Consolidated Communications Holdings, Inc.
Form 10-Q
November 07, 2013
Table of Contents

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

FORM 10-Q

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

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2013

or

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

OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 000-51446

**CONSOLIDATED COMMUNICATIONS HOLDINGS, INC.**

(Exact name of registrant as specified in its charter)

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

(217) 235-3311

(Registrant s telephone number, including area code)

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

Yes __X__ No ____

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

Yes __X__ No ____

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

Large accelerated filer ____ Accelerated filer __X__

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

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

Yes ____ No __X__

On October 23, 2013, the registrant had 40,111,518 shares of Common Stock outstanding.

Table of Contents

**TABLE OF CONTENTS**


| | | Page |
|---|---|---|
| **PART I - FINANCIAL INFORMATION** | | |
| Item 1. | Financial Statements | 1 |
| Item 2. | Management s Discussion and Analysis of Financial Condition and Results of Operations | 26 |
| Item 3. | Quantitative and Qualitative Disclosures About Market Risk | 41 |
| Item 4. | Controls and Procedures | 42 |
| **PART II - OTHER INFORMATION** | | |
| Item 1. | Legal Proceedings | 43 |
| Item 6. | Exhibits | 45 |
| SIGNATURES | | 46 |

Table of Contents

## PART I FINANCIAL INFORMATION

### ITEM 1. FINANCIAL STATEMENTS

**CONSOLIDATED COMMUNICATIONS HOLDINGS, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

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

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Net revenues | $ 150,773 | $ 151,025 | $ 453,621 | $ 324,033 |
| Operating expense: | | | | |
| Cost of services and products (exclusive of depreciation and amortization) | 55,780 | 55,442 | 166,774 | 118,515 |
| Selling, general and administrative expenses | 33,715 | 34,733 | 100,385 | 72,537 |
| Financing and other transaction costs | 355 | 14,525 | 712 | 19,909 |
| Depreciation and amortization | 34,756 | 38,140 | 104,306 | 81,822 |
| Income from operations | 26,167 | 8,185 | 81,444 | 31,250 |
| Other income (expense): | | | | |
| Interest expense, net of interest income | (20,632) | (20,624) | (65,929) | (52,117) |
| Investment income | 9,687 | 8,229 | 27,164 | 21,457 |
| Other, net | (687) | 232 | (712) | 431 |
| Income (loss) from continuing operations before income taxes | 14,535 | (3,978) | 41,967 | 1,021 |
| Income tax expense (benefit) | 4,205 | (2,667) | 15,219 | (1,166) |
| Income (loss) from continuing operations | 10,330 | (1,311) | 26,748 | 2,187 |
| Discontinued operations, net of tax: | | | | |
| Income (loss) from discontinued operations, net of tax | 92 | 467 | (156) | 1,759 |
| Gain on sale of discontinued operations, net of tax | 1,333 | - | 1,333 | - |
| Total discontinued operations | 1,425 | 467 | 1,177 | 1,759 |
| Net income (loss) | 11,755 | (844) | 27,925 | 3,946 |
| Less: net income attributable to noncontrolling interest | 61 | 121 | 254 | 366 |
| Net income (loss) attributable to common shareholders | $ 11,694 | $ (965) | $ 27,671 | $ 3,580 |

| | | | | |
|---|---|---|---|---|
| Net income (loss) per common share - basic and diluted | | | | |
| Income (loss) from continuing operations | $ 0.26 | $ (0.03) | $ 0.65 | $ 0.05 |
| Discontinued operations, net of tax | 0.03 | 0.01 | 0.03 | 0.05 |
| Net income (loss) per basic and diluted common share attributable to common shareholders | $ 0.29 | $ (0.02) | $ 0.68 | $ 0.10 |
| Dividends declared per common share | $ 0.39 | $ 0.39 | $ 1.16 | $ 1.16 |

See accompanying notes.

Table of Contents

**CONSOLIDATED COMMUNICATIONS HOLDINGS, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

*(Unaudited; Amounts in thousands)*

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2013** | **2012** | **2013** | **2012** |
| Net income (loss) | $ 11,755 | $ (844) | $ 27,925 | $ 3,946 |
| Pension and post-retirement obligations: | | | | |
| Amortization of actuarial losses and prior service cost to earnings, net of tax | 433 | 60 | 1,381 | 957 |
| Derivative instruments designated as cash flow hedges: | | | | |
| Change in fair value of derivatives, net of tax | (417) | (771) | (285) | (3,584) |
| Reclassification of realized loss to earnings, net of tax | 566 | 2,349 | 3,411 | 6,746 |
| Comprehensive income | 12,337 | 794 | 32,432 | 8,065 |
| Less: comprehensive income attributable to noncontrolling interest | 61 | 121 | 254 | 366 |
| Total comprehensive income attributable to common shareholders | $ 12,276 | $ 673 | $ 32,178 | $ 7,699 |

See accompanying notes.

Table of Contents

**CONSOLIDATED COMMUNICATIONS HOLDINGS, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

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

| | September 30, 2013 | December 31, 2012 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 6,291 | $ 17,854 |
| Accounts receivable, net | 56,849 | 57,957 |
| Income tax receivable | 1,546 | 12,020 |
| Deferred income taxes | 11,292 | 8,984 |
| Prepaid expenses and other current assets | 13,267 | 11,269 |
| Assets of discontinued operations | - | 1,772 |
| Total current assets | 89,245 | 109,856 |
| | | |
| Property, plant and equipment, net | 891,006 | 907,672 |
| Investments | 112,913 | 109,750 |
| Goodwill | 603,446 | 603,446 |
| Other intangible assets | 42,539 | 49,530 |
| Deferred debt issuance costs, net and other assets | 15,315 | 13,800 |
| Total assets | $ 1,754,464 | $ 1,794,054 |
| | | |
| **LIABILITIES AND SHAREHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 8,060 | $ 14,954 |
| Advance billings and customer deposits | 26,393 | 27,654 |
| Dividends payable | 15,538 | 15,463 |
| Accrued compensation | 18,890 | 21,912 |
| Accrued interest | 11,099 | 2,962 |
| Accrued expense | 35,129 | 44,263 |
| Income tax payable | 5,396 | - |
| Current portion of long-term debt and capital lease obligations | 9,870 | 9,596 |
| Current portion of derivative liability | - | 3,164 |
| Liabilities of discontinued operations | 179 | 4,209 |
| Total current liabilities | 130,554 | 144,177 |
| | | |
| Long-term debt and capital lease obligations | 1,202,164 | 1,208,248 |
| Deferred income taxes | 142,790 | 138,068 |
| Pension and other postretirement obligations | 143,921 | 156,710 |
| Other long-term liabilities | 10,864 | 10,746 |
| Total liabilities | 1,630,293 | 1,657,949 |
| | | |
| Commitments and contingencies | | |
| | | |
| Shareholders equity: | | |
| Common stock, par value $0.01 per share; 100,000,000 shares authorized, 40,111,518 and 39,877,998, shares outstanding as of September 30, 2013 and December 31, 2012, respectively | 401 | 399 |
| Additional paid-in capital | 160,618 | 177,315 |
| Retained earnings | - | - |
| Accumulated other comprehensive loss, net | (41,277) | (45,784) |
| Noncontrolling interest | 4,429 | 4,175 |

| | | |
|---|---|---|
| Total shareholders equity | 124,171 | 136,105 |
| Total liabilities and shareholders equity | $ 1,754,464 | $ 1,794,054 |

See accompanying notes.

Table of Contents

**CONSOLIDATED COMMUNICATIONS HOLDINGS, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

*(Unaudited; amounts in thousands)*

| | Nine Months Ended September 30, | |
|---|---|---|
| | **2013** | **2012** |
| Net cash provided by continuing operations | $ 124,053 | $ 70,700 |
| Net cash (used in) provided by discontinued operations | (3,412) | 1,200 |
| Net cash provided by operating activities | 120,641 | 71,900 |
| | | |
| Cash flows from investing activities: | | |
| Business acquisition, net of cash acquired | - | (377,021) |
| Purchases of property, plant and equipment, net | (80,584) | (50,323) |
| Other | (127) | 101 |
| Net cash used in continuing operations | (80,711) | (427,243) |
| Net cash provided by (used in) discontinued operations | 2,331 | (97) |
| Net cash used in investing activities | (78,380) | (427,340) |
| | | |
| Cash flows from financing activities: | | |
| Proceeds on bond offering | - | 298,035 |
| Proceeds from the issuance of long-term debt | 57,000 | 35,000 |
| Payment of capital lease obligation | (368) | (140) |
| Payment on long-term debt | (63,930) | (6,600) |
| Payment of financing costs | - | (13,147) |
| Dividends on common stock | (46,526) | (38,637) |
| Net cash (used in) provided by financing activities | (53,824) | 274,511 |
| | | |
| Decrease in cash and cash equivalents | (11,563) | (80,929) |
| | | |
| Cash and cash equivalents at beginning of period | 17,854 | 105,704 |
| | | |
| Cash and cash equivalents at end of period | $ 6,291 | $ 24,775 |

See accompanying notes.

Table of Contents

**CONSOLIDATED COMMUNICATIONS HOLDINGS, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Business and Basis of Accounting

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

We offer a wide range of telecommunications services to residential and business customers in the areas we serve. Our telecommunications services include local and long-distance service, high-speed broadband Internet access, video services, digital telephone service ( VOIP ), custom calling features, private line services, carrier grade access services, network capacity services over our regional fiber optic networks, directory publishing, Competitive Local Exchange Carrier ( CLEC ) services and equipment sales. As of September 30, 2013, we had approximately 260 thousand access lines, 124 thousand voice connections, 253 thousand data and Internet connections and 110 thousand video connections.

We historically operated our business as two separate reportable segments: Telephone Operations and Other Operations. Based on changes in our business structure, during the quarter ended June 30, 2013 we concluded that we operate our business as one reportable segment. See the Recent Business Developments section below for a more detailed discussion regarding the circumstances that resulted in the change to our segment reporting.

In the opinion of management, the accompanying condensed consolidated balance sheets and related consolidated statements of income, comprehensive income and cash flows include all adjustments, consisting only of normal recurring items, necessary for their fair presentation in conformity with accounting principles generally accepted in the United States ( U.S. GAAP or GAAP ) for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC ). Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to such SEC rules and regulations and accounting principles applicable for interim periods. Events subsequent to the balance sheet date have been evaluated for inclusion in the accompanying condensed consolidated financial statements through the date of issuance. Management believes that the disclosures made are adequate to make the information presented not misleading. Interim results are not necessarily indicative of results for a full year. The information presented in this Form 10-Q should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and the accompanying notes to the financial statements ( Notes ) thereto included in our 2012 Annual Report on Form 10-K filed with the SEC.

### Recent Business Developments

*Segment Reporting*

Historically, we classified our operations into two separate reportable business segments: Telephone Operations and Other Operations. Our Telephone Operations consisted of a wide range of telecommunications services to residential and business customers, including local and long-distance service, high-speed broadband Internet access, video services, VOIP services, custom calling features, private line services, carrier access services, network capacity services over a regional fiber optic network, mobile services and directory publishing. Our Other Operations segment operated two complementary non-core businesses including telephone services to state and county correctional facilities ( Prison Services ) and equipment sales. As discussed below, our contract to provide telephone services to correctional facilities operated by the Illinois Department of Corrections was not renewed and the process of transitioning those services to another service provider was completed during the quarter ended March 31, 2013. The remaining prison services assets and operations were classified as discontinued operations during the quarter ended June 30, 2013 and subsequently sold during the quarter ended September 30, 2013. Prison Services comprised nearly all of the Other Operations segment revenue and results of operations. Consequently, with the cessation of our Prison Services business and based on the segment accounting guidance, the Company concluded that we operate as one segment as of the quarter ended June 30, 2013. As required by the authoritative guidance for segment presentation, segment results of operations have been retrospectively adjusted to reflect this change for all periods presented.

Table of Contents

*Prison Services Contract*

We previously provided telephone service to inmates incarcerated at facilities operated by the Illinois Department of Corrections and to certain county jails. On June 27, 2012, the Illinois Department of Central Management Services announced its intent to replace us as the provider of those services with a competitor. Although we challenged our competitor s bid and the State s decision to accept that bid in a variety of different forums, during the quarter ended March 31, 2013, the process of transitioning these services to another service provider was completed. All related assets have been assessed for recoverability in light of this change and we determined that no impairment was necessary. During 2012, the prison services contract comprised 5% of consolidated operating revenues and approximately 2% of consolidated operating income, excluding financing and other transaction fees.

*Discontinued Operations*

On September 13, 2013, we completed the sale of the assets and contractual rights used to provide communications services to inmates in thirteen county jails located in Illinois for a total purchase price of $2.5 million. In accordance with the Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC ) 205-20, *Discontinued Operations* , the financial results of the prison services business have been reported as a discontinued operation in our condensed consolidated financial statements for all periods presented. For a more complete discussion of the transaction, refer to Note 2.

*SureWest Merger*

We completed the acquisition of SureWest Communications on July 2, 2012. SureWest Communications results of operations are included within our results following the acquisition date. For a more complete discussion of the transaction, refer to Note 2.

**Reclassifications**

Certain amounts in our 2012 condensed consolidated financial statements have been reclassified to conform to the presentation of our 2013 condensed consolidated financial statements, which consists of the effects of reclassifications from the presentation of prison services as a discontinued operation and the finalization of purchase accounting for the SureWest acquisition.

**Recent Accounting Pronouncements**

In July 2013, the FASB issued the Accounting Standards Update No. 2013-11 ( ASU 2013-11 ), *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. ASU 2013-11 provides guidance concerning the balance sheet presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss or a tax credit

carryforward is present. The amended guidance is effective for fiscal years and interim periods beginning after December 15, 2013, with early adoption permitted. We are currently evaluating the impact this update will have on our condensed consolidated financial statements.

Effective January 1, 2013, we adopted Accounting Standards Update No. 2012-02 ( ASU 2012-02 ), *Testing Indefinite-Lived Intangible Assets for Impairment*. ASU 2012-02 permits an entity to perform an initial assessment of qualitative factors to determine whether it is more likely than not that a non-goodwill indefinite-lived intangible asset is impaired and thus whether it is necessary to calculate the asset s fair value for the purpose of comparing it with the asset s carrying amount. The adoption of this standard did not have a material impact on our condensed consolidated financial statements.

Effective January 1, 2013, we adopted Accounting Standards Update No. 2013-02 ( ASU 2013-02 ), *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income,* which establishes new requirements for disclosing reclassifications of items out of accumulated other comprehensive income ( OCI ). ASU 2013-2 requires disclosures for the (i) changes in components of accumulated OCI, (ii) effects on individual line items in net income for each item of accumulated OCI that is reclassified in its entirety to net income, and (iii) cross references to other disclosures that provide additional details for OCI items that are not reclassified in their entirety to net income. For public companies, amendments were effective prospectively for reporting periods beginning after December 15, 2012, with early adoption permitted. In accordance with the provisions of this guidance, disclosures related to accumulated OCI can be found in Note 8.

Table of Contents

## 2. ACQUISITION AND DISPOSITIONS

***Merger With SureWest Communications***

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

Subsequent to the merger, the financial results of SureWest operations have been included in our condensed consolidated statement of income. For the quarter and nine months ended September 30, 2013, we paid change-in-control obligations to former members of the SureWest management team of $0.2 million and $8.1 million, respectively, that were previously accrued. At September 30, 2013, unpaid obligations under the change-in-control agreements was $0.1 million, which is expected to be paid during the three months ended December 31, 2013.

The acquisition of SureWest has been accounted for using the acquisition method in accordance with the FASB s ASC Topic 805, *Business Combinations*. Accordingly, the net assets acquired were recorded at their estimated fair values at July 2, 2012. These values were derived from a purchase price allocation, which was finalized during the quarter ended June 30, 2013. These final adjustments were retrospectively applied on the balance sheet to reflect the appropriate balances as of July 2, 2012. There was no impact to the income statement for the twelve months ended December 31, 2012.

*Unaudited Pro Forma Results*

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

| *(In thousands, except per share amounts)* | | **Nine Months Ended September 30, 2012** |
|---|---|---|
| Operating revenues | $ | 451,935 |
| Income from operations | $ | 48,823 |
| Income from continuing operations | $ | 5,835 |
| Discontinued operations, net of tax | $ | 1,759 |

| | | |
|---|---|---|
| Net income | $ | 7,594 |
| Less: income attributable to noncontrolling interest | | 366 |
| Net income attributable to common shareholders | $ | 7,228 |
| | | |
| Net income per common share - basic and diluted | | |
| Income from continuing operations | $ | 0.15 |
| Discontinued operations, net of tax | | 0.04 |
| Net income per basic and diluted common share attributable to common shareholders | $ | 0.19 |

***Discontinued Operations***

In September 2013, we completed the sale of the assets and contractual rights of our prison services business for a total cash purchase price of $2.5 million, which included the settlement of any pending legal matters. The financial results of the operations for prison services, which were previously reported in the Other Operations segment, have been reported as a discontinued operation in our condensed consolidated financial statements for all periods presented.

Table of Contents

As of September 30, 2013 and December 31, 2012, the major classes of the prison services assets and liabilities included in discontinued operations were as follows:

| *(In thousands)* | **September 30, 2013** | **December 31, 2012** |
|---|---|---|
| Accounts receivable, net | $ - | $ 625 |
| Deferred income taxes | - | 583 |
| Property, plant and equipment, net | - | 564 |
| Total assets | $ - | $ 1,772 |
| | | |
| Accounts payable | $ - | $ 13 |
| Advance billings and customer deposits | - | 938 |
| Accrued expense | 179 | 3,258 |
| Total liabilities | $ 179 | $ 4,209 |

The following table summarizes the financial information for the prison services operations for the quarters and nine months ended September 30, 2013 and 2012:

| | **Quarter Ended September 30,** | | **Nine Months Ended September 30,** | |
|---|---|---|---|---|
| *(In thousands)* | **2013** | **2012** | **2013** | **2012** |
| Operating revenues | $ 373 | $ 5,987 | $ 5,622 | $ 19,348 |
| Operating expenses including depreciation and amortization | 306 | 5,142 | 5,883 | 16,503 |
| Income (loss) from operations | 67 | 845 | (261) | 2,845 |
| Income tax expense (benefit) | (25) | 378 | (105) | 1,086 |
| Income (loss) from discontinued operations | $ 92 | $ 467 | $ (156) | $ 1,759 |
| | | | | |
| Gain on sale of discontinued operations, net of tax | $ 1,333 | $ - | $ 1,333 | $ - |

**3. EARNINGS PER SHARE**

The computation of basic and diluted earnings per share attributable to common shareholders computed using the two-class method is as follows:

| | **Quarter Ended September 30,** | | **Nine Months Ended September 30,** | |
|---|---|---|---|---|
| *(In thousands, except per share amounts)* | **2013** | **2012** | **2013** | **2012** |
| Income (loss) from continuing operations | $ 10,330 | $ (1,311) | $ 26,748 | $ 2,187 |
| Less: net income attributable to noncontrolling interest | 61 | 121 | 254 | 366 |
| Income (loss) attributable to common shareholders before allocation of earnings to participating securities | 10,269 | (1,432) | 26,494 | 1,821 |
| Less: earnings allocated to participating securities | 131 | - | 394 | 255 |
| Income (loss) from continuing operations attributable to common shareholders | 10,138 | (1,432) | 26,100 | 1,566 |
| Net income from discontinued operations | 1,425 | 467 | 1,177 | 1,759 |
| Net income (loss) attributable to common shareholders | $ 11,563 | $ (965) | $ 27,277 | $ 3,325 |

| | | | | |
|---|---|---|---|---|
| Weighted-average number of common shares outstanding | 39,755 | 39,439 | 39,755 | 32,963 |
| Basic and diluted earnings per common share: | | | | |
| Income (loss) from continuing operations | $ 0.26 | $ (0.03) | $ 0.65 | $ 0.05 |
| Income from discontinued operations, net of tax | 0.03 | 0.01 | 0.03 | 0.05 |
| Net income (loss) per common share attributable to common shareholders | $ 0.29 | $ (0.02) | $ 0.68 | $ 0.10 |

Table of Contents

Diluted earnings per common share attributable to common shareholders for the three and nine months ended September 30, 2013 excludes 0.4 million shares and 0.3 million shares, respectively, of potential common shares related to our share-based compensation plan, because the inclusion of the potential common shares would have had an antidilutive effect. For the three and nine months ended September 30, 2012, diluted earnings per share excluded 0.2 million potential common shares.

**4. INVESTMENTS**

Our investments are as follows:

| *(In thousands)* | **September 30, 2013** | **December 31, 2012** |
|---|---|---|
| Cash surrender value of life insurance policies | $ 2,143 | $ 2,045 |
| Cost method investments: | | |
| GTE Mobilnet of South Texas Limited Partnership (2.34% interest) | 21,450 | 21,450 |
| Pittsburgh SMSA Limited Partnership (3.60% interest) | 22,950 | 22,950 |
| CoBank, ACB Stock | 5,070 | 5,023 |
| Other | 215 | 430 |
| Equity method investments: | | |
| GTE Mobilnet of Texas RSA #17 Limited Partnership (20.51% interest) | 27,621 | 25,695 |
| Pennsylvania RSA 6(I) Limited Partnership (16.6725% interest) | 7,599 | 7,286 |
| Pennsylvania RSA 6(II) Limited Partnership (23.67% interest) | 24,094 | 23,338 |
| CVIN, LLC (12.86% interest) | 1,771 | 1,533 |
| Totals | $ 112,913 | $ 109,750 |

**Cost Method**

We own 2.34% of GTE Mobilnet of South Texas Limited Partnership (the Mobilnet South Partnership ). The principal activity of the Mobilnet South Partnership is providing cellular service in the Houston, Galveston, and Beaumont, Texas metropolitan areas. We also own 3.60% of Pittsburgh SMSA Limited Partnership ( Pittsburgh SMSA ), which provides cellular service in and around the Pittsburgh metropolitan area. Because of our limited influence over these partnerships, we use the cost method to account for both of these investments. It is not practicable to estimate fair value of these investments. We did not evaluate any of the investments for impairment during the quarters or nine months ended September 30, 2013 or 2012 as no factors indicating impairment existed. For the three months ended September 30, 2013 and 2012, we received cash distributions from these partnerships totaling $4.3 million and $3.7 million, respectively. For the nine months ended September 30, 2013 and 2012, we received cash distributions from these partnerships totaling $12.1 million and $9.3 million, respectively.

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

**Equity Method**

We own 20.51% of GTE Mobilnet of Texas RSA #17 Limited Partnership ( RSA #17 ), 16.6725% of Pennsylvania RSA 6(I) Limited Partnership ( RSA 6(I) ) and 23.67% of Pennsylvania RSA 6(II) Limited Partnership ( RSA 6(II) ). RSA #17 provides cellular service to a limited rural area in Texas. RSA 6 (I) and RSA 6 (II) provide cellular service in and around our Pennsylvania service territory. Because we have significant influence over the operating and financial policies of these three entities, we account for the investments using the equity method. For the three months ended September 30, 2013 and 2012, we received cash distributions from these partnerships totaling $4.2 million and $4.0 million, respectively. For the nine months ended September 30, 2013 and 2012, we received cash distributions from these partnerships totaling $12.2 million and $10.5 million, respectively.

We have a 12.86% interest in Central Valley Independent Network, LLC ( CVIN ), a joint enterprise comprised of affiliates of several independent telephone companies located in central and northern California. CVIN provides network services and oversees a broadband infrastructure project designed to expand and improve the availability of network services to counties in central California. Because we have significant influence over the operating and financial policies of this entity, we account for this investment using the equity method. During the three and nine months ended September 30, 2013, we made additional capital investments of $0.1 million and $0.2 million, respectively, in this partnership. We did not receive any distributions from this partnership during the quarters or nine months ended September 30, 2013 and 2012.

Table of Contents

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

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| *(In thousands)* | **2013** | **2012** | **2013** | **2012** |
| Total revenues | $ 82,394 | $ 75,317 | $ 238,455 | $ 221,207 |
| Income from operations | 25,874 | 21,611 | 74,762 | 63,538 |
| Net income before taxes | 25,896 | 21,626 | 74,808 | 63,582 |
| Net income | 25,896 | 21,522 | 74,808 | 63,270 |

| | September 30, 2013 | December 31, 2012 |
|---|---|---|
| *(In thousands)* | | |
| Current assets | $ 59,232 | $ 49,982 |
| Non-current assets | 86,137 | 79,529 |
| Current liabilities | 14,692 | 15,417 |
| Non-current liabilities | 1,594 | 1,351 |
| Partnership equity | 129,083 | 112,734 |

## 5. FAIR VALUE MEASUREMENTS

Our derivative instruments related to interest rate swap agreements are required to be measured at fair value on a recurring basis. The fair values of the interest rate swaps are determined using valuation models which rely on the expected London Interbank Offered Rate ( LIBOR ) based yield curve and estimates of counterparty and Consolidated s non-performance risk as the most significant inputs. Because each of these inputs are directly observable or can be corroborated by observable market data, we have categorized these interest rate swaps as Level 2 within the fair value hierarchy. See Note 7 for further discussion regarding our interest rate swap agreements.

Our interest rate swap liabilities measured at fair value on a recurring basis and subject to disclosure requirements at September 30, 2013 and December 31, 2012 were as follows:

| | | As of September 30, 2013 | | |
|---|---|---|---|---|
| *(In thousands)* | **Total** | **Quoted Prices In Active Markets for Identical Assets (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
| Long-term interest rate swap liabilities | $ (2,910) | $ | $ (2,910) | $ |
| Total | $ (2,910) | $ | $ (2,910) | $ |

| | As of December 31, 2012 | | |
|---|---|---|---|
| | **Quoted Prices In Active Markets for Identical Assets** | **Significant Other Observable Inputs** | **Significant Unobservable Inputs** |

| *(In thousands)* | **Total** | **(Level 1)** | **(Level 2)** | **(Level 3)** |
|---|---|---|---|---|
| Current interest rate swap liabilities | $ (3,164) | $ | $ (3,164) | $ |
| Long-term interest rate swap liabilities | (3,919) | | (3,919) | |
| Total | $ (7,083) | $ | $ (7,083) | $ |

The change in the fair value of the derivatives is primarily a result of a change in market expectations for future interest rates and the expiration of certain instruments during the nine months ended September 30, 2013.

Table of Contents

We have not elected the fair value option for any of our financial assets or liabilities. The carrying value of other financial instruments, including cash, accounts receivable, accounts payable and accrued liabilities approximate fair value due to their short maturities or variable-rate nature of the respective balances. The following table presents the other financial instruments that are not carried at fair value but which require fair value disclosure as of September 30, 2013 and December 31, 2012.

| | As of September 30, 2013 | | As of December 31, 2012 | |
|---|---|---|---|---|
| *(In thousands)* | **Carrying Value** | **Fair Value** | **Carrying Value** | **Fair Value** |
| Investments, equity basis | $ 61,085 | n/a | $ 57,852 | n/a |
| Investments, at cost | $ 49,685 | n/a | $ 49,853 | n/a |
| Long-term debt | $ 1,206,763 | $ 1,250,644 | $ 1,213,000 | $ 1,231,355 |

**Cost & Equity Method Investments**

Our investments at September 30, 2013 and December 31, 2012 accounted for under both the equity and cost methods consists primarily of minority positions in various cellular telephone limited partnerships and our investment in CoBank. These investments are recorded using either the equity or cost methods. It is impracticable to determine fair value of these investments.

**Long-term Debt**

The fair value of our long-term debt was estimated using a discounted cash flow analyses based on incremental borrowing rates for similar types of borrowing arrangements. We have categorized the long-term debt as Level 2 within the fair value hierarchy.

**6. LONG-TERM DEBT**

Long-term debt, presented net of unamortized discounts, consisted of the following:

| *(In thousands)* | **September 30, 2013** | **December 31, 2012** |
|---|---|---|
| Senior secured credit facility: | | |
| Term Loan 2 | $ 401,894 | $ 404,961 |
| Term Loan 3, net of discount of $4,523 and $5,088 at September 30, 2013 and December 31, 2012, respectively | 506,614 | 509,912 |
| Senior notes, net of discount of $1,744 and $1,873 at September 30, 2013 and December 31, 2012, respectively | 298,256 | 298,127 |
| Capital leases | 5,270 | 4,844 |
| | 1,212,034 | 1,217,844 |
| Less: current portion of long-term debt and capital leases | (9,870) | (9,596) |

| | | | | |
|---|---|---|---|---|
| Total long-term debt | $ | 1,202,164 | $ | 1,208,248 |

**Credit Agreement**

The Company, through certain of its wholly owned subsidiaries, has an outstanding credit agreement with several financial institutions, which consists of a $50.0 million revolving credit facility and outstanding term loans of $908.5 million at September 30, 2013. The credit facility also includes an incremental term loan facility which provides the ability to borrow up to $300.0 million of incremental term loans. As of September 30, 2013 and December 31, 2012, no amounts were outstanding under the revolving credit facility. Borrowings under the senior secured credit facility are secured by substantially all of the assets of the Company, with the exception of Illinois Consolidated Telephone Company and our majority-owned subsidiary, East Texas Fiber Line Incorporated.

Our term loans under the credit facility, as amended, were issued in separate tranches, resulting in different maturity dates and interest rate margins for each term loan. The second term loan ( Term 2 ) consists of an original aggregate principal amount of $409.1 million, matures on December 31, 2017 and currently has an applicable margin (at our election) equal to either 4.00% for a LIBOR-based term loan or 3.00% for an alternative base rate term loan. The Term 2 loan requires $1.0 million in quarterly principal payments, which began on March 31, 2012. The third term loan ( Term 3 ) consists of an original aggregate principal amount of $515.0 million, with a maturity date of December 31, 2018. The Term 3 loan requires quarterly principal payments of $1.3 million which commenced March 31, 2013 and has an applicable margin (at our election) equal to either 4.00% for a LIBOR-based term loan or 3.00% for an alternative base rate term loan subject to a 1.25% LIBOR floor. The Term 3 loan contains an original issuance discount of $5.2 million, which is being amortized over the term of the loan.

Table of Contents

Our revolving credit facility has a maturity date of June 8, 2016 and an applicable margin (at our election) of between 2.75% and 3.50% for LIBOR-based borrowings and between 1.75% and 2.50% for alternative base rate borrowings, depending on our leverage ratio. Based on our leverage ratio at September 30, 2013, the borrowing margin for the next three month period ending December 31, 2013 will be at a weighted-average margin of 3.25% for a LIBOR-based loan or 2.25% for an alternative base rate loan. The applicable borrowing margin for the revolving credit facility is adjusted quarterly to reflect the leverage ratio from the prior quarter-end. There were no borrowings or letters of credit outstanding under the revolving credit facility at September 30, 2013 and December 31, 2012.

The weighted-average interest rate on outstanding borrowings under our credit agreement was 4.78% and 4.79% at September 30, 2013 and December 31, 2012, respectively. Interest is payable at least quarterly.

Net proceeds from asset sales exceeding certain thresholds, to the extent not reinvested, are required to be used to repay loans outstanding under the credit agreement.

*Credit Agreement Covenant Compliance*

The credit agreement contains various provisions and covenants, including, among other items, restrictions on the ability to pay dividends, incur additional indebtedness, and issue capital stock. We have agreed to maintain certain financial ratios, including interest coverage and total net leverage ratios, all as defined in the credit agreement. As of September 30, 2013, we were in compliance with the credit agreement covenants.

Effective February 17, 2012, we amended our credit facility to provide us with the ability to incur indebtedness necessary to finance the acquisition of SureWest, which enabled us to issue the unsecured Senior Notes ( Senior Notes ), as described below. In connection with the amendment, fees of $3.5 million were recognized as financing and other transaction costs during the nine months ended September 30, 2012.

In general, our credit agreement restricts our ability to pay dividends to the amount of our Available Cash as defined in our credit agreement. As of September 30, 2013, and including the $15.5 million dividend declared in August 2013 and paid on November 1, 2013, we had $208.7 million in dividend availability under the credit facility covenant.

Under our credit agreement, if our total net leverage ratio (as defined in the credit agreement), as of the end of any fiscal quarter, is greater than 5.10:1.00, we will be required to suspend dividends on our common stock unless otherwise permitted by an exception for dividends that may be paid from the portion of proceeds of any sale of equity not used to fund acquisitions, or make other investments. During any dividend suspension period, we will be required to repay debt in an amount equal to 50.0% of any increase in Available Cash, among other things. In addition, we will not be permitted to pay dividends if an event of default under the credit agreement has occurred and is continuing. Among other things, it will be an event of default if our total net leverage ratio and interest coverage ratio as of the end of any fiscal quarter is greater than 5.25:1.00 and less than 2.25:1.00, respectively. As of September 30, 2013, our total net leverage ratio under the credit agreement was 4.19:1.00, and our interest coverage ratio was 3.34:1.00.

**Senior Notes**

On May 30, 2012, we completed an offering of $300.0 million aggregate principal amount of 10.875% unsecured Senior Notes, due 2020 through our wholly-owned subsidiary, Consolidated Communications Finance Co. ( Finance Co. ) for the acquisition of SureWest. The Senior Notes will mature on June 1, 2020 and earn interest at a rate of 10.875% per year, payable semi-annually in arrears on June 1 and December 1 of each year, commencing on December 1, 2012. The Senior Notes were sold in the United States to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933 (the Securities Act ) and outside the United States in compliance with Regulation S under the Securities Act. In addition, some of the Senior Notes were sold to certain accredited investors (as defined in Rule 501 under the Securities Act). The Senior Notes were sold to investors at a price equal to 99.345% of the principal amount thereof, for a yield to maturity of 11.00%. This discount is being amortized over the term of the Senior Notes. The proceeds of the sale of the Senior Notes were

Table of Contents

held in an escrow account prior to the closing of the SureWest transaction. Upon closing of the SureWest acquisition on July 2, 2012, Finance Co. merged with and into our wholly-owned subsidiary Consolidated Communications, Inc., which assumed the Senior Notes, and we and certain of our subsidiaries fully and unconditionally guaranteed the Senior Notes. On August 3, 2012, SureWest and its subsidiaries guaranteed the Senior Notes.

During the quarter ended June 30, 2013, we completed an exchange offer to issue registered notes ( Exchange Notes ) for $287.3 million of the original Senior Notes. The terms of the Exchange Notes are substantially identical to the Senior Notes, except that the Exchange Notes are registered under the Securities Act and the transfer restrictions and registration rights applicable to the Senior Notes do not apply to the Exchange Notes. The exchange offer did not impact the aggregate principal amount or the remaining terms of the Senior Notes outstanding.

*Senior Notes Covenant Compliance*

The indenture governing the Senior Notes contains customary covenants for high yield notes, which limits Consolidated Communications, Inc. s and its restricted subsidiaries ability to: incur debt or issue certain preferred stock; pay dividends or make other distributions on capital stock or prepay subordinated indebtedness; purchase or redeem any equity interests; make investments; create liens; sell assets; enter into agreements that restrict dividends or other payments by restricted subsidiaries; consolidate, merge or transfer all or substantially all of its assets; engage in transactions with its affiliates; or enter into any sale and leaseback transactions.

Among other matters, the Senior Notes indenture provides that Consolidated Communications, Inc. may not pay dividends or make other restricted payments to the Company if its total net leverage ratio is 4.25:1.00 or greater. At September 30, 2013, this ratio, which is calculated differently than the comparable ratio under the credit agreement, was 3.99:1.00. If this ratio is met, dividends and other restricted payments may be made from cumulative consolidated cash flow since the date the Senior Notes were issued, less 1.75 times fixed charges, less dividends and other restricted payments made since the date the Senior Notes were issued. Dividends may be paid and other restricted payments may also be made from a basket of $50.0 million, none of which has been used to date, and pursuant to other exceptions identified in the Senior Notes indenture. Since dividends of $93.0 million have been paid since May 30, 2012, at September 30, 2013 there was $135.9 million of the $228.9 million of cumulative consolidated cash flow since May 30, 2012 available to pay dividends.

**Bridge Loan Facility**

In connection with the acquisition of SureWest, in February 2012 the Company received committed financing for a total of $350.0 million to fund the cash portion of the anticipated transaction, to refinance SureWest s debt and to pay for certain transaction costs. The financing package included a $350.0 million Senior Unsecured Bridge Loan Facility ( Bridge Facility ). As anticipated, permanent financing for the SureWest acquisition was funded by our Senior Note offering, as described above. As a result, the $4.2 million commitment fee incurred for the Bridge Facility was capitalized as deferred debt issuance costs in February 2012 and was amortized over the expected life of the Bridge Facility, which was four months.

**Capital Leases**

As of September 30, 2013, we had seven capital leases which expire between 2015 and 2021. As of September 30, 2013, the present value of the minimum remaining lease commitments was approximately $5.3 million, of which $0.6 million was due and payable within the next twelve months. The leases require total remaining rental payments of $8.2 million as of September 30, 2013, of which $6.0 million will be paid to LATEL LLC, a related party entity.

During the nine months ended September 30, 2013, we acquired equipment of $0.8 million through capital lease agreements, which represents a noncash activity.

**7. DERIVATIVE FINANCIAL INSTRUMENTS**

We use derivative financial instruments to manage our exposure to the risks associated with fluctuations in interest rates. Our interest rate swap agreements effectively convert a portion of our floating-rate debt to a fixed-rate basis, thereby reducing the impact of interest rate changes on future cash interest payments. Derivative financial instruments are recorded at fair value in our condensed consolidated balance sheet. Certain of our interest rate swaps are designated as cash flow hedges of our expected future interest payments. For derivative instruments designated as a cash flow hedge, the effective portion of the change in the fair value is recognized as a

Table of Contents

component of accumulated other comprehensive income (loss) ( AOCI ) and is recognized as an adjustment to earnings over the period in which the hedged item impacts earnings. When an interest rate swap agreement terminates, any resulting gain or loss is recognized over the shorter of the remaining original term of the hedging instrument or the remaining life of the underlying debt obligation. If a derivative instrument is de-designated, the remaining gain or loss in AOCI on the date of de-designation is amortized to earnings over the remaining term of the hedging instrument. For derivative financial instruments that are not designated as a hedge, changes in fair value are recognized on a current basis in earnings. The ineffective portion of the change in fair value of any hedging derivative is recognized immediately in earnings. Cash flows from hedging activities are classified under the same category as the cash flows from the hedged items in our consolidated statement of cash flows.

The following interest rate swaps were outstanding at September 30, 2013:

| *(In thousands)* | | **Notional Amount** | **2013 Balance Sheet Location** | | **Fair Value** |
|---|---|---|---|---|---|
| **Cash Flow Hedges:** | | | | | |
| Fixed to 1-month floating LIBOR | $ | 275,000 | Other long-term liabilities | $ | (2,910) |
| Fixed to 1-month floating LIBOR (with floor) | | 50,000 | Other long-term liabilities | | - |
| Total Fair Values | | | | $ | (2,910) |

The following interest rate swaps were outstanding at December 31, 2012:

| *(In thousands)* | | **Notional Amount** | **2012 Balance Sheet Location** | | **Fair Value** |
|---|---|---|---|---|---|
| **Cash Flow Hedges:** | | | | | |
| Fixed to 1-month floating LIBOR | $ | 200,000 | Other long-term liabilities | $ | (2,758) |
| Fixed to 1-month floating LIBOR | | 100,000 | Current portion of derivative liability | | (1,069) |
| Forward starting fixed to 1-month floating LIBOR | | 75,000 | Other long-term liabilities | | (1,161) |
| **De-designated Hedges:** | | | | | |
| Fixed to 3-month floating LIBOR | | 130,000 | Current portion of derivative liability | | (1,300) |
| 3-month floating LIBOR minus spread to 1-month floating LIBOR | | 130,000 | Current portion of derivative liability | | (16) |
| Fixed to 1-month floating LIBOR | | 200,000 | Current portion of derivative liability | | (779) |
| Total Fair Values | | | | $ | (7,083) |

At September 30, 2013 and December 31, 2012, the interest rate on approximately 36% and 69%, respectively, of our outstanding debt under the term loan credit facility was fixed through the use of interest rate swaps.

As of September 30, 2013, the counterparties to our various swaps are four major U.S. and European banks. None of the swap agreements provide for either us or the counterparties to post collateral nor do the agreements include any covenants related to the financial condition of Consolidated or the counterparties. The swaps of any counterparty that is a Lender as defined in our credit facility are secured along with the other creditors under the credit facility. Each of the swap agreements provides that in the event of a bankruptcy filing by either Consolidated or the counterparty, any amounts owed between the two parties would be offset in order to determine the net amount due between parties. This provision allows us to partially mitigate the risk of non-performance by a counterparty.

On December 4, 2012, $660.0 million notional interest rate swaps designated as cash flow hedges were de-designated in connection with an amendment to our credit agreement. Prior to the de-designation, the effective portion of the change in fair value of these interest rate swaps were recognized in AOCI. The balance of the unrealized loss included in AOCI as of the date the swaps were de-designated was amortized to earnings over the remaining term of the swap agreements. On December 31, 2012, $200.0 million notional interest rate swap agreements expired and the remainder expired on March 31, 2013. Subsequent to December 4, 2012, changes in fair value of the de-designated swaps were recognized in earnings. During the nine months ended September 30, 2013, a gain of $2.1 million was recognized as a reduction to interest expense for the change in fair value of the de-designated swaps.

Table of Contents

Information regarding our cash flow hedge transactions is as follows:

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| *(In thousands)* | **2013** | **2012** | **2013** | **2012** |
| Loss recognized in AOCI, pretax | $ (673) | $ (1,221) | $ (460) | $ (5,676) |
| Loss reclassified from AOCI to interest expense | $ (913) | $ (3,719) | $ (5,450) | $ (10,681) |
| Gain arising from ineffectiveness reducing interest expense | $ - | $ 9 | $ - | $ 40 |

| *(In thousands, except months)* | **September 30, 2013** | **December 31, 2012** |
|---|---|---|
| Aggregate notional value of current derivatives outstanding | $ 325,000 | $ 630,000 |
| Aggregate notional value of forward derivatives outstanding | $ - | $ 75,000 |
| Period through which derivative positions currently exist | September 2016 | March 2016 |
| Fair value of derivatives | $ (2,910) | $ (7,083) |
| Deferred losses included in AOCI (pretax) | $ 2,910 | $ 7,899 |
| Losses included in AOCI to be recognized in the next 12 months | $ 3,652 | $ 6,363 |
| Number of months over which loss in AOCI is to be recognized | 12 | 12 |

**8. EQUITY**

**Share-Based Compensation**

The following table summarizes total compensation costs recognized for share-based payments during the quarters and nine-month periods ended September 30, 2013 and 2012:

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| *(In thousands)* | **2013** | **2012** | **2013** | **2012** |
| Restricted stock | $ 466 | $ 328 | $ 1,383 | $ 978 |
| Performance shares | 328 | 266 | 851 | 706 |
| Total | $ 794 | $ 594 | $ 2,234 | $ 1,684 |

Stock-based compensation expense is included in selling, general and administrative expenses in the accompanying statements of income.

As of September 30, 2013, total unrecognized compensation costs related to nonvested Restricted Stock Awards ( RSAs ) and Performance Share Awards ( PSAs ) was $4.2 million and will be recognized over a weighted-average period of approximately 1.08 years.

The following table summarizes the RSA and PSA activity for the nine-month period ended September 30, 2013:

| | RSAs | | PSAs | |
|---|---|---|---|---|
| | Shares | Weighted Average Grant Date Fair Value | Shares | Weighted Average Grant Date Fair Value |
| Non-vested shares outstanding - January 1, 2013 | 64,318 | $ 18.33 | 58,221 | $ 18.85 |
| Shares granted | 168,516 | 17.13 | 66,504 | 19.30 |
| Shares cancelled | (1,500) | 17.13 | - | - |
| Shares vested | - | - | - | - |
| Non-vested shares outstanding - September 30, 2013 | 231,334 | | 124,725 | |

Table of Contents

**Accumulated Other Comprehensive Income**

The following table summarizes the changes in accumulated other comprehensive loss, net of tax, by component for the nine-month period ended September 30, 2013:

| *(In thousands)* | Pension and Post-Retirement Obligations | Derivative Instruments | Total |
|---|---|---|---|
| Balance at December 31, 2012 | $ (40,581) | $ (5,203) | $ (45,784) |
| Other comprehensive income before reclassifications | - | (285) | (285) |
| Amounts reclassified from accumulated other comprehensive income | 1,381 | 3,411 | 4,792 |
| Net current period other comprehensive income | 1,381 | 3,126 | 4,507 |
| Balance at September 30, 2013 | $ (39,200) | $ (2,077) | $ (41,277) |

The following table summarizes reclassifications from accumulated other comprehensive loss for the three and nine-month periods ended September 30, 2013:

| | Amount Reclassified from AOCI | | |
|---|---|---|---|
| *(In thousands)* | Quarter Ended September 30, 2013 | Nine Months Ended September 30, 2013 | Affected Line Item in the Statement of Income |
| Amortization of pension and post-retirement items: | | | |
| Prior service credit | $ (247) | $ (478) | (a) |
| Actuarial loss | 957 | 2,739 | (a) |
| | 710 | 2,261 | Total before tax |
| | (277) | (880) | Tax benefit |
| | $ 433 | $ 1,381 | Net of tax |
| Loss on cash flow hedges: | | | |
| Interest rate derivatives | $ 913 | $ 5,450 | Interest expense |
| | (347) | (2,039) | Tax benefit |
| | $ 566 | $ 3,411 | Net of tax |

(a) These items are included in the components of net periodic benefit cost for our pension and post-retirement benefit plans. See Note 9 for additional details.

**9. PENSION PLAN AND OTHER POST-RETIREMENT BENEFITS**

*Defined Benefit Plans*

We sponsor a qualified defined benefit pension plan ( Retirement Plan ) that is non-contributory covering certain of our hourly employees who fulfill minimum age and service requirements. Certain salaried employees are also covered by the Retirement Plan, although these benefits have previously been frozen. In April 2013, the Retirement Plan was amended for certain employees to among other things: (i) change the benefit formula to a cash balance account as of May 1, 2013 and (ii) freeze entrance into the Retirement Plan so that no person is eligible to become a participant on or following May 1, 2013.

In connection with the acquisition of SureWest, we assumed sponsorship in 2012 of a frozen non-contributory defined benefit pension plan (the SureWest Plan ). The SureWest Plan covers certain eligible employees and benefits are based on years of service and the employee s average compensation during the five highest consecutive years of the last ten years of credited service. This plan has previously been frozen so that no person is eligible to become a new participant and all future benefit accruals for existing participants have ceased.

We also have two non-qualified supplemental retirement plans ( Supplemental Plans ): the Restoration Plan, which we acquired as part of our North Pittsburgh Systems, Inc. ( North Pittsburgh ) and TXU Communications Venture Company ( TXUCV ) acquisitions, and a Supplemental Executive Retirement Plan ( SERP ), which we acquired as part of our acquisition of SureWest. The Supplemental Plans provide supplemental retirement benefits to certain former employees by providing for incremental pension payments to partially offset the reduction that would have been payable under the qualified defined benefit pension plans if it were not for limitations imposed by federal income tax regulations. Both plans have previously been frozen so that no person is eligible to become a new participant in the Supplemental Plans. These plans are unfunded and have no assets. The benefits paid under the Supplemental Plans are paid from the general operating funds of the Company.

Table of Contents

The following table summarizes the components of net periodic pension cost for our defined benefit plans for the quarters and nine-month periods ended September 30, 2013 and 2012:

During the quarters ended September 30, 2013 and 2012, estimated annual pension cost was reduced $0.4 million and $1.1 million, respectively, based on the completion of the final actuarial calculations. This change in estimate increased net income from continuing operations by $0.2 million ($0.01 per share) and $0.7 million ($0.02 per share) during the quarters and nine-month periods ended September 30, 2013 and 2012, respectively.

*Other Non-qualified Deferred Compensation Agreements*

We also are liable for deferred compensation agreements with former members of the board of directors and certain other former employees of a subsidiary of TXUCV, which was acquired in 2004. The benefits are payable for up to the life of the participant or to the beneficiary upon the death of the participant and may begin as early as age 55. Participants accrue no new benefits as these plans had previously been frozen by TXUCV s predecessor company prior to our acquisition of TXUCV. Payments related to the deferred compensation agreements totaled approximately $0.1 million for the three month periods ended September 30, 2013 and 2012 and $0.4 million for the nine-month periods ended September 30, 2013 and 2012. The net present value of the remaining obligations was approximately $1.8 million and $2.2 million at September 30, 2013 and December 31, 2012, respectively, and is included in pension and post-retirement benefit obligations in the accompanying balance sheets.

We also maintain 37 life insurance policies on certain of the participating former directors and employees. We recognized $0.2 million and $0.4 million in life insurance proceeds as other non-operating income in the three and nine-month periods ended September 30, 2012. We did not recognize any life insurance proceeds during the nine-month period ending September 30, 2013. The excess of the cash surrender value of the remaining life insurance policies over the notes payable balances related to these policies is determined by an independent consultant, and totaled $2.1 million at September 30, 2013 and $2.0 million at December 31, 2012. These amounts are included in investments in the accompanying condensed consolidated balance sheets. Cash principal payments for the policies and any proceeds from the policies are classified as operating activities in the condensed consolidated statements of cash flows.

*Post-retirement Benefit Obligations*

We sponsor a healthcare and life insurance plan ( Post-retirement Plan ) that provides post-retirement medical benefits and life insurance to certain groups of retired employees. Retirees share in the cost of healthcare benefits, making contributions that are adjusted periodically either

based upon collective bargaining agreements or because total costs of the program have changed. Covered expenses for retiree health benefits are paid as they are incurred. Post-retirement life insurance benefits are fully insured. The Post-retirement Plan is unfunded and has no assets, and benefits are paid from the general operating funds of the Company.

Table of Contents

In connection with the acquisition of SureWest, we acquired its post-retirement benefit plan which provides life insurance benefits and a stated reimbursement for Medicare supplemental insurance to certain eligible retired participants. This plan has previously been frozen so that no person is eligible to become a new participant. Employer contributions for retiree medical benefits are separately designated within the SureWest Plan pension trust for the sole purpose of providing payments of retiree medical benefits. The nature of the assets used to provide payment of retiree medical benefits is the same as that of the SureWest Plan.

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| *(In thousands)* | **2013** | **2012** | **2013** | **2012** |
| Service cost | $ 231 | $ 160 | $ 694 | $ 587 |
| Interest cost | 398 | 419 | 1,181 | 1,247 |
| Expected return on plan assets | (58) | - | (174) | - |
| Net prior service credit amortization | (45) | (46) | (135) | (141) |
| Net periodic postretirement benefit cost | $ 526 | $ 533 | $ 1,566 | $ 1,693 |

*Contributions*

We expect to contribute approximately $11.5 million to our pension plans and $2.4 million to our other post-retirement plans in 2013. As of September 30, 2013, we have contributed $8.8 million and $1.9 million of the annual contribution to the pension plans and other post-retirement plans, respectively.

**10. INCOME TAXES**

Our unrecognized tax benefits as of September 30, 2013 and December 31, 2012 were $0 and $1.2 million, respectively. Due to the expiration of a state statute of limitations, during the three months ended September 30, 2013 we recognized $1.2 million of our previously unrecognized tax benefits, which resulted in a decrease to our tax expense of approximately $0.8 million. In addition, due to the expiration of federal and state statute of limitations, during the current year quarter we also recorded a decrease in accrued interest of $0.2 million. The tax benefit attributable to the decrease in unrecognized tax benefits did not have a significant effect on our effective tax rate.

Our practice is to recognize interest and penalties related to income tax matters in interest expense and general and administrative expense, respectively. At September 30, 2013, we did not have a material liability for interest or penalties and had no material interest or penalty expense.

The periods subject to examination for our federal return are years 2009 through 2012. The periods subject to examination for our state returns are years 2005 through 2012. We are currently under examination by federal and state taxing authorities. We have received proposed assessments in connection with our federal examination for tax years ended December 31, 2010 and 2011. We are in the process of responding to the IRS and providing support for our tax position. We believe that once the factual issues are understood by the IRS, our tax position, more likely than not, will be upheld. Accordingly, the Company has not made any adjustments to its unrecognized tax benefits for the proposed assessments. We do not expect any settlement or payment that may result from the audits to have a material effect on our results of operations or cash flows.

Our effective tax rate was 28.9% and 67.1% for the three-month periods ended September 30, 2013 and 2012, respectively, and 36.3% and (114.2%) for the nine-month periods ended September 30, 2013 and 2012, respectively. The acquisition of SureWest on July 2, 2012 resulted in changes to our unitary state filings and correspondingly our state deferred income taxes. These changes resulted in a net decrease of $1.3 million to our net state deferred tax liabilities and a corresponding decrease to our state tax. In addition, we incurred non-deductible transaction costs in relation to the acquisition that resulted in an increase to our tax provision of $0.4 million. We recognized these changes in the three month period ended September 30, 2012. As discussed above, during the three months ended September 30, 2013, we recorded a decrease of $1.2 million to our unrecognized tax benefits, which reduced our tax expense by $0.8 million, due to the expiration of a state statute of limitations. We also recognized approximately $0.7 million of tax expense during the nine months ended September 30, 2013 to adjust our 2012 provision to match our 2012 returns, and approximately $0.2 million of tax benefit in the three month period ended September 30, 2012 to adjust our 2011 provision to match our 2011 returns. Exclusive of these adjustments, our effective tax rate for the nine months ended September 30, 2013 and 2012 would have been approximately 36.5% and 15.1%. The adjusted effective tax rate for the nine months ended September 20, 2012 differs from the federal and state statutory rates primarily due to the acquisition of SureWest, which resulted in changes to the Company s forecasted income, state income tax expense, and non-deductible expenses.

Table of Contents

**11. COMMITMENTS AND CONTINGENCIES**

On April 15, 2008, Salsgiver Inc., a Pennsylvania-based telecommunications company, and certain of its affiliates filed a lawsuit against us and our subsidiaries North Pittsburgh Telephone Company and North Pittsburgh Systems Inc. in the Court of Common Pleas of Allegheny County, Pennsylvania alleging that we have prevented Salsgiver from connecting their fiber optic cables to our utility poles. Salsgiver seeks compensatory and punitive damages as the result of alleged lost projected profits, damage to its business reputation, and other costs. Salsgiver originally claimed to have sustained losses of approximately $125 million and did not request a specific dollar amount in damages. We believe that these claims are without merit and that the alleged damages are completely unfounded. Discovery concluded and Consolidated filed a motion for summary judgment on June 18, 2012 and the court heard oral arguments on August 30, 2012. On February 12, 2013, the court granted, in part, Consolidated s motion. The court ruled that Salsgiver could not recover prejudgment interest and could not use as a basis of liability any actions prior to April 14, 2006. In September 2013, in order to avoid the distraction and uncertainty of further litigation, the Company reached an agreement in principle (the agreement ) with Salsgiver, Inc. In accordance with the terms of the agreement, the Company will pay Salsgiver approximately $0.9 million in cash and grant approximately $0.3 million in credits that may be used for make-ready charges (the Credits ). The Credits will be available for services performed in connection with the pole attachment applications within five years of the execution of the agreement. The Company had previously recorded approximately $0.4 million in 2011 in anticipation of the settlement of this case. During the quarter ended September 30, 2013, per the terms of the agreement the Company recorded an additional $0.9 million, which included estimated legal fees. The agreement is contingent on appropriate documentation and there is no assurance that the agreement will be finalized.

Two of our subsidiaries, Consolidated Communications of Pennsylvania Company LLC ( CCPA ) and Consolidated Communications Enterprise Services Inc. ( CCES ), received assessment notices from the Commonwealth of Pennsylvania Department of Revenue increasing the amounts owed for Pennsylvania Gross Receipt Taxes for the tax period ending December 31, 2009. These two assessments adjusted the subsidiaries combined total outstanding taxable gross receipts liability (with interest) to approximately $2.3 million. In addition, based upon recently completed audits of CCES for 2008, 2009 and 2010, we believe the Commonwealth of Pennsylvania may issue additional assessments totaling approximately $1.7 million for Gross Receipt Taxes allegedly owed. Our CCPA subsidiary has also been notified by the Commonwealth of Pennsylvania that they will conduct a gross receipts audit for the calendar year 2008. An appeal challenging the 2009 CCPA assessment was filed with the Department of Revenue s Board of Appeals on September 15, 2011, and we filed a similar appeal for CCES with the Board of Appeals on November 11, 2011 challenging the 2009 CCES assessment. The Board of Appeals denied CCPA and CCES s appeals. On November 13, 2012, CCPA and CCES filed appeals with the Commonwealth s Board of Finance and Revenue. These have been stayed pending the outcome of present litigation in the Commonwealth Court between Verizon Pennsylvania, Inc. and the Commonwealth of Pennsylvania (Verizon Pennsylvania, Inc. v. Commonwealth, Docket No. 266 F.R. 2008). The Gross Receipts Tax issues in the Verizon Pennsylvania case are substantially the same as those presently facing CCPA and CCES. In addition, there are numerous telecommunications carriers with Gross Receipts Tax matters dealing with the same issues that are in various stages of appeal before the Board of Finance and Revenue and the Commonwealth Court. Those appeals by other similarly situated telecommunications carriers have been continued until resolution of the Verizon Pennsylvania case. We believe that these assessments and the positions taken by the Commonwealth of Pennsylvania are without substantial merit. We do not believe that the outcome of these claims will have a material adverse impact on our financial results or cash flows.

We previously provided telephone service to inmates incarcerated at facilities operated by the Illinois Department of Corrections. On June 27, 2012, the Illinois Department of Central Management Services announced its intent to replace the Company as the provider of those services with a competitor, Securus Technologies, Inc. Since that decision, Securus has replaced the Company as the provider of telephone service at the Illinois Department of Corrections facilities. We challenged Securus bid, and the State s decision to accept that bid, in a variety of different forums including: (i) protests with the Chief Procurement Officer of the Illinois Executive Ethics Commission, which were denied, (ii) a lawsuit filed in the Circuit Court of Sangamon County, Illinois that was dismissed, but is now under appeal in the Illinois Appellate Court Fourth District, (iii) a declaratory ruling request

Table of Contents

filed with the Illinois Commerce Commission, which was granted on April 9, 2013 and which Securus has appealed to the Illinois Appellate Court First District and (iv) a complaint filed with the Illinois Procurement Policy Board. In each of those challenges, we claimed either that Securus was not a responsible vendor, as defined by the State s bid solicitation document, and/or that rates for the services Securus proposed to provide are subject to regulatory limits below those Securus proposed to charge. Our efforts to challenge our competitors bid and the States decision to accept the bid have not been successful. The process to transition these services to our competitor was complete during the quarter ended March 31, 2013. On September 13, 2013, we completed the sale of the assets and contractual rights (the asset purchase agreement ) to Securus for our remaining Prison Services business, which historically provided communications services to thirteen county jails located in Illinois. The asset purchase agreement resolved any pending legal matters between the Company and Securus.

On January 18, 2012, we filed a petition with the U.S. Court of Appeals for the District of Columbia Circuit to review the FCC s Order issued November 18, 2011 that reformed intercarrier compensation and core parts of the Universal Service Fund. We are appealing five core issues in the November 18, 2011 FCC order. The U.S. Court of Appeals for the tenth circuit will hear oral arguments on November 19, 2013.

In order for eligible telecommunications carriers ( ETCs ) to receive high-cost support, the USF/ICC Transformation Order requires states to certify on an annual basis that federal universal service high-cost support ( USF ) is used only for the provision, maintenance, and upgrading of facilities and services for which the support is intended . States, in turn, require that ETCs file certifications with them as the basis for the state filings with the FCC. Failure to meet the annual data and certification deadlines can result in reduced support to the ETC based on the length of the delay in certification. For the calendar year 2013, the state certification was due to be filed with the FCC on or before October 1, 2012. We were notified in January 2013 that SureWest did not submit the required certification to the CPUC in time to be included in its October 1, 2012, submission to the FCC. On January 24, 2013, we filed a certification with the CPUC and filed a petition with the FCC for a waiver of the filing deadline for the annual state certification. On February 19, 2013, the CPUC filed a certification with the FCC with respect to SureWest. On October 29, 2013, the Wireline Competition Bureau of the FCC denied our petition for a waiver of the annual certification deadline. The Order states that SureWest was not eligible to receive USF for the six month period ended June 30, 2013, which, if sustained upon review, could result in a decrease of previously accrued revenues of approximately $3.0 million. Management intends to apply for review of the decision made by the FCC staff by the full Commission. Management believes, based on the change in SureWest Telephone s USF filing status caused by the change in the ownership of SureWest Telephone, the lack of formal notice by the FCC regarding this change in filing status, the fact that SureWest Telephone had a previously-filed certification of compliance in effect with the FCC for the two quarters for which USF was withheld, and the FCC s past practice of granting waivers to accept late filings in similar situations, that the Company will likely prevail in its application to the Commission and receive USF funding for the period January 1, 2013, through June 30, 2013. Based on past history of the FCC regarding late filings, an assessment in the range of $8 thousand to $10 thousand for each quarter the filer is delinquent is standard practice.

We are from time to time involved in various other legal proceedings and regulatory actions arising out of our operations. We do not believe that any of these, individually or in the aggregate, will have a material adverse effect upon our business, operating results or financial condition.

**12. CONDENSED CONSOLIDATING FINANCIAL INFORMATION**

Consolidated Communications, Inc. is the primary obligor under the unsecured Senior Notes it issued on May 30, 2012. We and the following of our subsidiaries: Consolidated Communications Enterprise Services, Inc., Consolidated Communications Services Company, Consolidated Communications of Fort Bend Company, Consolidated Communications of Texas Company, Consolidated Communications of Pennsylvania Company, LLC, SureWest Communications, Inc., SureWest Broadband, SureWest Communications, SureWest Long Distance, SureWest Telephone, SureWest TeleVideo, SureWest Kansas, Inc., SureWest Kansas Holdings, Inc., SureWest Fiber Ventures, LLC, SureWest Kansas Connections, LLC, SureWest Kansas Licenses, LLC, SureWest Kansas Operations, LLC and SureWest Kansas Purchasing, LLC, have jointly and severally guaranteed the Senior Notes. All of the subsidiary guarantors are 100% direct or indirect wholly owned subsidiaries of the parent, and all guarantees are full, unconditional and joint and several with respect to principal, interest and liquidated damages, if any. As such, we present condensed consolidating balance sheets as of September 30, 2013 and December 31, 2012, condensed consolidating statements of

operations for the quarters and nine-month periods ended September 30, 2013 and 2012 and condensed consolidating statements of cash flows for the nine months ended September 30, 2013 and 2012 for each of Consolidated Communications Holdings, Inc. (Parent), Consolidated Communications, Inc. (Subsidiary Issuer), guarantor subsidiaries and other non-guarantor subsidiaries with any consolidating adjustments. See Note 6 for more information regarding our Senior Notes.

Table of Contents

**Condensed Consolidating Balance Sheet**

*(amounts in thousands)*

| | September 30, 2013 | | | | | |
|---|---|---|---|---|---|---|
| | Parent | Subsidiary Issuer | Guarantors | Non-Guarantors | Eliminations | Consolidated |
| **ASSETS** | | | | | | |
| Current assets: | | | | | | |
| Cash and cash equivalents | $ - | $ 818 | $ 3,827 | $ 1,646 | $ - | $ 6,291 |
| Accounts receivable, net | - | 377 | 48,794 | 7,678 | - | 56,849 |
| Income taxes receivable | 40,233 | - | - | - | (38,687) | 1,546 |
| Deferred income taxes | (2) | 1,614 | 9,048 | 632 | | 11,292 |
| Prepaid expenses and other current assets | - | - | 12,798 | 469 | - | 13,267 |
| Total current assets | 40,231 | 2,809 | 74,467 | 10,425 | (38,687) | 89,245 |
| Property, plant and equipment, net | - | - | 839,184 | 51,822 | - | 891,006 |
| Intangibles and other assets: | | | | | | |
| Investments | - | 3,687 | 109,211 | 15 | - | 112,913 |
| Investments in subsidiaries | 1,041,110 | 278,375 | 11,926 | - | (1,331,411) | - |
| Goodwill | - | - | 537,265 | 66,181 | - | 603,446 |
| Other intangible assets | - | - | 33,452 | 9,087 | - | 42,539 |
| Deferred debt issuance costs, net and other assets | - | 10,625 | 4,690 | - | - | 15,315 |
| Total assets | $ 1,081,341 | $ 295,496 | $ 1,610,195 | $ 137,530 | $ (1,370,098) | $ 1,754,464 |
| **LIABILITIES AND SHAREHOLDERS EQUITY** | | | | | | |
| Current liabilities: | | | | | | |
| Accounts payable | $ - | $ - | $ 8,060 | $ - | $ - | $ 8,060 |
| Advance billings and customer deposits | - | - | 24,050 | 2,343 | - | 26,393 |
| Dividends payable | 15,538 | - | - | - | - | 15,538 |
| Accrued compensation | - | - | 17,233 | 1,657 | - | 18,890 |
| Accrued interest | - | 11,082 | 13 | 4 | - | 11,099 |
| Accrued expense | 49 | - | 33,441 | 1,639 | - | 35,129 |
| Income tax payable | - | 10,348 | 26,294 | 7,441 | (38,687) | 5,396 |
| Current portion of long term debt and capital lease obligations | - | 9,241 | 567 | 62 | - | 9,870 |
| Liabilities of discontinued operations | - | - | 179 | - | - | 179 |
| Total current liabilities | 15,587 | 30,671 | 109,837 | 13,146 | (38,687) | 130,554 |
| Long-term debt and capital lease obligations | - | 1,197,523 | 3,812 | 829 | - | 1,202,164 |
| Advances due to/from affiliates, net | 940,841 | (1,973,822) | 1,065,599 | (32,618) | - | - |
| Deferred income taxes | 5,095 | (2,896) | 131,453 | 9,138 | | 142,790 |
| Pension and postretirement benefit obligations | - | - | 119,587 | 24,334 | - | 143,921 |
| Other long-term liabilities | 76 | 2,910 | 7,595 | 283 | - | 10,864 |
| Total liabilities | 961,599 | (745,614) | 1,437,883 | 15,112 | (38,687) | 1,630,293 |
| Shareholders equity: | | | | | | |
| Common Stock | 401 | - | 17,411 | 30,000 | (47,411) | 401 |
| Other shareholders equity | 119,341 | 1,041,110 | 150,472 | 92,418 | (1,284,000) | 119,341 |
| Total Consolidated Communications Holdings, Inc. shareholders equity | 119,742 | 1,041,110 | 167,883 | 122,418 | (1,331,411) | 119,742 |
| Noncontrolling interest | - | - | 4,429 | - | - | 4,429 |
| Total shareholders equity | 119,742 | 1,041,110 | 172,312 | 122,418 | (1,331,411) | 124,171 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Total liabilities and shareholders equity | $ 1,081,341 | $ 295,496 | $ 1,610,195 | $ 137,530 | $ (1,370,098) | $ 1,754,464 |

Table of Contents

**Condensed Consolidating Balance Sheet**

*(amounts in thousands)*

| | December 31, 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Parent | Subsidiary Issuer | Guarantors | Non-Guarantors | Eliminations | Consolidated |
| **ASSETS** | | | | | | |
| Current assets: | | | | | | |
| Cash and cash equivalents | $ - | $ 6,577 | $ 8,530 | $ 2,747 | $ - | $ 17,854 |
| Accounts receivable, net | 19 | 457 | 49,483 | 7,998 | - | 57,957 |
| Income taxes receivable | 4,258 | - | 7,886 | (124) | - | 12,020 |
| Deferred income taxes | (51) | (310) | 8,969 | 376 | - | 8,984 |
| Prepaid expenses and other current assets | - | - | 10,855 | 414 | - | 11,269 |
| Assets of discontinued operations | - | - | 1,772 | - | - | 1,772 |
| Total current assets | 4,226 | 6,724 | 87,495 | 11,411 | - | 109,856 |
| Property, plant and equipment, net | - | - | 855,158 | 52,514 | - | 907,672 |
| Intangibles and other assets: | | | | | | |
| Investments | - | 3,641 | 106,094 | 15 | - | 109,750 |
| Investments in subsidiaries | 958,199 | 219,955 | 11,234 | - | (1,189,388) | - |
| Goodwill | - | - | 537,265 | 66,181 | - | 603,446 |
| Other intangible assets | - | - | 40,443 | 9,087 | - | 49,530 |
| Deferred debt issuance costs, net and other assets | - | 12,788 | 1,012 | - | - | 13,800 |
| Total assets | $ 962,425 | $ 243,108 | $ 1,638,701 | $ 139,208 | $ (1,189,388) | $ 1,794,054 |
| **LIABILITIES AND SHAREHOLDERS EQUITY** | | | | | | |
| Current liabilities: | | | | | | |
| Accounts payable | $ - | $ - | $ 14,954 | $ - | $ - | $ 14,954 |
| Advance billings and customer deposits | - | - | 25,131 | 2,523 | - | 27,654 |
| Dividends payable | 15,463 | - | - | - | - | 15,463 |
| Accrued compensation | 36 | - | 19,863 | 2,013 | - | 21,912 |
| Accrued interest | - | 2,943 | 14 | 5 | - | 2,962 |
| Accrued expense | 235 | 430 | 39,659 | 3,939 | - | 44,263 |
| Current portion of long term debt and capital lease obligations | - | 9,242 | 300 | 54 | - | 9,596 |
| Current portion of derivative liability | - | 3,164 | - | - | - | 3,164 |
| Liabilities of discontinued operations | - | - | 4,209 | - | - | 4,209 |
| Total current liabilities | 15,734 | 15,779 | 104,130 | 8,534 | - | 144,177 |
| Long-term debt and capital lease obligations | - | 1,203,760 | 3,611 | 877 | - | 1,208,248 |
| Advances due to/from affiliates, net | 817,118 | (1,934,978) | 1,137,159 | (19,299) | - | - |
| Deferred income taxes | (2,357) | (3,571) | 135,117 | 8,879 | - | 138,068 |
| Pension and postretirement benefit obligations | - | - | 125,706 | 31,004 | - | 156,710 |
| Other long-term liabilities | - | 3,919 | 6,587 | 240 | - | 10,746 |
| Total liabilities | 830,495 | (715,091) | 1,512,310 | 30,235 | - | 1,657,949 |
| Shareholders equity: | | | | | | |
| Common Stock | 399 | - | 17,411 | 30,000 | (47,411) | 399 |
| Other shareholders equity | 131,531 | 958,199 | 104,805 | 78,973 | (1,141,977) | 131,531 |
| Total Consolidated Communications Holdings, Inc. shareholders equity | 131,930 | 958,199 | 122,216 | 108,973 | (1,189,388) | 131,930 |
| Noncontrolling interest | - | - | 4,175 | - | - | 4,175 |
| Total shareholders equity | 131,930 | 958,199 | 126,391 | 108,973 | (1,189,388) | 136,105 |
| Total liabilities and shareholders equity | $ 962,425 | $ 243,108 | $ 1,638,701 | $ 139,208 | $ (1,189,388) | $ 1,794,054 |

Table of Contents

**Condensed Consolidating Statements of Operations**

*(amounts in thousands)*

| | Quarter Ended September 30, 2013 | | | | | |
|---|---|---|---|---|---|---|
| | Parent | Subsidiary Issuer | Guarantors | Non-Guarantors | Eliminations | Consolidated |
| Net revenues | $ - | $ (56) | $ 137,394 | $ 16,961 | $ (3,526) | $ 150,773 |
| Operating expenses: | | | | | | |
| Cost of services and products (exclusive of depreciation and amortization) | - | - | 55,257 | 3,742 | (3,219) | 55,780 |
| Selling, general and administrative expenses | 872 | 39 | 28,457 | 4,654 | (307) | 33,715 |
| Financing and other transaction costs | 36 | - | 319 | - | - | 355 |
| Depreciation and amortization | - | - | 32,478 | 2,278 | - | 34,756 |
| Operating income (loss) | (908) | (95) | 20,883 | 6,287 | - | 26,167 |
| Other income (expense): | | | | | | |
| Interest expense, net of interest income | 55 | (20,879) | 172 | 20 | - | (20,632) |
| Intercompany interest income (expense) | (27,199) | 32,585 | (5,785) | 399 | - | - |
| Investment income | - | 42 | 9,645 | - | - | 9,687 |
| Equity in earnings of subsidiaries, net | 30,243 | 19,378 | 170 | - | (49,791) | - |
| Other, net | - | - | (696) | 9 | - | (687) |
| Income (loss) from continuing operations before income taxes | 2,191 | 31,031 | 24,389 | 6,715 | (49,791) | 14,535 |
| Income tax expense (benefit) | (9,503) | 788 | 10,464 | 2,456 | - | 4,205 |
| Income (loss) from continuing operations | 11,694 | 30,243 | 13,925 | 4,259 | (49,791) | 10,330 |
| Discontinued operations, net of tax | - | - | 1,425 | - | - | 1,425 |
| Net income (loss) | 11,694 | 30,243 | 15,350 | 4,259 | (49,791) | 11,755 |
| Less: net income attributable to noncontrolling interest | - | - | 61 | - | - | 61 |
| Net income (loss) attributable to Consolidated Communications Holdings, Inc. | $ 11,694 | $ 30,243 | $ 15,289 | $ 4,259 | $ (49,791) | $ 11,694 |
| Total comprehensive income (loss) attributable to common shareholders | $ 11,694 | $ 30,392 | $ 15,591 | $ 4,390 | $ (49,791) | $ 12,276 |

| | Quarter Ended September 30, 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Parent | Subsidiary Issuer | Guarantors | Non-Guarantors | Eliminations | Consolidated |
| Net revenues | $ - | $ (23) | $ 137,679 | $ 16,939 | $ (3,570) | $ 151,025 |
| Operating expenses: | | | | | | |
| Cost of services and products (exclusive of depreciation and amortization) | - | - | 55,731 | 3,281 | (3,570) | 55,442 |
| Selling, general and administrative expenses | 648 | 23 | 29,952 | 4,110 | - | 34,733 |
| Financing and other transaction costs | 9,880 | 4,645 | - | - | - | 14,525 |
| Depreciation and amortization | - | - | 34,920 | 3,220 | - | 38,140 |
| Operating income (loss) | (10,528) | (4,691) | 17,076 | 6,328 | - | 8,185 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Other income (expense): | | | | | | |
| Interest expense, net of interest income | - | (20,528) | (80) | (16) | - | (20,624) |
| Intercompany interest income (expense) | (11,466) | 21,971 | (10,628) | 123 | - | - |
| Investment income | - | 61 | 8,168 | - | - | 8,229 |
| Equity in earnings of subsidiaries, net | 7,142 | 14,244 | 326 | - | (21,712) | - |
| Other, net | - | - | 241 | (9) | - | 232 |
| Income (loss) from continuing operations before income taxes | (14,852) | 11,057 | 15,103 | 6,426 | (21,712) | (3,978) |
| Income tax expense (benefit) | (13,887) | 3,915 | 3,709 | 3,596 | - | (2,667) |
| Income (loss) from continuing operations | (965) | 7,142 | 11,394 | 2,830 | (21,712) | (1,311) |
| Discontinued operations, net of tax | - | - | 467 | - | - | 467 |
| Net income (loss) | (965) | 7,142 | 11,861 | 2,830 | (21,712) | (844) |
| Less: net income attributable to noncontrolling interest | - | - | 121 | - | - | 121 |
| Net income (loss) attributable to Consolidated Communications Holdings, Inc. | $ (965) | $ 7,142 | $ 11,740 | $ 2,830 | $ (21,712) | $ (965) |
| Total comprehensive income (loss) attributable to common shareholders | $ (965) | $ 8,720 | $ 11,781 | $ 2,849 | $ (21,712) | $ 673 |

Table of Contents

**Condensed Consolidating Statements of Operations**

*(amounts in thousands)*

| | Nine Months Ended September 30, 2013 | | | | | |
|---|---|---|---|---|---|---|
| | Parent | Subsidiary Issuer | Guarantors | Non-Guarantors | Eliminations | Consolidated |
| Net revenues | $ - | $ (82) | $ 412,996 | $ 51,349 | $ (10,642) | $ 453,621 |
| Operating expenses: | | | | | | |
| Cost of services and products (exclusive of depreciation and amortization) | - | - | 165,599 | 10,919 | (9,744) | 166,774 |
| Selling, general and administrative expenses | 2,561 | 132 | 84,541 | 14,049 | (898) | 100,385 |
| Financing and other transaction costs | 393 | - | 319 | - | - | 712 |
| Depreciation and amortization | - | - | 97,547 | 6,759 | - | 104,306 |
| Operating income (loss) | (2,954) | (214) | 64,990 | 19,622 | - | 81,444 |
| Other income (expense): | | | | | | |
| Interest expense, net of interest income | 48 | (66,048) | 43 | 28 | - | (65,929) |
| Intercompany interest income (expense) | (75,966) | 94,455 | (19,364) | 875 | - | - |
| Investment income | - | 47 | 27,117 | - | - | 27,164 |
| Equity in earnings of subsidiaries, net | 78,402 | 57,037 | 691 | - | (136,130) | - |
| Other, net | (18) | - | (694) | - | - | (712) |
| Income (loss) from continuing operations before income taxes | (488) | 85,277 | 72,783 | 20,525 | (136,130) | 41,967 |
| Income tax expense (benefit) | (28,159) | 6,875 | 28,979 | 7,524 | - | 15,219 |
| Income (loss) from continuing operations | 27,671 | 78,402 | 43,804 | 13,001 | (136,130) | 26,748 |
| Discontinued operations, net of tax | - | - | 1,177 | - | - | 1,177 |
| Net income (loss) | 27,671 | 78,402 | 44,981 | 13,001 | (136,130) | 27,925 |
| Less: net income attributable to noncontrolling interest | - | - | 254 | - | - | 254 |
| Net income (loss) attributable to Consolidated Communications Holdings, Inc. | $ 27,671 | $ 78,402 | $ 44,727 | $ 13,001 | $ (136,130) | $ 27,671 |
| Total comprehensive income (loss) attributable to common shareholders | $ 27,671 | $ 81,528 | $ 45,665 | $ 13,444 | $ (136,130) | $ 32,178 |

| | Nine Months Ended September 30, 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Parent | Subsidiary Issuer | Guarantors | Non-Guarantors | Eliminations | Consolidated |
| Net revenues | $ - | $ - | $ 283,478 | $ 51,169 | $ (10,614) | $ 324,033 |
| Operating expenses: | | | | | | |
| Cost of services and products (exclusive of depreciation and amortization) | - | - | 118,356 | 10,773 | (10,614) | 118,515 |
| Selling, general and administrative expenses | 1,818 | 79 | 58,418 | 12,222 | - | 72,537 |
| Financing and other transaction costs | 10,698 | 9,211 | - | - | - | 19,909 |
| Depreciation and amortization | - | - | 71,377 | 10,445 | - | 81,822 |
| Operating income (loss) | (12,516) | (9,290) | 35,327 | 17,729 | - | 31,250 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Other income (expense): | | | | | | |
| Interest expense, net of interest income | (20) | (51,393) | (647) | (57) | - | (52,117) |
| Intercompany interest income (expense) | (33,715) | 62,301 | (28,901) | 315 | - | - |
| Investment income | - | 185 | 21,267 | 5 | - | 21,457 |
| Equity in earnings of subsidiaries, net | 27,025 | 31,231 | 989 | - | (59,245) | - |
| Other, net | - | 1 | 449 | (19) | - | 431 |
| Income (loss) from continuing operations before income taxes | (19,226) | 33,035 | 28,484 | 17,973 | (59,245) | 1,021 |
| Income tax expense (benefit) | (22,806) | 6,010 | 7,870 | 7,760 | - | (1,166) |
| Income (loss) from continuing operations | 3,580 | 27,025 | 20,614 | 10,213 | (59,245) | 2,187 |
| Discontinued operations, net of tax | - | - | 1,759 | - | - | 1,759 |
| Net income (loss) | 3,580 | 27,025 | 22,373 | 10,213 | (59,245) | 3,946 |
| Less: net income attributable to noncontrolling interest | - | - | 366 | - | - | 366 |
| Net income (loss) attributable to Consolidated Communications Holdings, Inc. | $ 3,580 | $ 27,025 | $ 22,007 | $ 10,213 | $ (59,245) | $ 3,580 |
| Total comprehensive income (loss) attributable to common shareholders | $ 3,580 | $ 30,187 | $ 22,643 | $ 10,534 | $ (59,245) | $ 7,699 |

Table of Contents

**Condensed Consolidating Statements of Cash Flows**

*(amounts in thousands)*

| | Nine Months Ended September 30, 2013 | | | | |
|---|---|---|---|---|---|
| | Parent | Subsidiary Issuer | Guarantors | Non-Guarantors | Consolidated |
| Net cash (used in) provided by continuing operations | $ (77,198) | $ 40,016 | $ 143,053 | $ 18,182 | $ 124,053 |
| Net cash used in discontinued operations | - | - | (3,412) | - | (3,412) |
| Net cash (used in) provided by operating activities | (77,198) | 40,016 | 139,641 | 18,182 | 120,641 |
| Cash flows from investing activities: | | | | | |
| Purchases of property, plant and equipment | - | - | (74,643) | (5,941) | (80,584) |
| Other | - | - | (144) | 17 | (127) |
| Net cash used in continuing operations | - | - | (74,787) | (5,924) | (80,711) |
| Net cash provided by discontinued operations | | | 2,331 | - | 2,331 |
| Net cash used in investing activities | - | - | (72,456) | (5,924) | (78,380) |
| Cash flows from financing activities: | | | | | |
| Proceeds from issuance of long-term debt | - | 57,000 | - | - | 57,000 |
| Payment of capital lease obligation | - | - | (328) | (40) | (368) |
| Payment on long-term debt | - | (63,930) | - | | (63,930) |
| Dividends on common stock | (46,526) | - | - | | (46,526) |
| Transactions with affiliates, net | 123,724 | (38,845) | (71,560) | (13,319) | - |
| Net cash provided by (used in) financing activities | 77,198 | (45,775) | (71,888) | (13,359) | (53,824) |
| Decrease in cash and cash equivalents | - | (5,759) | (4,703) | (1,101) | (11,563) |
| Cash and cash equivalents at beginning of period | - | 6,577 | 8,530 | 2,747 | 17,854 |
| Cash and cash equivalents at end of period | $ - | $ 818 | $ 3,827 | $ 1,646 | $ 6,291 |

| | Nine Months Ended September 30, 2012 | | | | |
|---|---|---|---|---|---|
| | Parent | Subsidiary Issuer | Guarantors | Non-Guarantors | Consolidated |
| Net cash (used in) provided by continuing operations | $ (38,017) | $ 11,911 | $ 78,856 | $ 17,950 | $ 70,700 |
| Net cash provided by discontinued operations | - | - | 1,200 | - | 1,200 |
| Net cash (used in) provided by operating activities | (38,017) | 11,911 | 80,056 | 17,950 | 71,900 |
| Cash flows from investing activities: | | | | | |
| Business acquisition, net of cash acquired | (377,021) | - | - | - | (377,021) |
| Purchases of property, plant and equipment | - | - | (45,646) | (4,677) | (50,323) |
| Other | (314) | - | 379 | 36 | 101 |
| Net cash used in continuing operations | (377,335) | - | (45,267) | (4,641) | (427,243) |
| Net cash used in discontinued operations | - | - | (97) | - | (97) |
| Net cash used in investing activities | (377,335) | - | (45,364) | (4,641) | (427,340) |
| Cash flows from financing activities: | | | | | |
| Proceeds on bond offering | - | 298,035 | - | - | 298,035 |
| Proceeds from issuance of long-term debt | - | 35,000 | - | - | 35,000 |
| Payment of capital lease obligation | - | - | (108) | (32) | (140) |
| Payment on long-term debt | - | (6,600) | - | - | (6,600) |
| Payment of financing costs | - | (13,147) | - | - | (13,147) |
| Dividends on common stock | (38,637) | - | - | - | (38,637) |
| Transactions with affiliates, net | 453,989 | (415,911) | (25,545) | (12,533) | - |
| | 415,352 | (102,623) | (25,653) | (12,565) | 274,511 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Net cash provided by (used in) financing activities | - | (90,712) | 9,039 | 744 | | (80,929) |
| (Decrease) increase in cash and cash equivalents | - | 103,369 | 80 | 2,255 | | 105,704 |
| Cash and cash equivalents at beginning of period | $ - | $ 12,657 | $ 9,119 | $ 2,999 | $ | 24,775 |
| Cash and cash equivalents at end of period | | | | | | |

Table of Contents

**ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

Certain statements included in this report, including that which relates to the impact on future revenue sources, pending and future regulatory orders, continued expansion of the telecommunications network and expected changes in the sources of our revenue and cost structure resulting from our entrance into new communications markets, are forward-looking statements and are made pursuant to the safe harbor provisions of the Securities Litigation Reform Act of 1995. These forward looking statements reflect, among other things, our expectations, plans, strategies, and anticipated financial results. There are a number of risks, uncertainties, and conditions that may cause our actual results to differ materially from those expressed or implied by these forward looking statements. Many of these circumstances are beyond our ability to control or predict. Moreover, forward looking statements necessarily involve assumptions on our part. These forward looking statements generally are identified by the words believe , expect , anticipate , estimate , intend , should , may , will , would , will be , will continue or similar expres looking statements involve known and unknown risks, the impact of current economic conditions, uncertainties and other factors that may cause actual results, performance or achievements of Consolidated Communications Holdings, Inc. and its subsidiaries ( Consolidated , the Company , we or our ) to be different from those expressed or implied in the forward looking statements. All forward looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements that appear throughout this report. A detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from such forward looking statements is included in our 2012 Annual Report on Form 10-K filed with the Securities and Exchange Commission ( SEC ). Furthermore, forward-looking statements speak only as of the date they are made. Except as required under the federal securities laws or the rules and regulations of the Securities and Exchange Commission, we disclaim any intention or obligation to update or revise publicly any forward-looking statements. You should not place undue reliance on forward-looking statements. Management s Discussion and Analysis ( MD&A ) should be read in conjunction with our unaudited condensed consolidated financial statements and accompanying notes to the financial statements ( Notes ) as of and for the nine months ended September 30, 2013 included in Item 1 of this Quarterly Report on Form 10-Q.

Throughout MD&A, we refer to measures that are not a measure of financial performance in accordance with United States generally accepted accounting principles ( US GAAP or GAAP ). We believe the use of these non-GAAP measures on a consolidated and segment basis provides the reader with additional information that is useful in understanding our operating results and trends. These measures should be viewed in addition to, rather than as a substitute for, those measures prepared in accordance with GAAP. See the Non-GAAP Measures section below for a more detailed discussion on the use and calculation of these measures.

**Overview**

We are an established telecommunications services company providing a wide range of telecommunications services to residential and business customers in Illinois, Texas, Pennsylvania, California, Kansas and Missouri. We offer a wide range of telecommunications services, including local and long-distance service, high-speed broadband Internet access, video services, digital telephone service ( VOIP ), custom calling features, private line services, carrier grade access services, network capacity services over our regional fiber optic networks, directory publishing, Competitive Local Exchange Carrier ( CLEC ) services and equipment sales.

We generate the majority of our consolidated operating revenues primarily from subscriptions to our voice, video and data services ( broadband services ) to residential and business customers. Revenues increased $129.6 million during the nine months ended September 30, 2013 compared to the same period in 2012, primarily from the SureWest acquisition and growth in data, video and Internet connections. We expect our broadband service revenues to continue to grow as consumer and business demands for data based services increase.

We market our services to residential and business customers, either individually or as a bundled package. Our triple play bundle includes our voice, video and data services. As of September 30, 2013, our video service was available to approximately 529,000 homes in the markets we serve. As of September 30, 2013, approximately 21% of the marketable homes in the areas we serve subscribe to our video service. Data and Internet connections continue to increase as a result of enhanced product and service offerings, such as our consumer VOIP service and data speeds of up to 50 megabits per second, depending on the geographic market availability. As of September 30, 2013, approximately 30% of the homes in the areas we serve subscribe to our data service.

Table of Contents

The increase in our operating revenues during the quarter and nine months ended September 30, 2013 was offset in part by an anticipated industry wide trend of a decline in access lines and related use of services. Many consumers are choosing to subscribe to alternative communications services and competition for these subscribers continues to increase. Progressively, consumers are utilizing over-the-top services to download and watch television shows of interest to them on their computers. Competition from wireless providers, competitive local exchange carriers and in some cases cable television providers has increased in recent years in the markets we serve. We have been able to mitigate some of the access line losses through marketing initiatives and product offerings, such as our VOIP service.

As discussed in the Regulatory Matters section below, our operating revenues are also impacted by legislative or regulatory changes at the federal and state levels, which could reduce or eliminate the current subsidies revenue we receive. A number of proceedings and recent orders relate to universal service reform, intercarrier compensation and network access charges. There are various ongoing legal challenges to the orders that have been issued. As a result, it is not yet possible to determine fully the impact of the regulatory changes on our operations.

**Significant Recent Developments**

*Merger With SureWest Communications*

On July 2, 2012, we completed the merger with SureWest Communications ( SureWest ), which resulted in the acquisition of 100% of all the outstanding shares of SureWest for $23.00 per share in a cash and stock transaction. The acquisition of SureWest provides additional diversification of the Company s revenues and cash flows both geographically and by service type, which offers a platform for future growth and is expected to generate operational and capital cost synergies. SureWest provides a wide range of telecommunications, digital video, Internet, data and other facilities-based communications services in Northern California, primarily in the greater Sacramento region, and in the greater Kansas City, Kansas and Missouri areas. For the year ended December 31, 2011, SureWest reported $248.1 million in total operating revenues. For the six months ended June 30, 2012, SureWest generated $127.9 million in operating revenues. The total purchase price of $550.8 million, consisted of cash and assumed debt of $402.4 million and 9,965,983 shares of the Company s common stock valued at the Company s opening stock price on July 2, 2012 of $14.89, which totaled $148.4 million. The cash portion of the merger consideration and the funds required to repay SureWest outstanding debt was financed with the sale of $300.0 million in aggregate principal amount of 10.875% Senior Notes due 2020 ( Senior Notes ). The Company also used cash on hand and approximately $35.0 million in borrowings from its revolving credit facility. Because the acquisition closed on July 2, 2012, the Company s financial information does not include any of the results of operations from SureWest prior to the acquisition date.

*Segment Reporting*

Historically, we have classified our operations into two separate reportable business segments: Telephone Operations and Other Operations. Our Telephone Operations consisted of a wide range of telecommunications services to residential and business customers, including local and long-distance service, high-speed broadband Internet access, video services, VOIP services, custom calling features, private line services, carrier access services, network capacity services over a regional fiber optic network, mobile services and directory publishing. Our Other Operations segment operated two complementary non-core businesses including telephone services to state and county correctional facilities ( Prison Services ) and equipment sales. As discussed below, our contract to provide telephone services to correctional facilities operated by the Illinois Department of Corrections was not renewed and the process of transitioning these services to another service provider was completed during the quarter ended March 31, 2013. The remaining prison services assets and operations were classified as discontinued operations during the quarter ended June 30, 2013 and subsequently sold during the quarter ended September 30, 2013, as discussed below. Prison Services comprised nearly all of the Other Operations segment revenue and results of operations. Consequently, with the cessation of our Prison Services business and

based on the segment accounting guidance, the Company concluded that we operate as one segment as of the quarter ended June 30, 2013. As required by the authoritative guidance for segment presentation, segment results of operations have been retrospectively adjusted to reflect this change for all periods presented.

Table of Contents

*Prison Services Contract*

We previously provided telephone service to inmates incarcerated at facilities operated by the Illinois Department of Corrections. On June 27, 2012, the Illinois Department of Central Management Services announced its intent to replace us as the provider of those services with a competitor. Although we challenged our competitor s bid and the State s decision to accept that bid in a variety of different forums, during the quarter ended March 31, 2013, the process of transitioning these services to another service provider was completed. All related assets have been assessed for recoverability in light of this change and we determined that no impairment was necessary. During 2012, the prison services contract comprised 5% of consolidated operating revenues and approximately 2% of consolidated operating income, excluding financing and other transaction fees.

*Discontinued Operations*

On September 13, 2013, we completed the sale of the assets and contractual rights used to provide communications services to thirteen county jails located in Illinois. The sale was completed for an aggregate purchase price of $2.5 million, resulting in a gain of $1.3 million, net of tax. The financial results of the operations for Prison Services, which were previously reported in the Other Operations segment, have been reported as discontinued operations in our condensed consolidated financial statements for all periods presented.

**Results of Operations**

The following tables reflect our financial results on a consolidated basis and key operating metrics as of and for the quarters and nine months ended September 30, 2013 and 2012.

**Financial Data**

| | Quarter Ended September 30, | | | | Nine Months Ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| *(In millions, except for percentages)* | 2013 | 2012 | $ Change | % Change | 2013 | 2012 | $ Change | % Change |
| Operating Revenues | | | | | | | | |
| Local calling services | $ 27.0 | $ 27.1 | $ (0.1) | (0) % | $ 79.9 | $ 66.7 | $ 13.2 | 20 % |
| Network access services | 26.9 | 29.5 | (2.6) | (9) | 85.4 | 68.9 | 16.5 | 24 |
| Video, Data and Internet services | 68.2 | 65.1 | 3.1 | 5 | 202.1 | 109.8 | 92.3 | 84 |
| Subsidies | 13.7 | 12.7 | 1.0 | 8 | 40.6 | 35.4 | 5.2 | 15 |
| Long-distance services | 4.8 | 5.4 | (0.6) | (11) | 14.6 | 12.4 | 2.2 | 18 |
| Other services | 10.2 | 11.2 | (1.0) | (9) | 31.0 | 30.8 | 0.2 | 1 |
| Total operating revenue | 150.8 | 151.0 | (0.2) | (0) | 453.6 | 324.0 | 129.6 | 40 |
| Expenses | | | | | | | | |
| Cost of services and products | 55.8 | 55.4 | 0.4 | 1 | 166.8 | 118.5 | 48.3 | 41 |
| Selling, general and administrative costs | 33.7 | 34.7 | (1.0) | (3) | 100.4 | 72.5 | 27.9 | 38 |
| Financing and other transaction costs | 0.3 | 14.5 | (14.2) | (98) | 0.7 | 19.9 | (19.2) | (96) |
| Depreciation and amortization | 34.8 | 38.2 | (3.4) | (9) | 104.3 | 81.8 | 22.5 | 28 |
| Total operating expenses | 124.6 | 142.8 | (18.2) | (13) | 372.2 | 292.7 | 79.5 | 27 |
| Income from operations | 26.2 | 8.2 | 18.0 | 220 | 81.4 | 31.3 | 50.1 | 160 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Interest expense, net | (20.6) | (20.6) | - | 0 | (65.9) | (52.1) | (13.8) | (26) | | |
| Other income | 9.0 | 8.4 | 0.6 | 7 | 26.5 | 21.8 | 4.7 | 22 | | |
| Income tax expense | 4.2 | (2.7) | 6.9 | 256 | 15.2 | (1.2) | 16.4 | 1,367 | | |
| Income (loss) from continuing operations | 10.4 | (1.3) | 11.7 | 900 | 26.8 | 2.2 | 24.6 | 1,118 | | |
| Income from discontinued operations, net of tax | 1.4 | 0.5 | 0.9 | 180 | 1.2 | 1.8 | (0.6) | (33) | | |
| Net income attributable to noncontrolling interest | 0.1 | 0.1 | - | 0 | 0.3 | 0.4 | (0.1) | (25) | | |
| Net income (loss) attributable to common shareholders | $ 11.7 | $ (0.9) | $ 12.6 | 1,400 | $ 27.7 | $ 3.6 | $ 24.1 | 669 | | |
| Adjusted EBITDA (1) | $ 71.2 | $ 69.9 | $ 1.3 | 2 % | $ 216.5 | $ 158.7 | $ 57.8 | 36 % | | |

(1) A non-GAAP measure. See the Non-GAAP Measures section below for additional information and reconciliation to the most directly comparable GAAP measure.

Table of Contents

**Key Operating Statistics**

| | As of September 30, | | | |
|---|---|---|---|---|
| | **2013** | **2012** | **Change** | **% Change** |
| **ILEC access lines** | | | | |
| Residential | 148,811 | 155,274 | (6,463) | (4) % |
| Business | 110,794 | 115,686 | (4,892) | (4) |
| Total | 259,605 | 270,960 | (11,355) | (4) |
| **Voice connections (1)** | | | | |
| Residential | 74,588 | 80,097 | (5,509) | (7) |
| Business | 49,830 | 51,360 | (1,530) | (3) |
| Total | 124,418 | 131,457 | (7,039) | (5) |
| **Data and internet connections (2)** | 252,516 | 246,817 | 5,699 | 2 |
| **Video connections (2)** | 109,882 | 105,202 | 4,680 | 4 |
| **Total connections** | 746,421 | 754,436 | (8,015) | (1) |

(1)Voice connections include voice lines outside the Incumbent Local Exchange Carrier ( ILEC ) service areas and Voice-over-IP inside the ILEC service areas.

(2)These connections include both residential and business (excluding SureWest business metrics) for services both inside and outside the ILEC service areas.

The comparability of our consolidated results of operations and key operating statistics was impacted by the SureWest acquisition, which closed on July 2, 2012, as described above. SureWest s results are included in our consolidated financial statements as of the date of the acquisition. The acquisition of SureWest provides additional diversification of the Company s revenues and cash flows both geographically and by service type.

**Operating Revenues**

*Local Calling Services*

We offer several different basic local phone service packages for residential and business customers. The plans include options for voicemail and other custom calling features such as caller ID, call forwarding and call waiting. Local calling services revenue decreased $0.1 million and increased $13.2 million during the quarter and nine months ended September 30, 2013, respectively, compared to the same periods in 2012 primarily due to the acquisition of SureWest. Excluding the addition of SureWest revenues for the first six months of 2013, local calling services decreased approximately $4.1 million during the nine months ended September 30, 2013 compared to the same period in 2012, primarily due to a 4% decline in local access lines. The number of local access lines in service directly affects the recurring revenue we generate

from end users and continues to be impacted by the industry-wide decline in access lines. We expect to continue to experience modest erosion in access lines due to market forces and through our own competing VOIP product.

*Network Access Services*

Network access service revenues include interstate and intrastate switched access revenue, network special access services and wireless backhaul services. Network access services revenue decreased $2.6 million and increased $16.5 million during the quarter and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. The increase during the nine months ended September 30, 2013 was primarily as a result of the acquisition of SureWest in 2012, which accounted for approximately $21.2 million of the year-to-date increase. Excluding the addition of the SureWest revenues for the first six months of 2013, network access service revenue decreased during the current year periods due to a decline in switched and special access revenue. As described in the Regulatory Matters section below, network access revenues were impacted by a decline in intrastate rates as a result of the intercarrier compensation ( ICC ) reform which became effective in July 2012.

Table of Contents

*Video, Data and Internet Services*

Video, data and Internet services include revenue from residential and business customers for subscriptions to our voice, video and data products. We offer high speed Internet access at speeds for residential consumers of up to 50 Mbps, depending on the nature of the network facilities that are available, the level of service selected and the location. We also offer a variety of data connectivity services in select markets, including Ethernet services over our copper and fiber-based networks, virtual hosting services and collocation services. Our VOIP digital phone service is also available in certain markets as an alternative to the traditional telephone line. Depending on geographic market availability, our video services range from limited basic service to advanced digital television, which includes several plans each with hundreds of local, national and music channels including premium and pay-per-view channels as well as video on demand service. Certain subscribers may also subscribe to our advanced video services, which consist of high-definition television, digital video recorders ( DVR ) and/or a whole home DVR.

Video, data and Internet revenue increased $3.1 million and $92.3 million during the quarter and nine months ended September 30, 2013, respectively, compared to the same periods in 2012 primarily as a result of the acquisition of SureWest, which accounted for $86.4 million of the year-to-date increase. The remaining increase in revenue was due to the continued growth in data and Internet connections and video connections, which increased 2% and 4% as of September 30, 2013, respectively. We expect video, data and Internet service revenue to continue to grow and comprise a greater percentage of consolidated operating revenues as a result of growth opportunities from the acquisition of SureWest and as a result of the rising consumer and business demand for data based services.

*Subsidies*

Subsidies consist of federal and state subsidies designed to promote widely available, quality telephone service at affordable prices in rural areas. Subsidy revenues increased $1.0 million and $5.2 million during the quarter and nine months ended September 30, 2013, respectively, compared to the same periods in 2012 primarily as a result of the addition of revenue from the acquisition of SureWest and the addition of revenues from the Connect America Fund ( CAF ), which was implemented by the Federal Communications Commission ( FCC ) in July 2012. See the Regulatory Matters section below for a further discussion of the subsidies we receive.

*Long-Distance Services*

We offer a variety of long-distance calling plans, including unlimited flat-rate calling plans, to residential and business customers. Long-distance services revenue decreased $0.6 million and increased $2.2 million during the quarter and nine months ended September 30, 2013, respectively, compared to the same periods in 2012 primarily due to the acquisition of SureWest. Excluding the addition of SureWest revenues for the first six months of 2013, long distance services decreased $0.8 million during the nine months ended September 30, 2013 compared to the same period in 2012. The decrease in long distance revenue was primarily due to the decline in access lines as described above and the shift in customers moving to unlimited long-distance plans.

*Other Services*

Other services include revenues from telephone directory publishing, wholesale transport services, billing and collection services, inside wiring service and maintenance and equipment sales. Other services revenue decreased $1.0 million and increased $0.2 million during the quarter and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. The changes in other services revenue was primarily due to the acquisition of SureWest and an increase in transport services, which were more than offset by a decline in directory publishing revenues and equipment sales.

**Operating Expenses**

*Cost of Services and Products*

Cost of services and products increased $0.4 million and $48.3 million during the quarter and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. The addition of the operations for SureWest during the first six months of 2013 accounted for $50.0 million of the year-to-date increase. Video programming costs continued to increase due to the growth in video connections and an increase in costs per program channel. However, the increase in video programming costs was partially offset by a reduction in access costs due to the decline in access lines and usage.

Table of Contents

*Selling, General and Administrative Costs*

Selling, general and administrative costs decreased $1.0 million and increased $27.9 million during the quarter and nine months ended September 30, 2013, respectively, compared to the same periods in 2012 primarily due to the addition of the operations for SureWest for the first six months of 2013, which accounted for $27.0 million of the year-to-date increase. The remaining changes in selling, general and administrative expense were due to an increase in professional fees for audit and legal services, which was offset in part by a reduction in bad debt expense in the current quarter.

*Transaction/Debt Refinancing Costs*

In connection with the acquisition of SureWest, we incurred $14.5 million and $19.9 million of transaction related fees which were recognized as financing and other transaction costs during the quarter and nine months ended September 30, 2012, respectively.

*Depreciation and Amortization*

Depreciation and amortization expense decreased $3.4 million and increased $22.5 million during the quarter and nine months ended September 30, 2013, respectively, compared to the same periods in 2012 primarily due to the additional operations for SureWest for the first six months of 2013, which accounted for $38.5 million of the year-to-date increase. Excluding the addition of the operations for SureWest, depreciation and amortization expense decreased during the current year periods as a result of certain intangible assets and network and outside plant equipment becoming fully amortized or depreciated during 2012.

**Reclassifications**

Certain amounts in our 2012 condensed consolidated financial statements have been reclassified to conform to the presentation of our 2013 condensed consolidated financial statements, which consists of the effects of reclassifications of prison services as a discontinued operation, the retrospective adjustments to report operating results as a single segment and the finalization of purchase accounting for the SureWest acquisition.

**Regulatory Matters**

Our revenues are subject to broad Federal and/or state regulation, which include such telecommunications services as local telephone service, network access service and toll service and are derived from various sources, including:

- business and residential subscribers of basic exchange services;

- surcharges mandated by state commissions;

- long distance carriers, for network access service;

- competitive access providers and commercial enterprises for network access service;

- interstate pool settlements from the National Exchange Carrier Association ( NECA ); and

- support payments from federal or state programs.

The telecommunications industry is subject to extensive federal, state and local regulation. Under the Telecommunications Act of 1996 ( Telecommunications Act ), federal and state regulators share responsibility for implementing and enforcing statutes and regulations designed to encourage competition and to preserve and advance widely available, quality telephone service at affordable prices.

At the federal level, the FCC generally exercises jurisdiction over facilities and services of local exchange carriers, such as our rural telephone companies, to the extent they are used to provide, originate, or terminate interstate or international communications. The FCC has the authority to condition, modify, cancel, terminate, or revoke our operating authority for failure to comply with applicable federal laws or FCC rules, regulations and policies. Fines or penalties also may be imposed for any of these violations.

State regulatory commissions generally exercise jurisdiction over carriers facilities and services to the extent they are used to provide, originate, or terminate intrastate communications. In particular, state regulatory agencies have substantial oversight over interconnection and network access by competitors of our rural telephone companies. In addition, municipalities and other local government agencies regulate the public rights-of-way necessary to install and operate networks. State regulators can sanction our rural telephone companies or revoke our certifications if we violate relevant laws or regulations.

Table of Contents

***FCC Matters***

In general, telecommunications service in rural areas is more costly to provide than service in urban areas. The lower customer density means that switching and other facilities serve fewer customers and loops are typically longer, requiring greater expenditures per customer to build and maintain. By supporting the high cost of operations in rural markets, Federal Universal Service Fund subsidies promote widely available, quality telephone service at affordable prices in rural areas. Revenues from the Federal Universal Service Fund, the Pennsylvania Universal Service Fund, and the Texas Universal Service Fund increased $1.0 million and $5.2 million during the quarter and nine month periods ended September 30, 2013, respectively, compared to the same periods in 2012. The increase in the Universal Service subsidies received during the current year was primarily due to the acquisition of SureWest and the new subsidies received from the CAF, as described below.

Historically, under FCC rules governing rate making, our California ILEC was required to establish rates for its interstate telecommunications services based on projected demand usage for the various services. We projected our earnings through the use of annual cost separation studies, which utilized estimated total cost information and projected demand usage. Carriers were required to follow FCC rules in the preparation of these annual studies. We determined actual earnings from our interstate rates as actual volumes and costs became known. In March 2013, we filed a waiver with the FCC to convert our California ILEC from a rate of return to a price cap company. The FCC granted the waiver with an effective date of our annual interstate access tariff filing of July 2, 2013. We expect certain adjustments to take place over the next twenty-four months as a result of exiting the NECA pool, however we do not anticipate that they will be material to our consolidated financial statements or results of operations.

An order adopted by the FCC in 2011 (the Order ) may significantly impact the amount of support revenue we receive from Universal Service Fund ( USF )/CAF and ICC. The Order reformed core parts of the USF, broadly recast the existing ICC scheme and established the CAF to replace support revenues provided by the current USF and redirects support from voice services to broadband services. In 2012, the first phase of the CAF was implemented freezing USF support to a price cap holding company until the FCC implements a broadband cost model to shift support from voice service to broadband. Initially, the second phase was anticipated to be implemented July 1, 2013. It is now anticipated that implementation will likely occur no sooner than January 2014. We anticipate that our revenues will be significantly impacted when the broadband cost model is implemented. The order also modifies the methodology used for ICC traffic exchanged between carriers. The initial phase of ICC reform was effective on July 1, 2012, beginning the transition of our terminating switched access rates to bill-and-keep over a seven year period. As a result of implementing the provisions of the Order, during the quarter and nine months ended September 30, 2013 our network access revenues decreased approximately $0.4 million and $1.4 million, respectively, compared to the same periods in 2012.

In order for eligible telecommunications carriers ( ETCs ) to receive high-cost support, the USF/ICC Transformation Order requires states to certify on an annual basis that federal universal service high-cost support ( USF ) is used only for the provision, maintenance, and upgrading of facilities and services for which the support is intended . States, in turn, require that ETCs file certifications with them as the basis for the state filings with the FCC. Failure to meet the annual data and certification deadlines can result in reduced support to the ETC based on the length of the delay in certification. For the calendar year 2013, the state certification was due to be filed with the FCC on or before October 1, 2012. We were notified in January 2013 that SureWest did not submit the required certification to the CPUC in time to be included in its October 1, 2012, submission to the FCC. On January 24, 2013, we filed a certification with the CPUC and filed a petition with the FCC for a waiver of the filing deadline for the annual state certification. On February 19, 2013, the CPUC filed a certification with the FCC with respect to SureWest. On October 29, 2013, the Wireline Competition Bureau of the FCC denied our petition for a waiver of the annual certification deadline. The Order states that SureWest was not eligible to receive USF for the six month period ended June 30, 2013, which, if sustained upon review, could result in a decrease of previously accrued revenues of approximately $3.0 million. Management intends to apply for review of the decision made by the FCC staff by the full Commission. Management believes, based on the change in SureWest Telephone s USF filing status caused by the change in the ownership of SureWest Telephone, the lack of formal notice by the FCC regarding this change in filing status, the fact that SureWest Telephone had a previously-filed certification of compliance in effect with the FCC for the two quarters for which USF was withheld, and the FCC s past practice of granting waivers to accept late filings in similar situations, that the Company will likely prevail in its application to the Commission and receive USF funding for the period January 1, 2013, through June 30, 2013. Based on past history of the FCC regarding late filings, an assessment in the range of $8 thousand to $10 thousand for each quarter the filer is delinquent is standard practice.

***State Matters***

*California*

In an ongoing proceeding relating to the New Regulatory Framework, the California Public Utilities Commission ( CPUC ) adopted Decision 06-08-030 in 2006, which grants carriers broader pricing freedom in the provision of telecommunications services, bundling of services, promotions and customer contracts. This decision adopted a new regulatory framework, the Uniform Regulatory Framework ( URF ), which among other things (i) eliminates price regulation and allows full pricing flexibility for all new and retail services, (ii) allows new forms of bundles and promotional packages of telecommunication services, (iii) allocates all gains and losses from the sale of assets to shareholders and (iv) eliminates almost all elements of rate of return regulation, including the calculation of shareable earnings. On December 31, 2010, the CPUC issued a ruling to initiate a new proceeding to assess whether, or to what extent, the level of competition in the telecommunications industry is sufficient to control prices for the four largest ILECs in the state. Subsequently, the CPUC issued a ruling temporarily deferring the proceeding. The status on when the CPUC may open this proceeding is unclear and on hold at this time. The CPUC s actions in this and future proceedings could lead to new rules and an increase in government regulation. The Company will continue to monitor this matter.

*Pennsylvania*

In 2011, the Pennsylvania Public Utilities Commission ( PAPUC ) issued an intrastate access reform order reducing intrastate access rates to interstate levels in a three-step process, beginning in March 2012. With the release of the FCC order in November 2011, the PAPUC temporarily issued a stay. A final stay was issued in 2012 to implement the FCC ordered intrastate access rate changes. The PAPUC has indicated that it will address state universal funding in 2013 pending any state legislative activity that may occur in the 2013 legislative session. The Company will continue to monitor this matter.

Table of Contents

*Texas*

The Texas Public Utilities Regulatory Act ( PURA ) directs the Public Utilities Commission of Texas ( PUCT ) to adopt and enforce rules requiring local exchange carriers to contribute to a state universal service fund that helps telecommunications providers offer basic local telecommunications service at reasonable rates in high cost rural areas. The Texas Universal Service Fund is also used to reimburse telecommunications providers for revenues lost by providing lifeline service. Our Texas rural telephone companies receive disbursements from this fund.

Our Texas ILECs receive two state funds, the small and rural incumbent local exchange company plan ( HCF ) and the high cost assistance fund ( HCAF ). The HCF is a line-based fund used to keep local rates low. The rate is applied on all residential lines and up to five single business lines. The amount we receive from the HCAF is a frozen monthly amount that was originally developed to offset high intrastate toll rates.

In September 2011, the Texas state legislature passed Senate Bill No. 980/House Bill No. 2603 which, among other things, mandated the PUCT to review the Universal Service Fund and issue recommendations by January 1, 2013 with the intent to effectively eliminate the HCF. This would be accomplished by implementing an urban floor to offset state funding reductions with a phase-in period of four years. The PUCT recommended that (i) frozen line counts be lifted effective September 1, 2013; and (ii) rural and urban local rate benchmarks be developed. The large company fund was completed in September 2012 and the PUCT currently has a docketed proceeding to address the small company fund participants. The proceeding is anticipated to be completed by December 2013. The elimination of the frozen line counts is not expected to impact funding until the fourth quarter of 2013. The potential impact on funding related to the urban benchmark is pending the docketed proceeding as well as potential legislative action. The Company will continue to monitor this matter.

In June 2013, the Texas state legislature passed Senate Bill No. 583 ( SB 583 ). The provisions of SB 583 were effective September 1, 2013 and froze HCF and HCAF support for the remainder of 2013 and will eliminate our annual $1.4 million HCAF support, effective January 1, 2014. In July 2013, the Company entered into a settlement agreement with the PUCT on Docket No. 41097, *Rate Rebalancing* ( Docket 41097 ), which was approved by the PUCT on August 30, 2013. In accordance with the provisions of settlement agreement, our HCF draw will be reduced by approximately $1.2 million annually, or approximately $4.8 million in total, over a 4 year period beginning June 1, 2014 through 2017. However, we have the ability to offset this reduction with increases to residential rates, where market conditions will allow.

***Other Regulatory Matters***

We are also subject to a number of regulatory proceedings occurring at the federal and state levels that may have a material impact on our operations. The FCC and state commissions have authority to issue rules and regulations related to our business. A number of proceedings are pending or anticipated that are related to such telecommunications issues as competition, interconnection, access charges, intercarrier compensation, broadband deployment, consumer protection and universal service reform. Some proceedings may authorize new services to compete with our existing services. Proceedings that relate to our cable television operations include rulemakings on set top boxes, carriage of programming, industry consolidation and ways to promote additional competition. There are various on-going legal challenges to the scope or validity of FCC orders that have been issued. As a result, it is not yet possible to determine fully the impact of the related FCC rules and regulations on our operations.

**Non-Operating Items**

*Other Income and Expense, Net*

Interest expense, net of interest income, increased $13.8 million during the nine months ended September 30, 2013 compared to the same period in 2012. The increase in interest expense was due primarily to an increase in total debt outstanding as a result of the acquisition of SureWest in 2012, which included the issuance of incremental term loans under our credit facility in December 2012 and the issuance of a $300.0 million Senior Note offering in May 2012, as described in the Liquidity and Capital Resources section below. An increase in interest rates on outstanding borrowings under our credit facility, which was amended in December 2012 to extend the maturity dates, also contributed to the increase in interest expense during the current year periods. The increase in the current year was offset in part by the inclusion of $4.2 million during the nine months ended September 30, 2012 of amortized financing costs for the temporary bridge loan facility obtained to fund the SureWest acquisition. In addition, interest expense related to our interest rate swap agreements has declined due to the maturity of several agreements during 2013.

Table of Contents

Investment income increased $1.5 million and $5.7 million during the quarter and nine months ended September 30, 2013, respectively, compared to the same periods in 2012, primarily due to higher earnings from our wireless partnership interests. Other, net decreased $0.9 million and $1.1 million during the quarter and nine months ended September 30, 2013, respectively, compared to the same periods in 2012, primarily due to a settlement agreement reached in legal dispute during the quarter ended September 30, 2013. See Note 11 for a more detailed discussion regarding the settlement agreement.

*Income Taxes*

Income taxes increased $6.9 million and $16.4 million during the quarter and nine months ended September 30, 2013, respectively, compared to the same periods in 2012. Our effective rate was 28.9% and 36.3% for the three and nine month periods ended September 30, 2013, respectively, compared to 67.1% and (114.2%) for the three and nine month periods ended September 30, 2012, respectively. During the nine months ended September 30, 2013, we recognized $1.2 million to our previously unrecognized tax benefits, which resulted in a decrease to our tax expense of $0.8 million, due to the expiration of a state statute of limitations. We also recognized approximately $0.7 million of tax expense during the nine months ended September 30, 2013 to adjust our 2012 provision to match our 2012 returns and approximately $0.2 million of tax benefit in the three month period ended September 30, 2012 to adjust our 2011 provision to match our 2011 returns. The acquisition of SureWest on July 2, 2012 resulted in changes to our unitary state filings and correspondingly our state deferred income taxes. These changes resulted in a net decrease of $1.3 million to our net state deferred tax liabilities and a corresponding decrease to our state tax. In addition, we incurred non-deductible transaction costs in relation to the acquisition that resulted in an increase to our tax provision of $0.4 million. We recognized these changes in the three month period ended September 30, 2012. Exclusive of these adjustments, our effective tax rate for the nine months ended September 30, 2013 and 2012 would have been approximately 36.5% and 15.1%. The adjusted effective tax rate for the nine months ended September 20, 2012 differed from the federal and state statutory rates primarily due to the acquisition of SureWest, which resulted in changes to the Company s forecasted income, state income tax expense, and non-deductible expenses.

**Non-GAAP Measures**

In addition to the results reported in accordance with US GAAP, we also use certain non-GAAP measures such as EBITDA and adjusted EBITDA to evaluate operating performance and to facilitate the comparison of our historical results and trends. These financial measures are not a measure of financial performance under US GAAP and should not be considered in isolation or as a substitute for net income as a measure of performance and net cash provided by operating activities as a measure of liquidity. They are not, on their own, necessarily indicative of cash available to fund cash needs as determined in accordance with GAAP. The calculation of these non-GAAP measures may not be comparable to similarly titled measures used by other companies. Reconciliations of these non-GAAP measures to the most directly comparable financial measures presented in accordance with GAAP are provided below.

EBITDA is defined as net earnings before interest expense, income taxes, and depreciation and amortization. Adjusted EBITDA is comprised of EBITDA, adjusted for certain items as permitted or required under our credit facility as described in the reconciliations below. These measures are a common measure of operating performance in the telecommunications industry and are useful, with other data, as a means to evaluate our ability to fund our estimated uses of cash.

Table of Contents

The following table is a reconciliation of net cash provided by operating activities to adjusted EBITDA for the quarters and nine months ended September 30, 2013 and 2012:

| | Quarter Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| *(In thousands)* | **2013** | **2012** | **2013** | **2012** |
| Net cash provided by operating activities from continuing operations | $ 56,707 | $ 21,472 | $ 124,053 | $ 70,700 |
| Adjustments: | | | | |
| Compensation from restricted share plan | (794) | (594) | (2,234) | (1,684) |
| Other adjustments, net | 1,833 | 1,812 | 13 | (2,243) |
| Changes in operating assets and liabilities | (12,660) | 14,139 | 9,222 | 17,236 |
| Interest expense, net | 20,632 | 20,624 | 65,929 | 52,117 |
| Income taxes | 4,205 | (2,667) | 15,219 | (1,166) |
| **EBITDA** | 69,923 | 54,786 | 212,202 | 134,960 |
| Adjustments to EBITDA: | | | | |
| Other, net (1) | (8,070) | 6,838 | (22,220) | 2,239 |
| Investment distributions (2) | 8,555 | 7,723 | 24,316 | 19,835 |
| Non-cash compensation (3) | 794 | 594 | 2,234 | 1,684 |
| **Adjusted EBITDA** | $ 71,202 | $ 69,941 | $ 216,532 | $ 158,718 |

(1) Other, net includes the equity earnings from our investments, dividend income, income attributable to noncontrolling interests in subsidiaries, transaction related costs including severance and certain other miscellaneous items.

(2) Includes all cash dividends and other cash distributions received from our investments.

(3) Represents compensation expenses in connection with the issuance of stock awards, which because of the non-cash nature of these expenses are excluded from adjusted EBITDA.

**Liquidity and Capital Resources**

***Outlook and Overview***

Our operating requirements have historically been funded from cash flows generated from our business and borrowings under our credit facilities. We expect that our future operating requirements will continue to be funded from cash flows from operating activities, existing cash and cash equivalents, and, if needed, from borrowings under our revolving credit facility and our ability to obtain future external financing. We anticipate that we will continue to use a substantial portion of our cash flow to fund capital expenditures, meet scheduled payments of long-term debt, make dividend payments and to invest in future business opportunities.

The following table summarizes our cash flows:

| *(In thousands)* | Nine Months Ended September 30, 2013 | 2012 |
|---|---|---|
| Cash flows provided by (used in): | | |
| Operating activities: | | |
| Continuing operations | $ 124,053 | $ 70,700 |
| Discontinued operations | (3,412) | 1,200 |
| Investing activities: | | |
| Continuing operations | (80,711) | (427,243) |
| Discontinued operations | 2,331 | (97) |
| Financing activities: | | |
| Continuing operations | (53,824) | 274,511 |
| Decrease in cash and cash equivalents | $ (11,563) | $ (80,929) |

Table of Contents

**Cash Flows Provided by Operating Activities**

Net cash provided by operating activities was $124.1 million during the nine-month period ended September 30, 2013, an increase of $53.4 million compared to the same period in 2012. Cash provided by operating activities increased as a result of the additional cash flows provided by the addition of the SureWest operations and a decrease in accounts receivable. These increases were offset in part by a decrease in accounts payable and accrued expenses related to the timing in payments to suppliers and the payment of accrued transaction costs during 2013.

**Cash Flows Used In Investing Activities**

Net cash used in investing activities was $80.7 million during the nine-month period ended September 30, 2013 and consisted primarily of cash used for capital expenditures.

*Capital Expenditures*

Capital expenditures continue to be our primary recurring investing activity and were $80.6 million during the nine-month period ended September 30, 2013, an increase of $30.3 million compared to the same period in 2012. The increase in capital expenditures was due to the addition of the SureWest operations and growth in residential customer additions. Capital expenditures for the remainder of 2013 are expected to be $25.0 million to $30.0 million of which approximately 30% is planned for success-based capital projects for residential and commercial initiatives.

**Cash Flows Provided by Financing Activities**

Net cash provided by financing activities consists primarily of our proceeds and principal payments on long-term borrowings and the payment of dividends.

**Long-term Debt**

**Credit Agreement**

The Company, through certain of its wholly owned subsidiaries, has an outstanding credit agreement with several financial institutions, which consists of a $50.0 million revolving credit facility and outstanding term loans of $908.5 million at September 30, 2013. The credit facility also includes an incremental term loan facility which provides the ability to borrow up to $300.0 million of incremental term loans. As of

September 30, 2013 and December 31, 2012, no amounts were outstanding under the revolving credit facility. Borrowings under the senior secured credit facility are secured by substantially all of the assets of the Company, with the exception of Illinois Consolidated Telephone Company and our majority-owned subsidiary, East Texas Fiber Line Incorporated.

Our term loans under the credit facility, as amended, were issued in separate tranches, resulting in different maturity dates and interest rate margins for each term loan. The second term loan ( Term 2 ) consists of an original aggregate principal amount of $409.1 million, matures on December 31, 2017 and currently has an applicable margin (at our election) equal to either 4.00% for a London Interbank Offered Rate ( LIBOR ) based term loan or 3.00% for an alternative base rate term loan. The Term 2 loan requires $1.0 million in quarterly principal payments which began on March 31, 2012. The third term loan ( Term 3 ) consists of an original aggregate principal amount of $515.0 million, with a maturity date of December 31, 2018. The Term 3 loan requires quarterly principal payments of $1.3 million which commenced March 31, 2013 and has an applicable margin (at our election) equal to either 4.00% for a LIBOR-based term loan or 3.00% for an alternative base rate term loan subject to a 1.25% LIBOR floor. The Term 3 loan contains an original issuance discount of $5.2 million, which is being amortized over the term of the loan.

Our revolving credit facility has a maturity date of June 8, 2016 and an applicable margin (at our election) of between 2.75% and 3.50% for LIBOR-based borrowings and between 1.75% and 2.50% for alternative base rate borrowings, depending on our leverage ratio. Based on our leverage ratio at September 30, 2013, the borrowing margin for the next three month period ending December 31, 2013 will be at a weighted-average margin of 3.25% for a LIBOR-based loan or 2.25% for an alternative base rate loan. The applicable borrowing margin for the revolving credit facility is adjusted quarterly to reflect the leverage ratio from the prior quarter-end. There were no borrowings or letters of credit outstanding under the revolving credit facility at September 30, 2013 and December 31, 2012.

Table of Contents

The weighted-average interest rate on outstanding borrowings under our credit agreement was 4.78% and 4.79% at September 30, 2013 and December 31, 2012, respectively. Interest is payable at least quarterly.

Net proceeds from asset sales exceeding certain thresholds, to the extent not reinvested, are required to be used to repay loans outstanding under the credit agreement.

*Credit Agreement Covenant Compliance*

The credit agreement contains various provisions and covenants, including, among other items, restrictions on the ability to pay dividends, incur additional indebtedness, and issue capital stock. We have agreed to maintain certain financial ratios, including interest coverage, and total net leverage ratios, all as defined in the credit agreement. As of September 30, 2013, we were in compliance with the credit agreement covenants.

Effective February 17, 2012, we amended our credit facility to provide us with the ability to incur indebtedness necessary to finance the acquisition of SureWest, which enabled us to issue the Senior Notes described below. In connection with the amendment, fees of $3.5 million were recognized as financing and other transaction costs during the nine months ended September 30, 2012.

In general, our credit agreement restricts our ability to pay dividends to the amount of our Available Cash as defined in our credit agreement. As of September 30, 2013 and including the $15.5 million dividend declared in August 2013 and paid on October 15, 2013, we had $208.7 million in dividend availability under the credit facility covenant.

Under our credit agreement, if our total net leverage ratio (as defined in the credit agreement), as of the end of any fiscal quarter, is greater than 5.10:1.00, we will be required to suspend dividends on our common stock unless otherwise permitted by an exception for dividends that may be paid from the portion of proceeds of any sale of equity not used to fund acquisitions, or make other investments. During any dividend suspension period, we will be required to repay debt in an amount equal to 50.0% of any increase in Available Cash, among other things. In addition, we will not be permitted to pay dividends if an event of default under the credit agreement has occurred and is continuing. Among other things, it will be an event of default if our total net leverage ratio and interest coverage ratio as of the end of any fiscal quarter is greater than 5.25:1.00 and less than 2.25:1.00, respectively. As of September 30, 2013, our total net leverage ratio under the credit agreement was 4.19:1.00 and our interest coverage ratio was 3.34:1.00.

**Senior Notes**

On May 30, 2012, we completed an offering of $300.0 million aggregate principal amount of 10.875% unsecured Senior Notes, due 2020 through our wholly-owned subsidiary, Consolidated Communications Finance Co. ( Finance Co. ) for the acquisition of SureWest. The Senior Notes will mature on June 1, 2020 and earn interest at a rate of 10.875% per year, payable semi-annually in arrears on June 1 and December 1 of each year, commencing on December 1, 2012. The Senior Notes were sold in the United States to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933 (the Securities Act ) and outside the United States in compliance with Regulation S under the Securities Act. In addition, some of the Senior Notes were sold to certain accredited investors (as defined in Rule 501 under the Securities Act).

The Senior Notes were sold to investors at a price equal to 99.345% of the principal amount thereof, for a yield to maturity of 11.00%. This discount is being amortized over the term of the Senior Notes. The proceeds of the sale of the Senior Notes were held in an escrow account prior to the closing of the SureWest transaction. Upon closing of the SureWest acquisition on July 2, 2012, Finance Co. merged with and into our wholly-owned subsidiary Consolidated Communications, Inc., which assumed the Senior Notes, and we and certain of our subsidiaries fully and unconditionally guaranteed the Senior Notes. On August 3, 2012, SureWest and its subsidiaries guaranteed the Senior Notes.

During the quarter ended June 30, 2013, we completed an exchange offer to issue registered notes ( Exchange Notes ) for $287.3 million of the original Senior Notes. The terms of the Exchange Notes are substantially identical to the Senior Notes, except that the Exchange Notes are registered under the Securities Act and the transfer restrictions and registration rights applicable to the Senior Notes do not apply to the Exchange Notes. The exchange offer did not impact the aggregate principal amount or the remaining terms of the Senior Notes outstanding.

Table of Contents

*Senior Notes Covenant Compliance*

The indenture governing the Senior Notes contains customary covenants for high yield notes, which limits Consolidated Communications, Inc. s and its restricted subsidiaries ability to: incur debt or issue certain preferred stock; pay dividends or make other distributions on capital stock or prepay subordinated indebtedness; purchase or redeem any equity interests; make investments; create liens; sell assets; enter into agreements that restrict dividends or other payments by restricted subsidiaries; consolidate, merge or transfer all or substantially all of its assets; engage in transactions with its affiliates; or enter into any sale and leaseback transactions.

Among other matters, the Senior Notes indenture provides that Consolidated Communications, Inc. may not pay dividends or make other restricted payments to the Company if its total net leverage ratio is 4.25:1.00 or greater. At September 30, 2013, this ratio, which is calculated differently than the comparable ratio under the credit agreement, was 3.99:1.00. If this ratio is met, dividends and other restricted payments may be made from cumulative consolidated cash flow since the date the Senior Notes were issued, less 1.75 times fixed charges, less dividends and other restricted payments made since the date the Senior Notes were issued. Dividends may be paid and other restricted payments may also be made from a basket of $50.0 million, none of which has been used to date, and pursuant to other exceptions identified in the Senior Notes indenture. Since dividends of $93.0 million have been paid since May 30, 2012, at September 30, 2013 there was $135.9 million of the $228.9 million of cumulative consolidated cash flow since May 30, 2012 available to pay dividends.

**Bridge Loan Facility**

In connection with the acquisition of SureWest, in February 2012 the Company received committed financing for a total of $350.0 million to fund the cash portion of the anticipated transaction, to refinance SureWest s debt and to pay for certain transaction costs. The financing package included a $350.0 million Senior Unsecured Bridge Loan Facility ( Bridge Facility ). As anticipated, permanent financing for the SureWest acquisition was funded by our Senior Note offering, as described above. As a result, the $4.2 million commitment fee incurred for the Bridge Facility was capitalized as deferred debt issuance costs in February 2012 and was amortized over the expected life of the Bridge Facility, which was four months.

**Capital Leases**

As of September 30, 2013, we had seven capital leases which expire between 2015 and 2021. As of September 30, 2013, the present value of the minimum remaining lease commitments was approximately $5.3 million, of which $0.6 million was due and payable within the next twelve months. The leases require total remaining rental payments of $8.2 million as of September 30, 2013, of which $6.0 million will be paid to LATEL LLC, a related party entity.

During the nine months ended September 30, 2013, we acquired equipment of $0.8 million through capital lease agreements, which represents a noncash investing activity.

**Dividends**

We paid $15.5 million in dividend payments to shareholders during the quarters ended September 30, 2013 and 2012. We paid $46.5 million and $38.6 million in dividend payments to shareholders during the nine-month periods ended September 30, 2013 and 2012, respectively. On August 5, 2013, our board of directors declared our next quarterly dividend of $0.38738 per common share, which is payable on November 1, 2013 to shareholders of record at the close of business on October 15, 2013. Our current annual dividend rate is approximately $1.55 per share.

The cash required to fund dividend payments is in addition to our other expected cash needs, which we expect to fund with cash flows from our operations. In addition, we expect we will have sufficient availability under our revolving credit facility to fund dividend payments in addition to any expected fluctuations in working capital and other cash needs, although we do not intend to borrow under this facility to pay dividends.

We believe that our dividend policy will limit, but not preclude, our ability to grow. If we continue paying dividends at the level currently anticipated under our dividend policy, we may not retain a sufficient amount of cash, and may need to seek refinancing, to fund a material expansion of our business, including any significant acquisitions or to pursue growth opportunities requiring capital expenditures significantly beyond our current expectations. In addition, because we expect a significant portion of cash available will be distributed to holders of common stock under our dividend policy, our ability to pursue any material expansion of our business will depend more than it otherwise would on our ability to obtain third-party financing.

Table of Contents

**Sufficiency of Cash Resources**

The following table sets forth selected information regarding our financial condition.

| *(In thousands, except for ratio)* | September 30, 2013 | December 31, 2012 |
|---|---|---|
| Cash and cash equivalents | $ 6,291 | $ 17,854 |
| Working capital (deficit) | (41,309) | (34,321) |
| Total debt and capital leases | 1,212,034 | 1,217,844 |
| Current ratio | 0.68 | 0.76 |

Our most significant uses of funds in the remainder of 2013 are expected to be for: (i) dividend payments of approximately $15.5 million; (ii) interest payments on our indebtedness of between $27.0 million and $30.0 million and principal payments on debt of $2.3 million; (iii) capital expenditures of between $25.0 million and $30.0 million and (iv) pension and other post-retirement obligations of $3.2 million. However, in the future our ability to use cash may be limited by our other expected uses of cash, including our dividend policy, and our ability to incur additional debt will be limited by our existing and future debt agreements.

With the acquisition of SureWest, we took on additional debt to fund the transaction. We believe that cash flows from operating activities, together with our existing cash and borrowings available under our revolving credit facility will be sufficient for at least the next twelve months to fund our current anticipated uses of cash. After that, our ability to fund these expected uses of cash and to comply with the financial covenants under our debt agreements will depend on the results of future operations, performance and cash flow. Our ability to fund these expected uses from the results of future operations will be subject to prevailing economic conditions and to financial, business, regulatory, legislative and other factors, many of which are beyond our control.

We may be unable to access the cash flows of our subsidiaries since certain of our subsidiaries are parties to credit or other borrowing agreements, or subject to statutory or regulatory restrictions, that restrict the payment of dividends or making intercompany loans and investments, and those subsidiaries are likely to continue to be subject to such restrictions and prohibitions for the foreseeable future. In addition, future agreements that our subsidiaries may enter into governing the terms of indebtedness may restrict our subsidiaries ability to pay dividends or advance cash in any other manner to us.

To the extent that our business plans or projections change or prove to be inaccurate, we may require additional financing or require financing sooner than we currently anticipate. Sources of additional financing may include commercial bank borrowings, other strategic debt financing, sales of nonstrategic assets, vendor financing or the private or public sales of equity and debt securities. There can be no assurance that we will be able to generate sufficient cash flows from operations in the future, that anticipated revenue growth will be realized, or that future borrowings or equity issuances will be available in amounts sufficient to provide adequate sources of cash to fund our expected uses of cash. Failure to obtain adequate financing, if necessary, could require us to significantly reduce our operations or level of capital expenditures which could have a material adverse effect on our financial condition and the results of operations.

*Surety Bonds*

In the ordinary course of business, we enter into surety, performance, and similar bonds as required by certain jurisdictions in which we provide services. As of September 30, 2013, we had approximately $2.8 million of these bonds outstanding.

*Defined Benefit Pension Plans*

As required, we contribute to qualified defined pension plans and non-qualified supplemental retirement plans (collectively the Pension Plans ) and other post-retirement benefit plans, which provide retirement benefits to certain eligible employees. Contributions are intended to provide for benefits attributed to service to date. Our funding policy is to contribute annually an actuarially determined amount consistent with applicable federal income tax regulations.

The cost to maintain our Pension Plans and future funding requirements are affected by several factors including the expected return on investment of the assets held by the Pension Plan, changes in the discount rate used to calculate pension expense and the amortization of unrecognized gains and losses. Returns generated on Plan assets have historically funded a significant portion of the benefits paid under the Pension Plans. As of January 1, 2013, we estimate the long-term rate of return of Plan assets will be 8.0%. The Pension Plans invest in marketable equity securities which are exposed to changes in the financial markets. If the financial markets experience a downturn and returns fall below our estimate, we could be required to make a material contribution to the Pension Plan, which could adversely affect our cash flows from operations.

Table of Contents

In 2013, we expect to make contributions totaling approximately $11.5 million to our pension plans and $2.4 million to our other post-retirement plans. As of September 30, 2013, we have contributed $8.8 million and $1.9 million to our pension plans and our other post-retirement plans, respectively. Our contribution amounts meet the minimum funding requirements as set forth in employee benefit and tax laws. See Note 9 for a more detailed discussion regarding our pension and other post-retirement plans.

*Income Taxes*

The timing of cash payments for income taxes, which is governed by the Internal Revenue Service and other taxing jurisdictions, will differ from the timing of recording tax expense and deferred income taxes, which are reported in accordance with GAAP. For example, tax laws in effect regarding accelerated or bonus depreciation for tax reporting resulted in less cash payments than the GAAP tax expense. Acceleration of tax deductions could eventually result in situations where cash payments will exceed GAAP tax expense.

It is more likely than not that the benefit from approximately $1.5 million in federal NOL carryforwards that are subject to separate return limitation year restrictions will not be realized. This loss carryover can only be used against consolidated taxable income to the extent of a single member s contribution to consolidated taxable income. The amount considered realizable, however, could be adjusted if estimates of future taxable income for the single member during the carryforward period are increased.

Historically, pre-tax earnings for financial reporting purposes have exceeded the amount of taxable income reported for income tax purposes. This has primarily occurred due to the acceleration of depreciation deductions for income tax reporting purposes.

*Regulatory Matters*

As discussed in the Regulatory Matters section above, an order adopted by the FCC may significantly impact the amount of support revenue we receive from USF/CAF and ICC. The Order seeks to reform the current USF system by redirecting support from voice services to broadband services. Although the broadband cost model for this reform is still being developed, we anticipate that our revenues will be significantly impacted when it is implemented. The initial phase of ICC reform decreased our network access revenues $0.4 million and $1.4 million during the quarter and nine months ended September 30, 2013. We anticipate network access revenues will continue to decline as a result of the Order through 2018 by as much as $0.5 million in the remainder of 2013 and $1.3 million, $1.0 million, $1.1 million, $2.5 million and $1.8 million in 2014, 2015, 2016, 2017 and 2018, respectively.

In accordance with the provisions of SB 583, as discussed above in the Regulatory Matters Section, our annual $1.4 million Texas HCAF will be eliminated, effective January 1, 2014. In addition, the terms of the settlement agreement reached with the PUCT in August 2013 will reduce our HCF draw by approximately $1.2 million annually, or approximately $4.8 million in total, over a 4 year period beginning June 1, 2014 through 2017. However, we have the ability to offset this reduction with increases to residential rates, where market conditions will allow.

**Critical Accounting Estimates**

Our condensed consolidated financial statements and accompanying notes are prepared in accordance with GAAP. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. These estimates and assumptions are affected by management s application of accounting policies. Our judgments are based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making estimates about the carrying values of assets and liabilities that are not readily apparent from other sources. For a full discussion of our accounting estimates and assumptions that we have identified as critical in the preparation of our condensed consolidated financial statements, refer to our 2012 Annual Report on Form 10-K.

Table of Contents

**Recent Accounting Pronouncements**

In July 2013, Financial Accounting Standards Board ( FASB ) issued the Accounting Standards Update No. 2013-11 ( ASU 2013-11 ), *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. ASU 2013-11 provides guidance concerning the balance sheet presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss or a tax credit carryforward is present. The amended guidance is effective for fiscal years and interim periods beginning after December 15, 2013, with early adoption permitted. We are currently evaluating the impact this update will have on our condensed consolidated financial statements.

Effective January 1, 2013, we adopted Financial Accounting Standards Board ( FASB ) Accounting Standards Update No. 2012-02 ( ASU 2012-02 ), *Testing Indefinite-Lived Intangible Assets for Impairment*. ASU 2012-02 permits an entity to perform an initial assessment of qualitative factors to determine whether it is more likely than not that a non-goodwill indefinite-lived intangible asset is impaired and thus whether it is necessary to calculate the asset s fair value for the purpose of comparing it with the asset s carrying amount. The adoption of this standard did not have a material impact on our condensed consolidated financial statements.

Effective January 1, 2013, we adopted Accounting Standards Update No. 2013-02 ( ASU 2013-02 ), *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income,* which establishes new requirements for disclosing reclassifications of items out of accumulated other comprehensive income ( OCI ). ASU 2013-2 requires disclosures for the (i) changes in components of accumulated OCI, (ii) effects on individual line items in net income for each item of accumulated OCI that is reclassified in its entirety to net income, and (iii) cross references to other disclosures that provide additional details for OCI items that are not reclassified in their entirety to net income. For public companies, amendments were effective prospectively for reporting periods beginning after December 15, 2012, with early adoption permitted. In accordance with the provisions of this guidance, disclosures related to accumulated OCI can be found in Note 8 to our condensed consolidated financial statements.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Our exposure to market risk is primarily related to the impact of interest rate fluctuations on our debt obligations. Market risk is the potential loss arising from adverse changes in market interest rates on our variable rate obligations. In order to manage the volatility relating to changes in interest rates, we utilize derivative financial instruments such as interest rate swaps to maintain a mix of fixed and variable rate debt. We do not use derivatives for trading or speculative purposes. Our interest rate swap agreements effectively convert a portion of our floating-rate debt to a fixed-rate basis, thereby reducing the impact of interest rate changes on future cash interest payments. We calculate the potential change in interest expense caused by changes in market interest rates by determining the effect of the hypothetical rate increase on the portion of our variable rate debt that is not subject to a variable rate floor or hedged through the interest rate swap agreements.

As of September 30, 2013, the interest rate on approximately $76.9 million of our floating rate debt was not fixed through the use of interest rate swaps or subject to a variable rate floor, thereby subjecting this portion of our debt to potential changes in interest rates. Based on variable rate debt outstanding at September 30, 2013, if market interest rates changed by 1.0%, annual interest expense would have increased or decreased by approximately $0.2 million.

As of September 30, 2013, the fair value of our interest rate swap agreements amounted to a net liability of $2.9 million. Pretax deferred losses related to our interest rate swap agreements included in accumulated other comprehensive loss ( AOCI ) was $2.9 million at September 30, 2013.

**Item 4. Controls and Procedures**

We maintain disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 ( Exchange Act ) that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in SEC rules and forms; and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. In connection with the filing of this Form 10-Q,

Table of Contents

management evaluated, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of the design to provide reasonable assurance of achieving their objectives and operation of our disclosure controls and procedures as of September 30, 2013. Based upon that evaluation and subject to the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective as of September 30, 2013.

Our assessment of the internal control structure excluded SureWest, which was acquired on July 2, 2012. SureWest had net revenues of $66.5 million and $200.1 million for the quarter and nine months ended September 30, 2013, respectively or approximately 44% for both the quarter and nine months ended September 30, 2013 of our consolidated net revenues and total assets of $684.0 million at September 30, 2013, or approximately 39% of our consolidated total assets, which are included in the condensed consolidated financial statements of the Company as of and for the quarter ended September 30, 2013. Under guidance issued by the SEC, companies are allowed to exclude acquisitions from their assessment of internal control over financial reporting during the first year of an acquisition while integrating the acquired company.

**Change in internal control over financial reporting**

During the quarter ended September 30, 2013, the Company had the following changes relating to its controls over financial reporting:

- As noted above, our assessment of the internal control structure excluded SureWest which was acquired on July 2, 2012. Under guidance issued by the SEC, companies are permitted to exclude acquisitions from their assessment of internal control over financial reporting during the first year of an acquisition while integrating the acquired company. Our internal control assessment for the year ended December 31, 2013 will include SureWest.

**Limitations on the effectiveness of controls**

We are responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control systems are designed to provide reasonable assurance to the Company s management, Board of Directors and Audit Committee regarding the reliability of financial reporting and the preparation of published financial statements in accordance with generally accepted accounting principles.

Table of Contents

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

On April 15, 2008, Salsgiver Inc., a Pennsylvania-based telecommunications company, and certain of its affiliates filed a lawsuit against us and our subsidiaries North Pittsburgh Telephone Company and North Pittsburgh Systems Inc. in the Court of Common Pleas of Allegheny County, Pennsylvania alleging that we have prevented Salsgiver from connecting their fiber optic cables to our utility poles. Salsgiver seeks compensatory and punitive damages as the result of alleged lost projected profits, damage to its business reputation, and other costs. Salsgiver originally claimed to have sustained losses of approximately $125 million and did not request a specific dollar amount in damages. We believe that these claims are without merit and that the alleged damages are completely unfounded. Discovery concluded and Consolidated filed a motion for summary judgment on June 18, 2012 and the court heard oral arguments on August 30, 2012. On February 12, 2013, the court granted, in part, Consolidated s motion. The court ruled that Salsgiver could not recover prejudgment interest and could not use as a basis of liability any actions prior to April 14, 2006. In September 2013, in order to avoid the distraction and uncertainty of further litigation, the Company reached an agreement in principle (the agreement ) with Salsgiver, Inc. In accordance with the terms of the agreement, the Company will pay Salsgiver approximately $0.9 million in cash and grant approximately $0.3 million in credits that may be used for make-ready charges (the Credits ). The Credits will be available for services performed in connection with the pole attachment applications within five years of the execution of the agreement. The Company had previously recorded approximately $0.4 million in 2011 in anticipation of the settlement of this case. During the quarter ended September 30, 2013, per the terms of the agreement the Company recorded an additional $0.9 million, which included estimated legal fees. The agreement is contingent on appropriate documentation and there is no assurance that the agreement will be finalized.

Two of our subsidiaries, Consolidated Communications of Pennsylvania Company LLC ( CCPA ) and Consolidated Communications Enterprise Services Inc. ( CCES ), received assessment notices from the Commonwealth of Pennsylvania Department of Revenue increasing the amounts owed for Pennsylvania Gross Receipt Taxes for the tax period ending December 31, 2009. These two assessments adjusted the subsidiaries combined total outstanding taxable gross receipts liability (with interest) to approximately $2.3 million. In addition, based upon recently completed audits of CCES for 2008, 2009 and 2010, we believe the Commonwealth of Pennsylvania may issue additional assessments totaling approximately $1.7 million for Gross Receipt Taxes allegedly owed. Our CCPA subsidiary has also been notified by the Commonwealth of Pennsylvania that they will conduct a gross receipts audit for the calendar year 2008. An appeal challenging the 2009 CCPA assessment was filed with the Department of Revenue s Board of Appeals on September 15, 2011, and we filed a similar appeal for CCES with the Board of Appeals on November 11, 2011 challenging the 2009 CCES assessment. The Board of Appeals denied CCPA and CCES s appeals. On November 13, 2012, CCPA and CCES filed appeals with the Commonwealth s Board of Finance and Revenue. These have been stayed pending the outcome of present litigation in the Commonwealth Court between Verizon Pennsylvania, Inc. and the Commonwealth of Pennsylvania (Verizon Pennsylvania, Inc. v. Commonwealth, Docket No. 266 F.R. 2008). The Gross Receipts Tax issues in the Verizon Pennsylvania case are substantially the same as those presently facing CCPA and CCES. In addition, there are numerous telecommunications carriers with Gross Receipts Tax matters dealing with the same issues that are in various stages of appeal before the Board of Finance and Revenue and the Commonwealth Court. Those appeals by other similarly situated telecommunications carriers have been continued until resolution of the Verizon Pennsylvania case. We believe that these assessments and the positions taken by the Commonwealth of Pennsylvania are without substantial merit. We do not believe that the outcome of these claims will have a material adverse impact on our financial results or cash flows.

We previously provided telephone service to inmates incarcerated at facilities operated by the Illinois Department of Corrections. On June 27, 2012, the Illinois Department of Central Management Services announced its intent to replace the Company as the provider of those services with a competitor, Securus Technologies, Inc. Since that decision, Securus has replaced the Company as the provider of telephone service at the Illinois Department of Corrections facilities. We challenged Securus bid, and the State s decision to accept that bid, in a variety of different forums including: (i) protests with the Chief Procurement Officer of the Illinois Executive Ethics Commission, which were denied, (ii) a lawsuit filed in the Circuit Court of Sangamon County, Illinois that was dismissed, but is now under appeal in the Illinois Appellate Court Fourth District, (iii) a declaratory ruling request filed with the Illinois Commerce Commission, which was granted on April 9, 2013 and which Securus has

Table of Contents

appealed to the Illinois Appellate Court First District and (iv) a complaint filed with the Illinois Procurement Policy Board. In each of those challenges, we claimed either that Securus was not a responsible vendor, as defined by the State s bid solicitation document, and/or that rates for the services Securus proposed to provide are subject to regulatory limits below those Securus proposed to charge. Our efforts to challenge our competitors bid and the States decision to accept the bid have not been successful. The process to transition these services to our competitor was complete during the quarter ended March 31, 2013. On September 13, 2013, we completed the sale of the assets and contractual rights (the asset purchase agreement ) to Securus for our remaining Prison Services business, which historically provided communications services to thirteen county jails located in Illinois. The asset purchase agreement resolved any pending legal matters between the Company and Securus.

On January 18, 2012, we filed a petition with the U.S. Court of Appeals for the District of Columbia Circuit to review the FCC s Order issued November 18, 2011 that reformed intercarrier compensation and core parts of the Universal Service Fund. We are appealing five core issues in the November 18, 2011 FCC order. The U.S. Court of Appeals for the tenth circuit will hear oral arguments on November 19, 2013.

We are from time to time involved in various other legal proceedings and regulatory actions arising out of our operations. We do not believe that any of these, individually or in the aggregate, will have a material adverse effect upon our business, operating results or financial condition.

Table of Contents

**Item 6. Exhibits**

(a) Exhibits

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| 31.1 | Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101 | The following financial information from Consolidated Communications Holdings, Inc. Quarterly Report on Form 10-Q for the quarter ended September 30, 2013, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Statements of Income, (ii) Condensed Consolidated Statements of Comprehensive Income, (iii) Condensed Consolidated Balance Sheets, (iv) Condensed Consolidated Statements of Cash Flows, and (iv) Notes to Unaudited Condensed Consolidated Financial Statements |

Table of Contents

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CONSOLIDATED COMMUNICATIONS HOLDINGS, INC.

(Registrant)

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|---|---|
| November 7, 2013 | By: /s/ Robert J. Currey<br>Robert J. Currey,<br>Chairman and Chief Executive Officer<br>(Principal Executive Officer) |
| November 7, 2013 | By: /s/ Steven L. Childers<br>Steven L. Childers,<br>Chief Financial Officer<br>(Principal Financial Officer and Chief Accounting Officer) |