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Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Consolidated Communications' Second Quarter 2020 Results Conference Call. (Operator Instructions) Please be advised that today's conference call is being recorded.

I would now like to hand the conference over to your speaker today, Ms. Jennifer Spaude. Thank you. Please go ahead, madam.

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

Thank you, and good morning. I would like to welcome everyone to Consolidated Communications' Second Quarter 2020 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 our operational results as well as how we are managing our business through the COVID-19 pandemic. Steve will provide details on our second quarter financial performance. Following the 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 our 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 expected future events and financial results that are forward looking and subject to certain risks and uncertainties. A discussion of factors that may affect future results is contained in Consolidated's 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 continue to operate effectively during this unprecedented and uncertain time. I am very pleased with the solid and stable results we delivered in both the second quarter and the first half of the year. We are successfully executing on our financial priorities as we deliver stable adjusted EBITDA and strengthen the balance sheet. We accomplished both again this quarter despite the challenging environment. The company's strong performance is a reflection of our team's hard work and dedication to serving our residential, business and carrier customers.

I am proud of our progress, and I'm confident that Consolidated is well positioned to continue this momentum through the second half of the year. In the recent quarter, we grew broadband and data transport revenue and reduced operating expenses, which allowed us to achieve stable revenue



and generate increased adjusted EBITDA. I continue to be inspired by the Consolidated team's resilience, and I'm proud of their ability to adapt and respond. As a critical infrastructure provider, we play a fundamental role in keeping consumers and businesses connected each and every day.

We continue to see increased traffic across our core backbone, and I'm pleased to report our network is performing very well and is designed to handle the increased usage. This is the result of our network architecture and our careful planning by our network team. The numerous safety measures we implemented to ensure business continuity are working and enable our teams to focus on supporting our customers. The safety and wellness of our employees and customers is our #1 priority.

We've demonstrated that our business is quite resilient. We've adjusted our operations and are closely monitoring any business impacts. At this time, I'm pleased to report there are no major disruptions or impacts as a result of COVID-19.

I'll provide more color on each of the customer channels as I discuss second quarter results. Let me start by sharing some highlights. Starting with data and transport, where revenue grew 1.2%, we demonstrated our consistent track record of revenue growth. Our carrier channel remained strong with continued 10-gig densification, including fiber and wave upgrades driving most of the activity. We're making it easy for our wholesale customers to increase capacity with efficient expedited order process where needed. Our sales team is doing an excellent job of maintaining strong relationships and collaborating closely with carriers as we identify transport solutions that offer diversity and maximize utilization for peak performance.

Our tower connections under contract increased 3% year-over-year, totaling 3,900 connections. A vertical, we continue to actively support is higher education. We recently won the Texas A&M University RFP for a 200-gig fiber connection to support their requirements and augment a statewide network between college station and Dallas. Through our relationships with this higher education institution, we have created a robust self-healing and scalable solution to meet their data and security and reliability needs. Beyond higher education, our hyperscale relationships and successful track record with a leading Internet technology company has allowed us to win a fiber build contract, connecting data centers and adding significant metro fiber to our assets.

As we build out carrier-grade capacity, our fiber network investments allowed us to increase on-net buildings by 15% from a year ago, totaling approximately 12,900. The vast majority of our new sales across all customer groups are on-net, which correlates to higher margins, increased opportunity to add products and a greater ability to ensure the best customer experience, ultimately attributing to customer retention.

Within our commercial channel, we are seeing demand for bandwidth upgrades and unified communications, collaboration solutions as well as data center services. Our SD-WAN sales pipeline is higher than it has ever been and is driving Metro E and cloud voice sales. VoIP revenue increased 12%. Just this week, we launched a really cool service Enterprise@Home, which is a secure solution connecting home offices with business class Internet and a full-featured unified communications platform. We listen to our business customers' needs and developed a solution that eases administrative and technical challenges, especially for employees managing remote locations.

We continue to see strong demand for our ProConnect Unified Communication Solution, which we recently expanded into Northern New England. We've been helping customers like a County Courthouse that leveraged our cloud-based collaboration solution across 40 county facilities all on-net. ProConnect's robust VoIP solution replaced an outdated call manager in this situation, giving the customer advanced features and collaboration tools as well as easier remote work arrangements.

Customers are seeing the many benefits of SD-WAN, including a Pennsylvania-based health organization, which recently upgraded 11 sites. This customer needed more visibility into their locations, especially as they ramped up use of telemedicine. Our SD-WAN solution, along with an LTE failover, gave the customer an affordable and flexible backup option and ultimately, more control over their network. Despite concerns about revenue pressures, we are finding the vast majority of our SD-WAN upgrades result in increased customer revenue. Route diversity and fiber connectivity between multistate sites was the key priority for a main-based financial institution. We won this business based on competitive pricing, a cost-effective fiber build and nimbleness to add a second 10-gig connection with complete diversity.

Our commercial sales team has modified and refined its sales approach, using a hybrid of virtual tools to meet customers where it makes the most sense. This quick pivot has been key in our ability to maintain our data and transport revenue growth. Within the consumer channel, we're very



proud to have achieved the fifth consecutive quarter of broadband revenue growth. Our strategy of leading with broadband services and continuous speed improvements is working. We continue to see higher consumer broadband order activity up nearly 50% from first quarter and 75% year-over-year. Our past investments allow us to efficiently and expeditiously complete more customer upgrades without requiring a technician visit.

CCiTV, our streaming video service, is fully launched in Northern New England and recently expanded the service in Texas. We continue to see the majority of subscribers bringing their own device. The easy self-install product further reduces overall capital intensity compared to a traditional video. We will further expand CCiTV in legacy markets this year, and we just announced a small business offering in Northern New England.

As you can see on Slide 10 of our presentation, our extensive fiber -- regional fiber networks connect essentially 100% of our consumer customer base to the network through either fiber-to-the-node or fiber-to-the-home. This fiber density and close proximity to customers gives us options to meet the demands for increased bandwidth. We are deploying new technologies in fiber-to-the-node areas that allow us to deliver speeds up to 500 meg per second. Our fiber density positions us well to partner with communities to deploy last mile fiber in rural areas that would otherwise be difficult to justify financially. We previously completed 2 community builds, one in Chesterfield, New Hampshire and one in Brooklin, Maine, and we currently have 5 builds underway in New Hampshire, all slated for completion in early 2021. We've accomplished a lot in this quarter. And through a combination of efforts, including public-private partnerships and innovative new technologies, we are building a more competitive consumer broadband business, and we know there is more work to do. We are taking additional steps to ensure we are the best positioned to capitalize on future opportunities in the market.

I will now turn the call over to Steve, who will provide more details on our financial results for the second quarter. Steve?

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

Good morning. As our earnings release outlines, we delivered another strong quarter of financial results. We continue to monitor key metrics of the business and for each customer channel. And so far, we have not seen any material impacts on our financials or cash flows as a result of current economic conditions caused by the pandemic.

Slide 3 of our earnings presentation summarizes the company's second quarter results. Operating revenue for the second quarter totaled \$325.2 million, while down 2.5% compared to Q2 '19, does represent a 200 basis point improvement over the comparable period 1 year ago.

As a result of improving revenue trends and ongoing cost structure improvement, second quarter adjusted EBITDA of \$133.1 million was up \$1.7 million from a year ago.

Commercial and carrier revenue totaled \$145.8 million in the second quarter. Data and transport revenue grew 1.2% and totaled \$89.6 million. Commercial voice service revenue declined \$1.4 million or 2.9%, which is a 2% sequential improvement. Other revenue declined \$3 million, primarily due to lower equipment sales. We have seen a slowdown in equipment sales, and we could see additional delays in customer decision-making over the last half of the year due to the current economic conditions. However, the impact on these low-margin revenues will be nominal.

We are continuing to closely monitor our small business, or SMB customers. And in the current environment, we could see a slowdown in sales and could see some higher customer churn over the last half of the year. Our carrier sales team continues to see strong demand for wireless backhaul to support capacity upgrades and 5G rollout with national and regional carriers. Capacity upgrades and expedites nearly doubled in the recent quarter, generating higher new incremental revenue run rate with wireless providers. These upgrades were completed in days and not months, which is a key differentiator and demonstration of our value in partnership with the wireless providers.

There are no material impacts that we are seeing with the carrier channel related to COVID-19. Overall, commercial and carrier channels remained strong and have a solid pipeline.

Now turning to our consumer channel, where revenue totaled \$127.9 million. Revenue was down just 1.3% or \$1.7 million in the second quarter. The second quarter decline is essentially half of Q1. Consumer broadband revenue grew for the fifth consecutive quarter and was up more than

2% in the second quarter. Consumer ARPU increased 5.7% year-over-year, totaling approximately \$75. Our strategy of leading with broadband, specifically in our newly upgraded areas is working and driving higher retention and higher ARPU.

Consumer voice revenue was down approximately 5% or \$2.1 million year-over-year. The decline in consumer voice was reduced by more than 1/2 from a year ago and improved slightly sequentially. We attribute this to a more robust and competitive broadband offering, which contributes to higher voice retention. Our video revenue declined 5.5%, an improvement of 2.3% from a year ago. And as Bob mentioned, we're gaining strong momentum with our CCiTV streaming services as we transition our video strategy. The \$1.1 million video revenue decline was more than offset by reductions in video programming expense and lower CapEx.

Network access revenues declined \$3.7 million, largely due to special access declines, while subsidy revenue was down slightly and remained at our expected \$18 million per quarter run rate.

With respect to the upcoming art of auction, we do plan to participate and have completed our short-form filing. We are evaluating the funding opportunities and potential returns on invested capital and will be selective as we look to enable to access underserved areas. We see good opportunities to bring high-speed broadband services to rural areas that are economically very difficult to serve today.

Now turning to operating expenses. Excluding depreciation and amortization, operating expenses totaled \$204.3 million, an improvement of \$17.6 million or an 8% decline from the prior year. We continue to identify and implement initiatives to transform the business and optimize free cash flow, which increased \$39.4 million in the recent quarter and is up \$89.3 million year-to-date.

Cost of services and products declined \$4.2 million, driven by lower CPE sales, video programming expense and salaries and benefits associated with ongoing cost-savings initiatives. Our cost of goods and service expense will fluctuate with revenue, especially on equipment sales and linear video content cost.

SG&A costs were reduced \$13.4 million in the recent quarter, primarily due to operational synergies and ongoing efficiencies.

With respect to bad debt, we continue to monitor customer payment activity closely. And at this time, we have not seen a material difference in our accounts receivable agings or daily cash receipt trends.

Net interest expense for the quarter was \$31.5 million, down \$3.3 million from the same period last year. Our weighted average cost of debt was approximately 5.3% at the end of the quarter.

Cash distributions from the company's wireless partnerships were \$9.6 million in the second quarter compared to \$10.6 million a year ago and are in line with our anticipated distribution levels. Historically, our cash distributions have been in the range of \$35 million to \$37 million a year. Based on the visibility that we have at this time, we expect cash distributions to be in line with historical run rates.

Adjusted net income per share was \$0.19 compared to a net loss of \$0.10 per share a year ago. The improvement reflects the consistency of our operating results and a decline in depreciation expense.

We invested approximately \$54 million in capital expenditures during the second quarter and \$96 million in the first half of the year, which supported success-based projects and broadband network infrastructure expansion.

Total liquidity, including cash on hand and availability under our revolver, was approximately \$137.3 million. In response to the economic impact of COVID-19, we have been and will be focused on maximizing liquidity.

Consistent with our capital allocation plan, we are focused on our delever first strategy with all cash flow committed to debt reduction or building cash liquidity. Since late in the first quarter, we have placed a higher priority in paying down the revolver and preserving cash and pursuing open market purchases of our bonds. Since December 31, we have reduced our total debt by \$56 million, an increase cash on hand by \$33 million.

Our net debt leverage ratio is 4.14x at the end of the second quarter, down from 4.33x at the end of the year. We will continue to commit all free cash flow to improving the balance sheet with the goal of getting our net leverage target of less than 4x by the end of the year. Our business is strong and stable, and we have demonstrated our ability to manage cost and make notable progress toward our capital allocation plan.

While COVID-19 continues to be prevalent and economic visibility is taking shape, we are not restating our 2020 guidance at this time.

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

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

Thank you, Steve. In closing, I want to reiterate how pleased I am with results and our team's nimbleness in adapting during these challenging times. Our efforts have enabled us to mitigate the impact of the pandemic on our business to continue serving our customers and deliver solid and consistent results in the second quarter and first half of the year. We remain laser focused on our strategic initiatives because we believe the continued execution on our plan will differentiate us within our industry and generate recognition for the fiber-rich assets we've built. As a result, our company is well positioned to capitalize on future opportunities and accelerate our growth trajectory.

Our strategic imperatives, which are outlined on Slide 10, continue to be our road map for success, and we are making notable progress with each one. We are producing stable earnings and growing our free cash flow. We are leveraging our fiber assets across 3 customer groups and demonstrating revenue growth in broadband and data transport, and we are executing on our capital allocation plan, demonstrating disciplined cash management and improving the balance sheet. Not only are we building better broadband networks, we are building stronger communities as evident with our recent support of food banks in the communities we serve and our employees' ongoing volunteer efforts. We have a strong, stable business and outstanding group of employees and continue to operate without material impacts related to these challenging times.

Operator, we'll now turn to questions at this time.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) It looks like our first question comes from the line of Greg Williams with Cowen.

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

So can you talk a little bit more about the small and medium business segment that you cautioned maybe a slowdown in possibly higher churn. It seems like your commercial business is doing very well, but the SMB side could see some weakness. And the second question is somewhat related. You posted very solid EBITDA, but you're not reinstating your guidance. What are the uncertainties? Is it the SMB segments? Or are there other COVID-19 uncertainties that you wanted to flag that keeps that guidance on the sidelines?

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

Yes. Thanks, Greg, and appreciate your patience. I've not experienced that kind of delay before. First, let me start with the second question, and Steve will take the rest. It's a interesting time with COVID cases increasing, and it just seems like the prudent thing to do to keep watching these revenue trajectories and cash remittance and all those things that we're watching on a recurring basis. So let Steve talk more specifically about the SMB.



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

Yes, Greg, this is Steve. So relative to the SMB, we talked last time on the call, that is about 7% or 8% of our total revenue. We are watching it very closely. And we had -- again, fortunately, through the second quarter and even as we speak today, we haven't seen any material impacts to the business as a result of COVID-19. But we really do remain cautious. And I don't think the remaining companies are reinstating guidance at this time. But with respect to the SMB, we are -- we could see -- again, we're operating in 23 different states. Everybody, every operating platform that we have, it's in a little bit of a different position relative to reopening of the economy when restaurants, hotels, whatever, open it up. So I think we are just being cautious. Again, we're -- relative to the SMB group, I think we've added -- fortunately, over the course of the year, we've added resource into that group to have more contact with the SMB group. But we do expect to see maybe a little slowdown in the sales piece on SMB as they come back, as economy reopens and then we -- again, we could see a little bit of higher churn, but we haven't seen that yet. We really haven't seen an increase in our AR agings, that I mentioned on the call. So I think we're in abundance of caution relative to what we could see SMB, maybe some delays in the equipment sales, which we, again, in the commercial group, which we would expect to not have a material impact in the business. I think we're just being cautious on what we don't know about the economic recovery.

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

Great. Can I sneak in another question. You've been talking about selling noncore assets for quite a while in this environment. Is that on pause? Or the liquidity back in the markets? Do you see activity and potential to sell noncore assets in the near term?

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

Yes. I think -- Greg, this is Bob. I think that, that's always something that's been in -- on our radar. And I wouldn't call any of our assets really noncore because we are intentional about expanding broadband in all of our operating areas. But what I would say is when there's someone nearby or interested, we're responsive to that. And so we're doing what we always have done. Looking at those opportunities, responding to them when they arise and we're really always in discussions with someone to see if they can bring faster speeds on a more rapid basis to those communities, then we'll do a deal. So there's nothing new to say until there is. That's about all I have.

Operator

(Operator Instructions) Our next question comes from the line of Davis Hebert with Wells Fargo.

James Davis Hebert - Wells Fargo Securities, LLC, Research Division - Director & Senior High Yield Analyst

One thing we've seen with COVID-19, I think, is the elevated activity on broadband, and you put out a really good net addition number this quarter. Are you seeing a decent backlog or pipeline that gives you more visibility on sustainable broadband growth for the rest of the year?

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

Yes. I would say the way we think about that is looking at year-over-year, there's definitely a stronger pipeline. I'll remind you, we have some seasonality in third quarter that's natural with the Northern New England property, or I guess, it's really in the fourth quarter and the third, beginning of fourth. And while we think that might be a bit muted this year and the growth may slow down, we think there's good logic to expect year-over-year improvements.

James Davis Hebert - Wells Fargo Securities, LLC, Research Division - Director & Senior High Yield Analyst

Okay. That's helpful. And then there was a pretty decent step down in SG&A costs for the quarter. And I think, Steve, you alluded to cost controls. Is that a sustainable level of SG&A we should expect going forward?

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

So David, thanks for the question. I think it is. I think we -- I mean there's -- year-over-year there were a few things going on in the second quarter of last year as we rounded out the integration or at least the 2-year window we had credit agreement for integration related expenses to get synergies from FairPoint. We were still -- again, we were in the final stages of -- even though that work has really never done, we really were accelerating some things in Q2 last year to try to maximize synergies within that 2-year window. So coming forward, I think we're benefiting from everything we did relative to the integration. We also did some pretty heavy lifting on cost structure in Q3, Q4 last year across the organization. So I mean, I do think we have sort of a new benchmark on SG&A kind of going forward, and it may fluctuate as we -- the reverse of the COVID or the impact of COVID on expenses. We probably had a little less advertising in Q2. We had less travel expense, as everybody is working at home. And -- well, as we get back into the market, we'll probably see a little bit of an increase there. But I think we've got -- we just have -- we have a repeatable cost structure going forward.

James Davis Hebert - Wells Fargo Securities, LLC, Research Division - Director & Senior High Yield Analyst

Okay. That's helpful. And I saw you added the fiber-to-the-home route miles to your fiber count. And I wonder if you could give us an update of the percentage of homes passed with fiber to the home. Is there any update there?

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

Well, I think the way to think about it is we're always matching the competitive situation with our speed upgrades to the best of our ability. And so we have really 100% of our network, either fed by fiber-to-the-home or fiber-to-the-node. And in the fiber-to-the-node areas, we're at max, on the average, 2,000 to 2,500 feet from the customer, and we're getting 500 meg with some of the newer technologies we're deploying. And so our cost for incremental upgrades is really low. And it's a progressive thing that we're doing to match the competition. And our sweet spot seems to be about 100 meg right now, but we're continuing to expand the amount of 1 gig passings we have. And that's about as specific as I can get right now.

James Davis Hebert - Wells Fargo Securities, LLC, Research Division - Director & Senior High Yield Analyst

Okay. That's helpful. And my last question is, I respect that in being conservative, you don't want to give guidance, but it seems like things are on track to date. And how do you think about your deleveraging plan and a recapitalization of your debt over the next 12 to 18 months?

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

David, this is Steve. I'll take that one. I mean we have shifts since we made the change capital allocation policy, and committed to all free cash flow going towards delevering at the end of Q1 last year. We've shown every quarter, not decent -- I shouldn't say decent, I should say, really nice progress towards our deleveraging. Our goal is still to get to 4x by the end of the year, and we want to do a global refi as soon as we can. As Bob talked about the network, we see a lot of growth potential and opportunity across our footprint. And we're ready to -- again, that's been our story since we changed capital allocation policy, right, care for the refi and then pivot to investment. That's still our thinking. And again, with the pace that we're going at right now, again, we're not reinstating guidance, but every dollar of free cash flow will continue to go towards debt reduction to get us towards that 4x as fast as we can go.

Operator

(Operator Instructions) And I'm showing no further questions, and I would like to turn the conference back over to Bob Udell for any further remarks.

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

Thank you. Well, thank you all for joining the call today. We appreciate your support of Consolidated Communications, and we look forward to updating you next quarter. Have a great day, and please stay safe.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program, and you all disconnect. Everyone, have a great day.

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