STATE OF VERMONT
PUBLIC UTILITY COMMISSION

Petition of the Department of Public Service for an Investigation into the Service Quality Provided by Telephone Operating Company of Vermont LLC d/b/a Consolidated Communications, Inc.	)))))	Case No. 18-3231-PET

PREFILED DIRECT TESTIMONY OF
SCOTT G. WHEELER

ON BEHALF OF THE
VERMONT DEPARTMENT OF PUBLIC SERVICE

April 26, 2019

Summary: Mr. Wheeler analyzes and summarizes the financial health of Telephone Operating Company of Vermont, LLC and its parent company Consolidated Communications, Inc. Mr. Wheeler's testimony concludes that both companies are in a financial position to further invest in improving service quality.

Mr. Wheeler Sponsors the Following Exhibits:

Exhibit DPS-SGW–1 Professional Resume of Scott G. Wheeler

Direct Testimony
of
Scott G. Wheeler

Q1. Please state your full name, address, and occupation.

A1. My name is Scott G. Wheeler. I am the Utilities Finance and Economics Analyst of the Vermont Department of Public Service ("Department"). My business address is 112 State Street, Montpelier, Vermont 05620.

Q2. Please describe your educational background and experience.

A2. I am a Certified Management Accountant and have a master's degree in Business Administration from California Pacific University. I have worked at the Department since October 1, 2018. Prior to joining the Department, I was employed with Sentinel Investments, a regulated mutual fund subsidiary of National Life Group, for over thirty years. During my tenure there I held various positions, most recently Vice President and Assistant Treasurer, which entailed reporting audited financial results of the mutual funds to shareholders and related filings to the Securities and Exchange Commission. I also served as volunteer Chairperson of the Board of Directors of Granite Hills Credit Union for 12 years with my tenure ending on June 30, 2017.

Q3. Have you previously testified before the Vermont Public Utility Commission ("Commission")?

A3. Yes. I am currently a witness in Case No. 18-2549-PET regarding Green Mountain Power's proposed upgrades to the Molly's Falls hydroelectric facility and Case No. 18-

3709-PET regarding Davenport Solar's proposed solar electric generation facility in Brandon, Vermont.

Q4. What is the purpose of your testimony?

A4. The purpose of my testimony is to present the Department's analysis of Telephone Operating Company of Vermont, LLC's ("TOCV") financial health and its parent company Consolidated Communications, Inc. ("Consolidated") to ascertain how it may impact service quality.

Q5. Please summarize your analysis of TOCV's financial statements.

A5. An initial review of TOCV's Income Statement for the Year Ended December 31, 2018 indicates that the company experienced a net loss of approximately [**START CONFIDENTIAL INFORMATION**] [**END CONFIDENTIAL INFORMATION**]. Based on such a loss, a reasonable person may conclude that if TOCV is already losing money, it likely will not have anything left to invest in improving service quality. However, this net loss included depreciation and amortization expenses of approximately [**START CONFIDENTIAL INFORMATION**] [**END CONFIDENTIAL INFORMATION**]. Amortization and depreciation are non-cash expenses on a company's income statement. Depreciation represents the cost of capital assets on the balance sheet being used over time, and amortization is the similar cost of using intangible assets like goodwill over time. Therefore, when adding back the non-cash expenses of [**START CONFIDENTIAL INFORMATION** [**END**

CONFIDENTIAL INFORMATION] to the net loss of [**START CONFIDENTIAL INFORMATION**] [**END CONFIDENTIAL INFORMATION**], nearly **[START CONFIDENTIAL INFORMATION**] [**END CONFIDENTIAL INFORMATION**] in net excess cash flows is left.

A high-level breakdown of TOCV's finances and net excess cash flows is below.

[**START CONFIDENTIAL INFORMATION**]

[**END CONFIDENTIAL INFORMATION**]

Q6. Are the financial results of Consolidated, as TOCV's parent company, consistent with those presented for TOCV?

A6. Yes. Excerpts from Consolidated's publicly available 2018 Annual Report indicate that TOCV's financial results are representative of the parent company's approach, as confirmed in President and Chief Executive Officer Bob Udell's message to Shareholders:

> "As we look forward to 2019 and beyond, I am confident in our ability to deliver consistent results and value to our stakeholders, and we should all be excited by what lies ahead for this company. We will continue to build business strength,

grow EBITDA margins and increase cash flow through our disciplined approach to cash management. And we're just getting started as we fully leverage the combined strengths of our operations, fiber network and significantly expanded scale."

Further confirmation is provided in Item 7 of the publicly available 2018 Annual Report, Management's Discussion and Analysis of Financial Condition and Results of Operations:

Liquidity and Capital Resources

Outlook and Overview

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

The following table summarizes our cash flows:

(In thousands)	Years Ended December 31. 2018	2017	2016
Cash flows provided by (used in):			
Operating activities	$ 357,321	$ 210,027	$ 218,233
Investing activities	(221,459)	(1,042,711)	(108,287)

Financing activities		(141,920)		821,264		(98,747)
Increase (decrease) in cash and cash equivalents	$	(6,058)	$	(11,420)	$	11,199

<u>Cash Flows Provided by Operating Activities</u>

Net cash provided by operating activities was $357.3 million in 2018, an increase of $147.3 million compared to the same period in 2017. Cash flows provided by operating activities increased primarily as a result of the additional cash flows provided by the addition of the FairPoint operations as of July 2017 as well as additional transaction costs paid in 2017 related to the acquisition of FairPoint. Cash distributions received from our wireless partnerships also increased $9.1 million in 2018 compared to 2017. In addition, income tax refunds increased approximately $10.0 million from 2017. However, cash contributions to our defined benefit pension plans increased $16.9 million in 2018 compared to 2017 of which $11.3 million is attributable to the acquisition of FairPoint.

Q7. Does Consolidated have a dividend policy in place that could possibly impact funding initiatives aimed at improving service quality?

A7. Yes. The discretionary nature of dividend payments makes them a potential source for funding service quality initiatives. The aforementioned publicly available 2018 Annual Report describes this area as follows:

Our Board of Directors could, at its discretion, depart from or change our dividend policy at any time. Our Board of Directors maintains a current dividend practice for the payment of quarterly dividends at an annual rate of approximately $1.55 per share of common stock. We are not required to pay dividends and our stockholders do not have contractual or other legal rights to receive them. Our Board of Directors may decide at any time, in its discretion, to change or revoke the dividend policy, including decreasing the amount of dividends or discontinuing paying dividends entirely. Our ability to pay dividends is dependent on our earnings, capital requirements, financial condition, expected cash needs, debt covenant compliance and other factors considered relevant by our Board of Directors. If we do not pay dividends, for any reason, shares of our common stock could become less liquid and the market price of our common stock could decline.

We paid $110.2 million and $94.1 million in dividend payments to shareholders during 2018 and 2017, respectively. In October 2018, our board of directors declared a quarterly dividend of $0.38738 per common share, which was paid on February 1, 2019 to stockholders of record at the close of business on January 15, 2019. In addition, on February 18, 2019, our board of directors declared its next quarterly dividend of $0.38738 per common share, which is payable on May 1, 2019 to stockholders of record at the close of business on April 15, 2019. Our current dividend policy pays a quarterly dividend of $0.38738 per common share which equals approximately $1.55 per share on an annual basis.

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

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

It is worth reiterating that Consolidated's Board has chosen to pay out discretionary dividends of $110.2 million in 2018 and $94.1 million in 2017 in lieu of investing at least a portion in service quality.

Q8. Does TOCV have the financial capacity to improve service quality?

A8. Yes. TOCV is fully supported by its parent company Consolidated and generated excess cash flow of [**START CONFIDENTIAL INFORMATION** [**END CONFIDENTIAL INFORMATION**] in 2018. This, coupled with the dividend policy that Consolidated currently has in place, exhibits that TOCV has the capacity to invest in service quality improvement initiatives.

Q9. Does this conclude your direct testimony?

A9. Yes.