FRONTIER COMMUNICATIONS CORP
Form 10-Q
November 04, 2011

FRONTIER COMMUNICATIONS CORPORATION

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2011

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2011

or

¨ 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: 001-11001

FRONTIER COMMUNICATIONS CORPORATION
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	06-0619596 (I.R.S. Employer Identification No.)
3 High Ridge Park Stamford, Connecticut (Address of principal executive offices)	06905 (Zip Code)

(203) 614-5600
(Registrant's telephone number, including area code)

N/A
(Former name, former address and former fiscal year, if changed since last report)

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 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 definition of "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [X] 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 X

The number of shares outstanding of the registrant's Common Stock as of October 28, 2011 was 995,127,000.

FRONTIER COMMUNICATIONS CORPORATION AND SUBSIDIARIES

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Explanatory Note

Effective July 1, 2010, Frontier's scope of operations and balance sheet capitalization changed materially as a result of the completion of the Transaction, as described in Note 3 of the Notes to Consolidated Financial Statements. Historical financial and operating data presented for Frontier is not indicative of the future financial position or operating results for Frontier, and includes the results of operations of the Acquired Business, as defined in Note 3 of the Notes to Consolidated Financial Statements, from the date of acquisition on July 1, 2010. The financial discussion represents an analysis of our results of operations on a historical basis for our Frontier operations as of and for the three and nine months ended September 30, 2011 and 2010, which includes the results of operations of the Acquired Business for the three months ended September 30, 2011 and 2010, and the nine months ended September 30, 2011.

PART I. FINANCIAL INFORMATION

Item 1.Financial Statements

FRONTIER COMMUNICATIONS CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

($ in thousands)

		(Unaudited) September 30, 2011		December 31, 2010
ASSETS				
Current assets:				
Cash and cash equivalents	$	205,817	$	251,263
Accounts receivable, less allowances of $60,763 and $73,571, respectively		527,395		568,308
Prepaid expenses		84,404		100,603
Income taxes and other current assets		152,130		208,245
Total current assets		969,746		1,128,419
Restricted cash		161,065		187,489
Property, plant and equipment, net		7,630,515		7,590,614
Goodwill		6,416,473		6,292,194
Other intangibles, net		2,095,220		2,491,195
Other assets		220,748		200,319
Total assets	$	17,493,767	$	17,890,230
LIABILITIES AND EQUITY				
Current liabilities:				
Long-term debt due within one year	$	43,763	$	280,002
Accounts payable		469,219		436,886
Advanced billings		161,944		171,602
Accrued other taxes		71,694		167,857
Accrued interest		212,129		170,228
Other current liabilities		209,393		212,782
Total current liabilities		1,168,142		1,439,357
Deferred income taxes		2,377,518		2,220,677
Pension and other postretirement benefits		780,142		816,588
Other liabilities		240,296		220,251
Long-term debt		8,151,081		7,983,614
Equity:				

Shareholders' equity of Frontier:					
Common stock, $0.25 par value (1,750,000,000 authorized shares, 995,137,000 and 993,855,000 outstanding, respectively, and 1,027,986,000 issued at September 30, 2011 and December 31, 2010)		256,997		256,997	
Additional paid-in capital		4,956,343		5,525,471	
Retained earnings		184,474		77,107	
Accumulated other comprehensive loss, net of tax		(221,225	)	(229,549	)
Treasury stock		(414,997	)	(433,286	)
Total shareholders' equity of Frontier		4,761,592		5,196,740	
Noncontrolling interest in a partnership		14,996		13,003	
Total equity		4,776,588		5,209,743	
Total liabilities and equity	$	17,493,767	$	17,890,230	

The accompanying Notes are an integral part of these Consolidated Financial Statements.

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PART I. FINANCIAL INFORMATION (Continued)

FRONTIER COMMUNICATIONS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010
($ in thousands, except for per-share amounts)
(Unaudited)

	For the three months ended September 30,		For the nine months ended September 30,	
	2011	2010	2011	2010
Revenue	$1,290,939	$1,402,968	$3,959,891	$2,438,954
Operating expenses:				
Network access expenses	119,941	136,373	397,854	243,055
Other operating expenses	571,388	614,123	1,729,824	996,797
Depreciation and amortization	351,907	339,894	1,062,150	540,917
Acquisition and integration costs	67,412	78,533	100,899	125,867
Total operating expenses	1,110,648	1,168,923	3,290,727	1,906,636
Operating income	180,291	234,045	669,164	532,318
Investment income (loss)	(666)	397	2,624	6,394
Other income, net	1,502	2,207	7,415	13,497
Interest expense	165,755	166,607	500,034	354,362
Income before income taxes	15,372	70,042	179,169	197,847
Income tax expense (benefit)	(6,948)	40,358	66,809	88,752
Net income	22,320	29,684	112,360	109,095
Less: Income attributable to the noncontrolling interest in a partnership	1,925	689	4,993	2,414
Net income attributable to common shareholders of Frontier	$20,395	$28,995	$107,367	$106,681
Basic and diluted net income per common share attributable to common shareholders of Frontier	$0.02	$0.03	$0.11	$0.18

The accompanying Notes are an integral part of these Consolidated Financial Statements.

PART I. FINANCIAL INFORMATION (Continued)

FRONTIER COMMUNICATIONS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EQUITY
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010, THE THREE MONTHS ENDED DECEMBER 31, 2010 AND THE NINE MONTHS ENDED SEPTEMBER 30, 2011
($ and shares in thousands)
(Unaudited)

	Frontier Shareholders								
	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock Shares	Treasury Stock Amount	Noncontrolling Interest	Total Equity
Balance January 1, 2010	349,456	$87,364	$956,401	$2,756	$(245,519)	(37,128)	$(473,391)	$11,459	$339,070
Acquisition of the Acquired Business	678,530	169,633	5,048,266	-	-	-	-	-	5,217,899
Stock plans	-	-	(31,927)	-	-	3,025	40,212	-	8,285
Dividends on common stock	-	-	(264,720)	(78,322)	-	-	-	-	(343,042)
Net income	-	-	-	106,681	-	-	-	2,414	109,095
Other comprehensive income, net of tax	-	-	-	-	4,172	-	-	-	4,172
Distributions	-	-	-	-	-	-	-	(1,500)	(1,500)
Balance September 30, 2010	1,027,986	256,997	5,708,020	31,115	(241,347)	(34,103)	(433,179)	12,373	5,333,979
Stock plans	-	-	3,798	-	-	(28)	(107)	-	3,691
Dividends on common stock	-	-	(186,347)	-	-	-	-	-	(186,347)
Net income	-	-	-	45,992	-	-	-	630	46,622
Other comprehensive income, net of tax	-	-	-	-	11,798	-	-	-	11,798
Balance December 31, 2010	1,027,986	256,997	5,525,471	77,107	(229,549)	(34,131)	(433,286)	13,003	5,209,743
Stock plans	-	-	(9,325)	-	-	1,282	18,289	-	8,964
Dividends on common stock	-	-	(559,803)	-	-	-	-	-	(559,803)
Net income	-	-	-	107,367	-	-	-	4,993	112,360
Other comprehensive income, net									

of tax	-	-	-	-	8,324	-	-	-	8,324
Distributions	-	-	-	-	-	-	-	(3,000)	(3,000)
Balance September 30, 2011	1,027,986	$256,997	$4,956,343	$184,474	$(221,225)	(32,849)	$(414,997)	$14,996	$4,776,588

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010
($ in thousands)
(Unaudited)

	For the three months ended September 30,		For the nine months ended September 30,	
	2011	2010	2011	2010
Net income	$ 22,320	$ 29,684	$ 112,360	$ 109,095
Other comprehensive income (loss), net of tax	3,334	(3,782)	8,324	4,172
Comprehensive income	25,654	25,902	120,684	113,267
Less: Comprehensive income attributable to the noncontrolling interest in a partnership	(1,925)	(689)	(4,993)	(2,414)
Comprehensive income attributable to the common shareholders of Frontier	$ 23,729	$ 25,213	$ 115,691	$ 110,853

The accompanying Notes are an integral part of these Consolidated Financial Statements.

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PART I. FINANCIAL INFORMATION (Continued)

FRONTIER COMMUNICATIONS CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010
($ in thousands)
(Unaudited)

	2011	2010
Cash flows provided by (used in) operating activities:		
Net income	$112,360	$109,095
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	1,062,150	540,917
Stock based compensation expense	10,729	9,930
Pension/OPEB costs	22,515	24,224
Other non-cash adjustments	(3,320)	5,866
Deferred income taxes	20,219	10,092
Change in accounts receivable	16,162	(13,356)
Change in accounts payable and other liabilities	(36,458)	166,398
Change in prepaid expenses, income taxes and other current assets	68,297	33,004
Net cash provided by operating activities	1,272,654	886,170
Cash flows provided from (used by) investing activities:		
Capital expenditures - Business operations	(636,569)	(252,360)
Capital expenditures - Integration activities	(62,641)	(77,936)
Cash paid for the Acquired Business (net of cash acquired)	-	(82,560)
Cash transferred to escrow	-	(115,000)
Other assets purchased and distributions received, net	22,236	(1,728)
Net cash used by investing activities	(676,974)	(529,584)
Cash flows provided from (used by) financing activities:		
Long-term debt payments	(78,990)	(6,286)
Dividends paid	(559,803)	(343,042)
Financing costs paid	-	(12,431)
Repayment of customer advances for construction, distributions to noncontrolling interests and other	(2,333)	(2,455)
Net cash used by financing activities	(641,126)	(364,214)
Decrease in cash and cash equivalents	(45,446)	(7,628)
Cash and cash equivalents at January 1,	251,263	358,693
Cash and cash equivalents at September 30,	$205,817	$351,065
Supplemental cash flow information:		
Cash paid during the period for:		
Interest	$447,645	$299,158
Income taxes (refunds)	$(16,247)	$4,042

Non-cash investing and financing activities:		
Financing obligation for contribution of real property to pension plan	$58,100	$-
Reduction of pension obligation	$(58,100)	$-
Shares issued for acquisitions	$-	$5,217,899
Assumed debt	$-	$3,456,782
Other acquired liabilities	$-	$1,058,956

The accompanying Notes are an integral part of these Consolidated Financial Statements.

PART I. FINANCIAL INFORMATION (Continued)
FRONTIER COMMUNICATIONS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) Summary of Significant Accounting Policies:

(a) Basis of Presentation and Use of Estimates:

Frontier Communications Corporation and its subsidiaries are referred to as “we,” “us,” “our,” “Frontier,” or the “Company” this report. On July 1, 2010, Frontier completed the Transaction for the acquisition of the Acquired Business, as described further in Note 3 – The Transaction. Our interim unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) and should be read in conjunction with the consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2010. Certain reclassifications of balances previously reported have been made to conform to the current presentation. All significant intercompany balances and transactions have been eliminated in consolidation. These interim unaudited consolidated financial statements include all adjustments (consisting of normal recurring accruals) considered necessary, in the opinion of Frontier’s management, to present fairly the results for the interim periods shown. Revenues, net income and cash flows for any interim periods are not necessarily indicative of results that may be expected for the full year. For our interim financial statements as of and for the periods ended September 30, 2011, we evaluated subsequent events and transactions for potential recognition or disclosure through the date that we filed this quarterly report on Form 10-Q with the Securities and Exchange Commission (SEC).

The preparation of our interim financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect (i) the reported amounts of assets and liabilities at the date of the financial statements, (ii) the disclosure of contingent assets and liabilities, and (iii) the reported amounts of revenue and expenses during the reporting period. Actual results may differ from those estimates. Estimates and judgments are used when accounting for allowance for doubtful accounts, impairment of long-lived assets, intangible assets, depreciation and amortization, income taxes, purchase price allocations, contingencies, and pension and other postretirement benefits, among others. Certain information and footnote disclosures have been excluded and/or condensed pursuant to SEC rules and regulations.

(b) Revenue Recognition:

Revenue is recognized when services are provided or when products are delivered to customers. Revenue that is billed in advance includes: monthly recurring network access services, special access services and monthly recurring local line and unlimited fixed long distance bundle charges. The unearned portion of these fees is initially deferred as a component of other liabilities on our consolidated balance sheet and recognized as revenue over the period that the services are provided. Revenue that is billed in arrears includes: non-recurring network access services, switched access services, non-recurring local services and long-distance services. The earned but unbilled portion of these fees is recognized as revenue in our consolidated statements of operations and accrued in accounts receivable in the period that the services are provided. Excise taxes are recognized as a liability when billed. Installation fees and their related direct and incremental costs are initially deferred and recognized as revenue and expense over the average term of a customer relationship. We recognize as current period expense the portion of installation costs that exceeds installation fee revenue.

As required by law, the Company collects various taxes from its customers and subsequently remits these taxes to governmental authorities. Substantially all of these taxes are recorded through the consolidated balance sheet and presented on a net basis in our consolidated statements of operations. We also collect Universal Service Fund (USF) surcharges from customers (primarily federal USF) which we have recorded on a gross basis in our consolidated statements of operations and included in revenue and other operating expenses at $24.5 million and $26.9 million, and

$78.7 million and $48.7 million, for the three and nine months ended September 30, 2011 and 2010, respectively.

(c) Goodwill and Other Intangibles:

Intangibles represent the excess of purchase price over the fair value of identifiable tangible net assets acquired. We undertake studies to determine the fair values of assets and liabilities acquired and allocate purchase prices to assets and liabilities, including property, plant and equipment, goodwill and other identifiable intangibles. We annually (during the fourth quarter) or more frequently, if appropriate, examine the carrying value of our goodwill and trade name to determine whether there are any impairment losses. We test for goodwill impairment at the “operating segment” level, as that term is defined in U.S. GAAP. Effective with the third quarter of 2011, the Company reorganized into six operating segments in order to leverage the full benefits of its local engagement model. The six operating segments consist of the following regions: National, Northeast, Southeast, Central, Midwest and West. Our operating segments are aggregated into one reportable segment. In conjunction with the reorganization of our operating segments effective with the third quarter of 2011, we reassigned goodwill to our reporting units using a relative fair value allocation approach.

The Company amortizes intangible assets with estimated useful lives over those lives and reviews such intangible assets to assess any impairment and whether factors exist that would necessitate a change in useful life and a different amortization period.

(2) Recent Accounting Literature:

Fair Value Measurements
In May 2011, the FASB issued Accounting Standards Update No. 2011-04 (ASU 2011-04), "Fair Value Measurements: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs" (ASC Topic 820). ASU 2011-04 changes the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements to ensure consistency between U.S. GAAP and IFRS. ASU 2011-04 also expands the disclosures for fair value measurements that are estimated using significant unobservable (Level 3) inputs. This new guidance is to be applied prospectively, and is effective for interim and annual periods beginning after December 15, 2011. We do not expect the adoption of ASU 2011-04 to have a material impact on our financial position, results of operations or cash flows.

Presentation of Comprehensive Income
In June 2011, the FASB issued Accounting Standards Update No. 2011-05 (ASU 2011-05), "Comprehensive Income: Presentation of Comprehensive Income," (ASC Topic 220). ASU 2011-05 eliminates the option to report other comprehensive income and its components in the statement of changes in equity. ASU 2011-05 requires that all non-owner changes in stockholders' equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. This new guidance is to be applied retrospectively, and is effective for interim and annual periods beginning after December 15, 2011. We do not expect the adoption of ASU 2011-05 to have a material impact on our financial position, results of operations or cash flows.

Testing Goodwill for Impairment
On September 15, 2011, the FASB ratified ASU No. 2011-08 (ASU 2011-08). "Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment." ASU 2011-08 permits an entity to first assess qualitative factors to determine whether it is more likely than not (a likelihood of more than 50 percent) that the fair value of a reporting unit is less than its carrying amount. After assessing qualitative factors, if an entity determines that it is not more likely than not that the fair value of the reporting unit is less than its carrying amount, no further testing is necessary. If an entity determines that it is more likely than not that the fair value of the reporting unit is less than its carrying value, then the traditional two-step goodwill impairment test must be performed. The Company plans to perform its annual impairment test during the fourth quarter ending December 31, 2011. While ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, early adoption is permitted. The Company is currently evaluating the impact of ASU 2011-08 on its future goodwill impairment tests and early adoption is under consideration.

(3) The Transaction:
On July 1, 2010, Frontier acquired the defined assets and liabilities of the local exchange business and related landline activities of Verizon Communications Inc. (Verizon) in Arizona, Idaho, Illinois, Indiana, Michigan, Nevada, North Carolina, Ohio, Oregon, South Carolina, Washington, West Virginia and Wisconsin and in portions of California bordering Arizona, Nevada and Oregon (collectively, the Territories), including Internet access and long distance services and broadband video provided to designated customers in the Territories (the Acquired Business). Frontier is considered the accounting acquirer of the Acquired Business.

We are accounting for our acquisition of approximately 4.0 million access lines from Verizon (the Transaction) using the guidance included in Accounting Standards Codification (ASC) Topic 805. We incurred approximately $67.4 million and $100.9 million of integration related costs in connection with the Transaction during the three and nine months ended September 30, 2011, respectively, and $78.5 million and $125.9 million of acquisition and integration related costs during the three and nine months ended September 30, 2010, respectively. Such costs are required to be expensed as incurred and are reflected in "Acquisition and integration costs" in our consolidated statements of operations.

The allocation of the purchase price of the Acquired Business is based on the fair value of assets acquired and liabilities assumed as of July 1, 2010, the effective date of the Transaction. Our assessment of fair value was final as of June 30, 2011, and was adjusted during the first half of 2011 for information that was previously not available to us, primarily related to: deferred income tax assets and liabilities and other accrued liabilities.

The final allocation of the purchase price presented below represents the effect of recording the final fair value of assets acquired, liabilities assumed and related deferred income taxes as of the date of the Transaction, based on the total transaction consideration of $5.4 billion. The following allocation of purchase price includes revisions to the preliminary allocation that was reported as of December 31, 2010, primarily for goodwill, deferred taxes and current liabilities.

($ in thousands)		
Total transaction consideration:		$5,411,705
Current assets	$454,513	
Property, plant & equipment	4,407,676	
Goodwill	3,774,151	
Other intangibles – primarily customer list	2,532,200	
Other noncurrent assets	75,092	
Current liabilities	(483,118)	
Deferred income taxes	(1,430,122)	
Long-term debt	(3,456,782)	
Other noncurrent liabilities	(461,905)	
Total net assets acquired	$5,411,705	

The fair value of the total consideration issued to acquire the Acquired Business amounted to $5.4 billion and included $5.2 billion for the issuance of Frontier common shares and cash payments of $105.0 million. As a result of the Transaction, Verizon stockholders received 678,530,386 shares of Frontier common stock. Immediately after the closing of the Transaction, Verizon stockholders owned approximately 68.4% of the combined company's outstanding equity, and existing Frontier stockholders owned approximately 31.6% of the combined company's outstanding equity.

The following unaudited pro forma financial information presents the combined results of operations of Frontier and the Acquired Business as if the Transaction had occurred as of January 1, 2010. The pro forma information is not necessarily indicative of what the financial position or results of operations actually would have been had the Transaction been completed as of January 1, 2010. In addition, the unaudited pro forma financial information is not indicative of, nor does it purport to project, the future financial position or operating results of Frontier. The unaudited pro forma financial information excludes acquisition and integration costs and does not give effect to any estimated and potential cost savings or other operating efficiencies that could result from the Transaction.

PART I. FINANCIAL INFORMATION (Continued)
FRONTIER COMMUNICATIONS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED PRO FORMA CONDENSED COMBINED
STATEMENTS OF OPERATIONS INFORMATION

($ in millions, except per share amounts)	For the nine months ended September 30, 2010	
Revenue	$	4,293
Operating income		941
Net income attributable to common shareholders of Frontier		273
Basic and diluted net income per common share attributable to common shareholders of Frontier	$	0.28

(4) Accounts Receivable:
The components of accounts receivable, net are as follows:

($ in thousands)	September 30, 2011		December 31, 2010	
End user	$	559,411	$	627,573
Other		28,747		14,306
Less: Allowance for doubtful accounts		(60,763)		(73,571)
Accounts receivable, net	$	527,395	$	568,308

We maintain an allowance for estimated bad debts based on our estimate of our ability to collect accounts receivable. Bad debt expense, which is recorded as a reduction to revenue, was $19.3 million and $20.3 million for the three months ended September 30, 2011 and 2010, respectively, and $65.7 million and $31.6 million for the nine months ended September 30, 2011 and 2010, respectively.

(5)Property, Plant and Equipment:
Property, plant and equipment is as follows:

($ in thousands)	September 30, 2011		December 31, 2010	
Property, plant and equipment	$	13,364,227	$	12,795,280
Less: Accumulated depreciation		(5,733,712)		(5,204,666)
Property, plant and equipment, net	$	7,630,515	$	7,590,614

Depreciation expense is principally based on the composite group method. Depreciation expense was $226.7 million and $211.2 million for the three months ended September 30, 2011 and 2010, respectively, and $671.2 million and $384.1 million for the nine months ended September 30, 2011 and 2010, respectively. As a resu