia Power/Dominion Resources for the Virginia Corporation Commission.
- New Jersey Natural/NJR for the New Jersey Board of Public Utilities.
- South Jersey Gas/SJI for the New Jersey Board of Public Utilities.
- Hawaiian Electric Company/HEI for the Hawaii Department of Commerce and Consumer Affairs.
- Major Northeastern Utility holding company — consulting on structure and affiliate relationships.

Q. What is the purpose of your testimony?

A. The purpose is to present the results of my evaluation of the proposed acquisition of FairPoint Communications, Inc. and its New Hampshire Operating Subsidiaries by Consolidated Communications Holdings, Inc. My testimony will generally refer to these applicants by the terms "FairPoint" and "Consolidated." It will also generally refer to the proposed acquisition as the "Acquisition." That evaluation applied the standards that we understand the Commission will apply in considering the Acquisition. I address the financial aspects of Consolidated's capability under the standards described in Section II (The Standards Applicable in Reviewing the Acquisition) of the direct testimony of Mr. Antonuk and Dr. King filed in this proceeding.

II. OVERALL CONCLUSIONS

Q. Please describe how you viewed Consolidated's post-acquisition financial capability in the context of providing basic service and relationships with other telecommunications carriers in New Hampshire.

A. Given Consolidated's lack of financial separation between facilities and operations for those two business areas and the others in which Consolidated engages, maintaining the capability to provide basic service and to effectively conduct relationships with other telecommunications carriers requires the maintenance of overall financial health. Financial distress or failure in other areas cannot be isolated. It was therefore appropriate to conduct a holistic examination of post-Acquisition finances and financial risks to address financial capability under the standards described in the testimony filed by Mr. Antonuk and Dr. King.

Q. What did you conclude overall from your evaluation under this standard?

A. This testimony offers three principal conclusions:

- Consolidated has the financial capability to meet the standards required by New Hampshire statutes.
- There is a material risk that FairPoint will have difficulty in efficiently undertaking refinancings required over the next several years.
- The pledge of assets that would accompany Consolidated's Acquisition presents an inappropriate potential risk, the remedy for which is addressed in the testimony filed by Mr. Antonuk and Dr. King.

III. FAIRPOINT FINANCIAL RESULTS

Q. Please provide a brief overview of FairPoint's financial results since its emergence from bankruptcy in 2011.

A. FairPoint experienced poor financial results following its emergence from bankruptcy in January 2011 through the end of 2014. In 2011, FairPoint immediately experienced a substantial impairment of intangible assets and goodwill and net income losses. In the following three years, 2012, 2013, and 2014, FairPoint recorded substantial net income losses. By December 31, 2014, FairPoint had accumulated a total stockholder's equity deficit of about $600 million, due primarily to recurring operating losses in its continuing operations.[1]

FairPoint's net income results improved significantly in 2015 and 2016, with reported net income of $90 million and $104 million in those two years, respectively. FairPoint's current collective bargaining agreements with its unions expire in 2018.

Q. Are FairPoint's net income losses and negative shareholder equity the most important measures of its financial health?

A. No. In the wireline industry sector where both FairPoint and Consolidated operate, book net income and balance sheet equity levels have limited value in determining financial health and viability. Declining revenue streams from voice, access, and convertible sources, only partially offset by growth in broadband revenues, cause net income measures that tend to indicate minimal or negative book net income for operating companies in this consolidating business sector. However, cash flows for operating companies tend to be strong and relatively steady, allowing heavily debt-leveraged financial structures.

The dynamics of leveraged financing structures make meeting debt financing covenants and related restrictions crucial in the face of revenue declines. Like Consolidated, several wireline companies have become consolidators of wireline operating companies, merging with other operating companies to provide a source of growth, as "organic" growth in revenue has tended to be flat or negative.

[1] FairPoint Response to Data Request Staff 1-4; FairPoint SEC Form 10-K for 2015, page 34.

"Earnings Before Interest, Taxes and Depreciation and Amortization" ("EBITDA") margins measure operating profitability and cash flow strength. These metrics have importance in measuring cash flow available to service capital expenditures and heavy debt obligations. The most important financial ratios in the wireline sector concern "Net Leverage" coverages, which measure the total company debt divided by the EBITDA generated to support capital expenditures and debt service.

Q. Please describe FairPoint's losses of revenue in recent years, especially in the voice, access, and convertible categories.

A. FairPoint has suffered severe declines in residential voice lines in each of the years 2014, 2015, and 2016 (11.4 percent, 12.2 percent, and 10.7 percent, respectively). Driven by high voice line losses, FairPoint voice service revenues declined by 8 percent, 11 percent, and 8 percent, respectively, over those three years.[2]

FairPoint access revenues have also declined significantly. Access revenue has decreased year-over-year by 7 percent, 4 percent, and 7 percent from 2014 through 2016.[3] FairPoint attempts to offset the declines in its legacy services of voice, access, and "convertible" (business voice, non-ethernet special access, and other convertible) categories) through growth in broadband, ethernet and hosted and advanced services. However, those growth services have not provided enough revenue growth to offset declines in the legacy services.

Q. How extensive are the losses in FairPoint total revenues over the past three years?

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[2] FairPoint SEC Form 10-Ks for 2015 on pages 38 and 39, and for 2016 on pages 39 and 40

[3] FairPoint SEC Form 10-Ks for 2015 on page 40, and for 2016 on page 40.

A. According to its SEC Form 10-Ks, FairPoint has lost 4.0 percent, 4.7 percent, and 4.1 percent of its total revenues in 2014, 2015 and 2016, respectively.[4] In February 2017, Moody's Investors Service noted that FairPoint's primary challenges "are related to the erosion of voice revenues at a faster pace than the modest growth in data and internet services revenue and the intense competition from cable operators." Moody's also stated that the "long-term trend remains in line with a mid-single digit percentage pace of annual revenue declines."[5]

Standard and Poor's addressed declining revenues in a March 7, 2016 ratings summary, stating that: "… we believe that growth in the company's data and internet services segment will not be able to offset the decline in the company's legacy service offerings, resulting in overall revenue decline in the low-single digit percent area."[6] Both rating agencies have recognized FairPoint's revenue performance as a major factor in their "weak business risk" assessments.

Q. Please describe FairPoint's operating profitability and cash flow strength over the past several years, as specifically measured by EBITDA margins?

A. FairPoint has experienced weak EBITDA margins in the past several years, ameliorated by expense reductions beginning in February 2015, which served to improve margins. Moody's reported FairPoint's annual EBITDA margins for the four-year period from 2012 through 2015 as 21.4 percent, 20.8 percent, 15.9 percent, and 27.0 percent, respectively. Moody's observed that the wireline industry peer group has a range of EBITDA margins in the 30 to 40 percent range, making FairPoint a performance a

[4] FairPoint SEC Form 10-Ks for 2015 on page 34, and for 2016 on page 35.
[5] FairPoint Response to Data Request Staff 1-1, Moody's February 3, 2017 report on FairPoint.
[6] FairPoint Response to Data Request Staff 1-2.6, S&P ratings summary on FairPoint dated March 7, 2016.

laggard under this key cash flow metric. However, Moody's saw FairPoint as significantly improving its EBITDA margins in 2016 and beyond to the 30 to 32 percent range, which represent significant improvement.[7] Standard and Poor's, however, has not expressed similar optimism about FairPoint's EBITDA margins, noting "[w]eak profitability relative to other incumbent telephone operators with adjusted EBITDA margins in the mid-20's area."[8]

FairPoint's EBITDA margins have been much lower than those of Consolidated. FairPoint's historical EBITDA margins **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL**, as noted by both credit rating agencies.[9]

IV. KEY MEASURES OF FINANCIAL HEALTH

Q. Please explain the financial metric "net leverage" and its relevance in measuring financial health and viability in the wireline industry.

A. The financial dynamics of the wireline business cause many operating companies to structure heavily-leveraged financing platforms. Despite flat or declining total revenues, cash flow tends to be strong and steady, allowing for internal funding of capital expenditures. Heavy debt leveraging can offer a less expensive form of long-term financing on an after-tax basis. For heavily leveraged companies, meeting debt financing covenants and related restrictions becomes crucial, requiring companies to manage to meet these covenants with room to spare.

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[7] FairPoint Response to Data Request Staff 1-1, Moody's Credit Opinion on FairPoint dated February 3, 2017, page 2.
[8] FairPoint Response to Data Request Staff 1-2.6, S&P Credit Summary dated March 7, 2016, page 2.
[9] Consolidated Response to Data Request Staff 1-9, page 27.

"Net Leverage" becomes an important financial measure in the debt financing of many wireline companies. Net leverage divides the net debt of a company by its annual EBITDA - - measuring the amount of debt financing divided by the operating cash flow produced to pay for capital expenditures, support dividends, and service debt. The higher the "net leverage", the greater the financial risk present for servicing debt. Financing covenants for wireline companies typically include a maximum net leverage for the trailing 12 months of financial results, with potential defaults on the debt if the maximum levels are exceeded.

Minimum interest coverage, or 12-month EBITDA/interest expense, comprises a second prominent financial measure in wireline industry financing. Debt financing for Consolidated and for FairPoint includes maximum leverage and minimum interest coverage covenants. Moody's and Standard and Poor's credit rating opinions focus heavily on net leverage financial metrics and on their individual components for wireline companies.

V. FAIRPOINT'S DEBT

Q. Please describe FairPoint's debt financing.

A. FairPoint has operated under two primary pieces of debt financing since 2013. In February 2013, FairPoint entered into a Credit Agreement that included a $640 million term loan maturing in 2019 and a $75 million revolving credit facility maturing in 2018. At the same date, FairPoint also issued $300 million of 8.75 percent senior secured notes, also due in February 2019. As of December 31, 2016, FairPoint had total outstanding debt of about $916 million; the Term Loan and the Senior Notes (over $900 million) mature in February 2019, and the revolving credit matures in February 2018.[10]

FairPoint pledges its common stock as security for its debt obligations, but has not provided pledges of its assets as collateral or loan guarantees as security.[11]

FairPoint is subject to variable interest rates under the Credit Agreement for the term loan and revolving credit portions, both utilizing the Intercontinental Exchange London Interbank Offered Rate ("LIBOR") as a base rate, with a minimum contracted floor rate of 1.25 percent for the term loan. Term loan interest is paid at the base rate plus a 6.25 percent financing margin, resulting in effective rates of 7.5 percent or more. In 2016, FairPoint was paying a weighted average rate of about 7.9 percent for its senior note, term loan, and revolving credit borrowings. The applicable rate financing margin for the revolving credit facility is 5.50 percent.[12] These rates are extremely high in today's financial markets. FairPoint's bankruptcy and its financial performance since emergence from bankruptcy cause debt capital markets to view FairPoint relatively unfavorably.

Q. What critical financial covenants does FairPoint's Credit Agreement include?

A. The yearly financial covenant thresholds on net leverage for FairPoint since 2014 have been 5.50X, 5.25X and 5.00X. The threshold drops to 4.75X in 2017, and continues through Credit Agreement maturity in February 2019. FairPoint had to maintain a minimum 2.00X interest coverage through 2015, increasing to 2.25X for 2016 through maturity in February 2019.

[10] FairPoint 2016 SEC Form 10-K, pages 51 and 75.
[11] Consolidated Response to Data Request Staff 1-17 Supplement.
[12] FairPoint 2016 SEC Form 10-K, page 51.

Q. Compare FairPoint's historical and projected net leverage and interest coverage metrics to those covenant thresholds.

A. The table below shows FairPoint's net leverage and interest coverage results historically and as projected through 2021. Almost all FairPoint debt matures in February 2019; projected information past this date assumes the ability to refinance debt on similar terms. That assumption is not a certainty, but represents a primary risk for FairPoint as a stand-alone entity on a going forward basis. **BEGIN CONFIDENTIAL**

FairPoint Financial and Covenant Highlights[13]

	2014A	2015A	2016F	2017F	2018F	2019F	2020F	2021F
EBITDA Margin	[redacted]%	[redacted]%	[redacted]%	[redacted]%	[redacted]%	[redacted]%	[redacted]%	[redacted]%
Position Reductions	[redacted]	[redacted]	([redacted])	([redacted])	([redacted])	([redacted])	([redacted])	([redacted])
Net Leverage Covenant	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
FairPoint Ratio	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Interest Coverage Covenant	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
FairPoint Ratio	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

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Q. What is your view of FairPoint's projected stand-alone financial results and financial covenant coverages?

A. FairPoint's past EBITDA margin performance makes projected increases to **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** percent in 2020 and 2021 optimistic. The table above shows **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** from 2016 through 2021 - - a primary reason for FairPoint's forecasts generating improvements in EBITDA margins. FairPoint estimated a **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** reduction

[13] Consolidated Response to Data Request Staff 3-9.2.

in annual employee and non-employee expenses during this period. The projections of post-acquisition synergies by Consolidated are additive to these stand-alone projections made by FairPoint.

Q. How have FairPoint's leverage levels changed after its bankruptcy?

A. FairPoint's Debt/EBITDA(leverage) ratio, as calculated by Moody's, decreased from 13.6X in 2010 to 5.9X in 2011.[14] Moody's "leverage" calculations are drastically different than FairPoint's covenant net leverage, which is the relevant leverage coverage metric for the company. FairPoint's covenant net leverage is lower than that of Consolidated, and is at about average levels compared to its other peers in the wireline business.

Q. How has FairPoint protected itself from variable interest rate risk?

A. FairPoint entered two interest rate swap agreements totaling $170 million, effective September 30, 2015. The interest rate swap agreements mature on September 30, 2017. The swap agreements require FairPoint to pay a fixed rate of 2.665 percent in exchange for the variable interest rates due under the Credit Agreement.[15] At the end of 2016, FairPoint was exposed to variable interest rates in the amount of about $446 million under the Credit Agreement, and $616 million after September 30, 2017.[16]

VI. FAIRPOINT'S FINANCIAL RISK

Q. How do the rating agencies view FairPoint's financial risk?

[14] FairPoint Response to Data Request Staff 1-2.2.
[15] Id.
[16] FairPoint 2016 SEC Form 10-K, page 75.

A. Moody's and Standard and Poor's have maintained equivalent and level credit ratings of B2 and B, respectively, for FairPoint since 2012. Moody's has summarized its ratings rationale on FairPoint as follows:

> *FairPoint's B2 corporate family rating reflects its moderate leverage, improved cost structure offset by its weak revenue trajectory. The primary challenges facing FairPoint are related to the erosion of voice revenues at a faster pace than the modest growth in data and internet services revenue and the intense competition from cable operators. Despite top line pressure, credit metrics have stabilized due to cost structure improvements following the company's resolution of labor negotiations last year. The meaningful improvement in cost structure has resulted in near term stability despite the company's fundamental competitive challenges. The ratings are also supported by the company's strong footprint and asset base in its core markets, its large base of recurring revenues and consistent positive free cash flows.*[17]

Moody's sees FairPoint as significantly improving its EBITDA margins in 2017 and 2018 to 32 percent. Moody's calculates EBITDA margin significantly differently from FairPoint, making direct comparisons difficult.

Standard and Poor's last provided a full ratings summary on FairPoint in March 2016. S&P noted "weak profitability relative to other incumbent telephone operators with the adjusted EBITDA margins in the mid- 20 percent area." It gave FairPoint a "weak" (second lowest of 6 levels) business risk profile, and a "highly leveraged" (lowest of 6

[17] FairPoint Response to Data Request Staff DR 1-1, Att.1, Moody's credit opinion dated February 3, 2017.

levels) financial risk profile. S&P's views are less positive than Moody's about future FairPoint EBITDA margins. Noting that FairPoint is subject to a stepped-down maximum leverage covenant to 5.0 times in the third quarter of 2016, S&P expected a more than 20 percent covenant cushion going forward.[18]

Standard and Poor's also addressed a "downside scenario" important in evaluating FairPoint's future risks:

> *We could lower the rating if there is a decline in adjusted EBITDA margins to the low 20 percent area and revenue declines in the mid- single digit percentage area or more over multiple quarters, resulting in negative free operating cash flow and leverage rising above six times with no prospects for improvement. We could also lower the rating if liquidity is pressured and the company is unable to demonstrate a viable plan to refinance its debt maturities in 2018 and 2019.*

Q. Please address FairPoint's prospects for efficiently refinancing its debt in February 2019.

A. FairPoint's accounting financial results have improved in 2015 and 2016, but its debt covenant coverages have not improved. FairPoint has experienced slight increases in net leverage and slight decreases in interest coverages - - both negative trends. The very specialized calculations of FairPoint's covenants cut against the cost improvements seen by Moody's and Standard and Poor's, painting a less optimistic picture.

We agree that one should consider economically efficient FairPoint re-financing in 2019 "uncertain" and heavily dependent upon FairPoint's financial performance over

[18] FairPoint Response to Data Request Staff DR 1-2.6.

the next two years. FairPoint may be able to re-finance its debt on a stand-alone basis, but appears unlikely to improve on its "deep junk category" interest rates, which currently include very expensive term loan interest rates of 7.50 percent and senior notes interest rates of 8.75 percent.

VII. RECENT CONSOLIDATED PERFORMANCE MEASURES

Q. Compare Consolidated's EBITDA margins over the past several years to its industry peers.

A. Consolidated's comparatively strong recent EBITDA margins have exceeded **BEGIN CONFIDENTIAL** [redacted] percent yearly ([redacted] percent, [redacted] percent, [redacted] percent and a [redacted] percent for 2013 through 2015 and estimated for 2016). **END CONFIDENTIAL** Consolidated also projects EBITDA margin improvements to **BEGIN CONFIDENTIAL** [redacted] percent in 2017, and [redacted] percent for 2020 and beyond.[19] **END CONFIDENTIAL** Consolidated reports that the sale of EIS, a low-margin equipment business, in December 2016 will increase future EBITDA margins. Consolidated has recorded comparatively strong EBITDA margins in part due to partnership payments from Verizon and to higher levels of USF subsidy payments.[20]

Q. Compare Consolidated voice revenue losses to those of FairPoint, which you described previously.

A. Consolidated's total revenues have increased substantially since 2012. Consolidated's total revenues increased from about $478 million in 2012 to about $776 million in 2015, primarily due to two acquisitions:

[19] Consolidated Response to Data Request Staff 1-7 financial model, CNSL stand-alone tab.
[20] Consolidated Response to Data Request Staff DR 1-2.12.

- SureWest Communications in 2012;
- Enventis Corporation in 2014.

Consolidated has also sold at least three smaller businesses in recent years, further complicating revenue comparisons.

Consolidated has experienced less dramatic voice revenue and line losses than FairPoint has during the past two years. Consolidated's voice services revenue decreased by 3 percent during 2016, and, excluding the addition of Enventis revenue from the 2014 acquisition, decreased by about 5.5 percent during 2015. FairPoint's voice revenue decreased by 8 percent and 11 percent in those same two years. Consolidated's SEC Form 10-K attributed the decline in voice service revenue to 10 percent and 9 percent declines in access lines during the two years. FairPoint reported voice line yearly declines of 10.7 percent and 12.7 percent in 2016 and 2015, respectively.[21]

VIII. CONSOLIDATED'S FINANCING

Q. Please describe Consolidated's debt financing structure and debt instruments.

A. Consolidated entered into a Restated Credit Agreement with its lenders on October 5, 2016, under which the company obtained term loans in the amount of $900 million (Initial Term Loan), with a maturity date of October 2023. The new financing was used to pay off outstanding term loans in the amount of $885 million. The new term loans have an interest rate of 3.0 percent plus the LIBOR rate, which is subject to a 1.0 percent floor. The Restated Credit Agreement also includes a revolving loan facility of $110 million maturing in October 2021. Consolidated used its Restated Credit facility to provide an additional $935 million in term loans to acquire FairPoint - - a financing

[21] Consolidated SEC Form 10-K for 2016.

amendment that was announced in December 2016, following announcement of the FairPoint Acquisition.[22]

The second major piece of Consolidated's current debt financing is $500 million of 6.50 percent coupon rate Senior Notes maturing on October 1, 2022. If the Senior Notes are repaid in full on or prior to March 31, 2022, the Initial Term Loan will then be subject to early maturity on March 31, 2022. Consolidated issued $200 million of the Senior Notes in 2014, and an additional $300 million in June 2016.[23] The interest rates on Consolidated's term loans and Senior Notes are 3.25 percent and 2.25 percent lower than the comparable securities of FairPoint, offering an important consideration in the economics of the proposed Acquisition.

Q. Please describe the financial covenants of Consolidated's Restated Credit Agreement and Senior Notes.

A. The Restated Credit Agreement net leverage covenant calls for an event of default on the term loans if the net leverage ratio at the end of any quarter is greater than 5.25 times. The interest coverage covenant calls for a default if the interest coverage at the end of any quarter is less than 2.25 times. In addition, if the net leverage ratio is greater than 5.10 times at the end of any quarter, Consolidated would be required to suspend dividends on its common stock, subject to certain exceptions. During a dividend suspension, Consolidated would be required to repay debt in an amount equal to 50 percent of any increase in available cash, as defined in the loan documents.[24]

[22] FairPoint SEC 10-K for 2016, page 37.
[23] FairPoint SEC 10-K for 2016, page 49.
[24] Consolidated SEC Form 10-K for 2016.

The financial covenants for Consolidated's Senior Notes are even more restrictive. If Consolidated's net leverage ratio is greater than 4.75 times, the company may not pay dividends. The Senior Notes' net leverage ratio is calculated differently than occurs under the Restated Credit Agreement, and credits Consolidated for synergies expected to be achieved through acquisitions.

IX. CONSOLIDATED'S FINANCIAL RISKS

Q. How does Consolidated's key net leverage ratio compare to that of industry peers?

A. Consolidated as a stand-alone entity has **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** levels of net leverage, both on a historical basis and as projected in company forecasts. Consolidated has **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** than its wireline industry peers - - and **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** as well. The table below summarizes net leverage as calculated by the company and relevant to its Restated Credit Agreement financial covenants. The table includes FairPoint's stand-alone projections as well.

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Net Leverage Ratios, 2016-2021[25]

	2016E	2017E	2018E	2019E	2020E	2021E
CCI Net Debt/Adjusted EBITDA	[redacted]X	[redacted]X	[redacted]X	[redacted]X	[redacted]X	[redacted]X
FairPoint Net Debt/Adj. EBITDA	[redacted]X	[redacted]X	[redacted]X	[redacted]X	[redacted]X	[redacted]X

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A presentation to the Consolidated Board of Directors about the FairPoint Acquisition compared 2016 leverage ratios for Consolidated and its wireline peer group. Consolidated's net leverage for 2016 was shown as **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** times, and mean and median net leverage of a peer group including

[25] Consolidated Response to Data Request Staff 1-9, page 8 and Response to Data Request Staff 3-9.2.

CenturyLink, Frontier, Cincinnati Bell, Windstream, Lumos and FairPoint at **BEGIN HIGHLY CONFIDENTIAL** [redacted] **END HIGHLY CONFIDENTIAL** times.[26]

Consolidated strategic planning documents express a desire to **BEGIN HIGHLY CONFIDENTIAL** [redacted].[27] **END HIGHLY CONFIDENTIAL** The FairPoint Acquisition would immediately improve Consolidated's net leverage to below 4 times.

Q. Describe Consolidated's dividend policy and how the FairPoint acquisition would affect dividend payout ratios.

A. Consolidated's dividend policy calls for the payment of $1.55 per common share annually. The dividend provides for a healthy current return to shareholders of 6 to 7 percent, supporting Consolidated's common share price. The payment of about $110 million in dividends annually significantly reduces the free cash flow of Consolidated - - consuming resources otherwise available for capital expenditures, buying back shares, or making voluntary prepayments to reduce debt levels.

Consolidated has projected that its dividend payout ratio would **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** percent or below. The FairPoint acquisition would reduce the 2020 dividend payout ratio to **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** percent.[28] From a credit and financial risk standpoint, Consolidated's dividends reduce financial flexibility, and limit the potential for

[26] Consolidated Response to Data Request Staff 1-9, page 27.
[27] Consolidated Response to Data Request Staff 1-66.2, page 32.
[28] Consolidated Response to Data Request Staff 1-9, page 11.

meaningful debt reduction. These circumstances have resulted in an "aggressive financial risk assessment" from Standard and Poor's.[29] Of the six levels of financial risk assessment, Consolidated is slotted in the fifth level, while FairPoint is rated in the sixth, or lowest, level.

Q. How do the rating agencies view Consolidated's business and financial risk, especially as compared to FairPoint?

A. Moody's and Standard and Poor's have issued equivalent stand-alone corporate credit ratings of B1 and B+, respectively, for Consolidated. These ratings are one rating notch higher than FairPoint's B2/B ratings. Both rating agencies give Consolidated's secured debt a rating one notch higher (Ba3 and BB-, respectively) than the corporate rating. The agencies consider Consolidated's business and financial risk profiles to be stronger than those of FairPoint. Standard and Poor's "Fair" rating of Consolidated's business risk reflects above-average EBITDA margins relative to peer wireline companies, stable distributions from wireless partnerships, and a fiber-based network that allows for potential entry increases in video and data penetration rates. By comparison, FairPoint has received a "Weak" business risk assessment from Standard and Poor's.

Consolidated has also received a financial risk assessment somewhat more favorable than that of FairPoint (the fifth-level, "Aggressive" assessment, indicating less risk than FairPoint's sixth, and lowest, "Highly Leveraged" profile). Standard and Poor's has also analyzed Consolidated's "recovery expectations" for debt holders to be 70 to 90

[29] Consolidated Response to Data Request Staff 1-2.12, page 5.

percent versus only 50 to 70 percent for FairPoint, denoting significantly better financial risk levels for Consolidated.[30]

X. CONSOLIDATED/FAIRPOINT MERGED FINANCIAL PROJECTIONS

Q. What are the projected revenue, EBITDA, and cash flow results for a merged Consolidated and FairPoint?

A. Management provided projections for the merged entity in a "pro forma model" to the Consolidated Board of Directors and to the credit rating agencies (summarized in the following table). The pro forma model shows a compound average growth rate (CAGR) of **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** percent for revenue from 2016 through 2021. The model shows a corresponding growth in adjusted EBITDA of **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** percent annually on a CAGR basis. Unlevered free class cash flow was projected to grow by **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** percent annually. **BEGIN CONFIDENTIAL**

Merged CCI/FRP ProForma ($ in millions)[31]

	2016E	2017E	2018E	2019E	2020E	2021E	CAGR
Revenue	$[redacted]	$[redacted]	$[redacted]	$[redacted]	$[redacted]	$[redacted]	[redacted]%
Adj. EBITDA	$[redacted]	$[redacted]	$[redacted]	$[redacted]	$[redacted]	$[redacted]	[redacted]%
CAPEX	$[redacted]	$[redacted]	$[redacted]	$[redacted]	$[redacted]	$[redacted]	[redacted]%
ULCFC	$[redacted]	$[redacted]	$[redacted]	$[redacted]	$[redacted]	$[redacted]	[redacted]%

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Consolidated has included the same EBITDA margins for Consolidated and FairPoint as developed in their stand-alone forecasts. Consolidated projects adjusted EBITDA of over **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** percent from 2017 through

[30] Consolidated Response to Data Request Staff 1-2.12 and FairPoint Response to Data Request Staff 1-2.6.
[31] Consolidated Response to Data Request Staff 1-9, page 14.

2024, while FairPoint's **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** from 2020 through 2024.[32] The adjusted EBITDA forecasts include estimated synergies for FairPoint due to the merger, with the projected Consolidated synergies additive to the assumed changes in numbers of positions projected by FairPoint management on a stand-alone basis.

Q. What are the expected acquisition impacts on Consolidated's cash flow per share, net leverage and dividend payout ratios?

A. As the next table shows, the Acquisition provides substantial improvements to Consolidated's cash flow, net leverage, and dividend payout ratio. Projections show the Acquisition reducing net leverage in 2017 from **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL**. The net leverage improvements are important to Consolidated's financial flexibility and improved ability to withstand stress factors after the transaction. Consolidated has a long-term strategic target for net leverage in the range of 3.5 times, and the Acquisition provides significant progress toward this target. **BEGIN CONFIDENTIAL**

CCI/FRP Pro Forma Financial Changes[33]

Year	FCF Share		Net Leverage		Payout Ratio	
	CCI	Pro Forma	CCI	Pro Forma	CCI	Pro Forma
2018	$[redacted]	$[redacted]	[redacted]X	[redacted]X	[redacted]%	[redacted]%
2019	$[redacted]	$[redacted]	[redacted]X	[redacted]X	[redacted]%	[redacted]%
2020	$[redacted]	$[redacted]	[redacted]X	[redacted]X	[redacted]%	[redacted]%

END CONFIDENTIAL

The FairPoint acquisition is also projected to be strongly accretive to Consolidated's cash flow per share, with improvement from **BEGIN CONFIDENTIAL** $[redacted] to $[redacted] **END**

[32] Consolidated Response to Data Request Staff 1-7, CCI + FRP Merger Output tab.
[33] Consolidated Response to Data Request Staff 1-9, pages 11 and 18.

CONFIDENTIAL per share in 2017. Dividends per share also would fall from about **BEGIN CONFIDENTIAL** [redacted] percent to [redacted] **END CONFIDENTIAL** percent per share in 2017, as projected cash flow growth is **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL.** Consolidated also projects meeting its maximum payout ratio target of 65 to 70 percent post-Acquisition, for similar reasons.

Q. How does Consolidated plan to finance the Acquisition?

A. Consolidated announced in December 2016 that the FairPoint acquisition would be financed with an exchange of common stock and a $935 million term loan. The stock exchange will result in ownership ratios of about 72 percent for Consolidated shareholders and about 28 percent for FairPoint shareholders.

The acquisition debt comes as an expansion of the Consolidated Restated Credit Agreement that was recently closed in October 2016, shortly before the announcement of the FairPoint acquisition. Consolidated's "Senior Secured Credit Facility" that provided $900 million in "Initial Term Loans" was expanded to provide an "Incremental Term Loan B-2" in the amount of $935 million.[34] Incremental Term Loan B-2 has a maturity of seven years, and the same terms and financial covenants as the existing Senior Secured Credit Facility, with the same lenders, financial covenants, interest rate margin, LIBOR floor rate, guarantors and collateral.[35] The $935 million Term Loan B-2 will more than double Consolidated's secured term loans from $900 million to about $1.83 billion as of

[34] Consolidated prefiled direct testimony of Steven Childers, page 14, lines 17-22.
[35] Consolidated Response to Data Request Staff 1-3, page 6.

the closing date. Consolidated will also retain its Senior Notes of $500 million, resulting in total Pro Forma debt of about $2.3 billion.[36]

Q. What is included in Consolidated's projections of $55 million per year in "synergies" through the implementation of the FairPoint Acquisition?

A. These synergies comprise an important portion of the "economic headlines" driving the acquisition. Consolidated has estimated synergies of $55 million annually, with estimated costs to achieve the synergies of **BEGIN CONFIDENTIAL** $[redacted] **END CONFIDENTIAL** in 2017 and 2018. Consolidated included estimated synergies of **BEGIN CONFIDENTIAL** $[redacted] **END CONFIDENTIAL** annually from reductions in management positions. Reductions in **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** in synergy operating expense reductions. Management estimated savings from **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL.** These three categories add to about **BEGIN CONFIDENTIAL** $[redacted] **END CONFIDENTIAL**, but Consolidated has publicly announced $55 million as a target for measuring Acquisition implementation performance.[37]

Wireline industry sector acquisitions generally are evaluated on the generation of synergies produced. Consolidated has based synergy estimates on its previous experience with its own acquisitions of North Pittsburgh, SureWest, and Enventis. Those three acquisitions generated synergies as a percentage of cash operating expenses of **BEGIN**

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[36] Consolidated Response to Data Request Staff 3-5.
[37] Consolidated Response to Data Request Staff 1-9, page 12.

CONFIDENTIAL [redacted] percent, [redacted] percent and [redacted] percent, respectively, with a median of [redacted] percent **END CONFIDENTIAL**. Twelve other wireline industry consolidations were also reviewed since 2005 by Consolidated. Those other consolidations had median reported synergies of **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** percent of cash operating expenses. Consolidated determined that the targeted level of synergies would be about **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** percent of cash operating expenses, noting that FairPoint is **BEGIN CONFIDENTIAL** [redacted].[38] **END CONFIDENTIAL** The synergies are also considered a portion of **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL.**

Q. How have the credit rating agencies viewed the Acquisition?

A. Moody's and Standard & Poor's have each maintained Consolidated's credit ratings, and assigned the same ratings to both the Consolidated $900 million refinancing and the $935 million Term Loan B. Moody's and Standard & Poor's have assigned ratings of B1/B+ to the Consolidated corporate family and Ba3/BB- ratings to the secured term loans.

Moody's has stated that the FairPoint acquisition is positive for Consolidated's financial standing, because it will result in a decrease in leverage, increased scale and the potential for growth through greater investment in the legacy FairPoint properties. Moody's also notes that synergy cost savings and the usage of FairPoint's net operating

[38] Consolidated Response to Data Request Staff 1-9, page 13.

losses ("NOLs") will be mostly offset by higher dividends, removing much of the cash benefit.[39]

Standard and Poor's has stated that Consolidated's estimates of net leverage and adjusted EBITDA, including the cost synergies, are achievable, and would "modestly lower" net leverage by 0.3 times by its own calculations.[40]

XI. CHANGES IN EMPLOYEE NUMBERS

Q. Please compare FairPoint's stand-alone and Consolidated's Pro Forma forecasts of changes in numbers of positions.

A. FairPoint's financial forecasts included a **BEGIN CONFIDENTIAL** [redacted][41] **END CONFIDENTIAL**

Q. What economic values do synergies and FairPoint's NOLs have in Consolidated's analysis?

A. Consolidated estimated the present value of net synergies at about **BEGIN CONFIDENTIAL $**[redacted] **END CONFIDENTIAL** after-tax, for the first five years, and an additional **BEGIN CONFIDENTIAL $**[redacted] **END**

[39] Consolidated Response to Data Request Staff 1-1.1.
[40] Consolidated Response to Data Request Staff 1-1.2.
[41] Consolidated confidential representation at Technical Session on April 10, 2017.

CONFIDENTIAL for 2022 and beyond. Consolidated estimated the present value of the NOLs at about **BEGIN CONFIDENTIAL $**[redacted] **END CONFIDENTIAL.**[42]

XII. STRESS TESTS OF CONSOLIDATED/FAIRPOINT

Q. Please discuss the primary risks to financial stability for a merged Consolidated/FairPoint.

A. Liberty identified four variables as important potential threats to Consolidated's post-Acquisition financial capabilities. Steep declines in total revenues for the merged entity comprise the first, given recently experienced declines in revenues for legacy services, such as voice and access, which may be partially offset by growth in broadband and data revenue. FairPoint has experienced declines in its total revenues of more than 4 percent in each of the last three years, and even steeper declines prior to that. Consolidated estimates compound annual growth rates of **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** percent for the merged entities in its forecasts through 2021.

EBITDA margins comprise a second key risk area. Forecasts have included EBITDA margins for legacy Consolidated of more than **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** percent, and for legacy FairPoint **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL.** Both forecasted EBITDA figures project **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL.** EBITDA margins include the components of revenue and cash flow from operations, making such margins important cash profitability

[42] Consolidated Response to Data Request Staff 1-9, page 30.

measures for the wireline industry segment. Shortfalls in forecasted EBITDA margins pose an important risk for the merged entities on a going-forward basis.

Synergy levels present a third risk area for the merged entities. Consolidated has set forth synergies "targets" of $55 million per year, "headlined" to make their attainment a primary factor in the success of the Acquisition, especially with the debt and equity investor communities. **BEGIN HIGHLY CONFIDENTIAL** [redacted] **END HIGHLY CONFIDENTIAL.**[43]

LIBOR rate variability presents a fourth source of financial risk. Consolidated has negotiated two secured term loans, one of $900 million and a second, Term Loan B, for $935 million. Both sources of debt financing have exposure to variable interest rate risk. The interest rates on both term loans tie to LIBOR. This variable-rate index has been at historically low levels in recent years. Consolidated recognizes in the Joint Petition and in its direct testimony that variable interest rates could easily rise substantially above the current, historically low levels. In fact, substantial increases in variable interest rates appear probable in the future, and create important risk for the merged companies.

Liberty recognizes that increases in other wireline business variables (such as capital expenditure levels) pose risks to the merged entities; however, we consider the four listed areas as posing the greatest potential risk to the financial capability of Consolidated following closing of the Acquisition.

Q. Please describe the stress tests that you asked Consolidated to perform.

[43] Consolidated highly confidential representation at Technical Session on April 10, 2017.

A. Liberty requested that Consolidated perform stress tests on the four key variables identified above, using the company's "Pro Forma" financial model as the base case. Consolidated management has used that Pro Forma financial model to provide financial forecasts presented to its Board of Directors, to the rating agencies, and to the investor community.

Our requested stress tests one through four tested the sensitivity of Consolidated's future financial viability to negative changes in the four financial factors (total revenues, adjusted EBITDA, synergies realized, and interest rate variability). Consolidated has advised that it considers the net leverage financial covenant for its Senior Notes to be the most restrictive financial covenant that must be met in the future. Violating the Senior Notes' net leverage covenant maximum of 4.75 times would cause suspension of Consolidated's dividends, and result in a technical default on the Notes. Consolidated may consider the suspension of its dividends to have a significantly adverse effect on its stock price and its ability to effectively raise equity capital. A default on its Senior Notes would also create a serious challenge to Consolidated's financial capability as a going concern.

Liberty requested that Consolidated perform the stress tests in a manner that would permit determination of the negative change in each variable that would cause the most restrictive Consolidated financial covenant to be in violation.

Q. Please describe the results of Stress Test 1.

A. Stress Test 1 used Total Revenues as the variable. Consolidated lowered the total revenues in each forecasted year through 2024 until reaching net leverage of 4.75 times under the Senior Notes covenant.[44] The stress test indicated that Consolidated has ample "headroom" to bear revenue decreases. It could lose **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** percent of its forecasted revenue in each year, without approaching violation of its most restrictive financial covenant.

Q. Please describe the results of Stress Test 2.

A. Stress Test 2 used EBITDA Margins as the variable. Consolidated lowered EBITDA margins for each legacy Consolidated and legacy FairPoint in each forecasted year through 2024, until reaching net leverage of 4.75 times under the Senior Notes covenant.[45] Stress Test 2 indicates that Consolidated has a fair amount of "headroom" regarding EBITDA margin decreases. Consolidated could lose **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** percentage points in EBITDA margins from its forecasts in each year without approaching violation of its most restrictive financial covenant.

Q. Please describe the results of Stress Test 3.

A. Stress Test 3 used Synergies Realized as the variable. Consolidated lowered Acquisition synergies in each forecasted year through 2024, until reaching net leverage of 4.75 times under the Senior Notes covenant. Stress Test 3 indicates that Consolidated has a **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** for failure to reach announced synergy amounts. Consolidated could have **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** in

[44] Consolidated Response to Data Request Staff 5-11, Confidential Attachment.
[45] Id.

each year of the forecast, without approaching violation of the Senior Notes financial covenant. Stress Test 3 indicates that Consolidated's future financial capability is not threatened by synergy realizations.

Q. Please describe the results of Stress Test 4.

A. Stress Test 4 used Interest Rates as the variable. Liberty requested that Consolidated determine the increase in LIBOR interest rates (for each year of the Pro Forma forecasts) that would cause a violation under the most restrictive financial covenant included in its debt financings. Consolidated performed a stress test analysis on interest rates for 2017 only, using the interest coverage covenant. The reported results showed that an increase of about **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** percentage points in LIBOR would trip the interest rate coverage covenant. Consolidated's Pro Forma variable rate debt levels remain **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** throughout the forecasts. We would therefore anticipate similarly **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** "break point" LIBOR interest rates for 2018-2024, indicating lower sensitivity of financial capability to interest rates.[46]

Q. Please describe the results of Stress Test 5.

A. Stress Test 5 did not add any variables, but sought a calculation that combined the Synergies Realized and EBITDA margin factors. Stress Test 5 sought to test the deterioration of these two factors simultaneously. Note that synergies are included in the calculation of adjusted EBITDA for the financial covenants (and therefore in the calculation of EBITDA margins), causing this stress test to be only a one-factor test on a 5 percent decline in EBITDA margins. This stress test does not trip the 4.75 times Senior

[46] Consolidated Response to Data Request Staff 5-11, Confidential Attachment.

Note covenant - - a result consistent with Stress Test 2 regarding EBITDA margin declines.

Q. Please describe the results of Stress Test 6.

A. Stress Test 6 sought to examine a case where all four of the negative risk factors combined, *i.e.*, total revenue declines, EBITDA margin decreases, synergies unrealized, and assuming a 300 basis point increase in LIBOR interest rates. Stress Test 6 tests negative changes in multiple risk factors simultaneously. Assuming five percent reductions in revenues and EBITDA margin as well as large increases in LIBOR rates tests Consolidated's financial results strenuously. The result of this stress test is that **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL**

XIII. CONCLUSIONS

Q. What overall conclusions are important to assessing the overall financial capability of Consolidated post-Acquisition?

A. Based on the data and analysis discussed above, Liberty has formed conclusions regarding Consolidated's financial capabilities post-Acquisition. We have formed conclusions regarding debt financing and financial market risks, and Consolidated's addressing of these risks. We have also formed a conclusion regarding FairPoint's refinancing risk, because its existing term loans mature in February 2019.

Revenue retention and EBITDA margins comprise important factors in maintaining Consolidated's financial capability post-Acquisition. Liberty has also formed conclusions regarding those factors. Based on the stress tests that Liberty requested, we have also considered Consolidated's expected performance in weathering negative changes in key risk factors.

Q. What have you concluded regarding Consolidated's debt financing for the acquisition?

A. Consolidated has secured comparatively attractive financing for the FairPoint Acquisition. It provides much more cost-effective debt financing and financing stability until 2023. The $935 million Term Loan B provides reasonable terms and relatively low interest rates, resulting in savings of $35 million per year as compared to FairPoint's existing financing. The term loan is priced with a 300 basis point financing margin and a LIBOR floor rate of 1.00 percent, resulting in a current interest rate of 4.0 percent. In comparison, FairPoint's term loans currently charge interest at 7.5 percent, and its senior notes at 8.75 percent.

Consolidated's Initial ($900 million) and Incremental ($935 million) term loan debt financing arrangements remove re-financing risks in 2019 that face FairPoint if it were to remain a stand-alone company. Consolidated's term loan financing has maturities in October 2023, a full 4½ years later than the looming maturities of FairPoint's debt.

Q. What have you concluded regarding FairPoint's refinancing risks?

A. FairPoint faces maturities for both its term loan and its senior notes, totaling over $900 million, in February 2019. FairPoint has difficulties with debt financing markets, due to its bankruptcy and financial performance following emergence from the bankruptcy.

FairPoint's financial performance has improved in 2015 and 2016 due to lower operating costs. If FairPoint were to post positive financial results in 2017 and 2018, the company may well be able to re-finance its debt. However, FairPoint faces real re-financing risk at this point, and would probably be saddled with financing terms and interest rates similar to its "lower high-yield" debt financing currently in place.

As noted above, Consolidated's Term Loan B financing for the FairPoint Acquisition takes 2019 re-financing risk off the table, and provides substantially lower financing costs that strengthen legacy FairPoint's post-Acquisition financial health.

Q. How are revenue retention and EBITDA margin results expected to change post-Acquisition?

A. Consolidated has exhibited strong performance regarding these two important financial factors historically. Consolidated's performance in revenue retention and EBITDA margins (indicating strong cost control) has been much better than that of FairPoint. Consolidated is forecasting legacy FairPoint's total revenues to **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** annually following the Acquisition, as compared to annual losses of more than 4 percent during each of the past three years. Consolidated has also projected improvements in FairPoint's **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL**, which seems to be attainable if it achieves reasonable success in improving revenue retention and cost control efforts, which include reduced positions and other synergies. **BEGIN CONFIDENTIAL** [redacted]. **END CONFIDENTIAL**

Q. What do you conclude from the results of the stress tests performed?

A. Consolidated's financial projections as pressured in the stress tests described in the previous section have indicated that the company can withstand material declines in revenues, synergies, and EBITDA margins, as well as increases in variable interest rates. The individual-risk stress tests successfully completed to date indicated that Consolidated would retain significant "headroom" above financial distress levels if each of these risks were realized. The stress tests indicate that Consolidated would have **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** percent or more headroom regarding declines in total revenues and EBITDA margin. Synergies realized could be significantly negative before causing financial distress for Consolidated, indicating lower levels of sensitivity to synergy realization risk. Interest rates also would have to increase to exorbitant levels for Consolidated to experience financial distress.

The combined-factor scenario (Stress Test 6) was the only stress test that would cause Consolidated to experience financial distress post-Acquisition, mainly in the form of default events that would cause suspension of the company's dividend payments. Only by simultaneously imposing all four of the specified risks in a worst case scenario would Consolidated trip its net leverage financial covenants. We would consider that case to be extreme and unlikely to occur; it would not be surprising if it were to cause financial distress in any of the wireline industry companies.

Q. Do you have areas of concern where Consolidated is "weaker" regarding its financial capability?

A. Consolidated has a higher level of net leverage at about **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL**. On a stand-alone basis, Consolidated was projecting **BEGIN CONFIDENTIAL** [redacted] **END**

CONFIDENTIAL for the foreseeable future, at least through the end of its forecasts in 2024. Consolidated was clearly not comfortable with **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** in the long term.[47]

The FairPoint Acquisition provides Consolidated with a unique opportunity to **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** its net leverage levels without using cash flow to pay down debt. The acquisition of FairPoint, which has lower levels of debt due to its bankruptcy, immediately reduces Consolidated net leverage to **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** times. According to Consolidated's post-acquisition forecasts, the **BEGIN CONFIDENTIAL** [redacted]. **END CONFIDENTIAL**[48]

The combination of the financial characteristics of Consolidated and FairPoint results in **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** for Consolidated post-acquisition, greatly improving weakness in its **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL.**[49]

Q. How are Consolidated's dividend payout levels and related financial flexibility changed with the FairPoint acquisition?

A. Consolidated's dividend levels and dividend payout ratios represent weaknesses on a stand-alone basis. Without the FairPoint Acquisition, the Consolidated dividend payout ratio was expected to near 80 percent, well above its strategic target of 65 to 70 percent.

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[47] Consolidated Response to Data Request Staff 1-9.
[48] Id.
[49] Id.

That high dividend payout ratio caused lower financial flexibility and reduced the capability to pay down debt with voluntary prepayments.

The FairPoint Acquisition also offers a unique opportunity for Consolidated to improve its dividend payout ratio and financial flexibility. The Acquisition **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL.** The acquisition reduces Consolidated's dividend payout ratio to **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** during the 2018-2020 period, greatly increasing financial flexibility and providing increased cash for financially beneficial actions such as stock buy-backs or debt prepayments.[50]

Q. What is your view of Consolidated's debt financing for the Acquisition insofar as it pledges FairPoint assets as collateral?

A. The ability to "scavenge" the FairPoint network and other operating assets in the event of severe financial distress is a large concern. One can fairly question whether financial capability is in all respects sound if such an extreme measure is required to support it.

Liberty requested information and analysis on the pledge of assets included in Consolidated's financial agreements. A portion of the $35 million in financing cost savings estimated by Consolidated is due to pledging assets as collateral, but the potential future risks of such an asset pledge are not clear. Consolidated has stated that that "[t]he risk, should there be a default event, is the same as a pledge of stock" (such as in FairPoint's the existing debt financing). "Please see section 5.1 of the Collateral

[50] Id.

Agreement."[51] However, pledging the stock of a physically and organizationally intact entity is not the same as potentially removing assets that may be central to providing service, including service provided to basic service customers and competitive carriers at the wholesale level.

The collateral agreement dated 2007 is applicable to all Consolidated secured debt financing, including both the "Initial" and "Incremental" term loans. Interpreting the Collateral Agreement takes legal experience beyond Liberty's, and likely beyond the capability of knowledgeable and experienced general practitioners of the law. It cannot be said to be clear to anyone not an expert in the law applicable to commercial secured financings and other secured transactions. For example, the Collateral Agreement includes provisions[52] stating that:

> *If an event of default shall occur and be continuing, The Administrative Agent, on behalf of the Secured Parties ...*
>
> *... may forthwith sell, lease, assign, give options or options to purchase, or otherwise dispose of and deliver the Collateral or any part thereof (or contract to do any of the foregoing), in one or more parcels at public or private sale or sales, at any exchange, brokers board or office of the Administrative Agent or Secured Party ...*

The Collateral Agreement later states that such sales are "... subject to the prior approval of or notice to and non-opposition of the FCC or any applicable PUC." These provisions do not clearly provide for prior approval by this Commission for any sales in whole or in

[51] Consolidated Response to Data Request Staff 1-17 Supplement.
[52] Consolidated Response to Data Request Staff 1-12.4, pages 17 and 18.

part of the FairPoint network or other operating assets as collateral that could severely damage the integrity of FairPoint's communications network to the detriment of all of its customers, including those taking basic service and those relying on the FairPoint network to provide competitive carrier services. Mr. Antonuk's testimony proposes a condition to address this significant concern.

Q. Does that complete your testimony?

A. Yes.