Consolidated Communications Holdings, Inc.
Form 10-K
March 12, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2012

o 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 000-51446

CONSOLIDATED COMMUNICATIONS HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	02-0636095 (I.R.S. Employer Identification No.)

121 South 17th Street, Mattoon, Illinois	61938-3987
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code (217) 235-3311

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock $0.01 par value	The NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes o No x

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 o

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 (§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 x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

Large accelerated filer o	Accelerated filer x	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting companyo

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes o No x

As of June 30, 2012, the aggregate market value of the shares held by non-affiliates of the registrant s common stock was $406,292,900 based on the closing price as reported on the NASDAQ Global Select Market. The market value calculations exclude shares held on the stated date by registrant s directors and officers on the assumption such shares may be shares owned by affiliates. Exclusion from these public market value calculations does not necessarily conclude affiliate status for any other purpose.

On February 15, 2013, the registrant had 39,877,998 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s Proxy Statement for the 2013 Annual Meeting of Shareholders are incorporated herein by reference in Part III of this Annual Report on Form 10-K to the extent stated herein. Such proxy statement will be filed with the Securities and Exchange Commission within 120 days of the registrant s fiscal year ended December 31, 2012.

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PART I

Note About Forward-Looking Statements

Certain statements in this report, including that which relates to the impact on future revenue sources and potential sharing obligations of pending and future regulatory orders, continued expansion of the telecommunications network and expected changes in the sources of our revenue and cost structure resulting from our entrance into new communications markets, are forward-looking statements and are made pursuant to the safe harbor provisions of the Securities Litigation Reform Act of 1995. Forward-looking statements reflect, among other things, our current expectations, plans, strategies, and anticipated financial results. There are a number of risks, uncertainties, and conditions that may cause our actual results to differ materially from those expressed or implied by these forward-looking statements. Many of these circumstances are beyond our ability to control or predict. Moreover, forward looking statements necessarily involve assumptions on our part. These forward looking statements generally are identified by the words believe , expect , anticipate , estimate , project , intend , plan , should , may , be , will continue or similar expressions. Such forward looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements of Consolidated Communications Holdings, Inc. and its subsidiaries to be different from those expressed or implied in the forward-looking statements. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements that appear throughout this report. A detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from such forward looking statements is included in the section entitled Risk Factors (refer to Part I, Item 1A). Furthermore, forward-looking statements speak only as of the date they are made. Except as required under the federal securities laws or the rules and regulations of the Securities and Exchange Commission, we disclaim any intention or obligation to update or revise publicly any forward-looking statements. You should not place undue reliance on forward-looking statements.

Item 1. Business.

Consolidated Communications Holdings, Inc. (the Company , we or our) is a Delaware holding company with operating subsidiaries (collectively Consolidated) providing a wide range of communications services to residential and business customers in Illinois, Texas, Pennsylvania, California, Kansas and Missouri. We were founded in 1894 as the Mattoon Telephone Company by the great-grandfather of our current Chairman, Richard A. Lumpkin. After several acquisitions, the Mattoon Telephone Company was incorporated as the Illinois Consolidated Telephone Company (ICTC) on April 10, 1924. We were incorporated under the laws of Delaware in 2002, and through our predecessors we have provided telecommunications services for more than a century. Through strategic acquisitions over the last eight years, we have grown our business, diversified our revenue and cash flow streams and created a strong platform for future growth. Our acquisitions strategy includes creating operating synergies associated with each acquisition. These operating synergies are created through the use of consistent platforms, convergence of processes and functional management of the combined entities. We measure our synergies during the first two years following an acquisition. For example, the acquisition of our Texas properties in 2004 tripled the size of our business and gave us the requisite scale to make systems and platform decisions that would facilitate future acquisitions. For the acquisition of our Pennsylvania properties, we achieved synergies in excess of $12.0 million in annualized savings, which at the time, represented about 20% of their operating expense. We have positioned our business to provide services in both rural and suburban markets with service territories spanning the country.

We offer a wide range of telecommunications services, including local and long-distance service, high-speed broadband Internet access, video services, digital telephone service (VOIP), custom calling features, private line services, carrier grade access services, network capacity services over our regional fiber optic networks, directory publishing and Competitive Local Exchange Carrier (CLEC) services. We also operate two non-core complementary businesses, prison services and equipment sales. We classify our operations into two reportable business segments: Telephone Operations and Other Operations.

Recent Developments in Our Business during 2012

SureWest Merger

On July 2, 2012, we completed the merger with SureWest Communications (SureWest), which resulted in the acquisition of 100% of all the outstanding shares of SureWest for $23.00 per share in a cash and stock transaction. The acquisition of SureWest provides additional diversification of the Company s revenues and cash flows both geographically and by service type, which offers a platform for future growth and is expected to generate operational and capital cost synergies. SureWest provides a wide range of telecommunications, digital video, Internet, data and other facilities-based communications services in Northern California, primarily in the greater Sacramento region, and in the greater Kansas City, Kansas and Missouri areas. For the year ended December 31, 2011, SureWest reported $248.1 million in total operating revenues. For the six months ended June 30, 2012, SureWest generated $127.9 million in operating revenues. The total purchase price of $550.8 million, consisted of cash and assumed debt of $402.4 million and 9,965,983 shares of the Company s common stock valued at the Company s opening stock price on July 2, 2012 of $14.89, which totaled $148.4 million. The cash portion of the merger consideration and the funds required to repay SureWest outstanding debt was financed with the sale of $300.0 million in aggregate principal amount of 10.875% Senior Notes due 2020 (Senior Notes). The Company also used cash on hand and approximately $35.0 million in borrowings from its revolving credit facility. Because the acquisition closed on July 2, 2012, the Company s financial information does not include any of the results of operations from SureWest prior to the acquisition date. The financial results of SureWest are included in the Telephone Operations segment as of the date of the acquisition.

As part of the acquisition of SureWest, we expect to generate annual operating synergies of approximately $25.0 million, which will be phased in over the first two years after the closing as integration projects are completed.

Prison Services Contract

We currently provide telephone service to inmates incarcerated at facilities operated by the Illinois Department of Corrections through our Prison Services business. On June 27, 2012, the Illinois Department of Central Management Services announced its intent to replace us as the provider of those services with a competitor. We have challenged our competitor s bid and the State s decision to accept that bid in a variety of different forums. Although we will continue to seek legal recourse to the State s decision, our business plans and projections assume that our contract with the State of Illinois will end during 2013. During 2012, the prison services contract comprised 82% of the operating revenues in our Other Operations segment, 5% of consolidated operating revenues and approximately 2% of consolidated operating income, excluding financing and other transaction fees. For a more detailed discussion regarding the legal actions we have taken with regards to the prison services contract, see Part I Item 3 Legal Proceedings .

Available Information

Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to reports filed or furnished pursuant to Sections 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, are available free of charge on our web site at *www.consolidated.com*, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission (SEC). Copies are also available free of charge upon request to Consolidated Communications, 121 S. 17th St, Mattoon, IL 61938, Attn: Vice President Investor Relations and Treasurer. Our website also contains copies of our Corporate Governance Guidelines, Code of Business Conduct and Ethics and charter of each committee of our Board of Directors. The information found on our web site is not part of this or any other report we file with or furnish to the SEC. The public may read and copy any materials we file with the SEC at the SEC s Public Reference Room at 100 F Street, NE., Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding our filings at http://*www.sec.gov*.

Description of Our Business

We derive our revenue principally from the sale of advanced telecommunication services to residential and business customers in six states, including local and long-distance telephone service, high-speed broadband Internet, VOIP, video services, carrier grade access services and telephone directory publishing, primarily in our Telephone Operations segment. We also derive revenues from two complementary non-core businesses, prison services and equipment sales. Prison services provides local and long-distance telephone service and automated calling service to inmates incarcerated at facilities operated by the Illinois Department of Corrections. Business systems sells and supports telecommunications equipment to business customers in Texas and Illinois. Prison services and business systems are included in our Other Operations segment.

Our Telephone Operations segment generates the substantial majority of our revenue and operating income and substantially all of our cash flow from operations. In 2012, the Telephone Operations segment generated 94% of our consolidated revenue and substantially all of our operating income before depreciation and amortization.

A summary of net operating revenues, operating income, total assets and capital expenditures for each of the business segments can be found in Note 13 in the Notes to Consolidated Financial Statements, in Item 8, which is incorporated herein by reference. A discussion of factors potentially affecting our operations is set forth in Risk Factors in Item 1A, which is incorporated herein by reference.

Sources of Revenue

The following table summarizes our sources of revenue for each of our two business segments for the last three fiscal years:

	2012		2011		2010	
(In millions, except for percentages)	$	% of Revenues	$	% of Revenues	$	% of Revenues
Telephone operations:						
Local calling services	93.5	18.6	84.2	22.5	91.0	23.7
Network access services	98.6	19.6	80.5	21.5	81.7	21.3
Subsidies	49.3	9.8	45.4	12.1	48.7	12.7
Long-distance services	17.3	3.4	15.9	4.2	18.0	4.7
Video, data and Internet services	176.7	35.1	83.0	22.2	76.1	19.8
Other services	36.7	7.3	33.6	9.0	34.1	8.9
Total telephone operations	472.1	93.8	342.6	91.5	349.6	91.2
Other operations	31.4	6.2	31.7	8.5	33.8	8.8
Total operating revenue	503.5	100.0	374.3	100.0	383.4	100.0

All telecommunications providers continue to face increased competition as a result of technology changes and industry legislative and regulatory developments. In recent years, changes in the legislative and regulatory environment and our recent acquisition of SureWest have provided us with significant growth opportunities for our video, data and Internet services. As indicated by the table above, the percentage of operating revenues we receive from our video, data and Internet services has nearly doubled since 2010. We anticipate that video, data and Internet revenues will continue to increase as a total percentage of operating revenues and offset the anticipated decline in traditional telephone services, which continue to be impacted by the industry-wide decline in access lines.

Telephone Operations

The following table provides the key operating statistics of our Telephone Operations segment as of December 31, 2012:

	2012	2011	2010
ILEC access lines			
Residential	153,855	137,179	140,660
Business	114,742	90,813	96,481
Total	268,597	227,992	237,141
Voice connections (1)			
Residential	78,811	2,388	2,957
Business	50,918	52,424	53,671
Total	129,729	54,812	56,628
Data and internet connections (2)	247,633	134,129	125,678
Video connections (2)	106,137	34,356	29,236
Total connections	752,096	451,289	448,683

(1)Voice connections include voice lines outside the Incumbent Local Exchange Carrier (ILEC) service areas and Voice-over-IP inside the ILEC service areas.

(2)These connections include both residential and business (excluding SureWest business metrics) for services both inside and outside the ILEC service areas.

Local calling services

Local calling services include traditional wireline telephone service and other basic services. Our service plans include options for voicemail and other enhanced custom calling features including caller ID, call forwarding and call waiting. Services are charged at a fixed monthly rate or can be bundled with selected services at a discounted rate.

We offer private lines that provide direct connections between two or more local locations at flat monthly rates. We provide a hosted VOIP package, which utilizes a soft switch and allows the customer the flexibility of utilizing new telephone technology and features without investing in a new telephone system. The package bundles local service, calling features, Internet protocol (IP) business telephones and unified messaging, which integrates multiple messaging technologies into a single system, which allows the customer to receive and listen to voice messages through email.

Network access services

Network access service revenues include interstate and intrastate switched access revenue and network special access services. Revenue from network access charges are received from long-distance and other carriers for customer s originating or terminating calls from/to our local exchanges. These services allow customers to make or receive calls in our service area. Our long-distance customers typically pay a monthly flat-rate fee for this service. In addition, other carriers pay network access charges for their originating or terminating calls within our service areas. These charges also apply to private lines that connect a customer in one of our service areas to a location outside of our service areas. Through these dedicated lines customers can transmit data and access external data networks. We also provide cell site backhaul services to wireless carriers. The demand for backhaul services continues to grow as wireless carriers are faced with escalating consumer and business demands for wireless data. Certain of our network access revenues are based on rates set or approved by federal and state regulatory commissions or as directed by law that are subject to change at any time.

Subsidies

Subsidies consist of federal and state subsidies designed to promote widely available, quality telephone service at affordable prices in rural areas. Subsidies come from pools to which we and other telecommunications providers, including local, long-distance and wireless carriers, contribute on a monthly basis. Subsidies are allocated and distributed to participating carriers monthly based upon their respective costs for providing local service. Like access charges, subsidies are regulated by federal and state regulatory commissions. See Part I   Item 1   Regulatory Environment   below and Item 1A   Risk Factors   Regulatory Risks .

Long-distance services

Long-distance services include traditional domestic and international long distance which enables customers to make calls that terminate outside their local calling area. These services also include calling cards, toll free calls and conference calling. We offer a variety of long-distance plans, including unlimited flat-rate calling plans and offer a combination of subscription and usage fees.

Video, Data and Internet services

Video, data and Internet services include revenue from residential and business customers for subscriptions to our video and data products. Our data service can provide high-speed Internet access at various symmetrical speeds of up to 50 megabits per second (Mbps), depending on the nature of the network facilities that are available, the level of service selected and the geographic market availability. We also offer a variety of data connectivity services in select markets, including Ethernet services capable of connecting multiple connections over our copper and fiber-based networks, virtual hosting services, Wi-Fi and collocation services.

Depending on geographic market availability, our video services range from limited basic service to advanced digital television, which includes several plans each with hundreds of local, national and music channels including premium and pay-per-view channels as well as video on demand service. Certain subscribers may also subscribe to our advanced video services, which consist of high-definition television, digital video recorders (DVR) and/or a whole home DVR. Our Whole Home DVR allows customers the ability to watch recorded shows on any television in the house, record multiple shows at one time and utilize an intuitive on-screen guide and user interface.

Our digital phone service, including VOIP, is also available in certain markets as an alternative to the traditional telephone line. We offer multiple voice service plans that provide for either usage based or unlimited calling plans, including options for long distance, voice mail and other calling features such as caller ID, call forwarding, call blocking, abbreviated dialing and conferencing.

Although we expect our revenues from video, data and Internet services to grow substantially, these products typically generate lower margins than our traditional wireline business.   As a result, as we replace traditional wireline revenue with revenue from video, data and Internet services, our margins may decline.

Other services

Other services include revenues from telephone directory publishing, wholesale transport services on our fiber-optic network in Texas, billing and collection services, inside wiring service and maintenance.

Other Operations

The Other Operations segment consists of two complementary non-core businesses:

• *Prison Services* provides local and long-distance services and automated calling services for correctional facilities. In 2012, we lost our bid on continuing to provide service to the state of Illinois correctional facilities. We are continuing to determine if a legal recourse to the decision and selection of another provider is available. However, we believe that it is likely that, by the end of 2013, we will no longer be providing these services in Illinois.

• *Business Systems* sells and supports telecommunications equipment, such as key, private branch exchange (PBX   ) and IP-based telephone systems, to business customers. We are an Avaya and ShoreTel distributor.

Prior to 2010, our Other Operations segment also included Market Response (telemarketing and order fulfillment) (CMR   ) and Operator Services. We sold both our CMR and Operator Services businesses during 2010.

Wireless partnerships

In addition to our core business, we also derive a significant portion of our cash flow and earnings from investments in five wireless partnerships. Wireless partnership investment income is included as a component of other income in the consolidated statements of income. Our wireless partnership investment consisted of five cellular partnerships: GTE Mobilnet of South Texas, GTE Mobilnet of Texas RSA #17, Pittsburgh SMSA, Pennsylvania RSA 6(I) and Pennsylvania RSA 6(II).

We own 2.34% of GTE Mobilnet of South Texas Limited Partnership (Mobilnet South Partnership   ).   The principal activity of the Mobilnet South Partnership is providing cellular service in the Houston, Galveston and Beaumont, Texas metropolitan areas. Because we have a minor ownership interest and cannot influence operations, we account for this investment using the cost basis. Income is recognized only upon cash distributions of our proportionate earnings in the partnership.

We own 20.51% of GTE Mobilnet of Texas RSA #17, which serves areas in and around Conroe, Texas. In December 2012, we purchased additional ownership interest for $6.7 million which increased our ownership from 17.02% to 20.51%. Because we have some influence over the operating and financial policies of this partnership, we account for the investment under the equity method, recognizing income on our proportionate share of earnings. Cash distributions are recorded as a reduction in our investment.

San Antonio MTA, L.P., a wholly owned partnership of Cellco Partnership (doing business as Verizon Wireless), is the general partner for both GTE Mobilnet of South Texas and GTE Mobilnet of Texas RSA #17.

We own 3.6% of Pittsburgh SMSA, 16.6725% of Pennsylvania RSA 6(I) and 23.67% of Pennsylvania RSA 6(II) wireless partnerships, all of which are majority owned and operated by Verizon Wireless. These partnerships cover territories that almost entirely overlap the markets served by our Pennsylvania ILEC and CLEC operations. Because of our limited influence over Pittsburgh SMSA, we account for the investment using the cost basis. The Pennsylvania RSA 6(I) and RSA 6(II) partnerships are accounted for under the equity method.

For the years ended December 31, 2012, 2011 and 2010, we recognized income of $30.2 million, $27.1 million and $27.4 million, respectively, and received cash distributions of $29.1 million, $28.3 million and $27.3 million, respectively, from these wireless partnerships.

Employees

At December 31, 2012, we employed approximately 1,632 employees, including part-time employees. We also use temporary employees in the normal course of our business. As of December 31, 2012 we had an approximate 71% increase in the number of employees compared to December 31, 2011 which was primarily the result of the acquisition of SureWest in 2012.

Approximately 28% of our employees were covered by collective bargaining agreements as of December 31, 2012. We have approximately 184 employees covered under a collective bargaining agreement with the International Brotherhood of Electrical Workers (IBEW) that have been working without a contract since November 2012. Employees continue to work without a contract and we remain in contract negotiations with the IBEW. For a more detailed discussion regarding how the collective bargaining agreements could affect our business, see Part I Item 1A Risk Factors Risks Relating to Our Business .

Customers and Markets

We operate as the ILEC in four states: Illinois, Texas, Pennsylvania, and California. We also operate as CLECs in each of these markets as well as Kansas and Missouri. The geographic areas we serve are characterized by a balanced mix of growing suburban areas and stable, rural territories. The acquisition of SureWest in 2012 further diversifies our operating revenues and cash flows across multiple business lines and markets.

Our Illinois local telephone markets consist of 35 geographically contiguous exchanges serving predominantly small towns and rural areas. We cover an area of 2,681 square miles, primarily in five central Illinois counties: Coles, Christian, Montgomery, Effingham and Shelby. As of December 31, 2012, we had total connections of 102,870, which included 58,579 local access lines (averaging 21.8 lines per square mile). Approximately 60.1% of our Illinois local access lines serve residential customers, with the remainder serving business customers. Our Illinois business customers are predominantly small retail, commercial, light manufacturing and service industry businesses, as well as universities and hospitals.

Our 21 exchanges in Texas serve three principal geographic markets Lufkin, Conroe and Katy in a 2,054 square mile area. This territory had 116,961 local access lines (averaging 56.9 lines per square mile) as of December 31, 2012. Approximately 66.3% of our Texas local access lines serve residential customers, with the remainder serving business customers. Our Texas business customers predominately operate in the manufacturing and retail industries; our largest business customers are hospitals, local governments and school districts.

The Lufkin market is centered primarily in Angelina County in east Texas, approximately 120 miles northeast of Houston, and extends into three neighboring counties. The Conroe market is located primarily in Montgomery County and is centered approximately 40 miles north of Houston. Parts of the Conroe operating territory extend south to within 28 miles of downtown Houston, including parts of the affluent suburb of The Woodlands. The Katy market is located in parts of Fort Bend, Harris, Waller and Brazoria Counties and is centered approximately 30 miles west of downtown Houston along the busy and expanding I-10 corridor. Most of the Katy market is considered part of metropolitan Houston.

Our Lufkin, Texas and central Illinois markets have experienced only nominal population growth over the past decade. These low growth, low customer density markets, along with the predominantly rural residential character of these areas, have limited the number of, and product offerings, from potential competitors in these areas. The Conroe and Katy markets have experienced above-average population and business employment growth over the past decade as compared to the remainder of Texas and the United States as a whole.

The Pennsylvania ILEC territory consists of nine exchanges and covers 285 square miles, serving portions of Allegheny, Armstrong, Butler and Westmorland Counties in western Pennsylvania. The southernmost point of the ILEC territory is 12 miles north of the city of Pittsburgh. As of December 31, 2012, we had 46,498 local access lines in this territory (averaging 163.2 lines per square mile). The local access lines in this territory consist of approximately 53.2% business customers and 46.8% residential customers. The CLEC operations expand south to serve the city of Pittsburgh and north to serve the city of Butler and surrounding areas. Our Pennsylvania territory has benefited from favorable market demographics and growth in suburban communities. Business customers consist primarily of small to mid-sized businesses, educational institutions, and healthcare facilities.

Our California ILEC territory consists of approximately 83 square miles, covering Roseville and Citrus Heights, California and adjacent areas in Placer and Sacramento Counties. As of December 31, 2012, we had 46,559 local access lines (averaging 561.0 lines per square mile), of which 58.5% consisted of business customers and 41.5% residential customers. Our CLEC operations expand both north and south to serve primarily the greater Sacramento region. The California territory has experienced rapid growth during the past two decades, but the pace of growth has slowed in recent years as the area has become more developed. The rapid growth also attracted new competitors to the area. In this market, our business customers primarily include financial institutions, healthcare, manufacturing, local governments and school districts.

We also serve as a competitive provider to residential and business customers in the greater Kansas City, Kansas and Missouri areas. A significant portion of the market area is in Johnson County, Kansas, which includes the cities of Lenexa, Overland Park and Shawnee. The Kansas City market has favorable market demographics and has experienced growth in its metropolitan and suburban communities in recent years which has resulted in tremendous business opportunities in this market. Business customers consist primarily of small to medium sized businesses and local government entities. As of December 31, 2012, the Kansas City territory had 113,737 connections, or 15% of the Company s total connections.

Sales and Marketing

The key components of our overall marketing strategy include:

- Organizing our sales and marketing activities around our consumer, enterprise, and carrier customers;
- Positioning ourselves as a single point of contact for our customers communications needs;
- Providing customers with a broad array of voice, data and video services and bundling these services whenever possible;
- Providing excellent customer service, including 24/7 centralized customer support to coordinate installation of new services, repair and maintenance functions;
- Developing and delivering new services to meet evolving customer needs and market demands; and
- Leveraging history and brand recognition across all market areas.

We currently offer our services through call centers, our website, communication centers and commissioned sales representatives. Our customer service call centers and dedicated sales teams serve as the primary sales channels for consumer, business enterprise customers and carrier services. Our sales efforts are supported by direct mail, bill inserts, newspaper, radio and television advertising, public relations activities, community events and website promotions.

We market our services both individually and as bundled services, including our triple-play offering of voice, data and video services. By bundling our service offerings, we are able to offer and sell a more complete and competitive package of services, which we believe simultaneously increases our average revenue per user (ARPU) and adds value for the consumer. We also believe that bundling leads to increased customer loyalty and retention.

Network Architecture and Technology

We have made significant investments in our technologically advanced telecommunications networks. As a result, we are able to deliver high-quality, reliable video, data and voice services in all markets we serve. Our wide-ranging network and extensive use of fiber provide an easy reach into existing and new areas. By bringing the fiber network closer to the customer premises, we can increase our service offerings, quality and bandwidth services. Our existing network enables us to efficiently respond and adapt to changes in technology and is capable of supporting the rising customer demand for bandwidth in order to support the growing amount of wireless data devices in the home.

Our networks are supported by advanced 100% digital switches, with a fiber network connecting in all but one of our exchanges. These switches provide all of our local telephone customers with access to custom calling features, value-added services and dial-up Internet access. We continue to enhance our copper network to increase bandwidth in order to provide additional products and services to our marketable homes. In addition to our copper plant enhancements, we have deployed fiber-optic cable extensively throughout our network, resulting in a 100% fiber backbone network that supports all of the inter-office and host-remote links, as well as the majority of business parks within our ILEC and CLEC service areas. In addition, this fiber infrastructure provides the connectivity required to provide video service, Internet and long-distance services to all Consolidated residential and enterprise customers. Our fiber network utilizes fiber-to-the-home (FTTH) and fiber-to-the-node (FTTN) networks to offer bundled residential and commercial services.

As a result of our advanced networks, we provide data and video service in the markets we serve. We leverage our high definition head-end equipment to distribute content across our network allowing the Company to better manage costs of future channel additions and upgrades. As of December 31, 2012, video service was available to approximately 524,019 homes in our markets up from 508,366 at December 31, 2011, which includes SureWest markets. Our video subscriber base continues to grow and now totals 106,137 connections at December 31, 2012 as compared to 100,753 at December 31, 2011, which includes the SureWest subscribers. We do not anticipate having to make any material capital upgrades to our network infrastructure in connection with the continued growth of our video product except for providing set-top boxes to future subscribers and additional high definition channel equipment. Our network provides 100% of our video marketable homes with bandwidth of at least 17 Mbps and approximately 56% with above 50 Mbps of bandwidth.

In our CLEC markets, we operate fiber networks which we own or have entered into long-term leases for fiber network access. Our CLEC s operate approximately 3,000 route-miles of fiber, which includes approximately 2,000 miles of fiber network in Texas, approximately 600 route-miles of fiber-optic facilities in the Pittsburgh metropolitan area, approximately 350 route-miles of fiber optic facilities in California that cover large parts of the greater Sacramento metropolitan area and over 60 route-miles of fiber optic facilities in Kansas City that service the greater Kansas City area including both Kansas and Missouri. Our CLEC operations provide both residential and commercial services. Residential service includes VOIP, data and video service. For commercial services, we sell competitive wholesale capacity on our fiber network to other carriers, wireless providers, CLECs and large commercial customers. We also provide carrier hotel space and data center space in the various markets we serve.

In all the markets we serve, we have launched initiatives to support fiber backhaul services to cell sites. As of December 31, 2012, we had 694 cell sites under contract with 488 connected and 206 scheduled for completion in 2013.

Business Strategies

Diversify revenues and increase revenues per customer

We continue to transform our business and diversify our revenue streams as we adapt to changes in the regulatory environment and advances in technology. As a result of acquisitions, our wireless partnerships and increases in the consumer and commercial demand for data services, we continue to reduce our reliance on subsidies and access revenue. Utilizing our existing network, we are able to acquire and serve a more diversified business customer base and create new long-term revenue streams such as wireless carrier backhaul services.

We also continue to focus on increasing our revenue per customer, primarily by improving our data and video market penetration, by increasing the sale of other value-added services and by encouraging customers to subscribe to our service bundles.

Improve operating efficiency

We continue to seek to improve operating efficiency through technology, better practices and procedures and through cost containment measures. Our current focus is on the integration of SureWest into our existing operations and creating operating synergies for the combined company.   In recent years, we have made significant operational improvements in our business through the centralization of work groups, processes and systems, which has resulted in significant cost savings and reductions in headcount. Because of these efficiencies, we are better able to deliver a consistent customer experience, service our customers in a more cost-effective manner and lower our cost structure. We continue to evaluate our operations in order to align our cost structure with operating revenues while continuing to launch new products and improve the overall customer experience.

Maintain capital expenditure discipline

Across all of our service territories, we have successfully managed capital expenditures to optimize returns through disciplined planning and targeted investment of capital. For example, investments in our networks allows significant flexibility to expand new service offerings and provide services in a cost-efficient manner while maintaining our reputation as a high-quality service provider.

Pursue selective acquisitions

We have in the past taken, and expect to continue to take in the future, a disciplined approach in pursuing company acquisitions. When we evaluate potential transactions, important factor include:

- The market;
- The quality of the network;

- The ability to integrate the acquired company efficiently;
- Significant potential operating synergies exist; and
- The transaction will be cash flow accretive from day one.

We believe all of the above criteria were met in connection with our acquisition of SureWest Communications in 2012. In the long term, we believe that this transaction gives us additional scale and better positions us financially, strategically and competitively to pursue additional acquisitions.

Competition

The telecommunications industry is subject to extensive competition and has increased significantly in recent years. Technological advances have expanded the types and uses of services and products available. In addition, differences in the regulatory environment applicable to comparable alternative services have lowered costs for these competitors. As a result, we face heightened competition but also have new opportunities to grow our broadband business. Our competitors include other incumbent and competitive local telephone companies, cable operators offering video, data and VOIP products, wireless carriers, long distance providers, satellite companies, Internet service providers and in some cases by new forms of providers who are able to offer competitive services through software applications, requiring a small initial investment. We expect competition to remain a significant factor affecting our operating results and that the nature and extent of that competition will continue to increase. See Part I - Item 1A Risk Factors Risks Relating to Our Business .

Voice, data and video service

In recent years, competition in our incumbent service areas has increased significantly. Except for the traditional multichannel video delivery business, which requires significant capital investment to serve customers, the barriers to entry are not high, and technology changes force rapid competitive adjustments. We compete against AT&T and a number of other carriers, as well as Comcast, Time Warner, Mediacom, Armstrong, Suddenlink and NewWave communications, in both the business and residential markets. Our competitors offer traditional telecommunications services as well as IP-based services and other emerging data-based services. Our competitors continue to add features and adopt aggressive pricing and packaging for services comparable to the services we offer.

We continue to face significant competition from wireless providers as the demand for substitute communication services, such as wireless phones and data devices, continues to increase. Customers are increasingly foregoing traditional telephone services and land-based Internet service and relying exclusively on wireless service. In addition, the expanded availability for free or lower cost services, such as video over the Internet and complimentary Wi-Fi service in an increasing number of commercial venues has increased competition among other providers for our video and data services.

In most cases, we have entered the cable television service markets as the operator of a second (or subsequent) cable system. Therefore, we face the challenge of drawing customers away from the incumbent cable service provider. Similarly, the possession of comparatively greater size and scale can give an incumbent cable competitor an advantage in both access to and pricing of the program content needed to operate a cable television business. Our competitors, in some cases, possess significantly greater size and scale than we do.

In order to meet the competition, we have responded in part by introducing new services and service bundles, offering services in convenient groupings with package discounts and billing advantages, providing excellent customer service and by continuing to invest in our network and business operations.

In our rural markets, services are more costly to provide than service in urban areas as a lower customer density necessitates higher capital expenditures on a per-customer basis. As a result, it generally is not economically viable for new entrants to overlap existing networks in rural territories. Despite the barriers to entry, rural telephone companies still face significant competition from wireless providers, cable providers and, to a lesser extent, competitive telephone companies.

Other competition

Our other lines of business are subject to substantial competition from local, regional and national competitors. In particular, our directory publishing and transport businesses operate in competitive markets. We expect that competition in all of our businesses will continue to intensify as new technologies and new services are offered.

Regulatory Environment

The following summary does not describe all existing and proposed legislation and regulations affecting the telecommunications industry. Regulation can change rapidly, and ongoing proceedings and hearings could alter the manner in which the telecommunications industry operates. We cannot predict the outcome of any of these developments, nor their potential impact on us. See Part I Item 1A Risk Factors Regulatory Risks .

Overview

The telecommunications industry is subject to extensive federal, state and local regulation. Under the Telecommunications Act of 1996 (Telecommunications Act), federal and state regulators share responsibility for implementing and enforcing statutes and regulations designed to encourage competition and to preserve and advance widely available, quality telephone service at affordable prices.

At the federal level, the Federal Communications Commission (FCC) generally exercises jurisdiction over facilities and services of local exchange carriers, such as our rural telephone companies, to the extent they are used to provide, originate, or terminate interstate or international communications. The FCC has the authority to condition, modify, cancel, terminate, or revoke our operating authority for failure to comply with applicable federal laws or FCC rules, regulations and policies. Fines or penalties also may be imposed for any of these violations.

State regulatory commissions generally exercise jurisdiction over carriers facilities and services to the extent they are used to provide, originate, or terminate intrastate communications. In particular, state regulatory agencies have substantial oversight over interconnection and network access by competitors of our rural telephone companies. In addition, municipalities and other local government agencies regulate the public rights-of-way necessary to install and operate networks. State regulators can sanction our rural telephone companies or revoke our certifications if we violate relevant laws or regulations.

Federal regulation

Our rural telephone companies and competitive local exchange companies must comply with the Communications Act of 1934, which requires, among other things, that telecommunications carriers offer services at just and reasonable rates and on non-discriminatory terms and conditions. The 1996 amendments to the Communications Act (contained in the Telecommunications Act discussed below) dramatically changed, and likely will continue to change, the landscape of the industry.

Removal of Entry Barriers

The central aim of the Telecommunications Act is to open local telecommunications markets to competition while enhancing universal service. Before the Telecommunications Act was enacted, many states limited the services that could be offered by a company competing with an incumbent telephone company. The Telecommunications Act preempts these state and local laws.

The Telecommunications Act imposes a number of interconnection and other requirements on all local communications providers. All telecommunications carriers have a duty to interconnect directly or indirectly with the facilities and equipment of other telecommunications carriers. Local exchange carriers, including our rural telephone companies, are required to:

- Allow other carriers to resell their services;
- Provide number portability where feasible;
- Ensure dialing parity, meaning that consumers can choose their default local or long-distance telephone company without having to dial additional digits;
- Ensure that competitors customers receive non-discriminatory access to telephone numbers, operator service, directory assistance and directory listings;
- Afford competitors access to telephone poles, ducts, conduits, and rights-of-way; and
- Establish reciprocal compensation arrangements with other carriers for the transport and termination of telecommunications traffic.

Furthermore, the Telecommunications Act imposes on incumbent telephone companies (other than rural telephone companies that maintain their so-called rural exemption as our subsidiaries do) additional obligations to:

- Negotiate interconnection agreements with other carriers in good faith;
- Interconnect their facilities and equipment with any requesting telecommunications carrier, at any technically feasible point, at non-discriminatory rates and on non-discriminatory terms and conditions;
- Offer their retail services to other carriers for resale at discounted wholesale rates;
- Provide reasonable notice of changes in the information necessary for transmission and routing of services over the incumbent telephone company s facilities or in the information necessary for interoperability; and
- Provide, at rates, terms, and conditions that are just, reasonable, and non-discriminatory, for the physical collocation of other carriers equipment necessary for interconnection or access to UNEs at the premises of the incumbent telephone company.

Access Charges

On November 18, 2011, the FCC released its comprehensive order on intercarrier compensation and universal service reform. For detailed discussion on the FCC order see Part I Item 1 Regulatory Environment *FCC Access Charge and Universal Service Reform Order* below.

A significant portion of our rural telephone companies revenues come from network access charges paid by long-distance and other carriers for using our companies local telephone facilities for originating or terminating calls within our service areas. The amount of network access revenues our rural telephone companies receive is based on rates set or approved by federal and state regulatory commissions, and these rates are subject to change at any time.

Intrastate network access charges are regulated by state commissions. Network access charges in our Illinois market currently mirror interstate charges for everything except local switching. Illinois law requires that our intrastate access charges may not exceed our interstate access charges established by the Illinois Commerce Commission (ICC). Interstate and intrastate network access charges in our Pennsylvania market are also very similar. In contrast, as required by Texas regulators, our Texas rural telephone companies impose significantly higher network access charges for intrastate calls than for interstate calls.

The FCC regulates the prices we may charge for the use of our local telephone facilities to originate or terminate interstate and international calls. The FCC has structured these prices as a combination of flat monthly charges paid by customers and both usage-sensitive (per-minute) charges and flat monthly charges paid by long-distance or other carriers.

The FCC regulates interstate network access charges by imposing price caps on Regional Bell Operating Companies, referred to as RBOC s, and other large incumbent telephone companies. These price caps can be adjusted based on various formulas, such as inflation and productivity, and otherwise through regulatory proceedings. Incumbent telephone companies, such as our local telephone companies, may elect to base network access charges on price caps, but are not required to do so.

Historically, all of our rural telephone companies had elected not to apply federal price caps. Instead, they employed a rate-of-return regulation for their network interstate access charges, whereby they earned a fixed return on their investment over and above operating costs. In December 2007, we filed a petition with the FCC seeking to permit our Illinois and Texas companies to convert to price cap regulation. Our petition was approved on May 6, 2008, and became effective on July 1, 2008. The conversion to price cap regulation gives us greater pricing flexibility for interstate services, especially the increasingly competitive special access segment. It also provides us with the potential to increase our net earnings by becoming more productive and introducing new services. On the other hand, we were required to reduce our interstate access charges in Illinois significantly, and because our Illinois intrastate access charges mirror interstate rates, this conversion also resulted in lower intrastate revenues in Illinois. In addition, we now receive somewhat reduced subsidies from the interstate Universal Service Fund program.

Our Pennsylvania rural telephone company was an average schedule rate-of-return company. On March 1, 2012 we filed a petition for waiver to exit the National Exchange Carrier Association (NECA) settlement pools & tariff and become a price cap company. The FCC approved our waiver request on December 13, 2012. The exit of the NECA settlement pools and tariff was retroactive to July 1, 2012 and the price cap waiver was effective January 1, 2013.

Our California rural telephone company is a cost based rate of return company. We are in the NECA Common Line pool for ICLS purposes and we file our own end user, switched access and special access tariff and rates. Under current federal rules, we will be required to convert our California property by July 1, 2013.

Traditionally, regulators have allowed network access rates for rural areas to be set higher than the actual cost of terminating or originating long-distance calls as an implicit means of subsidizing the high cost of providing local service in rural areas. Following a series of federal court decisions ruling that subsidies must be explicit rather than implicit, the FCC adopted reforms in 2001 that reduced per-minute network access charges and shifted a portion of cost recovery, which historically was imposed on long-distance carriers, to flat-rate, monthly subscriber line charges imposed on end-user customers. While the FCC also increased explicit subsidies to rural telephone companies through the Universal Service Fund, the aggregate amount of interstate network access charges paid by long-distance carriers to access providers, such as our rural telephone companies, has decreased and may continue to decrease.

Unlike the federal system, California and Illinois do not provide an explicit subsidy in the form of a universal service fund. Therefore, while subsidies from the Federal Universal Service Fund offset the decrease in revenues resulting from the reduction in interstate network access rates, there was no corresponding offset for the decrease in revenues from the reduction in California or Illinois intrastate network access rates. In Pennsylvania and Texas, the intrastate network access rate regime applicable to our rural telephone companies does not mirror the FCC regime, so the impact of the reforms was revenue neutral.

In recent years, carriers have become more aggressive in disputing the FCC s interstate access charge rates and the application of access charges to their telecommunications traffic. We believe these disputes have increased in part because advances in technology have made it more difficult to determine the identity and jurisdiction of traffic, giving carriers an increased opportunity to challenge access costs for their traffic. For example, in September 2003, Vonage Holdings Corporation filed a petition with the FCC to preempt an order of the Minnesota Public Utilities Commission asserting jurisdiction over Vonage. The FCC determined that it was impossible to divide Vonage s VOIP service into interstate and intrastate components without negating federal rules and policies. Accordingly, the FCC found it was an interstate service not subject to traditional state telephone regulation. While the FCC order did not specifically address whether intrastate access charges were applicable to Vonage s VOIP service, the fact that the service was found to be solely interstate raises that concern. We cannot predict what other actions other long-distance carriers may take before the FCC or with their local exchange carriers, including our rural telephone companies, to challenge the applicability of access charges. Due to the increasing deployment of VOIP services and other technological changes, we believe these types of disputes and claims are likely to increase.

Unbundled Network Element Rules

The unbundling requirements have been some of the most controversial provisions of the Telecommunications Act. In its initial implementation of the law, the FCC generally required incumbent telephone companies to lease a wide range of UNE s to CLECs. Those rules were designed to enable competitors to deliver services to their customers in combination with their existing networks or as recombined service offerings on an unbundled network element platform, commonly known as UNE-P, which allowed competitors with no facilities of their own to purchase all the elements of local telephone service from the incumbent and resell them to customers. These unbundling requirements, and the duty to offer UNEs to competitors, imposed substantial costs on the incumbent telephone companies and made it easier for customers to shift their business to other carriers. After a court challenge and a decision vacating portions of the UNE rules, the FCC issued revised rules in February 2005 that reinstated some unbundling requirements for incumbent telephone companies that are not protected by the rural exemption, but eliminated the UNE-P option and certain other unbundling requirements.

Each of the subsidiaries through which we operate our local telephone businesses is an incumbent telephone company and provides service in rural areas. As discussed above, the Telecommunications Act exempts rural telephone companies from certain of the more burdensome interconnection requirements. However, the Telecommunications Act provides that the rural exemption will cease to apply as to competing cable companies if and when the rural carrier introduces video services in a service area. In that event, a competing cable operator providing video programming and seeking to provide telecommunications services in the area may interconnect. Since each of our subsidiaries now provides video services in their major service areas, the rural exemption no longer applies to cable company competitors in those service areas. Additionally, in Texas, the Public Utilities Commission of Texas (PUCT) has removed the rural exemption for our Texas subsidiaries with respect to telecommunications services furnished by Sprint Communications, L.P. on behalf of cable companies. We believe the benefits of providing video services outweigh the loss of the rural exemptions to cable operators.

Under its current rules, the FCC has eliminated unbundling requirements for ILECs providing broadband services over fiber facilities, but continues to require unbundled access to mass-market narrowband loops. ILECs are no longer required to unbundle packet switching services. In addition, the FCC found that CLECs generally are not at a disadvantage at certain wire center locations in regard to high bandwidth (DS-1 and DS-3) loops, dark fiber loops and dedicated interoffice transport facilities. However, where a disadvantage persists, ILECs continue to be required to unbundle loops and transport facilities.

The FCC rules regarding the unbundling of network elements did not have an impact on our Illinois and Pennsylvania ILEC operations because these ILECs have rural exemptions. Our Pennsylvania CLEC operations were not significantly affected by the 2005 changes to the UNE rules because they use their own switching for business customers that are served by high capacity loops. In July 2011, our Pennsylvania CLEC renewed, for a three-year term, a commercial agreement with Verizon that sets the terms of the pricing and provisioning of lines previously served utilizing UNE-P, including Verizon switching service. Less than 5% of our Pennsylvania CLEC access lines are provisioned utilizing this commercial arrangement. Although the costs for this arrangement will increase over time pursuant to the terms of the agreement, our relatively low use of Verizon s switching and our ability to migrate some of the lines to alternative provisioning sources will limit the overall impact on our current cost structure. The CLEC has experienced moderate increases in the overall cost to provision high-capacity loops, interoffice transport facilities and dark fiber as a result of the FCC s changes to unbundling requirements for those facilities.

In 2006, Verizon filed a petition requesting that the FCC refrain from applying a number of regulations to the Verizon operations in six major metropolitan markets, including the Pittsburgh market area. Among other things, Verizon urged the FCC to forbear from applying loop and transport unbundling regulations, claiming there was sufficient competition in the Pittsburgh market to mitigate the need for these rules. The FCC denied Verizon s petition in December 2007, but a federal court of appeals remanded this decision to the FCC for further analysis in 2009. If the FCC grants this remanded petition or any similar forbearance petitions in markets in which our CLEC operates, our cost to obtain access to loop and transport facilities would increase substantially for the 5%, or less, of the lines provisioned under the commercial agreement discussed above.

Promotion of Universal Service

In general, telecommunications service in rural areas is more costly to provide than service in urban areas. The lower customer density means that switching and other facilities serve fewer customers and loops are typically longer, requiring greater expenditures per customer to build and maintain. By supporting the high cost of operations in rural markets, Federal Universal Service Fund subsidies promote widely available, quality telephone service at affordable prices in rural areas. We received $50.8 million and $46.2 million from the Federal Universal Service Fund, the Pennsylvania Universal Service Fund and the Texas Universal Service Fund in 2012 and 2011, respectively.

Federal Universal Service Fund subsidies are paid only to carriers that are designated eligible telecommunications carriers (ETCs), by a state commission. Each of our rural telephone companies have been designated an ETC. However, under FCC rules prior to 2008, competitors could obtain the same level of Federal Universal Service Fund subsidies as we do, per line served, if the applicable state regulator determined that granting such Federal Universal Service Fund subsidies to competitors would be in the public interest and the competitors offered and advertised certain services as required by the Telecommunications Act and the FCC. The ICC has granted several petitions for ETC designations, but to date no other ETCs are operating in our Illinois service area. We are not aware that any carriers have filed petitions to be designated an ETC in our Pennsylvania or Texas service areas. In May 2008, the FCC adopted an interim cap on payments to ETCs that are not incumbent telephone companies, based on the payments received by such companies in March 2008, which reduces (but does not eliminate) the incentive for ETCs to seek to compete against our rural telephone companies.

FCC Access Charge and Universal Service Reform Order

In November 2011, the FCC released its comprehensive order on Access Charge and Universal Service Reform (the order). The access charge portion of the order systematically reduces minute of use based interstate access, intrastate access and reciprocal compensation rates over a six to nine year period to an end state of Bill and Keep, in which each carrier recovers the costs of its network through charges to its own subscribers, not through intercarrier compensation. The reductions apply to terminating access rates and usage, while originating access will be addressed by the FCC in a later proceeding. To help with the transition to Bill and Keep, the FCC created two mechanisms. The first is an Access Recovery Mechanism (ARM) which is funded from the Connect America Fund, and the second is an Access Recovery Charge (ARC) which is recovered from the end users. The universal service portion of the order shifts the national policy goal from voice service to broadband and is now called the Connect America Fund (CAF). In order to receive CAF funding, carriers must agree to provide broadband capability to 100% of their customer base at a minimum speed of 4 Mbps downstream and 1Mbps upstream. The current high cost funding program is frozen at 2011 levels and will be eliminated upon development and implementation of a CAF census block model.

The order has already been appealed by state commissions and carriers including Consolidated. We filed our petition for review on January 18, 2012 and raised issues with the order pertaining to access rates, universal service and transition provisions. In addition, several other carriers and associations have filed petitions for reconsideration at the FCC. The timeframe and results of these appeals and petitions for reconsideration are not known at this time.

In the FCC order, holding companies with price cap study areas and rate of return study areas are mandated to move all their interstate rate of return study areas to price cap for universal service purposes only. The intercarrier compensation rules will keep rate of return study areas under the rate of return intercarrier compensation transitions plan and the price cap study areas under the price cap intercarrier compensation transition.

Step 1 of the FCC s intercarrier compensation and universal service reform order was implemented on July 1, 2012 with the annual interstate tariff filing as well as intrastate filings, which reduced intrastate switched access rates toward the interstate rate, eliminated wireless reciprocal compensation charges and introduced the ARC which is assessed to end users. Step 2 will occur on July 1, 2013 which will bring intrastate switched access charges in parity with interstate and increase the ARC charges assessed to end users.

State Regulation

California

The California Public Utilities Commission (CPUC) has the power, among other things, to establish rates, terms and conditions for intrastate service, to prescribe uniform systems of accounts and to regulate the mortgaging or disposition of public utility properties.

In an ongoing proceeding relating to the New Regulatory Framework, the CPUC adopted Decision 06-08-030 in 2006, which grants carriers broader pricing freedom in the provision of telecommunications services, bundling of services, promotions and customer contracts. This decision adopted a new regulatory framework, the Uniform Regulatory Framework (URF), which among other things (i) eliminates price regulation and allows full pricing flexibility for all new and retail services, (ii) allows new forms of bundles and promotional packages of telecommunication services, (iii) allocates all gains and losses from the sale of assets to shareholders and (iv) eliminates almost all elements of rate of return regulation, including the calculation of shareable earnings. On December 31, 2010, the CPUC issued a ruling to initiate a new proceeding to assess whether, or to what extent, the level of competition in the telecommunications industry is sufficient to control prices for the four largest ILECs in the state. Subsequently, the CPUC issued a ruling temporarily deferring the proceeding. The status on when the CPUC may open this proceeding is unclear and on hold at this time. The CPUC s actions in this and future proceedings could lead to new rules and an increase in government regulation. The Company will continue to monitor this matter.

Illinois

Our Illinois Telephone Operations long-distance and payphone services subsidiary holds the necessary certifications in Illinois (and the other states in which it operates). This subsidiary is required to file tariffs with the ICC, but generally can change the prices, terms, and conditions stated in its tariffs on one day s notice, with prior notice of price increases to affected customers. Our Illinois Telephone Operations other services are not subject to any significant state regulations in Illinois, and our Other Illinois Operations are not subject to any significant state regulation outside of any specific contractually imposed obligations.

Our Illinois rural telephone company is certified by the ICC to provide local telephone services. This entity operates as a distinct company from a regulatory standpoint and is regulated under a rate of return system for intrastate revenues. Although, as explained above, the FCC has preempted certain state regulations pursuant to the Telecommunications Act, Illinois retains the authority to impose requirements on our Illinois rural telephone company to preserve universal service, protect public safety and welfare, ensure quality of service and protect consumers. For instance, our Illinois rural telephone company must file tariffs setting forth the terms, conditions, and prices for its intrastate services; these tariffs may be challenged by third parties. Our Illinois rural telephone company has not had a general rate proceeding before the ICC since 1983.

The ICC has broad authority to impose service quality and service offering requirements on our Illinois rural telephone company, including credit and collection policies and practices, and can require our Illinois rural telephone company to take actions to ensure that it meets its statutory obligation to provide reliable local exchange service. For example, as part of its approval of the reorganization we implemented in connection with our 2005 initial public offering, the ICC imposed various conditions, including (1) prohibitions on payment of dividends or other cash transfers from ICTC to us if ICTC fails to meet or exceed agreed benchmarks for a majority of seven service quality metrics, and (2) the requirement that ICTC have access to $5.0 million or its currently approved capital expenditure budget (whichever is higher) for each calendar year through a combination of available cash and credit facilities. During 2012, we satisfied each of the applicable Illinois regulatory requirements necessary to permit ICTC to pay dividends to us.

The Illinois General Assembly has made major revisions and added significant new provisions to the portions of the Illinois Public Utilities Act governing the regulation and obligations of telecommunications carriers on a number of occasions since 1985. In 2007, the Illinois legislature addressed competition for cable and video services and authorized statewide licensing by the ICC to replace the existing system of individual town franchises. This legislation also imposed substantial state-mandated consumer service and consumer protection requirements on providers of cable and video services. The requirements generally became applicable to us on January 1, 2008, and we are operating in compliance with the new law. Although we have franchise agreements for cable and video services in all the towns we serve, this statewide franchising authority will simplify the process in the future. In 2010, the Illinois General Assembly passed Public Act 96-0927, which updates the telecommunications statute, allowing ILECs, beginning January 1, 2011, to elect deregulation of local services. To date, ICTC has not made an election to deregulate its local services. Under this option, an ILECs rates for local services would become competitive and no longer subject to rate of return regulation, and certain other service quality obligations would be reduced. The electing ILECs would have obligations to make certain basic local exchange service packages available to customers. Public Act 96-0927 also specified that local exchange carriers may not charge intrastate access rates at levels higher than their interstate access rates. The Governor of Illinois signed the bill into law on June 15, 2010. The Illinois telecommunications statute is scheduled to sunset in 2013. In the past, such sunset dates in telecommunication legislation have led to further amendments to reflect changing industry technological and competitive conditions.

Texas

Our Texas rural telephone companies are each certified by the PUCT to provide local telephone services in their respective territories. In addition, our Texas long-distance and transport subsidiaries are registered with the PUCT as interexchange carriers. The transport subsidiary also has obtained a service provider certificate of operating authority (SPCOA) to better assist the transport subsidiary with its operations in municipal areas. Recently, to assist with expanding services offerings, Consolidated Communications Enterprise Services, Inc. also obtained a SPCOA from the PUCT. While our Texas rural telephone company services are extensively regulated, our other services, such as long-distance and transport services, are not subject to any significant state regulation.

Our Texas rural telephone companies operate as distinct companies from a regulatory standpoint. Each is separately regulated by the PUCT in order to preserve universal service, protect public safety and welfare, ensure quality of service and protect consumers. Each Texas rural telephone company must file and maintain tariffs setting forth the terms, conditions and prices for its intrastate services.

Currently, both of our Texas rural telephone companies have immunity from adjustments to their rates, including their intrastate network access rates, because they elected incentive regulation under the Texas Public Utilities Regulatory Act (PURA). In order to qualify for incentive regulation, our rural telephone companies agreed to fulfill certain infrastructure requirements. In exchange, they are not subject to challenge by the PUCT regarding their rates, overall revenues, return on invested capital, or net income.

PURA prescribes two different forms of incentive regulation in Chapter 58 and Chapter 59. Under either election, the rates, including network access rates, an incumbent telephone company may charge for basic local services generally cannot be increased from the amount(s) on the date of election without PUCT approval. Even with PUCT approval, increases can only occur in very specific situations. Pricing flexibility under Chapter 59 is extremely limited. In contrast, Chapter 58 allows greater pricing flexibility on non-basic network services, customer-specific contracts and new services.

Initially, both of our Texas rural telephone companies elected incentive regulation under Chapter 59 and fulfilled the applicable infrastructure requirements, but they changed their election status to Chapter 58 in 2003, which gives them some pricing flexibility for basic services, subject to PUCT approval. The PUCT could impose additional infrastructure requirements or other restrictions in the future. Any requirements or restrictions could limit the amount of cash that is available to be transferred from our rural telephone companies to the parent entities, and could adversely affect our ability to meet our debt service requirements and repayment obligations.

In September 2005, the Texas legislature adopted significant additional telecommunications legislation. Among other things, this legislation created a statewide video franchise for telecommunications carriers, established a framework to deregulate the retail telecommunications services offered by incumbent local telecommunications carriers, imposed concurrent requirements to reduce intrastate access charges and directed the PUCT to initiate a study of the Texas Universal Service Fund. The PUCT study submitted to the legislature in 2007 recommended that the Small Company Area High-Cost Program, which covers our Texas telephone companies, should be reviewed by the PUCT from a policy perspective regarding basic local telephone service rates and lines eligible for support. The PUCT has only addressed the large company fund and has no immediate plans to conduct a small company review.

Texas Universal Service

The Texas Universal Service Fund is administered by NECA. PURA, the governing law, directs the PUCT to adopt and enforce rules requiring local exchange carriers to contribute to a state universal service fund that helps telecommunications providers offer basic local telecommunications service at reasonable rates in high cost rural areas. The Texas Universal Service Fund is also used to reimburse telecommunications providers for revenues lost by providing Tel-Assistance and to reimburse carriers for providing lifeline service. Our Texas rural telephone companies receive disbursements from this fund.

In 2011, the Texas legislature passed Senate Bill 985 which requires the PUCT to review the large and small company Texas Universal Service Funds in 2012 and report back to the legislature by January 2013. The PUCT began a series of dockets in 2012 reviewing the Texas universal service high cost fund programs, for both large and small companies. The large company dockets were settled in late 2012. The small company dockets will not be reviewed until after the 2013 legislative session has been completed. We expect that any impact from these proceedings will most likely occur in 2014.

Pennsylvania

The Pennsylvania Public Utilities Commission (PAPUC) regulates the rates, the system of financial accounts for reporting purposes, and certain aspects of service quality, billing procedures and universal service funding, among other things, related to our rural telephone company and CLEC s provision of intrastate services. In addition, the PAPUC sets the rates and terms for interconnection between carriers within the guidelines ordered by the FCC. Pennsylvania intrastate rates are regulated under a statutory framework referred to as Act 183. Under this statute, rates for non-competitive intrastate services are allowed to increase based on an index that measures economy-wide price increases. In return, we committed to continue to upgrade our network to ensure that all our customers would have access to broadband services, and to deploy a ubiquitous broadband (defined as 1.544 mbps) network throughout our entire service area by December 31, 2008, which we did.

Pennsylvania Universal Service and Access Charges

On September 30, 1999, as part of a proceeding that resolved a number of pending issues, the PAPUC ordered ILECs, including our Pennsylvania property, to rebalance and reduce intrastate toll and switched access rates. In that same order, the PAPUC also created a Pennsylvania Universal Service Fund (PAUSF) to help offset the resulting loss of ILEC revenues. In 2003, the PAPUC ordered ILECs to further rebalance and reduce intrastate access charges and left the PAUSF in place pending further review. In 2008, our Pennsylvania ILECs annual receipts from and contributions to the PAUSF total $5.2 million and $0.3 million, respectively. Our Pennsylvania CLEC receives no funding from the PAUSF but currently contributes $0.2 million annually. Since Act 183 was adopted in 2004, the PAPUC may not require a local exchange carrier to reduce intrastate access rates except on a revenue neutral basis.

In 2011, the PAPUC issued an intrastate access reform order reducing intrastate access rates to interstate levels in a three step process, beginning in March 2012. With the release of the FCC order in October 2011, the PAPUC has temporarily issued a stay. A final stay was issued in 2012 to implement the FCC ordered intrastate access rate changes. The PAPUC has indicated that it will address state universal funding in 2013 pending any state legislative activity that may occur in the 2013 legislative session.

Local Government Authorizations

In Illinois, we historically have been required to obtain franchises from each incorporated municipality in which our rural telephone company operates. An Illinois state statute prescribes the fees that a municipality may impose for the privilege of originating and terminating messages and placing facilities within the municipality. Our Illinois Telephone Operations may also be required to obtain permits for street opening and construction, or for operating franchises to install and expand fiber optic facilities. These permits or other licenses or agreements typically require the payment of fees.

Similarly, Texas incumbent telephone companies had historically been required to obtain franchises from each incorporated municipality in which they operated. Texas law now provides that incumbent telephone companies do not need to obtain franchises or other licenses to use municipal rights-of-way for delivering services. Instead, payments to municipalities for rights-of-way are administered through the PUCT and through a reporting process by each telecommunications provider. Incumbent telephone companies are still required to obtain permits from municipal authorities for street opening and construction, but most burdens of obtaining municipal authorizations for access to rights-of-way have been streamlined or removed.

Our Texas rural telephone companies still operate pursuant to the terms of municipal franchise agreements in some territories served by Consolidated Communications of Fort Bend Company. As the franchises expire, they are not being renewed.

Like Illinois, California and Pennsylvania operates under a structure in which each municipality may impose various fees.

Regulation of Broadband and Internet Services

Video Services

Our cable television subsidiaries each require a state or local franchise or other authorization in order to provide cable service to customers. Each of these subsidiaries is subject to regulation under a framework that exists in Title VI of the Communications Act.

Under this framework, the responsibilities and obligations of franchising bodies and cable operators have been carefully defined. The law addresses such issues as the use of local streets and rights of way; the carriage of public, educational and governmental channels; the provision of channel space for leased commercial access; the amount and payment of franchise fees; consumer protection; and similar issues. In addition, Federal laws place limits on the common ownership of cable systems and competing multichannel video distribution systems, and on the common ownership of cable systems and local telephone systems in the same geographic area. Many provisions of the Federal law have been implemented through FCC regulations. The FCC has expanded its oversight and regulation of the cable television-related matters recently. In some cases, it has acted to assure that new competitors in the cable television business are able to gain access to potential customers and can also obtain licenses to carry certain types of video programming.

The Communications Act also authorizes the licensing and operation of open video systems (OVS). An OVS is a form of multichannel video delivery that was initially intended to accommodate unaffiliated providers of video programming on the same network. The OVS regulatory structure also offered a means for a single provider to serve less than an entire community. Our Kansas City operations in Missouri utilize an OVS that allows us to operate in only a part of Kansas City.

A number of state and local provisions also affect the operation of our cable systems. The California legislature adopted the Digital Infrastructure and Video Competition Act of 2006 (DIVCA) to encourage further entrance of telephone companies and other new cable operators to compete against the large incumbent cable operators. DIVCA changed preexisting California law to require new franchise applicants to obtain franchise authorizations on the state level. In addition, DIVCA established a general set of state-defined terms and conditions to replace numerous terms and conditions that had applied uniquely in local municipalities, and it repealed a state law that had prohibited local governments from adopting terms for new competitive franchises that differed in any material way from the incumbent s franchise, even if competitive circumstances were very different. Some portions of this law are also available to incumbent cable operators with existing local franchises who compete against us.

A state franchising law also has been enacted in Kansas. While these laws have reduced franchise burdens on our subsidiaries and have made it easier for them to seek out and enter new markets, they also have reduced the entry barriers for others who may want to enter our cable television markets.

Federal law and regulation also affects numerous issues related to video programming and other content.

Under Federal law, certain local television broadcast stations (both commercial and non-commercial) can elect, every three years, to take advantage of rules that require a cable operator to distribute the station s content to the cable system s customers without charge, or to forego this must-carry obligation and to negotiate for carriage on an arm s length contractual basis, which typically involves the payment of a fee by the cable operator, and sometimes involves other consideration as well. The current three year cycle began on January 1, 2012. The company has successfully negotiated agreements with all of the local television broadcast stations that would have been eligible for must carry treatment in each of its markets. As anticipated, fees under retransmission consent agreements generally underwent marked increases for the 2012-2014 period.

Federal law and regulation regulate access to certain programming content that is delivered by satellite. The FCC has provisions in place to ban certain discriminatory practices and unfair acts, and include a presumption that the withholding of regional sports programming by content affiliates of incumbent cable operators is presumptively unlawful. The existing FCC complaint process for program access for both satellite and terrestrially-delivered content is governed on a case-by-case basis. The FCC currently is considering adopting rules that could make it less burdensome for competing multichannel video programming providers who are denied access to cable-affiliated satellite programming on reasonable terms and conditions to pursue and meet evidentiary standards with respect to program access complaints. That proceeding remains pending before the FCC.

The FCC recently adopted an order banning exclusive contracts between affiliates where the programming is sent via terrestrial media, and banning certain other unfair acts, making it clear that the withholding of regional sports programming and high definition television programming by content affiliates of incumbent cable operators would receive special attention. Unlike the satellite provisions, the new rules will not expire. The FCC s order was upheld in an appeals court decision issued on March 12, 2010.

In connection with the FCC s approval of a cable transaction involving Comcast and Time Warner in July 2006, the parties regional sports networks were subject to certain program access rules until July 2012. The FCC did not extend these obligations beyond July 2012. This does not change the existing Comcast/NBC Universal merger conditions which expire in 2018, as described below. It is unknown what, if any, impact this decision will have on us.

In early 2010, Comcast proposed to enter into a joint venture with NBC Universal, through which it would acquire control of numerous NBC properties, including both broadcast and cable television programming operations of NBC. In early 2011, the FCC and the Department of Justice (DOJ) approved the transaction, with a significant number of conditions designed to promote programming diversity, to limit the ability of the combined entity to affect competition adversely, and to protect newly emerging markets such as independent on-line (over-the-top) video. These conditions include requirements for program access and carriage, non-discrimination in making programming available, limits on bundling that would affect competition, and the relationship of the joint venture to emerging on-line competition. In addition, conditions were imposed to maintain independence within the NBC unit in dealing with competing cable operators. The parties agreed to the conditions and the transaction was completed during 2011. Most of the conditions will have a duration of seven years.

The contractual relationships between cable operators and most providers of content who are not television broadcast stations generally are not subject to FCC oversight or other regulation. The majority of providers of content to our subsidiaries, including content providers affiliated with incumbent cable operators such as Comcast, but who are not subject to any FCC or DOJ conditions, do so through arm s length contracts where the parties have mutually agreed upon the terms of carriage and the applicable fees.

The transition to digital television (DTV) has led the FCC to adopt and implement new rules designed to ease the shift. These rules also can be expected to make broadcast content more accessible over the air to smartphones, personal computers and other non-television devices. Local television broadcast stations will also be able to offer more content over their assigned digital spectrum after the DTV transition, including additional channels.

The Company continues to monitor the emergence of video content options for customers that have become available over the Internet, and that may be made available free, by individual subscription or in conjunction with a separate cable service agreement. In some cases, this involves the ability to watch episodes of desirable network television programming and to procure additional content related to programs carried on linear cable channels.

These options have increased significantly, and can lead cable television customers to terminate or reduce their level of services. At this time, over-the-top programming options cannot duplicate the nature or extent of desirable programming carried by cable systems, and the market is still comparatively nascent, but in light of changing technology and events such as the Comcast-NBC transaction, the over-the-top market will continue to grow and evolve rapidly.

Cable operators depend to some degree upon their ability to utilize the poles (and conduit) of electric and telephone utilities. The terms and conditions under which such attachments can be made were established in the Federal Pole Attachment Act of 1978, as amended. The Pole Attachment Act outlined the formula for calculating the fee to be charged for the use of utility poles, a formula that assesses fees based on the proportionate amount of space assigned for use and an allocation of certain qualified costs of the pole owner. The FCC has put in place a structure for pole attachment regulation that has covered cable operators and other types of providers. The FCC has adopted new rules that apply a single rate to all providers who use poles, whether they are cable operators, telecommunications providers, or Internet providers, even if they use the attachment to offer more than one service. These rules only affect attachments in states where the Federal rules apply. States have the option to opt out of the Federal formula and to regulate pole attachments independently. Kansas, Missouri, Texas, Pennsylvania and Illinois follow the FCC pole attachment framework. California has elected to separately regulate pole attachments and pole attachment rates. The FCC decision has been appealed, and the ultimate outcome of the appeal cannot be predicted.

Cable operators are subject to longstanding cable copyright obligations where they pay copyright fees for some types of programming that are considered secondary retransmissions. The copyright fees are updated from time to time, and are paid into a pool administered by the United States Copyright Office for distribution to qualifying recipients.

The FCC has so far declined to require that cable operators allow unaffiliated Internet service providers to gain access to customers by using the network of the operator s cable system. The FCC also has considered the benefits of a requirement that cable operators offer programming on their systems on an a la carte or themed basis, but to date has not adopted regulations requiring such action. These matters may resurface in the future, particularly as the over-the-top market grows. In light of the fact that programming is increasingly being made available through Internet connections, some cable operators have considered their own a la carte alternatives. Content owners with linear channels also are moving toward greater on demand programming, offerings that maintain the value of their linear channels for customers.

The outcome of pending matters cannot be determined at this time but can lead to increased costs for the Company in connection with our provision of cable services, and can affect our ability to compete in the markets we serve.

Internet Services

The provision of Internet access services is not significantly regulated by either the FCC or the state commissions. However, the FCC has been moving toward the imposition of some controls on the provision of Internet access. In 2002, in part to place cable modem service and Digital Subscriber Line (DSL) service on an equal competitive footing, the FCC asserted jurisdiction over these services as information services under Title I of the Communications Act, and removed them from treatment under Title II of the Act, but to date it has not determined what regulatory framework, if any, is appropriate for Internet services under Title I.

The FCC has also adopted policy principles to signal its objectives with respect to high speed Internet and related services. These principles are intended to encourage broad customer access to the content and applications of their choice, to promote the unrestricted use of lawful equipment by users of Internet services and to promote competition among providers.

In 2009, the FCC proposed to enact rules related to Internet access services, relying in part on the policy principles that it had earlier adopted, but expanding their reach and adding additional provisions. The adoption of the rules as they have been proposed would prohibit discrimination with respect to applications providers, among other things, subject to reasonable network management by an Internet access service provider.

While this initiative was getting underway, a Federal appeals court decision in April 2010 assessed the FCC s authority over Internet services under the Communications Act, and invalidated action taken by the FCC that was based on authority that the FCC thought it possessed. The FCC continues to assert that it has jurisdictional authority in some areas related to the promotion of an open Internet. Notwithstanding the court setback, the FCC elected to adopt rules in this regard in December 2010. That action also has been appealed to a Federal appeals court. The extent of the FCC s jurisdiction in connection with the Internet will not be resolved for some time. We are unable to predict the outcome of current proceedings.

The Federal Trade Commission (FTC) is currently assessing certain advertising and marketing practices of Internet-related companies, as well as the use of the Internet in connection with other businesses. FTC action can affect the manner of operation of some of our businesses. The outcome of pending matters cannot be determined at this time but can lead to increased costs for the Company in connection with our provision of Internet services, and can affect our ability to compete in the markets we serve.

Item 1A. Risk Factors.

Our operations and financial results are subject to various risks and uncertainties, including but not limited to those described below, that could adversely affect our business, financial condition, results of operations, cash flows and the trading price of our common stock.

Risks Relating to Current Economic Conditions

Unfavorable changes in financial markets could adversely affect pension plan investments resulting in material funding requirements to meet our pension obligations. We expect that we will continue to make future cash contributions to our pension plans, the amount and timing of which will depend on various factors including funding regulations, future investment performance, changes in future discount rates and changes in participant demographics. Our pension plans have investments in marketable securities, including marketable debt and equity securities, whose values are exposed to changes in the financial markets. Returns generated on plan assets have historically funded a large portion of the benefits paid under these plans. If the financial markets experience a downturn and returns fall below our the estimated long-term rate of return, as seen in recent years, our future funding requirements could increase significantly, which could adversely affect cash flows from operations.

Weak economic conditions may have a negative impact on our business, results of operations and financial condition. Downturns in the economic conditions in the markets and industries we serve could adversely affect demand for our products and services and have a negative impact on our results of operations. Economic weakness or uncertainty may make it difficult for us to obtain new customers and may cause our existing customers to reduce or discontinue their services to which they subscribe. This risk may be worsened by the expanded availability of free or lower cost services, such as video over the Internet, or substitute services, such as wireless phones and data devices. Weak economic conditions may also impact the ability of third parties to satisfy their obligations to us. If weak economic conditions were to continue or further deteriorate, the growth of our business, results of operations and financial condition may be adversely affected.

Risks Relating to Our Common Stock and Payment of Dividends

Our Board of Directors could, in 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 decrease the amount of dividends, change or revoke the dividend policy, or discontinue 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 whatever reason, shares of our common stock could become less liquid and the market price of our common stock could decline.

We might not have sufficient cash to maintain current dividend levels. Our debt agreements, applicable state, legal and corporate law, regulatory requirements and other risk factors described in this section, could materially reduce the cash available from operations or significantly increase our capital expenditure requirements, and these outcomes could cause funds not to be available when needed in amount sufficient to support our current dividend practice.

If we continue to pay dividends at the level currently anticipated under our dividend policy, our ability to pursue growth opportunities may be limited. We believe that our dividend practice could limit, but not preclude, our ability to grow. If we continue paying dividends at the level currently anticipated, we may not retain a sufficient amount of cash to fund a material expansion of our business, including any acquisitions or growth opportunities requiring significant and unexpected capital expenditures. For that reason, our ability to pursue any material expansion of our business may depend on our ability to obtain third-party financing. We cannot guarantee that such financing will be available to us on reasonable terms or at all, particularly in the current economic environment.

Our organizational documents could limit or delay another party s ability to acquire us and, therefore, could deprive our investors of a possible takeover premium for their shares. A number of provisions in our amended and restated certificate of incorporation and bylaws will make it difficult for another company to acquire us. Among other things, these provisions:

- Divide our Board of Directors into three classes, which results in roughly one-third of our directors being elected each year;
- Provide that directors may only be removed for cause and then only upon the affirmative vote of holders of two-thirds or more of the voting power of our outstanding common stock;
- Require the affirmative vote of holders of two-thirds or more of the voting power of our outstanding common stock to amend, alter, change, or repeal specified provisions of our amended and restated certificate of incorporation and bylaws;
- Require stockholders to provide us with advance notice if they wish to nominate any candidates for election to our Board of Directors or if they intend to propose any matters for consideration at an annual stockholders meeting; and
- Authorize the issuance of so-called blank check preferred stock without stockholder approval upon such terms as the Board of Directors may determine.

We also are subject to laws that may have a similar effect. For example, federal, Illinois, and Pennsylvania telecommunications laws and regulations generally prohibit a direct or indirect transfer of control over our business without prior regulatory approval. Similarly, Section 203 of the Delaware General Corporation Law restricts our ability to engage in a business combination with an interested stockholder . These laws and regulations make it difficult for another company to acquire us, and therefore could limit the price that investors might be willing to pay in the future for shares of our common stock. In addition, the rights of our common stockholders will be subject to, and may be adversely affected by, the rights of holders of any class or series of preferred stock that we may issue in the future.

Risks Relating to Our Indebtedness and Our Capital Structure

We have a substantial amount of debt outstanding and may incur additional indebtedness in the future, which could restrict our ability to pay dividends and fund working capital and planned capital expenditures. As of December 31, 2012, we had $1,217.8 million of debt outstanding. Our substantial level of indebtedness could adversely impact our business, including:

- We may be required to use a substantial portion of our cash flow from operations to make principal and interest payments on our debt, which will reduce funds available for operations, future business opportunities and dividends;
- We may have limited flexibility to react to changes in our business and our industry;
- It may be more difficult for us to satisfy our other obligations;
- We may have a limited ability to borrow additional funds or to sell assets to raise funds if needed for working capital, capital expenditures, acquisitions, or other purposes;
- We may become more vulnerable to general adverse economic and industry conditions, including changes in interest rates; and
- We may be at a disadvantage compared to our competitors that have less debt.

We cannot guarantee that we will generate sufficient revenues to service our debt and have adequate funds left over to achieve or sustain profitability in our operations, meet our working capital and capital expenditure needs, compete successfully in our markets, or pay dividends to our stockholders.

Our credit agreement and the indenture governing the Senior Notes contain covenants that limit management s discretion in operating our business and could prevent us from capitalizing on opportunities and taking other corporate actions. Among other things, our credit agreement limits or restricts our ability (and the ability of certain of our subsidiaries), and the indenture governing the Senior Notes limits the ability of our subsidiary, Consolidated Communications, Inc., and its restricted subsidiaries, to:

- Incur additional debt and issue preferred stock;

- Make restricted payments, including paying dividends on, redeeming, repurchasing, or retiring our capital stock;
- Make investments and prepay or redeem debt;
- Enter into agreements restricting our subsidiaries ability to pay dividends, make loans, or transfer assets to us;
- Create liens;
- Sell or otherwise dispose of assets, including capital stock of, or other ownership interests in, subsidiaries;
- Engage in transactions with affiliates;
- Engage in sale and leaseback transactions;
- Engage in a business other than telecommunications; and
- Consolidate or merge.

In addition, our credit agreement requires us to comply with specified financial ratios, including ratios regarding total leverage and interest coverage. Our ability to comply with these ratios may be affected by events beyond our control. These restrictions limit our ability to plan for or react to market conditions, meet capital needs, or otherwise constrain our activities or business plans. They also may adversely affect our ability to finance our operations, enter into acquisitions, or engage in other business activities that would be in our interest.

A breach of any of the covenants contained in our credit agreement, in any future credit agreement, or in the indenture governing the Senior Notes, or our inability to comply with the financial ratios could result in an event of default, which would allow the lenders to declare all borrowings outstanding to be due and payable. If the amounts outstanding under our credit facilities were to be accelerated, we cannot assure that our assets would be sufficient to repay in full the money owed. In such a situation, the lenders could foreclose on the assets and capital stock pledged to them.

We may not be able to refinance our existing debt if necessary, or we may only be able to do so at a higher interest expense. We may be unable to refinance or renew our credit facilities and our failure to repay all amounts due on the maturity dates would cause a default under the credit agreement. Alternatively, any renewal or refinancing may occur on less favorable terms. If we refinance our credit facilities on terms that are less favorable to us than the terms of our existing debt, our interest expense may increase significantly, which could impact our results of operations and impair our ability to use our funds for other purposes, such as to pay dividends.

Our variable-rate debt subjects us to interest rate risk, which could impact our cost of borrowing and operating results. Certain of our debt obligations are at variable rates of interest and expose us to interest rate risk. Increases in interest rates could negatively impact our results of operations and operating cash flows. To mitigate the risk of rising interest rates, we have entered into interest rate swap agreements that convert a portion of our variable-rate debt to a fixed-rate basis. However, we do not maintain interest rate hedging agreements for all of our variable-rate debt and our existing hedging agreements may not fully mitigate our interest rate risk, may prove disadvantageous or may create additional risks. Changes in fair value of cash flow hedges that have been determined to be ineffective are recognized in earnings. Significant increases or decreases in the fair value of ineffective cash flow hedges could cause favorable or adverse fluctuations in our results of operations.

Risks Relating to Our Business

We expect to continue to face significant competition in all parts of our business and the level of competition could intensify. The telecommunications, Internet and digital video businesses are highly competitive. We face actual or potential competition from many existing and emerging companies, including other incumbent and competitive local telephone companies, long-distance carriers and resellers, wireless companies, Internet service providers, satellite companies, cable television companies and in some cases by new forms of providers who are able to offer competitive services through software applications, requiring a comparatively small initial investment. Due to consolidation and strategic alliances within the industry, we cannot predict the number of competitors we will face at any given time.

The wireless business has expanded significantly and has caused many subscribers to traditional telephone services and land-based Internet access services to give up those services and to rely exclusively on wireless service. Consumers are finding individual television shows of interest to them through the Internet and are watching content that is downloaded to their computers. Some providers, including television and cable television content owners, have initiated what are called over-the-top services that deliver video content to televisions and computers over the Internet. Over-the-top services can include episodes of highly-rated television series in their current broadcast seasons. They also can include content that is related to broadcast or sports content that we carry, but that is distinct and may be available only through the alternative source. Finally, the transition to digital broadcast television has allowed many consumers to obtain high definition local broadcast television signals (including many network affiliates) over-the-air, using a simple antenna. Consumers can pursue each of these options without foregoing any of the other options. We may not be able to successfully anticipate and respond to many of these various competitive factors affecting the industry, including regulatory changes that may affect our competitors and us differently, new technologies, services and applications that may be introduced, changes in consumer preferences, demographic trends and discount or bundled pricing strategies by competitors. The incumbent telephone carrier in the markets we serve enjoys certain business advantages, including size, financial resources, favorable regulatory position, a more diverse product mix, brand recognition and connection to virtually all of our customers and potential customers. The largest cable operators also enjoy certain business advantages, including size, financial resources, ownership of or superior access to desirable programming and other content, a more diverse product mix, brand recognition and first-in-the-field advantages with a customer base that generates positive cash flow for its operations. Our competitors continue to add features and adopt aggressive pricing and packaging for services comparable to the services we offer. Their success in selling some services competitive with ours can lead to revenue erosion in other related areas. We face intense competition in our markets for long-distance, Internet access and other ancillary services that are important to our business and to our growth strategy. If we do not compete effectively we could lose customers, revenue and market share; customers may reduce their usage of our services or switch to a less profitable service; and we may need to lower our prices or increase our marketing efforts to remain competitive.

We must adapt to rapid technological change. If we are unable to take advantage of technological developments, or if we adopt and implement them more slowly than our competitors, we may experience a decline in the demand for our services. The telecommunications industry operates in a technologically complex environment. New technologies are continually developed and products and services undergo constant improvement. These offer consumers a variety of choices for their communication needs. To remain competitive, we will need to adapt to future changes in technology to enhance our existing offerings and to introduce new or improved offerings that anticipate and respond to the varied and continually changing demands of our customers. If we are unable to match the benefits offered by competing technologies on a timely basis or at an acceptable cost, if we fail to employ technologies desired by our customers before our competitors do so, or if we do not successfully execute on our technology initiatives, our business and results of operations could be adversely affected.

In addition, evolving technologies can reduce the costs of entry for others, resulting in greater competition and give competitors significant new advantages. Technological developments could require us to make a significant new capital investment in order to remain competitive with other service providers. If we do not replace or upgrade our network and its technology once it becomes obsolete, we will be unable to compete effectively and will likely lose customers. We also may be placed at a cost disadvantage in offering our services. Technology changes are also allowing individuals to bypass telephone companies and cable operators entirely to make and receive calls, and to provide for the distribution and viewing of video programming without the need to subscribe to traditional voice and video products and services. Increasingly, this can be done over wireless facilities and other emerging mobile technologies as well as traditional wired networks. Wireless companies are aggressively developing networks using next-generation data technologies, which are capable of delivering high-speed Internet service via wireless technology to a large geographic footprint. As these technologies continue to expand in availability and reliability, they could become an effective alternative to our high-speed Internet services. Although we use fiber optics in parts of our networks, including in some residential areas, we continue to rely on coaxial cable and copper transport media to serve customers in many areas. The facilities we use to offer our video services, including the interfaces with customers, are undergoing a rapid evolution, and depend in part on the products, expertise and capabilities of third parties. If we cannot develop new services and products to keep pace with technological advances, or if such services and products are not widely embraced by our customer, our results of operations could be adversely impacted.

Transport and content costs are substantial and continue to increase. We expect the cost of video transport and content costs to continue to be one of our largest operating costs associated with providing video service. Video programming content includes cable-oriented programming designed to be shown in linear channels, as well as the programming of local over-the-air television stations that we retransmit. In addition, on-demand programming is being made available in response to customer demand. In recent years, the cable industry has experienced rapid increases in the cost of programming, especially the costs for sports programming and for local broadcast station retransmission consent. Programming costs are generally assessed on a per-subscriber basis, and therefore are related directly to the number of subscribers to which the programming is provided. Our relatively small base of subscribers limits our ability to negotiate lower per-subscriber programming costs. Larger providers often can qualify for discounts based on the number of their subscribers. This cost difference can cause us to experience reduced operating margins, while our competitors with a larger subscriber base may not experience similar margin compression. In addition, escalators in existing content agreements cause cost increases that are out of line with general inflation. While we expect these increases to continue we may not be able to pass our programming cost increases on to our customers, particularly as an increasing amount of programming content becomes available via the Internet at little or no cost. Also, some competitors (or their affiliates) own programming in their own right and we may be unable to secure license rights to that programming. As our programming contracts with content providers expire, there can be no assurance that they will be renewed on acceptable terms or that they will be renewed at all, in which case we may be unable to provide such programming as part of our video services packages and our business and results of operations may be adversely affected.

A disruption in our networks and infrastructure could cause delays or interruptions of service, which could cause us to lose customers and incur additional expenses. Our customers depend on reliable service over our network. The primary risks to our network infrastructure include physical damage to lines, security breaches, capacity limitations, power surges or outages, software defects and disruptions beyond our control, such as natural disasters and acts of terrorism. From time to time in the ordinary course of business, we will experience short disruptions in our service due to factors such as physical damage, inclement weather and service failures of our third party service providers. We could experience more significant disruptions in the future. Disruptions may cause interruptions in service or reduced capacity for customers, either of which could cause us to lose customers and incur unexpected expenses.

We have employees who are covered by collective bargaining agreements. If we are unable to enter into new agreements or renew existing agreements before they expire, we could have a work stoppage or other labor actions that could materially disrupt our ability to provide services to our customers. At December 31, 2012, approximately 28% of our employees were covered by collective bargaining agreements. These employees are hourly workers located in Texas, Pennsylvania and Illinois service territories and are represented by various unions and locals. Our relationship with these unions generally has been satisfactory, but occasional work stoppages can occur, including a four day work stoppage that did occur in December 2012. Our collective bargaining agreement with International Brotherhood of Electrical Workers (IBEW) for our Illinois Incumbent Local Exchange Carrier (ILEC) expired on November 14, 2012. Employees continue to work without a contract and we remain in negotiations with the IBEW on a new collective bargaining agreement. All the other existing collective bargaining agreements expire between 2013 through 2015.

We cannot predict the outcome of negotiations of the collective bargaining agreements covering our employees. If we are unable to reach new agreements or renew existing agreements, employees subject to collective bargaining agreements may engage in strikes, work stoppages or slowdowns, or other labor actions, which could materially disrupt our ability to provide services. New labor agreements or the renewal of existing agreements may impose significant new costs on us, which could adversely affect our financial condition and result of operations. While we believe our relations with the unions representing these employees are good, any protracted labor disputes or labor disruptions by any of our employees could have a significant negative effect on our financial results and operations.

We may be unable to obtain necessary hardware, software and operational support from third party vendors. We depend on third party vendors to supply us with a significant amount of hardware, software and operational support necessary to provide certain of our services and to maintain, upgrade and enhance our network facilities and operations and to support our information and billing systems. Some of our third-party vendors are our primary source of supply for products and services for which there are few substitutes. If any of these vendors should experience financial difficulties, have demand that exceeds their capacity or they cannot otherwise meet our specifications, our ability to provide some services may be materially adversely affected in which case our business, results of operations and financial condition may be adversely affected.

If we cannot obtain and maintain necessary rights-of-way for our network, our operations may be interrupted and we would likely face increased costs. We are dependent on easements, franchises and licenses from various private parties such as established telephone companies and other utilities, railroads, long-distance companies and from state highway authorities, local governments and transit authorities for access to aerial pole space, underground conduits and other rights-of-way in order to construct and operate our networks. Some agreements relating to rights-of-way may be short-term or revocable at will, and we cannot be certain that we will continue to have access to existing rights-of-way after the governing agreements are terminated or expire. If any of our right-of-way agreements were terminated or could not be renewed, we may be forced to remove our network facilities from the affected areas, relocate or abandon our networks which would interrupt our operations and force us to find alternative rights-of-way and make unexpected capital expenditures.

Our ability to retain certain key management personnel and attract and retain highly qualified management and other personnel in the future could have an adverse effect on our business. We rely on the talents and efforts of key management personnel, many of whom have been with our company and in our industry for decades. While we maintain long-term and emergency transition plans for key management personnel and believe we could either identify internal candidates or attract outside candidates to fill any vacancy created by the loss of any key management personnel, the loss of one or more of our key management personnel and the ability to attract and retain highly qualified technical and management personnel in the future could have a negative impact on our business, financial condition and results of operations.

Future acquisitions could be expensive and may not be successful. From time to time we make acquisitions and investments and enter into other strategic transactions. In connections with these types of transactions we may incur unanticipated expenses, fail to realize anticipated benefits, have difficulty incorporating the acquired businesses, disrupt relationships with current and new employees, customers and vendors, incur significant indebtedness, or have to delay or not proceed with announced transactions. The occurrence of any of the foregoing events could have a material adverse effect on our business, results of operations, cash flows and financial condition.

Risks Relating to Our Acquisition of SureWest

The integration of the Company and SureWest following the merger may present significant challenges. We may face significant challenges in combining SureWest s operations into our operations in a timely and efficient manner and in retaining key SureWest personnel. The failure to successfully integrate the Company and SureWest and to manage successfully the challenges presented by the integration process may result in our not achieving the anticipated benefits of the merger, including operational and financial synergies.

We will incur transaction, integration and restructuring costs in connection with the merger. We have incurred significant transaction costs in connection with the merger, including fees of our attorneys, accountants and financial advisors. We expect to continue to incur additional integration and restructuring costs as we continue to integrate the businesses of SureWest with those of the Company. Although we expect that the realization of efficiencies related to the integration of the businesses will offset incremental transaction, integration and restructuring costs over time, we cannot give any assurance that this net benefit will be achieved in the near term.

Risks Related to the Regulation of Our Business

We are subject to a complex and uncertain regulatory environment, and we face compliance costs and restrictions greater than those of many of our competitors. Our businesses are subject to regulation by the Federal Communications Commission (FCC) and other Federal, state and local entities. Rapid changes in technology and market conditions have required corresponding changes in how government addresses telecommunications, video programming and Internet services. Many businesses that compete with our ILEC and Non-ILEC subsidiaries are comparatively less regulated. Some of our competitors are either completely free from utilities regulation, or are regulated on a significantly less burdensome basis. Further, in comparison to our subsidiaries regulated as cable operators, satellite video providers, on-demand and over-the-top video providers, and motion picture and DVD firms have almost no regulation of their video activities. Recently, Federal and state authorities have become far more active in seeking to address critical issues in each of our product and service markets. The adoption of new laws or regulations or changes to the existing regulatory framework at the federal or state levels could require significant and costly adjustments, and adversely affect our business plans. New regulations could impose additional costs or capital requirements, require new reporting, impair revenue opportunities, potentially impede our ability to provide services in a manner that would be attractive to our customers and us and potentially create barriers to enter new markets or acquire new lines of business. We face continued uncertainty in the regulatory area for the immediate future. Not only are these governmental entities continuing to move forward on these matters, their actions remain subject to reconsideration, appeal and legislative modification over an extended period of time, and it is unclear how their actions ultimately will impact our markets. We cannot predict future developments or changes to the regulatory environment or the impact such developments or changes may have on us.

We receive support from various funds established under federal and state law and the continued receipt of that support is not assured. A significant portion of our ILECs revenues come from network access and subsidies. An order adopted by the FCC in 2011 (the Order) may significantly impact the amount of support revenue we receive from Universal Service Fund (USF)/Connect America Fund (CAF) and intercarrier compensation (ICC). The Order reformed core parts of the USF, broadly recast the existing ICC scheme and established the CAF to replace support revenues provided by the current USF and redirects support from voice services to broadband services. In 2012, the first phase of the CAF was implemented freezing USF support to a price cap holding company until the FCC implements a broadband cost model to shift support from voice service to broadband, which could be as early as July 2013. We anticipate that our revenues will be significantly impacted when the broadband cost model is implemented. The order also modifies the methodology used for ICC traffic exchanged between carriers. The initial phase of ICC reform was effective on July 1, 2012, beginning the transition of our terminating switched access rates to bill-and-keep over a seven year period. As a result of implementing the provisions of the Order, our 2012 network access revenues decreased approximately $972 thousand. We anticipate network access revenues will continue to decline as a result of the Order through 2018 and could be as much as $1.9 million, $805 thousand, $936 thousand, $1.0 million, $2.5 million and $618 thousand in 2013, 2014, 2015, 2016, 2017 and 2018, respectively.

The Order is currently subject to both reconsideration and appeal. Further regulatory actions on these issues may have a material impact on our consolidated financial position and our results of operations in future periods. The impact cannot be fully determined at this time.

We receive subsidy payments from various federal or state universal service support programs. These include high cost support, Lifeline, Schools and Libraries programs within the Federal universal service program. In addition, our Pennsylvania and Texas ILEC s receive state universal service funding. The Pennsylvania PUC (PAPUC) issued an order in 2012 addressing state ICC and USF, but rescinded the order in early 2012 due to the FCC order usurping the PAPUC rules. In the future the PAPUC may reintroduce a universal service proceeding. In Texas, the Public Utilities Commission of Texas (PUCT) has initiated a proceeding to review the large company and small company high cost funds. The proceedings will undertake a comprehensive review of high cost funds and provided recommended changes to the legislature. Any legislative or PUCT action would not occur until September 1, 2013.

The total cost of all of the various Federal universal service programs has increased greatly in recent years, putting pressure on regulators to reform them, and to limit both eligibility and support flows. We cannot predict when or how these matters will be decided or the effect on our subsidy revenues. However, future reductions in the subsidies we receive may directly affect our profitability and cash flows.

We are subject to extensive laws and regulations relating to the protection of the environment, natural resources, and worker health and safety. Our operations and properties are subject to federal, state, and local laws and regulations relating to protection of the environment, natural resources, and worker health and safety, including laws and regulations governing and creating liability in connection with the management, storage, and disposal of hazardous materials, asbestos and petroleum products. We also are subject to laws and regulations governing air emissions from our fleets of vehicles. As a result, we face several risks, including:

- Hazardous materials may have been released at properties that we currently own or formerly owned (perhaps through our predecessors). Under certain environmental laws, we could be held liable, without regard to fault, for the costs of investigating and remediating any actual or threatened contamination at these properties and for contamination associated with disposal by us or our predecessors of hazardous materials at third-party disposal sites.

- We could incur substantial costs in the future if we acquire businesses or properties subject to environmental requirements or affected by environmental contamination. In particular, environmental laws regulating wetlands, endangered species, and other land use and natural resource issues may increase costs associated with future business or expansion opportunities or delay, alter, or interfere with such plans.

- The presence of contamination can adversely affect the value of our properties and make it difficult to sell any affected property or to use it as collateral.
- We could be held responsible for third-party property damage claims, personal injury claims, or natural resource damage claims relating to contamination found at any of our current or past properties.

The cost of complying with environmental requirements could be significant. Similarly, the adoption of new environmental laws or regulations or changes in existing laws or regulations or their interpretations could result in significant compliance costs or unanticipated environmental liabilities.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

Our corporate headquarters are located at 121 S. 17th St., Mattoon, Illinois, a leased facility. We also own and lease office facilities and related equipment for administrative personnel, central office buildings, and operations in Illinois, Pennsylvania, Texas, California, Kansas and Missouri utilized primarily by our Telephone Operations segment. We own approximately 21 acres of undeveloped land in Roseville, California. Our Other Operations segment shares certain facilities with the Telephone Operations segment in Illinois.

In addition to land and structures, our property consists of equipment necessary for the provision of communication services including central office equipment, customer premises equipment and connections, pole lines, video head-end, remote terminals, aerial and underground cable and wire facilities, vehicles, furniture and fixtures, computers and other equipment. We also own certain other communications equipment held as inventory for sale or lease.

In addition to plant and equipment that we wholly-own, we utilize poles, towers and cable and conduit systems jointly-owned with other entities, and lease space on facilities to other entities. These arrangements are in accordance with written agreements customary in the industry.

We have appropriate easements, rights of way and other arrangements for the accommodation of our pole lines, underground conduits, aerial and underground cables and wires. See Note 11 in the Notes to Consolidated Financial Statements and Part II, Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations for information regarding our lease obligations.

As a result of efficiencies realized through cost controls and efficiencies gained through our acquisition of SureWest Communications in February 2012, certain of our owned and leased facilities are not being utilized to their full capacity. We are actively reviewing all of our holdings to determine if we have excess properties. As of December 31, 2012, we are actively marketing 21 acres of undeveloped land, an office campus in Roseville, California and an office building in Cranbury, Pennsylvania.

Item 3. Legal Proceedings.

Prior to the completion of the SureWest Merger on July 2, 2012, six putative class action lawsuits were filed by alleged SureWest shareholders challenging the Company s proposed merger with SureWest in which the Company, WH Acquisition Corp. and WH Acquisition II Corp, SureWest and members of the SureWest board of directors have been named as defendants. Five shareholder actions were filed in the Superior Court of California, Placer County, and one shareholder action was filed in the United States District Court for the Eastern District of California. The actions are called Needles v. SureWest Communications, et al., filed February 17, 2012, Errecart v. Oldham, et al., filed February 24, 2012, Springer v. SureWest Communications, et al., filed March 9, 2012, Aievoli v. Oldham, et al., filed March 15, 2012, and Waterbury v. SureWest Communications, et al., filed March 26, 2012, and the federal action is called Broering v. Oldham, et al., filed April 18, 2012. The actions generally allege, among other things, that each member of the SureWest board of directors breached fiduciary duties to SureWest and its shareholders by authorizing the sale of SureWest to the Company for consideration that allegedly was unfair to the SureWest shareholders and agreed to terms that allegedly unduly restrict other bidders from making a competing offer. The complaints also allege that the Company and SureWest aided and abetted the breaches of fiduciary duties allegedly committed by the members of the SureWest board of directors. The Broering complaint also alleges, among other things, that the joint proxy statement/prospectus filed with the SEC on March 28, 2012 did not make sufficient disclosures regarding the merger, that SureWest s board should have appointed an independent committee to negotiate the transaction and that SureWest should have gone back to another bidder to create a competitive bid process. The lawsuits seek equitable relief, including an order to prevent the defendants from consummating the merger on the agreed-upon terms and/or an award of unspecified monetary damages. On March 14, 2012, the Placer County Superior Court entered an order consolidating the Needles, Errecart and Springer actions into a single action under the caption In re SureWest Communications Shareholder Litigation. Under the terms of this order, all cases subsequently filed in the Superior Court for the State of California, County of Placer, that relate to the same subject matter and involve similar questions of law or fact were to be consolidated with these cases as well. This included the Aievoli and Waterbury cases. On April 10, 2012, the plaintiff in Waterbury filed a request for voluntary dismissal of her complaint without prejudice. On May 18, 2012, pursuant to the parties stipulation, the federal Court entered an order staying the Broering action for 90 days. The federal Court subsequently extended the stay of the Broering action until June 1, 2013. On June 1, 2012, the parties entered into a proposed settlement of all of the shareholder actions without any admission of liability by the Company or the other defendants. Pursuant to the proposed settlement, SureWest agreed to make, and subsequently made, certain additional disclosures in a Current Report on Form 8-K filed with the SEC in advance of the special meeting of SureWest shareholders held on June 12, 2012. The proposed settlement also provided that plaintiffs counsel collectively are to receive attorneys fees of $0.525 million, of which the Company is to pay $36.25 thousand, with the balance to be paid by SureWest and its insurer. The proposed settlement is subject to approval by the Placer County Superior Court. On December 20, 2012, the court issued a ruling preliminarily approving the proposed settlement. The court set a hearing for March 28, 2013 at which it will consider final approval of the proposed settlement. Upon final approval by the court, the consolidated state court actions and the federal action will be dismissed with prejudice.

On April 15, 2008, Salsgiver Inc., a Pennsylvania-based telecommunications company, and certain of its affiliates filed a lawsuit against us and our subsidiaries North Pittsburgh Telephone Company and North Pittsburgh Systems Inc. in the Court of Common Pleas of Allegheny County, Pennsylvania alleging that we have prevented Salsgiver from connecting their fiber optic cables to our utility poles. Salsgiver seeks compensatory and punitive damages as the result of alleged lost projected profits, damage to its business reputation, and other costs. Salsgiver originally claimed to have sustained losses of approximately $125 million and did not request a specific dollar amount in damages. We believe that these claims are without merit and that the alleged damages are completely unfounded. We intend to defend against these claims vigorously. Discovery concluded and Consolidated filed a motion for summary judgment on June 18, 2012 and the court heard oral arguments on August 30, 2012. On February 12, 2013, the court granted, in part, Consolidated s motion. The court ruled that Salsgiver could not recover prejudgment interest and could not use as a basis of liability any actions prior to April 14, 2006. We anticipate a status conference being held in late March 2013, at which time the court will set a briefing and trial schedule.

In addition, we have asked the Federal Communications Commission (FCC) Enforcement Bureau to address Salsgiver s unauthorized pole attachments and safety violations on those attachments. We believe that these are violations of an FCC order regarding Salsgiver s complaint against us. We do not believe that these claims will have a material adverse impact on our financial results.

Two of our subsidiaries, Consolidated Communications of Pennsylvania Company LLC (CCPA) and Consolidated Communications Enterprise Services Inc. (CCES), received assessment notices from the Commonwealth of Pennsylvania Department of Revenue increasing the amounts owed for Pennsylvania Gross Receipt Taxes for the tax period ending December 31, 2009. These two assessments adjusted the subsidiaries combined total outstanding taxable gross receipts liability (with interest) to approximately $2.3 million. In addition, based upon recently completed audits of CCES for 2008, 2009 and 2010, we believe the Commonwealth of Pennsylvania may issue additional assessments totaling approximately $1.7 million for Gross Receipt Taxes allegedly owed. Our CCPA subsidiary has also been notified by the Commonwealth of Pennsylvania that they will conduct a gross receipts audit for the calendar year 2008. An appeal challenging the 2009 CCPA assessment was filed with the Department of Revenue s Board of Appeals on September 15, 2011, and we filed a similar appeal for CCES with the Board of Appeals on November 11, 2011 challenging the 2009 CCES assessment. The Board of Appeals denied CCPA and CCES s appeals. On November 13, 2012, CCPA and CCES filed appeals with the Commonwealth s Board of Finance and Revenue. These have been stayed pending the outcome of present litigation in the Commonwealth Court between Verizon Pennsylvania, Inc. and the Commonwealth of Pennsylvania (Verizon Pennsylvania, Inc. v. Commonwealth, Docket No. 266 F.R. 2008). The Gross Receipts Tax issues in the Verizon Pennsylvania case are substantially the same as those presently facing CCPA and CCES. In addition, there are numerous telecommunications carriers with Gross Receipts Tax matters dealing with the same issues that are in various stages of appeal before the Board of Finance and Revenue and the Commonwealth Court. Those appeals by

other similarly situated telecommunications carriers have been continued until resolution of the Verizon Pennsylvania case. We believe that these assessments and the positions taken by the Commonwealth of Pennsylvania are without substantial merit. We do not believe that the outcome of these claims will have a material adverse impact on our financial results or cash flows.

We currently provide telephone service to inmates incarcerated at facilities operated by the Illinois Department of Corrections. On June 27, 2012, the Illinois Department of Central Management Services announced its intent to replace the Company as the provider of those services with a competitor, Securus Technologies, Inc. We have challenged Securus bid, and the State s decision to accept that bid, in a variety of different forums including: (i) protests with the Chief Procurement Officer of the Illinois Executive Ethics Commission, which were denied, (ii) a lawsuit filed in the Circuit Court of Sangamon County, Illinois that was dismissed, but is now under appeal in the Illinois Appellate Court Fourth District, (iii) a declaratory ruling request filed with the Illinois Commerce Commission and (iv) a complaint filed with the Illinois Procurement Policy Board. In each of those challenges, we claimed either that Securus was not a responsible vendor, as defined by the State s bid solicitation document, and/or that rates for the services Securus proposes to provide are subject to regulatory limits below those Securus has proposed to charge. Although we will continue to pursue legal recourse to the State s decision, our business plans and projections assume that our contract with the State of Illinois will end during 2013.

On January 18, 2012, we filed a petition with the U.S. Court of Appeals for the District of Columbia Circuit to review the FCC s Order issued November 18, 2011 that reformed intercarrier compensation and core parts of the Universal Service Fund. We are appealing five core issues in the November 18, 2011 FCC order. The U.S. Court of Appeals for the tenth circuit will hear oral arguments on November 19, 2013.

We are from time to time involved in various other legal proceedings and regulatory actions arising out of our operations. We do not believe that any of these, individually or in the aggregate, will have a material adverse effect upon our business, operating results or financial condition.

Item 4. Mine Safety Disclosures.

Not Applicable.

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our common stock is traded on The NASDAQ Global Select Market (NASDAQ) under the symbol CNSL . As of February 15, 2013, there were approximately 3,751 stockholders of record of the Company s common stock. The following table indicates the range of stock closing prices of the Company s common stock as reported on the NASDAQ, for each of the quarters ending on the dates indicated:

	2012		2011	
Period	**High**	**Low**	**High**	**Low**
First quarter	19.80	18.08	19.50	17.25
Second quarter	19.63	13.95	19.50	17.94
Third quarter	17.79	15.21	20.02	16.77
Fourth quarter	17.40	13.48	19.39	16.83

Dividend Policy and Restrictions

Our Board of Directors declared dividends of approximately $0.38738 per share in each of the periods listed above. Our Board of Directors adopted a dividend policy that reflects its judgment that our stockholders are better served if we distribute a substantial portion of the cash generated by our business in excess of our expected cash needs rather than retaining the cash or using it for investments, acquisitions, or other purposes. We expect to continue to pay quarterly dividends at an annual rate of approximately $1.55 per share during 2013. Future dividend payments are at the discretion of our Board of Directors. Changes in our dividend program will depend on our earnings, capital requirements, financial condition, debt covenant compliance, expected cash needs and other factors considered relevant by our Board of Directors. Dividends on our common stock are not cumulative.

See Part II, Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources for a discussion regarding restrictions on the payment of dividends. See Part I Item 1A Risk Factors of this report, which sets forth several factors that could prevent stockholders from receiving dividends in the future. Additional information concerning dividends may be found in Selected Financial Data in Item 6, which is incorporated herein by reference.

Share Repurchases

During the quarter ended December 31, 2012, we repurchased 36,914 common shares surrendered by employees in the administration of employee share-based compensation plans. The following table summarizes the share repurchase activity:

Purchase period	**Total number of shares purchased**	**Average price paid per share**	**Total number of shares purchased as part of publicly announced plans**

October 1-October 31, 2012	-	n/a	n/a
November 1-Novermber 30, 2012	-	n/a	n/a
December 1-December 31, 2012	36,914	$ 15.14	n/a

Performance Graph

The following graph shows a five-year comparison of cumulative total shareholder return of our common stock (assuming dividend reinvestment) with the S&P 500 index, the Dow Jones US Fixed-Line Telecommunications index and a customized peer group of four companies that includes: Alaska Communications Systems Group, Inc., Consolidated Communications Holdings, Inc., Otelco, Inc. and Shenandoah Telecommunications Company. The comparison of total return on investment (change in year-end stock price plus reinvested dividends) for each of the periods assumes that $100 was invested on December 31, 2007 respectively in each index, and in the peer group. The stock performance shown on the graphs below is not necessarily indicative of future price performance.

	At December 31,					
(In dollars)	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Consolidated Communications Holdings, Inc.	$ 100	$ 67	$ 111	$ 134	$ 143	$ 131
S&P 500	$ 100	$ 63	$ 80	$ 92	$ 94	$ 109
Dow Jones US Fixed-Line Telecommunications	$ 100	$ 73	$ 79	$ 94	$ 100	$ 115
Peer group	$ 100	$ 82	$ 90	$ 108	$ 74	$ 66

During the year ended December 31, 2012, we did not sell any equity securities of the Company, which were not registered under the Securities Act of 1933, as amended.

Item 6. Selected Financial Data.

The selected financial data set forth below should be read in conjunction with Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations , our consolidated financial statements and the related notes, and other financial data included elsewhere in this annual report. Historical results are not necessarily indicative of the results to be expected in future periods.

	Year Ended December 31,				
(In millions, except per share amounts)	**2012 (1)**	**2011**	**2010**	**2009**	**2008**
Telephone operations revenues	$ 472.1	$ 342.6	$ 349.6	$ 364.6	$ 379.0
Other operations revenues	31.4	31.7	33.8	41.6	39.4
Total operating revenues	503.5	374.3	383.4	406.2	418.4
Cost of products and services (exclusive of depreciation and amortization)	193.7	139.3	142.3	145.5	143.5
Selling, general and administrative expense	111.7	81.1	88.0	104.8	108.8
Financing and other transaction costs (2)	20.8	2.6			
Intangible asset impairment	2.9				6.1
Depreciation and amortization	121.0	88.7	87.2	85.2	91.7
Income from operations	53.4	62.6	65.9	70.7	68.3
Interest expense, net and loss on extinguishment of debt (3)	(77.1)	(49.4)	(50.7)	(57.9)	(66.3)
Other income, net	31.2	28.6	27.0	25.5	10.8
Income before income taxes and extraordinary item	7.5	41.8	42.2	38.3	12.8
Income tax expense	1.4	14.8	9.0	12.4	6.6
Income before extraordinary item	6.1	27.0	33.2	25.9	6.2
Extraordinary item, net of tax					7.2
Net income	6.1	27.0	33.2	25.9	13.4
Net income of noncontrolling interest (4)	0.5	0.6	0.6	1.0	0.9
Net income attributable to common shareholders (4)	$ 5.6	$ 26.4	$ 32.6	$ 24.9	$ 12.5
Income per common share - basic and diluted: (5)					
Income per common share before extraordinary item	$ 0.15	$ 0.88	$ 1.09	$ 0.84	$ 0.18
Extraordinary item per share					0.24
Net income per common share - basic and diluted	$ 0.15	$ 0.88	$ 1.09	$ 0.84	$ 0.42
Weighted-average number of shares - basic and diluted	34,652	29,600	29,490	29,396	29,321
Cash dividends per common share	$ 1.55	$ 1.55	$ 1.55	$ 1.55	$ 1.55
<u>Consolidated cash flow data:</u>					
Cash flows from operating activities	$ 123.2	$ 129.5	$ 116.1	$ 115.7	$ 93.4
Cash flows used for investing activities	(468.6)	(40.8)	(41.8)	(41.0)	(49.0)
Cash flows used for financing activities	257.5	(50.7)	(49.4)	(47.4)	(63.3)
Capital expenditures	77.1	41.9	42.9	41.8	49.0
<u>Consolidated Balance Sheet:</u>					
Cash and cash equivalents	$ 17.9	$ 105.7	$ 67.7	$ 42.8	$ 15.5
Total current assets	108.5	161.9	129.2	102.0	72.1
Net property, plant and equipment	908.2	338.4	363.2	383.1	406.8
Total assets	1,794.8	1,194.1	1,209.5	1,226.6	1,241.6
Total debt (including current portion)	1,217.8	884.7	884.1	880.3	881.3
Stockholders equity	136.1	47.8	71.9	80.7	75.3
<u>Other financial data (unaudited):</u>					
Adjusted EBITDA (6)	$ 236.2	$ 189.5	$ 185.6	$ 188.8	$ 189.8

(1) In July 2012, we acquired 100% of the outstanding shares of SureWest Communications (SureWest) in a cash and stock transaction. SureWest results of operations have been included in our consolidated financial statements as of the acquisition date of July 2, 2012.

(2) Financing and other transaction costs includes costs incurred related to the acquisition of SureWest including severance costs.

(3) In 2012, we entered into a $350.0 million Senior Unsecured Bridge Loan Facility (Bridge Facility) to fund the SureWest acquisition. During 2012, we incurred $4.2 million of amortization related to the financing costs and $1.5 million of interest related to ticking fees associated with the Bridge Facility. In addition, in 2012 we entered into a Second Amendment and Incremental Facility Agreement to amend our term loan facility. As a result, we incurred a loss on the extinguishment of debt of $4.5 million related to the repayment of our outstanding term loan.

(4) We adopted the Financial Accounting Standards Board s (FASB) authoritative guidance on the presentation of noncontrolling interests in consolidated financial statements effective January 1, 2009. This presentation has been retrospectively applied to all periods presented.

(5) We adopted the FASB s authoritative guidance on the treatment of participating securities in the calculation of earnings per share on January 1, 2009. This presentation has been retrospectively applied to all periods presented.

(6) In addition to the results reported in accordance with accounting principles generally accepted in the United States (US GAAP or GAAP), we also use certain non-GAAP measures such as EBITDA and adjusted EBITDA to evaluate operating performance and to facilitate the comparison of our historical results and trends. These financial measures are not a measure of financial performance under US GAAP and should not be considered in isolation or as a substitute for net income (loss) as a measure of performance and net cash provided by operating activities as a measure of liquidity. They are not, on their own, necessarily indicative of cash available to fund cash needs as determined in accordance with GAAP. The calculation of these non-GAAP measures may not be comparable to similarly titled measures used by other companies. Reconciliations of these non-GAAP measures to the most directly comparable financial measures presented in accordance with GAAP are provided below.

EBITDA is defined as net earnings before interest expense, income taxes, and depreciation and amortization. Adjusted EBITDA is comprised of EBITDA, adjusted for certain items as permitted or required under our credit facility as described in the reconciliations below. These measures are a common measure of operating performance in the telecommunications industry and are useful, with other data, as a means to evaluate our ability to fund our estimated uses of cash.

The following tables are a reconciliation of net cash provided by operating activities to Adjusted EBITDA:

	Year Ended December 31,				
(In millions, unaudited)	**2012**	**2011**	**2010**	**2009**	**2008**
Net cash provided by operating activities	$ 123.2	$ 129.5	$ 116.1	$ 115.7	$ 93.4
Adjustments:					
Non-cash, stock-based compensation	(2.3)	(2.1)	(2.4)	(1.9)	(1.9)
Other adjustments, net	(11.3)	(11.0)	4.2	(1.0)	3.8
Changes in operating assets and liabilities	17.6	(0.6)	2.4	(1.6)	8.9
Interest expense, net	72.6	49.4	50.7	57.9	66.3
Income taxes	1.4	14.8	9.0	12.4	6.6
EBITDA	201.2	180.0	180.0	181.5	177.1
Adjustments to EBITDA:					
Other, net (a)	(3.9)	(21.0)	(24.3)	(17.0)	(15.1)
Investment distributions (b)	29.2	28.4	27.5	22.4	17.8
Loss on extinguishment of debt (c)	4.5				9.2
Intangible asset impairment (d)	2.9				6.1
Extraordinary item (e)					(7.2)
Non-cash, stock-based compensation (f)	2.3	2.1	2.4	1.9	1.9
Adjusted EBITDA	$ 236.2	$ 189.5	$ 185.6	$ 188.8	$ 189.8

(a) Other, net includes the equity earnings from our investments, dividend income, income attributable to noncontrolling interests in subsidiaries, transaction related costs including severance and certain other miscellaneous items related to the acquisition of SureWest. 2009 and 2008 also includes expenses associated with Sarbanes-Oxley maintenance costs, costs to integrate our technology, administrative and customer service functions and billing systems in connection with the acquisition of North Pittsburgh.

(b) Includes all cash dividends and other cash distributions received from our investments.

(c) Represents the redemption premium and write-off of unamortized debt issuance costs in connection with the redemption or retirement of our debt obligations.

(d) Represents intangible asset impairment charges recognized during the period.

(e) Upon making the election to discontinue the applicable accounting guidance for regulated enterprises in accounting for the effects of certain types of regulation, we recognized an extraordinary non-cash gain and began to apply the authoritative guidance required for the discontinuance of the application of regulatory accounting.

(f) Represents compensation expenses in connection with the issuance of stock awards, which because of their non-cash nature, these expenses are excluded from Adjusted EBITDA.

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

Reference is made to Part I, Item 1 Note About Forward Looking Statements and Item 1A Risk Factors which describes important factors that could cause actual results to differ from expectations and non-historical information contained herein. In addition, the following Management s Discussion and Analysis (MD&A) is intended to help the reader understand the results of operations and financial condition of Consolidated Communications Holdings, Inc. (Consolidated , the Company , we or our). MD&A should be read in conjunction with our audited consolidated financial statements and accompanying notes to the consolidated financial statements (Notes) as of and for each of the three years in the period ended December 31, 2012 included elsewhere in this Annual Report on Form 10-K.

Throughout MD&A, we refer to measures that are not a measure of financial performance in accordance with United States generally accepted accounting principles (US GAAP or GAAP). We believe the use of these non-GAAP measures on a consolidated and segment basis provides the reader with additional information that is useful in understanding our operating results and trends. These measures should be viewed in addition to, rather than as a substitute for, those measures prepared in accordance with GAAP. See the Non-GAAP Measures section below for a more detailed discussion on the use and calculation of these measures.

Significant Recent Development

On July 2, 2012, we completed the merger with SureWest Communications (SureWest), which resulted in the acquisition of 100% of all the outstanding shares of SureWest for $23.00 per share in a cash and stock transaction. The acquisition of SureWest provides additional diversification of the Company s revenues and cash flows both geographically and by service type, which offers a platform for future growth and is expected to generate operational and capital cost synergies. SureWest provides a wide range of telecommunications, digital video, Internet, data and other facilities-based communications services in Northern California, primarily in the greater Sacramento region, and in the greater Kansas City, Kansas and Missouri areas. For the year ended December 31, 2011, SureWest reported $248.1 million in total operating revenues. For the six months ended June 30, 2012, SureWest generated $127.9 million in operating revenues. The total purchase price of $550.8 million consisted of cash and assumed debt of $402.4 million and 9,965,983 shares of the Company s common stock valued at the Company s opening stock price on July 2, 2012 of $14.89, which totaled $148.4 million. The cash portion of the merger consideration and the funds required to repay SureWest outstanding debt was financed with the sale of $300.0 million in aggregate principal amount of 10.875% Senior Notes due 2020 (Senior Notes). The Company also used cash on hand and approximately $35.0 million in borrowings from its revolving credit facility. Because the acquisition closed on July 2, 2012, the Company s financial information does not include any of the results of operations from SureWest prior to the acquisition date. The financial results of SureWest are included in the Telephone Operations segment as of the date of the acquisition.

Overview

We are an established telecommunications services company providing a wide range of services to residential and business customers in Illinois, Texas, Pennsylvania, California, Kansas and Missouri. We offer a wide range of telecommunications services, including local and long-distance service, high-speed broadband Internet access, video services, digital telephone service (VOIP), custom calling features, private line services, carrier grade access services, network capacity services over our regional fiber optic networks, directory publishing and Competitive Local Exchange Carrier (CLEC) services. We also operate two non-core complementary businesses, prison services and equipment sales. We classify our operations into two reportable business segments: Telephone Operations and Other Operations.

Telephone Operations Segment

Our Telephone Operations segment generated approximately 94% of our consolidated operating revenues during 2012, primarily from subscriptions to our voice, video and data services (broadband services) to residential and business customers. Revenues in the Telephone Operations segment increased $129.5 million during 2012 compared to 2011, primarily from the SureWest acquisition and growth in data, video and Internet connections. We expect our broadband service revenues to continue to grow as consumer and business demands for data based services increase.

We market our services to residential and business customers, either individually or as a bundled package. Our triple play bundle includes our voice, video and data services. As of December 31, 2012, our video service was available to approximately 524,000 homes in Illinois, Texas, Pennsylvania, California, Kansas and Missouri markets. As of December 31, 2012, approximately 20% of the homes in the areas we serve subscribe to our video service. Data and Internet connections continue to increase as a result of enhanced product and service offerings, such as our VOIP service and data speeds of up to 50 megabits per second, depending on the geographic market availability.

The increase in Telephone Operations revenues during 2012 was offset in part by an anticipated industry wide trend of a decline in access lines and related use of services. Many consumers are choosing to subscribe to alternative communications services and competition for these subscribers continues to increase. Progressively, consumers are utilizing over-the-top services to download and watch television shows of interest to them on their computers. Competition from wireless providers, competitive local exchange carriers and in some cases cable television providers has increased in recent years in the markets we serve. We have been able to mitigate some of the access line losses through marketing initiatives and product offerings, such as our VOIP service.

Other Operations Segment

Our Other Operations segment is comprised of non-core business activities including prison services and business systems. Prison services, which operates primarily in Illinois, provides local and long-distance telephone service and automated calling service to inmates incarcerated at facilities operated by the Illinois Department of Corrections. On June 27, 2012, the Illinois Department of Central Management Services announced its intent to replace us as the provider of those services with a competitor. We have challenged our competitor s bid and the State s decision to accept that bid in a variety of different forums. Although we will continue to seek legal recourse to the State s decision, our business plans and projections assume that our contract with the State of Illinois will end during 2013. During 2012, the prison services contract comprised 82% of the operating revenues in our Other Operations, 5% of consolidated operating revenues and approximately 2% of consolidated operating income, excluding financing and other transaction fees. Business systems sells and supports telecommunications equipment to business customers in Texas and Illinois.

Consolidated Results of Operations

The following tables reflect our financial results on a consolidated basis and key operating statistics as of and for the years ended December 31, 2012, 2011 and 2010.

Financial Data

								% Change	
(In millions, except for percentages)		**2012**		**2011**		**2010**	**2012 vs. 2011**		**2011 vs. 2010**
Revenue									
Telephone operations	$	472.1	$	342.6	$	349.6	38	%	(2) %
Other operations		31.4		31.7		33.8	(1)		(6)
Total operating revenue		503.5		374.3		383.4	35		(2)
Expenses									
Telephone operations		277.4		192.0		199.1	44		(4)
Other operations		28.0		28.4		31.2	(1)		(9)
Transaction/Debt refinancing costs		20.8		2.6			700		
Impairment of intangible assets		2.9					100		100

Depreciation and amortization	121.0	88.7	87.2	36	2
Total operating expense	450.1	311.7	317.5	44	(2)
Income from operations	53.4	62.6	65.9	(15)	(5)
Interest expense, net	(72.6)	(49.4)	(50.7)	47	(3)
Loss on extinguishment of debt	(4.5)			100	100
Other income	31.2	28.6	27.0	9	6
Income tax expense	1.4	14.8	9.0	(91)	64
Net income	6.1	27.0	33.2	(77)	(19)
Net income attributable to noncontrolling interest	0.5	0.6	0.6	(17)	0
Net income attributable to common stockholders	$ 5.6	$ 26.4	$ 32.6	(79)	(19)
Adjusted EBITDA (1)	$ 236.2	$ 189.5	$ 185.6	25 %	2 %

(1)A non-GAAP measure. See the Non-GAAP Measures section below for additional information and reconciliation to the most directly comparable GAAP measure.

Key Operating Statistics

				% Change	
	2012	**2011**	**2010**	**2012 vs. 2011**	**2011 vs. 2010**
ILEC access lines					
Residential	153,855	137,179	140,660	12 %	(2) %
Business	114,742	90,813	96,481	26	(6)
Total	268,597	227,992	237,141	18	(4)
Voice connections (1)					
Residential	78,811	2,388	2,957	3200	(19)
Business	50,918	52,424	53,671	(3)	(2)
Total	129,729	54,812	56,628	137	(3)
Data and internet connections (2)	247,633	134,129	125,678	85	7
Video connections (2)	106,137	34,356	29,236	209	18
Total connections	752,096	451,289	448,683	67	1

(1)Voice connections include voice lines outside the Incumbent Local Exchange Carrier (ILEC) service areas and Voice-over-IP inside the ILEC service areas.

(2)These connections include both residential and business (excluding SureWest business metrics) for services both inside and outside the ILEC service areas.

Consolidated Overview

The comparability of our consolidated results of operations and key operating statistics was impacted by the SureWest acquisition, which closed on July 2, 2012, as described above. SureWest s results are included in our consolidated financial statements as of the date of the acquisition. We also incurred transaction costs directly related to the SureWest acquisition in 2012. During 2012, we incurred $20.8 million in expense related to the acquisition, which included change-in-control payments to former members of the SureWest management team of $9.4 million of which $8.6 million were accrued for at December 31, 2012 and are expected to be paid during the six months ended June 30, 2013. We also incurred additional interest costs of $24.9 million, which included $19.2 million of interest incurred on the Senior Notes obtained for the SureWest acquisition, $4.2 million of amortization of fees related to securing the bridge loan commitment to finance the SureWest acquisition, and $1.5 million of interest related to ticking fees associated with the bridge loan financing.

Consolidated operating revenue increased $129.2 million during 2012 due to the SureWest acquisition. The SureWest operations accounted for $133.1 million of the annual increase in operating revenues. The acquisition of SureWest provides additional diversification of the Company s revenues and cash flows both geographically and by service type. Excluding the addition of the operations for SureWest, consolidated operating revenues decreased $3.9 million during 2012. Revenues related to our traditional wireline telephone business decreased due to the continued decline in access lines, but were partially offset by an increase in video, data and Internet revenue as we continue to grow our broadband services. The SureWest operations accounted for 296,459 of the total connections at December 31, 2012.

Our operating revenues are also impacted by legislative or regulatory changes at the federal and state levels, which could reduce or eliminate the current subsidies revenue we receive. A number of proceedings and recent orders relate to universal service reform, intercarrier compensation and network access charges. There are various ongoing legal challenges to the orders that have been issued. As a result, it is not yet possible to determine fully the impact of the regulatory changes on our operations.

Operating expenses increased $138.4 million due to the acquisition of SureWest and the transaction costs directly related to the acquisition as described above. During 2012, the SureWest operations accounted for $119.5 million of the year-to-date increases in operating expenses and transaction costs increased $18.2 million.

Operating revenues and expenses by segment are discussed below.

Reclassifications

Certain amounts in our 2011 and 2010 consolidated financial statements have been reclassified to conform to the presentation of our 2012 consolidated financial statements. These reclassifications had no effect on total shareholders equity, total revenue, income from operations or net income.

During 2012, inventories and the related activity were reclassified from current assets to property, plant and equipment on the consolidated balance sheets and statements of cash flows. Inventories consist primarily of network construction materials and supplies that when issued are capitalized as part of new customer installations and the construction of the network. The change in classification of inventories impacts the calculation of certain financial ratios. Prior period calculations have been revised to conform to the current year presentation.

In addition, the calculation of certain key operating statistics was revised during 2012 to reflect a new methodology for the Company following the acquisition of SureWest. Accordingly, prior period operating statistics have been revised to conform to the current practice.

2012 versus 2011

Segment Results of Operations

Telephone Operations

(In millions, except for percentages)	**2012**	**2011**	**$ Change**	**% Change**
Revenue				
Local calling services	$ 93.5	$ 84.2	$ 9.3	11 %
Network access services	98.6	80.5	18.1	22
Subsidies	49.3	45.4	3.9	9
Long-distance services	17.3	15.9	1.4	9
Video, data and Internet services				