

CINCINNATI BELL INC
Form 10-Q
August 09, 2012

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

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

For the Quarterly Period Ended June 30, 2012

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

For the transition period from _____ to _____
Commission File Number 1-8519
CINCINNATI BELL INC.

Ohio
(State of Incorporation)
221 East Fourth Street, Cincinnati, Ohio 45202
(Address of principal executive offices) (Zip Code)
(513) 397-9900
(Registrant's telephone number, including area code)

31-1056105
(I.R.S. Employer Identification No.)

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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, 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 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.

Large accelerated filer Accelerated filer
Non-accelerated filer 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

At July 31, 2012, there were 197,388,041 common shares outstanding.

Table of Contents

Form 10-Q Part I

Cincinnati Bell Inc.

TABLE OF CONTENTS

PART I. Financial Information

Description	Page
Item 1. Financial Statements	
<u>Condensed Consolidated Statements of Operations (Unaudited) Three and Six Months Ended June 30, 2012 and 2011</u>	<u>1</u>
<u>Condensed Consolidated Statements of Comprehensive Income (Unaudited) Three and Six Months Ended June 30, 2012 and 2011</u>	<u>2</u>
<u>Condensed Consolidated Balance Sheets (Unaudited) June 30, 2012 and December 31, 2011</u>	<u>3</u>
<u>Condensed Consolidated Statements of Cash Flows (Unaudited) Six Months Ended June 30, 2012 and 2011</u>	<u>4</u>
<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	<u>5</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>24</u>
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>38</u>
Item 4. <u>Controls and Procedures</u>	<u>38</u>
<u>PART II. Other Information</u>	
Item 1. <u>Legal Proceedings</u>	<u>39</u>
Item 1A. <u>Risk Factors</u>	<u>39</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>39</u>
Item 3. Defaults upon Senior Securities – None	
Item 4. Mine Safety Disclosure – None	
Item 5. Other Information – No reportable items	
Item 6. <u>Exhibits</u>	<u>40</u>
<u>Signatures</u>	<u>41</u>

Table of Contents

Form 10-Q Part I

Cincinnati Bell Inc.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in millions, except per share amounts)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2012	2011	June 30, 2012	2011
Revenue				
Services	\$318.9	\$314.8	\$636.9	\$626.2
Products	49.3	52.7	94.1	102.1
Total revenue	368.2	367.5	731.0	728.3
Costs and expenses				
Cost of services, excluding items below	121.6	114.8	242.0	225.5
Cost of products sold, excluding items below	50.1	54.2	95.5	102.7
Selling, general and administrative	63.4	66.6	127.4	131.2
Depreciation and amortization	53.7	48.8	104.8	97.2
Restructuring charges	1.2	—	2.1	—
Curtailement loss	—	4.2	—	4.2
Acquisition costs	—	0.8	—	1.9
Asset impairments	13.0	0.5	13.0	1.6
Total operating costs and expenses	303.0	289.9	584.8	564.3
Operating income	65.2	77.6	146.2	164.0
Interest expense	53.7	53.4	108.1	107.9
Other expense, net	—	—	1.5	—
Income before income taxes	11.5	24.2	36.6	56.1
Income tax expense	7.0	10.7	19.5	24.7
Net income	4.5	13.5	17.1	31.4
Preferred stock dividends	2.6	2.6	5.2	5.2
Net income applicable to common shareowners	\$1.9	\$10.9	\$11.9	\$26.2
Basic earnings per common share	\$0.01	\$0.06	\$0.06	\$0.13
Diluted earnings per common share	\$0.01	\$0.05	\$0.06	\$0.13

The accompanying notes are an integral part of the condensed consolidated financial statements.

1

Table of Contents

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in millions)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2012	2011	2012	2011
Net income	\$4.5	\$13.5	\$17.1	\$31.4
Other comprehensive income, net of tax:				
Defined benefit pension and postretirement plans:				
Net gain arising from remeasurement during the period, net of tax of \$0.9	—	1.4	—	1.4
Amortization of prior service benefits included in net income, net of tax of (\$1.1), (\$1.2), (\$2.3), (\$2.4)	(2.1)	(2.0)	(4.2)	(4.0)
Amortization of net actuarial loss included in net income, net of tax of \$2.8, \$1.8, \$4.8, \$3.8	4.8	3.3	8.3	6.5
Reclassification adjustment for curtailment loss included in net income, net of tax of \$1.5	—	2.7	—	2.7
Other comprehensive income	2.7	5.4	4.1	6.6
Total comprehensive income	\$7.2	\$18.9	\$21.2	\$38.0

The accompanying notes are an integral part of the condensed consolidated financial statements.

2

Table of Contents

Form 10-Q Part I

Cincinnati Bell Inc.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in millions, except share amounts)

(Unaudited)

	June 30, 2012	December 31, 2011
Assets		
Current assets		
Cash and cash equivalents	\$4.1	\$73.7
Receivables, less allowances of \$12.2 and \$11.6	194.8	179.4
Inventory, materials and supplies	24.4	23.8
Deferred income taxes, net	33.1	30.2
Prepaid expenses	14.2	11.2
Other current assets	8.0	2.7
Total current assets	278.6	321.0
Property, plant and equipment, net	1,471.5	1,400.5
Goodwill	290.6	290.6
Intangible assets, net	203.4	216.9
Deferred income taxes, net	399.0	423.5
Other noncurrent assets	59.6	62.2
Total assets	\$2,702.7	\$2,714.7
Liabilities and Shareowners' Deficit		
Current liabilities		
Current portion of long-term debt	\$13.5	\$13.0
Accounts payable	119.7	133.4
Unearned revenue and customer deposits	50.5	48.2
Accrued taxes	16.3	15.5
Accrued interest	45.8	45.6
Accrued payroll and benefits	48.1	52.6
Other current liabilities	37.5	48.1
Total current liabilities	331.4	356.4
Long-term debt, less current portion	2,538.7	2,520.6
Pension and postretirement benefit obligations	368.4	389.9
Other noncurrent liabilities	160.4	163.0
Total liabilities	3,398.9	3,429.9
Shareowners' deficit		
Preferred stock, 2,357,299 shares authorized, 155,250 shares (3,105,000 depositary shares) of 6 ³ / ₄ % Cumulative Convertible Preferred Stock issued and outstanding at June 30, 2012 and December 31, 2011; liquidation preference \$1,000 per share (\$50 per depositary share)	129.4	129.4
Common shares, \$.01 par value; 480,000,000 shares authorized; 197,864,910 and 196,322,649 shares issued; 197,373,191 and 195,721,796 shares outstanding at June 30, 2012 and December 31, 2011	2.0	2.0
Additional paid-in capital	2,582.1	2,584.6
Accumulated deficit	(3,202.9) (3,220.0
Accumulated other comprehensive loss	(204.8) (208.9
Common shares in treasury, at cost	(2.0) (2.3
Total shareowners' deficit	(696.2) (715.2

Total liabilities and shareowners' deficit	\$2,702.7	\$2,714.7
--	-----------	-----------

The accompanying notes are an integral part of the condensed consolidated financial statements.

Table of Contents

Form 10-Q Part I

Cincinnati Bell Inc.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in millions)

(Unaudited)

	Six Months Ended	
	June 30,	
	2012	2011
Cash flows from operating activities		
Net income	\$17.1	\$31.4
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	104.8	97.2
Provision for loss on receivables	7.4	6.7
Asset impairments	13.0	1.6
Noncash portion of interest expense	3.9	3.7
Deferred income tax provision	19.5	24.6
Pension and other postretirement payments in excess of expense	(15.0)	(12.1)
Stock-based compensation	2.4	1.9
Other, net	(0.6)	(1.5)
Changes in operating assets and liabilities		
Increase in receivables	(22.7)	(2.6)
Increase in inventory, materials, supplies, prepaid expenses and other current assets	(8.2)	(2.8)
Decrease in accounts payable	(18.1)	(16.4)
Decrease in accrued and other current liabilities	(9.4)	(7.6)
Increase in other noncurrent assets	(0.7)	(0.4)
Decrease in other noncurrent liabilities	(1.5)	(5.8)
Net cash provided by operating activities	91.9	117.9
Cash flows from investing activities		
Capital expenditures	(167.4)	(92.5)
Other, net	—	(0.2)
Net cash used in investing activities	(167.4)	(92.7)
Cash flows from financing activities		
Borrowing on corporate credit and receivables facilities, net	19.0	0.4
Repayment of debt	(8.0)	(6.2)
Debt issuance costs	—	(0.8)
Dividends paid on preferred stock	(5.2)	(5.2)
Common stock repurchase	(0.3)	—
Other, net	0.4	(0.6)
Net cash provided by (used in) financing activities	5.9	(12.4)
Net (decrease) increase in cash and cash equivalents	(69.6)	12.8
Cash and cash equivalents at beginning of period	73.7	77.3
Cash and cash equivalents at end of period	\$4.1	\$90.1
Noncash investing and financing transactions:		
Acquisition of property by assuming debt and other noncurrent liabilities	\$7.0	\$23.6
Acquisition of property on account	\$25.1	\$13.5

The accompanying notes are an integral part of the condensed consolidated financial statements.

4

Table of Contents

Form 10-Q Part I

Cincinnati Bell Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Description of Business and Accounting Policies

Description of Business — Cincinnati Bell Inc. and its consolidated subsidiaries (the “Company” or “we”) provide diversified telecommunications and technology services through businesses in four segments: Wireline, Wireless, Data Center Colocation, and IT Services and Hardware.

Basis of Presentation — The Condensed Consolidated Financial Statements of the Company have been prepared pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (“SEC”) and, in the opinion of management, include all adjustments necessary for a fair presentation of the results of operations, other comprehensive income, financial position, and cash flows for each period presented.

The adjustments referred to above are of a normal and recurring nature. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) have been condensed or omitted pursuant to SEC rules and regulations for interim reporting.

The Condensed Consolidated Balance Sheet as of December 31, 2011 was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP. These Condensed Consolidated Financial Statements should be read in conjunction with the Company’s 2011 Annual Report on Form 10-K. Operating results for the three and six months ended June 30, 2012 are not necessarily indicative of the results expected for the full year or any other interim period.

Use of Estimates — Preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported. Actual results could differ from those estimates. In the normal course of business, the Company is subject to various regulatory and tax proceedings, lawsuits, claims, and other matters. The Company believes adequate provision has been made for all such asserted and unasserted claims in accordance with U.S. GAAP. Such matters are subject to many uncertainties and outcomes that are not predictable with assurance.

Recently Issued Accounting Standards — In July 2012, the Financial Accounting Standards Board (“FASB”) amended the guidance in Accounting Standards Codification (“ASC”) 350-30 on testing indefinite-lived intangibles assets, other than goodwill, for impairment. Under the revised guidance, an entity testing an indefinite-lived intangible asset for impairment has the option of performing a qualitative assessment before performing quantitative tests. If the entity determines, on the basis of qualitative factors, that the fair value of the indefinite-lived intangible asset is not more likely than not impaired, the entity would not need to perform the quantitative tests. This guidance will be effective for our annual and interim impairment tests for the year ending December 31, 2013. Early adoption is permitted. The adoption of this guidance is not expected to have a material impact on the Company’s financial statements; rather it may change management’s approach to testing indefinite-lived intangible assets for impairment.

In December 2011, the FASB amended the guidance in ASC 210 related to disclosures about offsetting assets and liabilities. The amendments would require an entity to disclose information about financial instruments and derivative instruments that are either offset subject to ASC 210-20-45 or ASC 815-10-45, or subject to enforceable master netting arrangements or similar arrangements. We will be required to adopt this guidance beginning with our interim financial statements for the three months ending March 31, 2013. The adoption of this accounting standard is not expected to have a material impact on our financial statements.

In September 2011, the FASB amended the guidance in ASC 350-20 on testing goodwill for impairment. Under the revised guidance, entities testing goodwill for impairment have the option of performing a qualitative assessment before calculating the fair value of the reporting unit. If entities determine, on the basis of qualitative factors, that the fair value of the reporting unit is more likely than not less than the carrying amount, the two-step impairment test would be required. The Company adopted this guidance beginning with its interim financial statements for the three months ended March 31, 2012. The adoption of this accounting standard did not have a material impact on the Company’s financial statements; but rather it may change the Company’s approach for annual goodwill testing.

In June 2011, the FASB issued new guidance under ASC 220 regarding the presentation of comprehensive income in financial statements. An entity has the option to present the components of net income and other comprehensive income either in a single continuous statement or in two separate but consecutive statements. The Company adopted this guidance beginning with its interim financial statements for the three months ended March 31, 2012. The adoption of this new standard did not have a material impact on the Company's financial statements, but rather it prescribes the presentation of other comprehensive income in our financial statements. Separately, in December 2011, the FASB amended a portion of this guidance to defer proposed changes to the presentation of reclassification adjustments.

Table of Contents

Form 10-Q Part I

Cincinnati Bell Inc.

Income Taxes — The Company's income tax provision for interim periods is determined through the use of an estimated annual effective tax rate applied to year-to-date ordinary income, as well as the tax effects associated with discrete items.

2. Earnings Per Common Share

Basic earnings per common share ("EPS") is based upon the weighted average number of common shares outstanding during the period. Diluted EPS reflects the potential dilution that would occur upon issuance of common shares for awards under stock-based compensation plans, exercise of warrants or conversion of preferred stock, but only to the extent that they are considered dilutive.

The following table shows the computation of basic and diluted EPS:

(in millions, except per share amounts)	Three Months Ended		Six Months Ended	
	June 30, 2012	2011	June 30, 2012	2011
Numerator:				
Net income	\$4.5	\$13.5	\$17.1	\$31.4
Preferred stock dividends	2.6	2.6	5.2	5.2
Income available to common shareholders - basic and diluted	\$1.9	\$10.9	\$11.9	\$26.2
Denominator:				
Weighted average common shares outstanding - basic	195.8	198.0	195.5	197.9
Warrants	3.1	0.2	3.1	0.1
Stock-based compensation arrangements	2.8	2.8	3.1	2.7
Weighted average common shares outstanding - diluted	201.7	201.0	201.7	200.7
Basic earnings per common share	\$0.01	\$0.06	\$0.06	\$0.13
Diluted earnings per common share	\$0.01	\$0.05	\$0.06	\$0.13

For the three and six months ended June 30, 2012, awards under the Company's stock-based compensation plans for common shares of 7.2 million and 7.1 million, respectively, were excluded from the computation of diluted EPS as the inclusion would have been anti-dilutive. For the three and six months ended June 30, 2011, awards for common shares of 11.7 million and 11.8 million, respectively, were excluded from the computation of diluted EPS as the inclusion would have been anti-dilutive. For all periods, preferred stock convertible into 4.5 million common shares was excluded as the inclusion would have been anti-dilutive.

3. Long-Lived and Intangible Assets

In the three and six months ended June 30, 2012, asset impairment losses of \$13.0 million were recognized on certain data center long-lived and intangible assets. During the second quarter of 2012, management identified impairment indicators for a customer relationship intangible associated with the GramTel acquisition and fixed assets at two data centers. Once we determined the results of the step one analysis indicated an impairment loss may exist, management engaged a third party valuation specialist to assist in estimating the fair value of these assets. A preliminary estimate of the impairment loss, which is subject to change upon completion of the third party valuation specialist's report, was recognized in the accompanying statement of operations and the Data Center Colocation segment. Remaining net book value of the affected assets after the impairment charge totaled \$5.5 million at June 30, 2012.

In the six months ended June 30, 2011, asset impairment losses of \$1.6 million were recognized. In the first quarter of 2011, the Wireless segment had certain capital projects canceled or abandoned resulting in an asset impairment of \$1.1 million, which represents the full carrying value of the canceled and abandoned projects. In the second quarter of 2011, a \$0.5 million asset impairment charge was recorded on certain properties held for sale in the Wireline segment which were impaired as their estimated fair value was lower than their carrying value.

Table of Contents

Form 10-Q Part I

Cincinnati Bell Inc.

4. Debt

The Company's debt consists of the following:

(dollars in millions)	June 30, 2012	December 31, 2011
Current portion of long-term debt:		
Capital lease obligations and other debt	\$ 13.5	\$ 13.0
Current portion of long-term debt	13.5	13.0
Long-term debt, less current portion:		
Receivables facility	19.0	—
7% Senior Notes due 2015*	250.0	250.4
8 1/4% Senior Notes due 2017	500.0	500.0
8 3/4% Senior Subordinated Notes due 2018	625.0	625.0
8 3/8% Senior Notes due 2020	775.0	775.0
7 1/4% Senior Notes due 2023	40.0	40.0
Various Cincinnati Bell Telephone notes	207.5	207.5
Capital lease obligations and other debt	130.1	131.4
	2,546.6	2,529.3
Net unamortized discount	(7.9) (8.7
Long-term debt, less current portion	2,538.7	2,520.6
Total debt	\$2,552.2	\$2,533.6

* The face amount of these notes has been adjusted for the unamortized called amounts received on terminated interest rate swaps.

As of June 30, 2012, the Company had no outstanding borrowings on its revolving credit facility, leaving \$210.0 million available for borrowings. This revolving credit facility expires in June 2014.

As of June 30, 2012, the Company had \$19.0 million of borrowings and \$23.2 million of letters of credit outstanding under the accounts receivable securitization facility ("Receivables Facility"), leaving \$62.8 million remaining on the available borrowings of \$105.0 million. The Receivables Facility is subject to renewal every 364 days. On June 4, 2012, the Company amended its Receivables Facility to extend its term to June 3, 2013. In the event the Receivables Facility is not renewed, the Company has the ability to refinance any outstanding borrowings with borrowings under its revolving credit facility. The permitted borrowings vary depending on the level of eligible receivables and other factors. Under the Receivables Facility, certain subsidiaries, or originators, sell their respective trade receivables on a continuous basis to Cincinnati Bell Funding LLC ("CBF"). Although CBF is a wholly-owned consolidated subsidiary of the Company, CBF is legally separate from the Company and each of the Company's other subsidiaries. Upon and after the sale or contribution of the accounts receivable to CBF, such accounts receivable are legally assets of CBF and, as such, are not available to creditors of other subsidiaries or the Company.

5. Financial Instruments and Fair Value Measurements

Fair Value of Financial Instruments

The carrying values of the Company's financial instruments approximate the estimated fair values as of June 30, 2012 and December 31, 2011, except for the Company's debt and other financing arrangements.

The carrying value and fair value of the Company's long-term debt and other financing arrangements are as follows:

(dollars in millions)	June 30, 2012		December 31, 2011	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Long-term debt, including current portion	\$2,552.2	\$2,547.7	\$2,533.6	\$2,460.5

Other financing arrangements	48.3	48.5	47.9	47.2
------------------------------	------	------	------	------

7

Table of Contents

Form 10-Q Part I

Cincinnati Bell Inc.

The fair value of debt instruments was based on closing or estimated market prices of the Company's debt at June 30, 2012 and December 31, 2011, which is considered Level 2 of the fair value hierarchy. The fair value of other financing arrangements was calculated using a discounted cash flow model that incorporates current borrowing rates for obligations of similar duration, which is considered Level 3 of the fair value hierarchy.

Non-Recurring Fair Value Measurements

Certain long-lived assets, intangibles, and goodwill are required to be measured at fair value on a non-recurring basis subsequent to their initial measurement. These non-recurring fair value measurements generally occur when evidence of impairment has occurred.

As of June 30, 2012, the following assets were measured at fair value:

(dollars in millions)	June 30, 2012	Fair Value Measurements Using			Impairment Losses
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Customer relationship intangible	\$—	\$—	\$—	\$—	\$(4.3)
Property	5.5	—	—	5.5	(8.7)
Impairment losses					\$(13.0)

In the second quarter of 2012, the customer relationship intangible obtained in the Gramtel acquisition was deemed impaired. The fair value of this asset was estimated at zero, resulting in an impairment loss of \$4.3 million. The fair value of this asset was estimated by management using a third party valuation specialist. The fair value was estimated using the income approach, which discounted the expected future earnings attributable to the acquired customer contracts. This fair value measurement is considered a Level 3 measurement due to the significance of its unobservable inputs.

In addition, leasehold improvements and other property at two data centers were deemed impaired. Prior to recognizing the impairment, these assets had a net book value of \$14.2 million as of June 30, 2012. The fair value of the assets was written down to the estimated fair value of \$5.5 million, resulting in an impairment loss of \$8.7 million. The fair value of these assets was estimated by management using a third party valuation specialist. Fair value was estimated using either a cost approach or the market approach. This fair value measurement is considered a Level 3 measurement due to the significance of its unobservable inputs.

6. Restructuring Charges

Restructuring liabilities have been established for employee separation obligations, lease abandonments and contract terminations. A summary of the activity in these liabilities is presented below:

(d)