

CINCINNATI BELL INC
Form 10-Q
November 08, 2010
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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, 2010

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

For the transition period from _____ to _____

Commission File Number 1-8519

CINCINNATI BELL INC.

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Ohio
(State of Incorporation)

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

221 East Fourth Street, Cincinnati, Ohio 45202

(Address of principal executive offices) (Zip Code)

(513) 397-9900

(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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

At October 31, 2010, there were 201,781,187 common shares outstanding.

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Cincinnati Bell Inc.

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Form 10-Q Part I

Cincinnati Bell Inc.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in millions, except per share amounts)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Revenue				
Services	\$ 308.4	\$ 291.3	\$ 892.3	\$ 878.7
Products	43.5	46.4	121.9	112.1
Total revenue	351.9	337.7	1,014.2	990.8
Costs and expenses				
Cost of services, excluding items below	107.8	102.0	304.7	304.9
Cost of products sold, excluding items below	45.0	50.9	128.0	126.1
Selling, general and administrative	68.3	64.7	202.7	209.4
Depreciation and amortization	48.2	41.2	129.7	122.0
Restructuring charges (gains), net		0.9	5.2	(5.5)
Loss on sale of asset		4.8		4.8
Acquisition costs			9.1	
Total operating costs and expenses	269.3	264.5	779.4	761.7
Operating income	82.6	73.2	234.8	229.1
Interest expense	52.0	31.5	131.5	94.6
Loss (gain) on extinguishment of debt		(7.6)	10.4	(7.4)
Other expense (income), net		(0.1)	0.1	
Income before income taxes	30.6	49.4	92.8	141.9
Income tax expense	16.1	21.7	45.9	59.1
Net income	14.5	27.7	46.9	82.8
Preferred stock dividends	2.6	2.6	7.8	7.8
Net income applicable to common shareowners	\$ 11.9	\$ 25.1	\$ 39.1	\$ 75.0
Basic earnings per common share	\$ 0.06	\$ 0.12	\$ 0.19	\$ 0.35
Diluted earnings per common share	\$ 0.06	\$ 0.12	\$ 0.19	\$ 0.34
Weighted average common shares outstanding (in millions)				
Basic	201.2	209.0	201.0	215.7
Diluted	204.2	213.2	204.9	218.1

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

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CONDENSED CONSOLIDATED BALANCE SHEETS**(Dollars in millions, except share amounts)****(Unaudited)**

	September 30, 2010	December 31, 2009
Assets		
Current assets		
Cash and cash equivalents	\$ 34.2	\$ 23.0
Receivables, less allowances of \$15.0 and \$17.2	170.5	159.9
Inventory, materials and supplies	25.7	23.7
Deferred income taxes, net	52.3	83.9
Prepaid expenses	11.9	29.0
Other current assets	2.2	1.5
Total current assets	296.8	321.0
Property, plant and equipment, net	1,261.8	1,123.3
Goodwill	343.0	71.9
Intangible assets, net	238.9	110.1
Deferred income taxes, net	382.2	393.6
Other noncurrent assets	70.3	44.4
Total assets	\$ 2,593.0	\$ 2,064.3
Liabilities and Shareowners Deficit		
Current liabilities		
Current portion of long-term debt	\$ 21.6	\$ 15.8
Accounts payable	88.1	106.2
Unearned revenue and customer deposits	49.0	46.6
Accrued taxes	15.9	14.8
Accrued interest	34.0	40.2
Accrued payroll and benefits	43.0	39.2
Deposit received for sale of wireless towers	4.7	25.6
Other current liabilities	31.4	35.4
Total current liabilities	287.7	323.8
Long-term debt, less current portion	2,458.0	1,963.3
Pension and postretirement benefit obligations	307.3	314.9
Other noncurrent liabilities	151.4	116.9
Total liabilities	3,204.4	2,718.9
Shareowners deficit	129.4	129.4

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Preferred stock, 2,357,299 shares authorized, 155,250 shares (3,105,000 depositary shares) of 6 ³ / ₄ % Cumulative Convertible Preferred Stock issued and outstanding at September 30, 2010 and December 31, 2009; liquidation preference \$1,000 per share (\$50 per depositary share)		
Common shares, \$.01 par value; 480,000,000 shares authorized; 202,331,684 and 201,039,764 shares issued; 201,772,574 and 200,383,886 outstanding at September 30, 2010 and December 31, 2009	2.0	2.0
Additional paid-in capital	2,614.7	2,619.7
Accumulated deficit	(3,220.0)	(3,266.9)
Accumulated other comprehensive loss	(135.2)	(136.1)
Common shares in treasury, at cost: 559,110 and 655,878 shares at September 30, 2010 and December 31, 2009	(2.3)	(2.7)
Total shareowners deficit	(611.4)	(654.6)
Total liabilities and shareowners deficit	\$ 2,593.0	\$ 2,064.3

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

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Cincinnati Bell Inc.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**(Dollars in millions)****(Unaudited)**

	Nine Months Ended September 30,	
	2010	2009
Cash flows from operating activities		
Net income	\$ 46.9	\$ 82.8
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	122.6	118.9
Amortization	7.1	3.1
Loss (gain) on extinguishment of debt	10.4	(7.4)
Loss on sale of asset		4.8
Provision for loss on receivables	10.8	16.7
Noncash interest expense	5.8	3.0
Deferred income tax expense, including valuation allowance change	42.4	56.2
Payments in excess of pension and other postretirement expense	(6.1)	(4.8)
Other, net	1.4	4.4
Changes in operating assets and liabilities, net of effects of acquisitions		
Increase in receivables	(11.8)	(5.0)
Decrease in inventory, materials, supplies, prepaid expenses and other current assets	14.8	10.1
Decrease in accounts payable	(19.5)	(3.0)
Decrease in accrued and other current liabilities	(13.8)	(37.1)
(Increase) decrease in other noncurrent assets	(2.4)	7.4
(Decrease) increase in other noncurrent liabilities	(4.0)	0.2
Net cash provided by operating activities	204.6	250.3
Cash flows from investing activities		
Capital expenditures	(101.2)	(141.7)
Acquisitions of businesses, net of cash acquired	(526.7)	(3.4)
Proceeds from sale of wireless spectrum		5.8
Other, net	0.5	0.8
Net cash used in investing activities	(627.4)	(138.5)
Cash flows from financing activities		
Issuance of long-term debt	1,353.4	
Increase (decrease) in corporate credit and receivables facilities, net	(85.9)	23.6
Repayment of debt	(791.6)	(32.4)
Debt issuance costs	(32.9)	(4.4)
Preferred stock dividends	(7.8)	(7.8)
Common stock repurchase		(59.4)
Other, net	(1.2)	(0.6)

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Net cash provided by (used in) financing activities	434.0	(81.0)
Net increase in cash and cash equivalents	11.2	30.8
Cash and cash equivalents at beginning of year	23.0	6.7
Cash and cash equivalents at end of period	\$ 34.2	\$ 37.5

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

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Cincinnati Bell Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**1. Description of Business and Accounting Policies**

The following represents a summary of the business and accounting policies of Cincinnati Bell Inc. and its consolidated subsidiaries (the Company). A more detailed presentation can be found in the Company's 2009 Annual Report on Form 10-K.

Description of Business The Company provides diversified telecommunications and technology services through businesses in three segments: Wireline, Wireless and Technology Solutions. On June 11, 2010, the Company purchased Cyrus Networks, LLC (CyrusOne), a data center operator based in Texas, for approximately \$526 million. The CyrusOne financial results are included in the Technology Solutions segment. Refer to Note 2 for further discussion concerning the CyrusOne acquisition.

Beginning in 2010, the Company realigned its reportable business segments to be consistent with changes to its management reporting. Certain data center operations that were historically included in the Wireline segment have been reclassified to the Technology Solutions segment. Prior year amounts have been reclassified to conform to the current segment reporting. Refer to Note 9 for further discussion concerning the Company's segments.

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

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

The Condensed Consolidated Balance Sheet as of December 31, 2009 was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. These Condensed Consolidated Financial Statements should be read in conjunction with the Company's 2009 Annual Report on Form 10-K. Operating results for the three and nine months ended September 30, 2010 are not necessarily indicative of the results expected in the subsequent quarter or for the year ending December 31, 2010.

Recently Issued Accounting Standards In September 2009, new accounting guidance under Accounting Standards Codification (ASC) Topic 605 related to revenue arrangements with multiple deliverables was issued. The guidance addresses the unit of accounting for arrangements involving multiple deliverables, how arrangement consideration should be allocated to the separate units of accounting and eliminates the criterion that objective and reliable evidence of fair value of any undelivered items must exist for the delivered item to be considered a separate unit of accounting. Such guidance is effective for fiscal years beginning on or after June 15, 2010. Early adoption is permitted. The Company has not yet assessed the impact of this guidance on the Company's financial statements.

In September 2009, new accounting guidance under ASC 605 was issued regarding tangible products containing both software and non-software components that function together to deliver the product's essential functionality. Such guidance is effective for fiscal years beginning on or after June 15, 2010. Early adoption is permitted. The Company has not yet assessed the impact of this guidance on the Company's financial statements.

Income Taxes The Company's income tax effective rate for the nine months ended September 30, 2010 was affected by several discrete items. In the nine months ended September 30, 2010, the Company recognized a \$7 million tax benefit associated with a change in the valuation allowance on state deferred tax assets that are expected to be utilized as a result of the CyrusOne acquisition. This tax benefit was more than offset by a \$6 million charge related to tax matters associated with the refinancing of the 8³/₈% Senior Subordinated Notes due 2014 and a \$4 million charge related to a tax law change in the first quarter of 2010 that now requires the application of federal income taxes against the retiree Medicare drug subsidy received by the Company.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**2. Acquisition of Cyrus Networks, LLC**

On June 11, 2010 (the Acquisition Date), the Company purchased Cyrus Networks, LLC, a data center operator based in Texas, for approximately \$526 million, net of cash acquired. CyrusOne is the largest data center colocation provider in Texas, servicing primarily large businesses. CyrusOne is now a wholly-owned subsidiary of the Company. The purchase of CyrusOne has been accounted for as a business combination under the acquisition method.

The following table summarizes the allocation of the assets acquired and liabilities assumed at the Acquisition Date:

(dollars in millions)	
Assets acquired	
Receivables	\$ 10.4
Other current assets	0.4
Property, plant and equipment	153.6
Goodwill	270.9
Intangible assets	136.3
Other noncurrent assets	0.1
Total assets acquired	571.7
Liabilities assumed	
Accounts payable	3.1
Unearned revenue and customer deposits	7.7
Accrued taxes	1.0
Accrued payroll and benefits	0.7
Other current liabilities	0.8
Noncurrent liabilities	32.1
Total liabilities assumed	45.4
Net assets acquired	\$ 526.3

As required under ASC 805, the Company has valued the assets acquired and liabilities assumed at fair value. The Company has determined the fair value of property, plant and equipment, identifiable intangible assets and noncurrent liabilities with the assistance of an independent valuation firm. All other fair value determinations were made solely by the Company. The preliminary purchase price allocation for this transaction may be adjusted upon completion of the Company's valuation of the related assets and liabilities of the business. During the quarter ended September 30, 2010, goodwill decreased by approximately \$1.9 million due to changes in the preliminary purchase price allocation, including finalization of the post-closing working capital adjustment.

The following table presents detail of the purchase price allocated to intangible assets of CyrusOne at the Acquisition Date:

(dollars in millions)	Fair Value	Weighted Average Amortization
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		Period in Years
Intangible assets subject to amortization:		
Customer relationships	\$ 125.0	15 years
Trademark	7.4	15 years
Favorable leasehold interest	3.9	56 years
Total intangible assets	\$ 136.3	16 years

The customer relationships and trademark assets are being amortized relative to the estimated economic value generated by these assets in future years. The favorable leasehold interest is being amortized on a straight-line basis. The Company anticipates both the goodwill and intangible assets to be fully deductible for tax purposes.

CyrusOne is party to three agreements to lease operations facility space. CyrusOne made structural changes to this leased space in excess of normal tenant improvements in order to equip the space for data center operations. For accounting purposes, in accordance with ASC 840, CyrusOne is considered to be the owner of these facilities as the tenant improvements are considered

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

structural in nature. In the CyrusOne opening balance sheet, these leased facilities have been presented at fair value in property, plant and equipment with a corresponding credit to noncurrent liabilities for amounts totaling \$32.1 million. Due to CyrusOne's continuing involvement, the obligation for leased facilities will remain until the end of the lease term for each facility.

The results of operations of CyrusOne are included in the consolidated results of operations beginning June 11, 2010, and are included in the Technology Solutions segment. For the three and nine months ended September 30, 2010, \$20.0 million and \$24.2 million of revenue, respectively, and \$4.9 million and \$6.2 million of operating income, respectively, are included in the consolidated results of operations. The Company incurred approximately \$9.1 million of acquisition-related costs.

The following unaudited pro forma consolidated results of operations assume the acquisition of CyrusOne was completed as of the beginning of the annual reporting periods presented:

(dollars in millions, except per share amounts)	Nine Months Ended	
	September 30, 2010	2009
Revenue	\$ 1,045.8	\$ 1,030.9
Net income	41.9	63.6
Earnings per share:		
Basic and diluted earnings per common share	0.17	0.26

These results include adjustments related to the purchase price allocation and financing of the acquisition, primarily to reduce revenue for the elimination of the unearned revenue liability in the opening balance sheet, to increase depreciation and amortization associated with the higher values of property, plant and equipment and identifiable intangible assets, to increase interest expense for the additional debt incurred to complete the acquisition, and to reflect the related income tax effect and change in tax status. The pro forma information does not necessarily reflect the actual results of operations had the acquisition been consummated at the beginning of the annual reporting period indicated nor is it necessarily indicative of future operating results. The pro forma information does not include any (i) potential revenue enhancements, cost synergies or other operating efficiencies that could result from the acquisition or (ii) transaction or integration costs relating to the acquisition.

Estimated amortization expense for 2010 through 2014, including the CyrusOne acquisition, is as follows:

(dollars in millions)	
2010	\$ 11.5
2011	17.5
2012	18.2
2013	18.5
2014	18.3

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**3. Earnings Per Common Share**

Basic earnings per common share (EPS) is based upon the weighted average number of common shares outstanding during the period. Diluted EPS reflects the potential dilution that would occur if potential common shares were exercised or converted to common stock but only to the extent that they are considered dilutive to the Company's earnings. The following table is a reconciliation of the numerators and denominators of the basic and diluted EPS computations for the following periods:

(in millions, except per share amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Numerator:				
Net income	\$ 14.5	\$ 27.7	\$ 46.9	\$ 82.8
Preferred stock dividends	2.6	2.6	7.8	7.8
Numerator for basic and diluted EPS	\$ 11.9	\$ 25.1	\$ 39.1	\$ 75.0
Denominator:				
Denominator for basic EPS - weighted average common shares outstanding	201.2	209.0	201.0	215.7
Warrants		1.2	0.9	0.4
Stock-based compensation arrangements	3.0	3.0	3.0	2.0
Denominator for diluted EPS	204.2	213.2	204.9	218.1
Basic earnings per common share	\$ 0.06	\$ 0.12	\$ 0.19	\$ 0.35
Diluted earnings per common share	\$ 0.06	\$ 0.12	\$ 0.19	\$ 0.34
Potentially issuable common shares excluded from denominator for diluted EPS due to anti-dilutive effect	40.6	41.0	40.0	43.1

4. Comprehensive Income

(dollars in millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net income	\$ 14.5	\$ 27.7	\$ 46.9	\$ 82.8
Amortization and remeasurement of pension and postretirement liabilities, net of taxes	0.3	7.2	0.9	74.6
Comprehensive income	\$ 14.8	\$ 34.9	\$ 47.8	\$ 157.4

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**5. Debt**

The Company's debt consists of the following:

(dollars in millions)	September 30, 2010	December 31, 2009
Current portion of long-term debt:		
Credit facility, Tranche B Term Loan	\$ 7.6	\$ 2.1
Capital lease obligations and other debt	14.0	13.7
Current portion of long-term debt	21.6	15.8
Long-term debt, less current portion:		
Credit facility, Tranche B Term Loan	748.6	202.8
8 ³ / ₈ % Senior Subordinated Notes due 2014*	500.0	569.8
7% Senior Notes due 2015*	251.6	252.3
8 ¹ / ₄ % Senior Notes due 2017	500.0	500.0
8 ³ / ₄ % Senior Subordinated Notes due 2018	625.0	
7 ¹ / ₄ % Senior Notes due 2023	40.0	40.0
Receivables Facility		85.9
Various Cincinnati Bell Telephone notes	207.5	207.5
Capital lease obligations and other debt	122.2	111.8
	2,494.9	1,970.1
Net unamortized discount	(36.9)	(6.8)
Long-term debt, less current portion	2,458.0	1,963.3
Total debt	\$ 2,479.6	\$ 1,979.1

* The face amount of these notes has been adjusted for the unamortized called amounts received on terminated interest rate swaps. On June 11, 2010, the Company entered into a new Credit Agreement, which includes a new Corporate revolving credit facility and a \$760 million secured term loan credit facility (Tranche B Term Loan).

The new Corporate revolving credit facility replaced the existing Corporate revolving credit facility, which would have expired in August 2012. The new Corporate revolving credit facility has a \$210 million revolving line of credit and terminates in June 2014. The new revolving credit facility is funded by 11 different financial institutions, with no financial institution having more than 15% of the total facility. Borrowings under the new Corporate revolving credit facility bear interest, at the Company's election, at a rate per annum equal to (i) LIBOR plus an applicable margin, or (ii) the base rate plus an applicable margin. The applicable margin is based on certain Company financial ratios and ranges between 4.25% and 5.00% for LIBOR rate advances and 3.25% and 4.00% for base rate advances. Base rate is the highest of the bank prime rate, the one-month LIBOR rate plus one percent or the federal funds rate plus one-half of one percent. Commitment fees for the unused capacity on the Corporate revolving credit facility range from 0.50% to 0.75%, and letter of credit fees on outstanding letters of credit range from 4.25% to 5.00%, respectively, based on certain financial ratios.

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As of September 30, 2010, the Company did not have any outstanding borrowings under its revolving credit facility, but had outstanding letters of credit totaling \$24.6 million, leaving \$185.4 million in additional borrowing availability under its revolving credit facility.

The Tranche B Term Loan matures at the earlier of (i) November 18, 2014, if the Company's 7% Senior Notes due 2015 have not been redeemed and repaid in full on or prior to such date, or (ii) June 11, 2017. The net proceeds of \$737 million from the Tranche B Term Loan were used to repay the Company's previous term loan facility totaling \$204.3 million, to fund the acquisition of CyrusOne, and to pay related fees and expenses. Borrowings under the Tranche B Term Loan bear interest, at the Company's election,