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PRESENTATION

Operator

Good morning. My name is Adam, and I'll be your conference operator today. At this time, I would like to welcome everyone to the Consolidated Communications Second Quarter Earnings Conference Call. Please be advised that today's conference is being recorded. (Operator Instructions) I'd now like to turn the call over to Jennifer Spaude, Senior Vice President of Investor Relations and Corporate Communications. Jennifer, you may begin your conference.

Jennifer M. Spaude - *Consolidated Communications Holdings, Inc. - SVP of Corporate Communications & IR*

Thank you, and good morning. I'd like to welcome everyone to Consolidated Communications Second Quarter 2021 Earnings Call. On the call today are Bob Udell, President and Chief Executive Officer; and Steve Childers, our Chief Financial Officer. Bob's comments today will highlight our strategic initiatives and progress with our fiber build plans. Steve will provide details on our second quarter financial performance and an update on the Searchlight investment. Following their prepared remarks, we will open the call up for questions. Before we proceed, I will remind you our earnings release, financial statements and earnings presentation are all posted on the Investor Relations section of our website at consolidated.com. Please review the safe harbor provisions on Slide 2 of our presentation.

Today's discussion includes statements about future events and financial results that are forward-looking and subject to risks and uncertainties. A discussion of factors that may affect future results is contained in consolidated filings with the SEC. Today's discussion will also include certain non-GAAP financial measures. Our earnings release includes reconciliations of these measures to the nearest GAAP equivalent. I will now turn the call over to Bob Udell.

C. Robert Udell - *Consolidated Communications Holdings, Inc. - President, CEO & Director*

Thank you, Jennifer, and good morning, everyone. We've had a highly productive second quarter, delivering stable revenue, strong broadband growth and exceeded our very aggressive build plans. In the quarter, we upgraded 76,000 gig capable fiber passings, and for the year, we have completed 122,000 fiber upgrades, which is a great start to our 5-year 1.6 million location bill plan. The first half of the year demonstrates our team's strong execution on our fiber-first strategy. I'm proud of what the team has accomplished in just 6 months in the transformation that is taking place. With that, we are on track to achieve our target and upgrade over 300,000 locations in 2021. Our build plan is outlined on Slide 6 of our investor presentation. The recent upgrades were primarily in Northern New England, California, Texas and Minnesota markets. Crews constructed almost 1,400 miles of new fiber in the second quarter, which is double the miles constructed in the first quarter. We are placing 288 fiber count or larger cables to meet the high-capacity needs of our consumer, commercial and carrier customers for years to come.

Our near net regional fiber networks allow for very attractive average cost per passing. Our cost per passing is approximately 465 year-to-date, which includes EDGE Access equipment, labor and fiber components. This is well within our expectations. Our go-to-market strategy has been meticulously planned out. We're offering simple packages with highly competitive pricing and an optimized customer experience. Our gig capable symmetrical product offering with no data caps will be a key differentiator compared to cable. We are installing fiber services within 3 days and on time for our customers for their appointments, and we have significantly improved our contact center performance and productivity. Our premium tech support, which comes with all fiber connections, ensures the best possible experience.

Additionally, the investments we are making in our digital transformation projects will give our customers new self-serve options, making it easy to do business with us the way they want. In short, all of these factors support a highly competitive differentiated fiber product and a transformed customer experience. Keene, New Hampshire is a great example of a recent local market launch with very positive receptivity to our new fiber product. Our marketing strategy included a community event, local sponsorships and a competitive offer that is making it easy for residents to choose Consolidated. We have been working very closely with our partners and vendors to understand supply relative to our forecast. We are cautiously optimistic that we have sufficiently been to meet our forecast for the remainder of the year, and from a construction perspective, we have high confidence we can achieve our 2021 fiber build objectives and are already in the planning stages with our vendors for 2022 and beyond.

We are seeing early successes in penetration rates, and they are in line or exceeding our plan. Early Q1 build areas with cable competition have already achieved double-digit penetration. We added approximately 3,000 consumer fiber gig capable subscribers in the second quarter and nearly 7,000 fiber subscribers year-to-date. In fact, some of our late Q4 cohorts in rural areas with less competition are at 51% penetration. We are very pleased with the sales activity and receptivity to our fiber offering. It's a powerful combination of delivering not only the fastest symmetrical speed but also a truly differentiated customer experience, which is key to our value proposition that comes with our new fiber services.

We have completed 5 public-private partnership builds this year, totaling roughly 8,000 passings and are well-positioned to participate in any additional funding opportunities that allow us to expand broadband to rural America. This year alone, we have won bids for 16 additional municipal partnerships and have dozens more in the planning stages, not to mention a very solid track record with state and federal programs. Simply put, we understand the funding sources have good relationships with our community partners and have the infrastructure in place to build fiber at scale and support the network for the long term.

Within our commercial channel, we are experiencing an increase of face-to-face meetings in most markets, which is good news. However, sales cycles or time from quote-to-close still seems extended due to lingering COVID-19 concerns. Our commercial go-to-market strategy is based on leveraging our fiber network to provide application solutions, which grow data and Ethernet revenue. Our sales teams are always focused on network, and we utilize a solutions-based sales approach, which we call CCI Ignite. We work to become a trusted adviser to our customers and provide simple solutions to complex problems.

Data and transport revenue grew 1.4% year-over-year, and it's up from roughly 1% growth in the first quarter. We are pleased with the momentum of our sales teams and the sales activity around Ethernet, unified communications and SD-WAN, which are our leading solutions. As we build out carrier-grade capacity, we increased on-net buildings by roughly 1,400 or 11% year-over-year. We had nearly 200 strategic builds in the quarter, and on-net revenue represents roughly 90% of our revenue for commercial. Our strong balance sheet enables us to support this channel and commit the capital needed to grow the business with the highest return projects in focus.

Our partner 1 agent channel performed well in the recent quarter and is highly engaged. This provides us a 150 agents selling on our network. We continue to move upmarket and also to help bring in new logos. Our carrier team is actively engaged with emerging 5G network opportunities across all the major carriers. The carrier product mix like commercial is weighted toward Ethernet, and we are seeing more interest in carrier-grade wave solutions. Our carrier sales team is experienced, nimble and proactive in pursuing network growth opportunities as we manage the pressures of price compression on second-generation contracts and an increasingly competitive landscape.

We continue to be optimistic about business recovery and are pleased with the receptiveness for meetings in resolving projects. I'll now turn the call over to Steve, who will provide more insight on our second quarter financial results. Steve?

Steven L. Childers - *Consolidated Communications Holdings, Inc. - CFO & Treasurer*

Thank you, Bob, and good morning to everyone. It was another exciting quarter for our team as we made great progress in our transformational fiber-first build strategy. Today, I will provide an update on our second quarter results, reiterate our full year 2021 guidance and remind you the strength of our balance sheet. Our second quarter highlights can be found starting on Slide 4 of the presentation. Operating revenue for the quarter was $320.4 million, down just 1.5% compared to a year ago. Adjusted EBITDA was $126.7 million, which is in line with our guidance, which factors in the start-up investments into the sales and support functions of the fiber build plan. The quarter also included a $3 million increase in wireless cash distributions, which was largely offset by increased marketing cost to support the rollout of our new 1 gig plus fiber products.

Now, looking closer at revenue. Total commercial and carrier revenue was $143.8 million in the second quarter, down $2 million or 1.4%. Data and transport revenue was $90.8 million, up approximately 1.4% in the second quarter. Growth continues to be led by customers adding dedicated internet bandwidth and internet services as well as our commercial VoIP solution ProConnect. Voice revenue declined $2.3 million or 5.1%, driven by a reduction in access lines and the migration of our customers to VoIP solutions, which we recorded in data.

Turning to our consumer channel. Total consumer revenue was $125 million, which represents a year-over-year decline of 2.3%. Consumer broadband revenue was $68 million, up 3.7% and reflects the highest growth rate on a year-over-year basis that we have realized over the past few years. It also represents more than 2 years of consecutive year-over-year growth in broadband revenue. While we are laser-focused on the execution of our fiber to -- build plan, our growth is driven by driving data ARPU through speed upgrades to both fiber and copper customers, combined with targeted rate increase activity.

Consumer data ARPU in the second quarter was $57.26, up approximately $4.5 or 8% from a year ago. Consumer voice revenue was down 6.8% or $2.9 million. Video revenue was down $2.4 million, and on a stand-alone basis, this product has a slightly negative margin. The pace of our video revenue decline has increased this year as we sunset our linear video services and transition to new and in-demand streaming partnerships. Our current over-the-top partner strategy allows us to meet our customers' needs and manage any rising content cost or CapEx spend. The decline in linear video revenue actually improves gross margins and free cash flow.

Network access revenues totaled $31.1 million, up slightly from a year ago. Special access declines were offset by increase in Universal Service fund revenue, driven by higher rates to end users during the quarter. Subsidy revenue was down approximately $600,000 due to a mandated reduction in state funding from the Texas high cost fund. We are filing an appeal, which is being filed by the Texas Telephone Association on the recent ruling in an effort to restore funding to prior levels.

Now turning to operating expenses. Exclusive of depreciation and amortization, were $214.3 million, up $10 million or 4.9% from the second quarter of 2020. Cost of services and products increased $5.8 million, primarily due to 2 factors. First, universal service fees increased $3.6 million as a result of higher-end user rates in the second quarter. As a reminder, these fees are pass-through expense and are neutral to EBITDA. Second, in the quarter, we recognized a $3.4 million one-time charge related to asset sale, which we treated as an add-back to adjusted EBITDA.

SG&A costs increased $4.2 million or $6.5 million or 6.5%, primarily due to an increase in marketing expense targeting customers where we have completed the 1 gig upgrade and rolled out our new fiber products. And as Bob mentioned, we have upgraded more than 122,000 passings here to date. Net interest expense for the first quarter was $45.4 million, an increase of $14 million from a year ago. As displayed on Slide 7, the increase reflects our new capitalized balance sheet with a Searchlight investment and the global refinancing we completed last October, which allowed us to extend maturities, increase liquidity and reduce leverage.

For the quarter, noncash interest on the Searchlight note, combined with the amortization of deferred financing costs and the related discount totaled $10.9 million. The remaining increase in interest expense is primarily due to the higher mix of senior notes as compared to 2020. As a reminder, in early April, we completed a repricing of our term loan, further strengthening our balance sheet. The repricing, combined with a $400 million bond offering, reduced our annualized cash interest cost by approximately $18 million. At the end of the second quarter, we have over $500 million in liquidity, and we expect to receive the $75 million from the second stage of the Searchlight transaction once we receive FCC approval later this year.

Our new capital structure and strong liquidity position provides us with a fully funded build plan to return to growth. At June 30th, we recognized a noncash loss of $39.8 million related to the increase in the fair value of the contingent payment related to Searchlight. Slide 8 of our presentation outlines the investment steps of our Searchlight partnership. We have received approval under the Hart-Scott-Rodino Act, and in April, we received overwhelming support from shareholders who approved all proposals related to the investment.

Additionally, subsequent to the end of the second quarter, on July 15th, we received all required PUC regulatory approvals necessary for the conversion of the CPR issued to Searchlight. The second stage of the investment, which is $75 million, will occur following FCC approval, which is expected by year-end. The change in administration and in light of FCC and Team Telecom Review Processes have impacted the time line for approval. However, we are aware of no substantial issue or challenge to the petition.

The in state with Searchlight's full investment of $425 million will result with Searchlight holding approximately 35% of an estimated 112 million shares of common stock pro forma reflecting the full conversion of CPR. And upon the second closing, Searchlight's convertible equity interest or note will convert to perpetual preferred stock and will retain a 9% coupon. Cash distributions from the company's wireless partnerships totaled $12.7 million in the second quarter and are $22 million for the first half of 2021 as compared to $19.7 million for the first half of 2020.

Capital expenditures totaled $119.2 million in the second quarter, just over $195 in the first half of the year. 40% of our CapEx year-to-date is supporting our fiber network expansions and our digital transformation technology. Our fiber growth plan is fully funded in our 5-year plan to upgrade at least 70% of our service area with fiber gig plus capable services, enabling highly competitive broadband services, is off to a great start.

Today, I'll affirm our previous guidance for 2021, which is outlined on Slide 9. Capital expenditures are expected to be in the range of $400 million to $420 million. This guidance reflects increased investment levels driven by our build and success-based CapEx related to the fiber expansion plan. Adjusted EBITDA is expected to be in the range of $500 million to $510 million. Cash interest expense is expected to be in the range of $130 million to $135 million. We expect to take the Searchlight investment at least through 2022 and have the option to do so through 2025. Cash income taxes are expected to be in the range of $2 million to $4 million.

With that, I'll now turn it back over to Bob for closing remarks.

C. Robert Udell - *Consolidated Communications Holdings, Inc. - President, CEO & Director*

Thanks, Steve. While it's early on in our 5-year growth plan, I'm very pleased with the team's ability to exceed our fiber upgrade targets and to be on track with a very aggressive first year build plan. I'm confident in our ability to deliver a differentiated superior fiber product with an excellent customer experience and with improved digital capabilities. Furthermore, I am very confident in the fiber construction machine we are developing as we continue to scale. The investments we are making today is creating a new trajectory and path forward for the growth of consolidated communications. We have a clear plan for growth and the expertise to execute on this strategy as demonstrated by our first half of the year results. Our balance sheet is strong, and we have the support from an experienced strategic partner in Searchlight. We are on a path to return to total company top line growth in 2023.

In closing, I want to thank our consolidated team who is working hard to deliver on this bold plan. Our path forward is all about building long-term sustainability and value for our investors, our customers and our employees. I couldn't be more excited for what our future holds. Adam, we'll now take questions.

QUESTIONS AND ANSWERS

Operator

Your first question comes from the line of Greg Williams with Cowen.

Gregory Bradford Williams - *Cowen and Company, LLC, Research Division - Director*

I have 3 questions, if I may. The first one is on the wireless CAF distribution. It sounds like $12.7 million is coming in a little higher-than-expected and trends, and where do you see that shaking up through the end of the year? I assume it comes down in the second half as you typically guide around $37 million to $39 million for the year and assuming that still holds. Second question is, just on bottlenecks and inflation. Bob, you mentioned that your plans don't see any bottlenecks now and in fact, your orders for 2022 are ready to go but maybe on the inflation side, I think last quarter, you mentioned resin was creeping up a bit for the conduit. Are you seeing anything there that could cause a little more scrutiny. And then the last question is just on cable's response to your fiber build. You mentioned some good penetration levels and what's cable doing in response to your fiber deployment in their footprint?

C. Robert Udell - *Consolidated Communications Holdings, Inc. - President, CEO & Director*

Thanks, Greg. Steve, do you want to start with the wireless and then I'll take the other 2.

Steven L. Childers - *Consolidated Communications Holdings, Inc. - CFO & Treasurer*

Yes, sure, Greg. The question on wireless. I appreciate the question. So yes, previously, we have always said we'd be in the range of 37% to 39% for full year, and to your point, you're exactly right. We are running ahead of where we thought we would be for the first half of the year. And so if we would hit what's in our internal models, we would be at 41%. So we're cautiously optimistic that we're going to exceed that $39 million that we've been talking about. But again, that assumes we kind of hit our internal numbers for Q3 and Q4. And I will remind you, we don't -- as a limited partner, we don't have a lot of visibility to what's coming down the pipe from Verizon. So we wish them the best and putting up good numbers the rest of the year. And I will remind you that we did have $41 million in cash distributions at the end of -- for 2020 but we're a little bit cautious since we don't necessarily have the control of the checkbook [terms].

C. Robert Udell - *Consolidated Communications Holdings, Inc. - President, CEO & Director*

With regards to the second part of your question, bottlenecks or inflation, no, we really don't see any bottlenecks at this stage on the fiber construction side. We're actually seeing improved delivery on commit dates, and we feel pretty good about even the start of 2022 from a terminal and miscellaneous equipment perspective. On the CPE side, we're a little more cautious from a chip perspective. We're all trying in this industry to make the transition from WiFi 5 to WiFi 6, and so seeing that product delivery slip a little bit is causing us to work even closer with those vendors that we have that integrate with our digital infrastructure for service delivery and create some additional options. So. we've got good flexibility with the inventory we have on WiFi 5 product or access to inventory WiFi product, but we're being a little bit cautious on the move to WiFi 6. As far as pricing, I haven't seen anything from an inflation perspective. We've got some long-term contracts. We made some volume commitments last fall, and so we feel like we're in a pretty good shape to hedge at least for the next couple of years from an inflation perspective. And with respect to your cable response to fiber build, I think we're so small still that we don't get a ton of attention. We're seeing some natural speed upgrades by cable in some of our markets, but it's a natural pattern that we ourselves have deployed. And with the 1 gig symmetrical product, it is hard to compete with. We feel very confident in that product, the simple service experience for how it's ordered, and so I don't think anyone can really match us in the reliability of what we're deploying in our fairly suburban and rural markets compared to it being more distant cable markets from a plant perspective. So I feel good about our product.

Operator

And your next question comes from the line of Eric Luebchow with Wells Fargo.

Eric Thomas Luebchow - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

Just 2 from me. So first, on the fiber build. Obviously, good penetration levels so far. Maybe you could talk about the activity. Are they mostly net new customers to consolidate it? Or are you seeing more of the early gross adds coming from existing customers that may be upgrading from DSL or fiber to the node, where the sales process might be a little easier. And then secondly, I'm curious your aspiration to get the total company top line growth by 2023. I think we can get our arms around the consumer broadband business and the opportunity there. Maybe you can talk about the commercial and carrier segment. At what point in some of these growth areas, Ethernet, SD-WAN that you talked about can offset some of the legacy declines in products like voice?

C. Robert Udell - *Consolidated Communications Holdings, Inc. - President, CEO & Director*

Yes. Great. Let me start first with the activity on the fiber builds from a passing perspective. We're really benefiting from probably 60% being new adds, and that is growing because where we're upgrading, we're hitting some of the areas where, I think, competitive activity on the cable side has outpaced our DSL loop shortening, and that's why we've made the transition as we have and obviously started that process about a year ago in planning and are now executing on it. So it's going from 59%, 60% gross new adds to higher as the quarters progress, and we feel good about that. In terms of the top line growth, I would tell you that commercial and carrier continues to benefit from transport and data growth. That is not necessarily consistent across the industry, and we've been able to do that because we continue to have a pretty strong network product that we extend for customers between the $500 a month range and higher. As soon as they go for a dedicated Ethernet product, we're doing almost all of that with fiber versus a bundled copper solution. And so that allowed us to have some consistent growth and high reliability in that bucket. And so when we do our planning and look at all the regions in which we're deploying fiber from an FTTP perspective, we feel pretty confident that we'll be in a good position to see those lines crossed from a revenue decline on voice, offset with a growing fiber-based broadband growth curve. Steve, anything to add?

Steven L. Childers - *Consolidated Communications Holdings, Inc. - CFO & Treasurer*

Yes, Bob, I agree with what everything you just said. I guess the reminder to Eric and everybody else on the call, part of the calculus and saying we're going to return to growth is we're obviously very focused and very excited about the FTT plan, everything that you said on commercial and carrier side. I think we've demonstrated that we have best-in-class teams in that area. I think we're one of the few putting up consistent growth on the commercial or on the enterprise side. And then I would just remind you that we do have to reset from RDOF from CAF-II to RDOF funding January 1, '22, I think everybody has built into their models right now, but that is being taken into consideration in the top line growth number for 2023. I think you'll start seeing some sequential growth in 2022 due to the plan and consistency of the commercial carrier teams.

Operator

And your next question comes from the line of Ana Goshko with Bank of America.

Anastazia Goshko - *BofA Securities, Research Division - MD*

So just a follow-up on the prior question and comment. So in the -- with the gross adds that you're getting on the fiber-to-the-home, to clarify, are those actually competitive wins from cable and if so, on what basis? Is it the superiority of the product or are you being promotional as well?

C. Robert Udell - *Consolidated Communications Holdings, Inc. - President, CEO & Director*

Yes. We're absolutely being aggressive with marketing and demonstrated our pop in marketing spend. We're trying new things and cycling quickly through programs that work. And so I would say there are competitive wins from cable, where we have a duopoly. And they're based on our local activity in the market. We start with the softening of the market with construction, kind of like the air attack, if you will. Set up a website, very tightly managed for soliciting interest, do some PR, then we do direct mail and then direct sales comes in and helping us drive both electronic, which is really low cost, customer onboarding and marketing and onboarding. And then the direct sales spreads word-to-mouth as well as in itself produces sales. And so that kind of air attack and ground troops coming in with door-to-door is really an equation that works quite well.

Anastazia Goshko - *BofA Securities, Research Division - MD*

Okay. And then I was referring to promotional pricing. I'm just -- how aggressive are you being on promotional pricing.

C. Robert Udell - *Consolidated Communications Holdings, Inc. - President, CEO & Director*

Yes. I would tell you, on commercial, we really lean on our relationship with the customer. And so we take the -- first, the customer's input on what they're doing with broadband and then focus on providing them a solution. And we have our building blocks from a product perspective, whether it's DDoS or cloud secure that allows us to -- or SD-WAN, it allows us to use the new technology to solve a problem for them. And so we're definitely competitive on price, and the fiber has high reliability and so the maintenance behind it after it's installed, it isn't high. And I think that equation with our aggressive work with the customer to understand what their use of broadband looks like allows us quickly to assess how we solve the problem for them with a competitive price. So we're definitely competitive. I wouldn't say we're under pricing competition.

Anastazia Goshko - *BofA Securities, Research Division - MD*

And then secondly, just a follow-up on the topic of some of the post pandemic impacts we're seeing on pricing and inflation and the labor market. Do you have adequate labor now or are there unfilled positions in your company that potentially could be a hindrance to either the rollout or kind of other parts of your operations?

C. Robert Udell - *Consolidated Communications Holdings, Inc. - President, CEO & Director*

We have sufficient resources to meet our plan, and we continue to iterate on other areas that we might expand to. So we don't see a labor or inflation challenge right now, but we watch the economy in the world around us. I can't see inflation or labor challenges hurting us any worse than any other competitor. In fact, I think we're better positioned because of our culture, and we've got a sticky culture. Our tenure and retention of employees is outstanding, and we have provided a new opportunity for employees to renew their excitement around bringing a wonderful service to the communities that we serve in suburban and rural areas. So there's a lot of energy in the company right now. We have a lot of good candidates for positions that might become open. And so I don't see any labor shortage that's impacting us in the foreseeable future, but we're always looking for good people and so far have a good pipeline for them.

Anastazia Goshko - *BofA Securities, Research Division - MD*

And then final question. I know you've got a lot on your plate right now, but it looks like there are kind of other local markets potentially available around the country. Are you open to any kind of acquisitions or tuck-ins or M&A at this point?

C. Robert Udell - *Consolidated Communications Holdings, Inc. - President, CEO & Director*

I would tell you that never say never, but we're really focused on executing our plan that's in front of us now and we think there's more value in our organic builds than trying to chase the price up on additional M&A activity, but we've got some great partners in Searchlight that are really good at assessing those opportunities. and so I'm really fortunate to have them as a -- specifically, Andrew Frey as my -- contact there, as a partner that allows us to see and evaluate opportunities that come across their radar.

Operator

There are no further questions at this time. I would like to turn the call back over to Mr. Bob Udell.

C. Robert Udell - *Consolidated Communications Holdings, Inc. - President, CEO & Director*

Thank you, Adam, and thank you all for joining the call today. We appreciate you tuning in and look forward to updating you on our third quarter results. Have a great day.

Operator

This concludes today's conference call. You may now disconnect.
