WINDSTREAM CORP
Form 10-Q
November 08, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
FORM 10-Q

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

For the quarterly period ended September 30, 2012

or

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

Commission file number 1-32422

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

DELAWARE	20-0792300
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

4001 Rodney Parham Road, Little Rock, Arkansas	72212
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (501) 748-7000
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
ý YES ¨ NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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).
ý YES ¨ NO

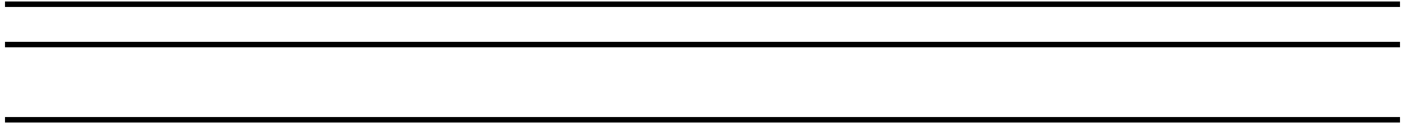
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ý Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨

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

¨ YES ý NO
Number of common shares outstanding as of October 31, 2012 - 588,127,475

The Exhibit Index is located on page 70



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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Millions, except per share amounts)	2012	2011	2012	2011
Revenues and sales:				
Service revenues:				
Business	$906.4	$491.8	$2,694.8	$1,468.0
Consumer	335.4	344.9	1,010.0	1,038.7
Wholesale	219.8	147.6	658.9	452.8
Other	26.1	10.3	82.4	33.3
Total service revenues	1,487.7	994.6	4,446.1	2,992.8
Product sales	64.7	28.6	189.3	83.1
Total revenues and sales	1,552.4	1,023.2	4,635.4	3,075.9
Costs and expenses:				
Cost of services (exclusive of depreciation and amortization included below)	671.3	366.3	1,987.3	1,101.5
Cost of products sold	56.8	24.5	159.3	68.6
Selling, general, and administrative	225.4	130.9	713.4	397.8
Depreciation and amortization	326.4	203.8	958.5	605.8
Merger and integration costs	12.7	19.9	54.4	33.9
Restructuring charges	12.1	0.5	23.3	0.7
Total costs and expenses	1,304.7	745.9	3,896.2	2,208.3
Operating income	247.7	277.3	739.2	867.6
Other (expense) income, net	(5.3)	(1.5)	4.6	(2.1)
(Loss) gain on early extinguishment of debt	—	(20.5)	1.9	(124.4)
Interest expense	(155.4)	(134.2)	(465.4)	(417.1)
Income from continuing operations before income taxes	87.0	121.1	280.3	324.0
Income taxes	33.3	43.0	107.1	119.8
Income from continuing operations	53.7	78.1	173.2	204.2
Discontinued operations, net of tax	—	—	(0.7)	—
Net income	$53.7	$78.1	$172.5	$204.2
Basic and diluted earnings per share:				
From continuing operations	$.09	$.15	$.29	$.40
From discontinued operations	—	—	—	—
Net income	$.09	$.15	$.29	$.40

See the accompanying notes to the unaudited interim consolidated financial statements.

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Millions)	2012	2011	2012	2011
Net income	$53.7	$78.1	$172.5	$204.2
Other comprehensive (loss) income:				
Interest rate swaps:				
Changes in designated interest rate swaps	(18.8)	(22.9)	(23.6)	(34.4)
Amortization of unrealized losses on de-designated interest rate swaps	11.3	12.3	33.0	37.3
Income tax benefit (expense)	2.9	4.1	(3.6)	(1.1)
Unrealized holding (losses) gains on interest rate swaps	(4.6)	(6.5)	5.8	1.8
Postretirement and pension plans:				
Change in net actuarial gain (loss) for postretirement plan	0.6	(0.7)	3.8	53.1
Gain from plan curtailment	—	—	(9.6)	(14.7)
Amounts included in net periodic benefit cost:				
Amortization of net actuarial loss	0.6	0.3	1.8	0.8
Amortization of prior service credits	(3.1)	(3.0)	(9.1)	(7.6)
Income tax benefit (expense)	0.5	1.8	4.8	(12.1)
Change in postretirement and pension plans	(1.4)	(1.6)	(8.3)	19.5
Other comprehensive (loss) income	(6.0)	(8.1)	(2.5)	21.3
Comprehensive income	$47.7	$70.0	$170.0	$225.5

See the accompanying notes to the unaudited interim consolidated financial statements.

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CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(Millions, except par value)	September 30, 2012	December 31, 2011
Assets		
Current Assets:		
Cash and cash equivalents	$114.8	$227.0
Restricted cash	39.9	21.7
Accounts receivable (less allowance for doubtful accounts of $36.4 and $29.9, respectively)	632.9	657.4
Income tax receivable	1.9	124.1
Inventories	74.4	76.5
Deferred income taxes	126.0	232.1
Prepaid income taxes	22.7	15.3
Prepaid expenses and other	200.9	102.9
Assets held for sale	—	61.4
Total current assets	1,213.5	1,518.4
Goodwill	4,411.6	4,301.7
Other intangibles, net	2,394.0	2,685.3
Net property, plant and equipment	5,824.9	5,708.1
Other assets	184.4	178.6
Total Assets	$14,028.4	$14,392.1
Liabilities and Shareholders' Equity		
Current Liabilities:		
Current maturities of long-term debt and capital lease obligations	$1,182.5	$213.7
Current portion of interest rate swaps	30.0	30.5
Accounts payable	320.0	296.0
Advance payments and customer deposits	224.8	240.4
Accrued dividends	148.5	148.0
Accrued taxes	114.4	117.9
Accrued interest	178.8	161.8
Other current liabilities	243.4	251.2
Total current liabilities	2,442.4	1,459.5
Long-term debt and capital lease obligations	7,848.3	8,936.7
Deferred income taxes	1,835.7	1,851.5
Other liabilities	657.4	646.3
Total liabilities	12,783.8	12,894.0
Commitments and Contingencies (See Note 7)		
Shareholders' Equity:		
Common stock, $0.0001 par value, 1,000.0 shares authorized, 588.1 and 586.3 shares issued and outstanding, respectively	0.1	0.1
Additional paid-in capital	1,245.1	1,496.1
Accumulated other comprehensive (loss) income	(0.6)	1.9
Retained earnings	—	—
Total shareholders' equity	1,244.6	1,498.1
Total Liabilities and Shareholders' Equity	$14,028.4	$14,392.1

See the accompanying notes to the unaudited interim consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Millions)	Nine Months Ended September 30, 2012	2011
Cash Provided from Operations:		
Net income	$172.5	$204.2
Adjustments to reconcile net income to net cash provided from operations:		
Depreciation and amortization	958.5	605.8
Provision for doubtful accounts	41.7	32.3
Share-based compensation expense	19.3	17.4
Deferred income taxes	91.9	181.9
Unamortized net (premium) discount on retired debt	(16.2)	18.3
Amortization of unrealized losses on de-designated interest rate swaps	33.0	37.3
Gain from plan curtailment	(9.6)	(14.7)
Other, net	(16.1)	16.1
Changes in operating assets and liabilities, net		
Accounts receivable	(71.8)	(48.6)
Income tax receivable	122.2	—
Prepaid income taxes	(7.4)	(54.3)
Prepaid expenses and other	(55.0)	(7.5)
Accounts payable	(2.2)	31.9
Accrued interest	(5.5)	(54.7)
Accrued taxes	(1.2)	6.7
Other current liabilities	(3.5)	(19.8)
Other liabilities	2.6	(3.0)
Other, net	(9.6)	(32.9)
Net cash provided from operations	1,243.6	916.4
Cash Flows from Investing Activities:		
Additions to property, plant and equipment	(809.4)	(506.5)
Broadband network expansion funded by stimulus grants	(68.8)	(9.2)
Changes in restricted cash	(18.2)	(9.2)
Grant funds received for broadband stimulus projects	26.5	0.5
Disposition of wireless assets	57.0	—
Other, net	7.0	1.2
Net cash used in investing activities	(805.9)	(523.2)
Cash Flows from Financing Activities:		
Dividends paid on common shares	(440.5)	(380.7)
Repayment of debt	(1,848.6)	(3,150.8)
Proceeds of debt issuance	1,775.0	3,147.0
Debt issuance costs	(19.0)	(20.9)
Payment under capital lease obligations	(15.3)	(0.6)
Other, net	(1.5)	4.8
Net cash used in financing activities	(549.9)	(401.2)
Decrease in cash and cash equivalents	(112.2)	(8.0)
Cash and Cash Equivalents:		
Beginning of period	227.0	42.3
End of period	$114.8	$34.3
Supplemental Cash Flow Disclosures:		

Interest paid	$448.9	$427.6
Income taxes refunded, net	$103.8	$10.4

See the accompanying notes to the unaudited interim consolidated financial statements.

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CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (UNAUDITED)

(Millions, except per share amounts)	Common Stock and Additional Paid-In Capital	Accumulated Other Comprehensive (Loss) Income	Retained Earnings	Total
Balance at December 31, 2011	$1,496.2	$1.9	$—	$1,498.1
Net income	—	—	172.5	172.5
Other comprehensive (loss) income, net of tax:				
Change in postretirement and pension plans	—	(8.3)	—	(8.3)
Amortization of unrealized losses on de-designated interest rate swaps	—	20.3	—	20.3
Changes in designated interest rate swaps	—	(14.5)	—	(14.5)
Comprehensive income	—	(2.5)	172.5	170.0
Share-based compensation expense	19.3	—	—	19.3
Stock options exercised	5.4	—	—	5.4
Taxes withheld on vested restricted stock and other	(6.8)	—	—	(6.8)
Dividends of $0.75 per share declared to stockholders	(268.9)	—	(172.5)	(441.4)
Balance at September 30, 2012	$1,245.2	$(0.6)	$—	$1,244.6

See the accompanying notes to the unaudited interim consolidated financial statements.

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

1. Background and Basis for Presentation:

Unless the context requires otherwise, the use of the terms “Windstream,” “we,” “us” and “our” in this Quarterly Report on Form 10-Q refers to Windstream Corporation and its consolidated subsidiaries.

Description of the Business - We are a leading provider of advanced communications and technology solutions, including managed services and cloud computing, to businesses nationwide. In addition to business services, we offer broadband, voice and video services to consumers in primarily rural markets. We have operations in 48 states and the District of Columbia, a local and long-haul fiber network spanning approximately 115,000 miles, a robust business sales division and 23 data centers offering managed services and cloud computing.

Business service revenues include revenues from integrated voice and data services, advanced data, traditional voice and long-distance services to enterprise and small-business customers, and revenues from other carriers for special access circuits and fiber connections. Consumer service revenues are generated from the provision of high-speed Internet, voice and video services to consumers. Wholesale service revenues include switched access revenues, Universal Service Fund ("USF") revenues and voice and data services sold on a wholesale basis. Other service revenues include revenues from certain consumer markets where we lease the connection to the customer premise, software and other miscellaneous services.

Basis of Presentation – The accompanying unaudited consolidated financial statements have been prepared based upon Securities and Exchange Commission ("SEC") rules that permit reduced disclosure for interim periods. Certain information and footnote disclosures have been condensed or omitted in accordance with those rules and regulations. The accompanying consolidated balance sheet as of December 31, 2011, was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States. In our opinion, these financial statements reflect all adjustments that are necessary for a fair presentation of results of operations and financial condition for the interim periods shown including normal recurring accruals and other items. The results for the interim periods are not necessarily indicative of results for the full year. For a more complete discussion of significant accounting policies and certain other information, this report should be read in conjunction with the consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2011, which was filed with the SEC on February 22, 2012.

The preparation of financial statements, in accordance with accounting principles generally accepted in the United States ("U.S. GAAP"), requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities. The estimates and assumptions used in the accompanying consolidated financial statements are based upon management’s evaluation of the relevant facts and circumstances as of the date of the consolidated financial statements. Actual results may differ from the estimates and assumptions used in preparing the accompanying consolidated financial statements, and such differences could be material.

Effective during the fourth quarter of 2011, we changed our method of recognizing actuarial gains and losses for pension benefits. We have retrospectively adjusted financial information for all prior periods presented to reflect our voluntary change in accounting principle for pension benefits. We also elected to revise historical results for certain previously unrecorded immaterial errors and concluded that the effects, individually and in the aggregate, are immaterial to the unaudited quarterly financial information. See Notes 2 and 8 to the consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2011. Additionally, certain prior year amounts have been reclassified to conform to the current year financial statement presentation. These reclassifications did not impact net or comprehensive income.

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2. Summary of Significant Accounting Policies and Changes:

Significant Accounting Policies

Assets Held For Sale – On June 15, 2012, we completed the sale of the energy business acquired in conjunction with the acquisition of PAETEC Holding Corp ("PAETEC") which was previously presented in assets held for sale. The results of our energy business are reported as discontinued operations for all periods presented. See Note 14 for further discussion. On February 22, 2012 and March 30, 2012, we completed the sales of wireless assets acquired from D&E Communications, Inc. ("D&E") and Iowa Telecommunications Services, Inc. ("Iowa Telecom"), respectively, which were previously presented in assets held for sale. As a result of these transactions, we received gross proceeds of approximately $57.0 million and recognized a gain of $5.2 million, net of transaction fees.

Goodwill and Other Intangible Assets – Goodwill represents the excess of cost over the fair value of net identifiable tangible and intangible assets acquired through various business combinations. We have acquired identifiable intangible assets through our acquisitions. The cost of acquired entities at the date of the acquisition is allocated to identifiable assets, and the excess of the total purchase price over the amounts assigned to identifiable assets is recorded as goodwill. In accordance with authoritative guidance, goodwill is to be assigned to a company's reporting units and tested for impairment at least annually using a consistent measurement date, which for us is January 1st of each year. Goodwill is tested at the reporting unit level. A reporting unit is an operating segment or one level below an operating segment, referred to as a component. A component of an operating segment is a reporting unit for which discrete financial information is available and our executive management team regularly reviews the operating results of that component. Additionally, components of an operating segment can be combined as a single reporting unit if the components have similar economic characteristics. Effective January 1, 2012, we have determined that we have one reporting unit to test for impairment that includes all Windstream operations. We assessed impairment of our goodwill by evaluating the carrying value of our shareholders' equity against the current fair market value of our outstanding equity, where the fair market value of our equity is equal to our current market capitalization plus a control premium estimated to be 20.0 percent. The fair market value of our equity, both including and excluding the control premium, exceed our goodwill carrying value as of January 1, 2012.

Change in Accounting Estimate – The calculation of depreciation and amortization expense is based on the estimated economic useful lives of the underlying property, plant and equipment and finite-lived intangible assets. Our regulated operations use a group composite depreciation method. Under this method, when finite long-lived tangible assets are retired, the original cost, net of salvage value, is charged against accumulated depreciation and no immediate gain or loss is recognized on the disposition of such assets. In accordance with authoritative guidance, we periodically obtain updated depreciation studies to evaluate whether certain useful lives remain appropriate. With the assistance of outside expertise, we completed analyses of the depreciable lives of assets held for certain subsidiaries in 2012. Based on those results, we implemented new depreciation rates resulting in a net increase to depreciation of $44.7 million and a net decrease in net income of $27.6 million or $0.05 per share for the nine month period ended September 30, 2012.

Recently Adopted Accounting Standards

Testing Goodwill for Impairment – In September 2011, the Financial Accounting Standards Board ("FASB") issued authoritative guidance related to the testing of goodwill for impairment. This guidance allows an entity the option to first assess qualitative factors before calculating the fair value of a reporting unit. The entity may avoid applying the current two-step impairment test to a reporting unit if it determines, based on its assessment of qualitative factors, it is more likely than not that the fair value of the reporting unit is greater than its carrying amount. This guidance is

effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. This guidance did not have a material impact on our consolidated financial statements.

Fair Value Measurements – In May 2011, FASB issued authoritative guidance related to fair value measurements. This guidance expands existing disclosure requirements for fair value measurements and makes other amendments. Key additional disclosures include quantitative disclosures about unobservable inputs in Level 3 measures, qualitative information about sensitivity of Level 3, as described in Note 6, measures and valuation process, and classification within the fair value hierarchy for instruments where fair value is only disclosed in the footnotes but carrying amount is on some other basis. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. We have updated our disclosures accordingly.

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2. Summary of Significant Accounting Policies and Changes, Continued:

Recently Issued Authoritative Guidance

Balance Sheet Offsetting – In December 2011, the FASB issued authoritative guidance related to balance sheet offsetting. This guidance requires enhanced disclosures for financial instruments and derivative instruments that are subject to an enforceable master netting arrangement. This guidance is effective for fiscal years beginning on or after January 1, 2013, including interim periods therein and requires retrospective application. We are currently evaluating the impact this guidance will have on our consolidated financial statements.

Comprehensive Income – In June 2011, the FASB issued authoritative guidance requiring reclassification adjustments for items that are reclassified from other comprehensive income to net income be presented on the face of the financial statements where the components of net income and the components of other comprehensive income are presented, which was deferred in December 2011. We will continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before the authoritative guidance issued in June 2011 until further guidance is issued. We do not expect this guidance to have a material impact on our consolidated financial statements.

3. Acquisition:

Acquisition of PAETEC - On November 30, 2011, we completed the acquisition of PAETEC in an all-stock transaction valued at approximately $2.4 billion. PAETEC shareholders received 0.460 shares of our stock for each PAETEC share owned at closing. We issued 70.0 million shares and assumed equity awards shares for a total transaction value of $842.0 million, based on our closing stock price on November 30, 2011, and the fair value of the equity awards assumed. We also assumed PAETEC's debt, net of cash acquired, of approximately $1,591.3 million, which included a net premium of $113.9 million based on the fair value of the debt on November 30, 2011 and bank debt of $99.5 million that was repaid on December 1, 2011. The PAETEC transaction enhances our capabilities in strategic growth areas, including Internet protocol ("IP") based services, cloud computing and managed services. It significantly advances our strategy to drive top-line revenue growth by expanding our focus on business and fiber transport services.

The purchase price allocation was based on preliminary information regarding the fair value of assets acquired and liabilities assumed as of the date of acquisition. We are assessing the fair values of the assets acquired and liabilities assumed and the amount of goodwill recognized as of November 30, 2011. This assessment of fair value of assets and liabilities acquired, including accounts receivable, property, plant and equipment, intangible assets and deferred taxes requires a significant amount of judgment and we have not completed this analysis as it relates to the valuation of PAETEC. We expect this analysis to be complete in the fourth quarter of 2012. Adjustments to the preliminary purchase price allocation were based on updated information regarding the fair value of assets acquired and liabilities assumed as of the date of acquisition and were primarily associated with changes in accounts receivable, property, plant and equipment, customer lists, trade names and other, accounts payable and other current liabilities that existed as of the date of acquisition.

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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3. Acquisition, Continued:

The following table summarizes the preliminary and adjusted fair values of the assets acquired and liabilities assumed for PAETEC:

(Millions)	Preliminary Allocation	Adjusted Allocation
Fair value of assets acquired:		
Cash and other current assets	$247.9	$241.4
Accounts receivable	273.4	232.4
Property, plant and equipment	880.9	875.7
Goodwill	614.1	723.9
Customer lists (a)	855.0	830.0
Trade names and other (b)	22.0	15.0
Other assets	8.4	8.6
Total assets acquired	2,901.7	2,927.0
Fair value of liabilities assumed:		
Current maturities of long-term debt and capital lease obligations	(19.0)	(19.0)
Other current liabilities	(453.2)	(473.2)
Deferred income taxes on acquired assets	108.6	108.6
Long-term debt and capital lease obligations	(1,643.7)	(1,643.7)
Other liabilities	(52.4)	(57.7)
Total liabilities assumed	(2,059.7)	(2,085.0)
Common stock issued (inclusive of additional paid-in capital)	$842.0	$842.0

(a) Customer lists are being amortized using the sum-of-years digit methodology over an estimated useful life of ten years.

(b) Trade names are amortized on a straight-line basis over an estimated useful life of one year. Other intangibles, which includes internally developed software, are amortized on a straight-line basis over an estimated useful life of three years.

The fair values of the assets acquired and liabilities assumed were determined using income, cost, and market approaches. Identified intangible assets, consisting primarily of customer lists, were valued primarily on the basis of the present value of future cash flows, which is an income approach. Significant assumptions utilized in the income approach were based on our specific information and projections, which are not observable in the market and are thus considered Level 3 measurements as defined by authoritative guidance. The cost approach, which estimates value by determining the current cost of replacing an asset with another of equivalent economic utility, was used as appropriate for property, plant and equipment. The cost to replace a given asset reflects the estimated reproduction or replacement cost for the asset, less an allowance for loss in value due to depreciation. The fair value of the assumed long-term debt and related interest rate swap agreements assumed were determined based on trade value for the repayment of these instruments.

The credit facility was valued based on the expected redemption cost, while the remaining bonds were valued based on market value. Equity consideration was based on the closing price of our common stock on November 30, 2011. Consideration related to assumed restricted stock units was calculated based on the closing price of our common stock on November 30, 2011, net of the portion of the fair value attributable to future vesting requirements. Consideration related to assumed stock options was calculated based on the fair value of the new Windstream stock options issued as

of November 30, 2011, net of the portion of the fair value attributable to future vesting requirements. The fair value of these stock option awards was calculated using the Hull-White II Lattice model based on assumptions determined as of November 30, 2011. The amount allocated to unearned compensation cost for awards subject to future service requirements was calculated based on the fair value of such awards at the acquisition date and will be recognized as compensation cost over the remaining future service period.

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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3. Acquisition, Continued:

The accompanying consolidated financial statements reflect our combined operations with PAETEC for the periods following the acquisition date. Employee severance and transaction costs we incurred in conjunction with this acquisition have been expensed to merger and integration expense in the accompanying consolidated statements of income (see Note 9). The costs of the acquisition were allocated to the assets acquired and liabilities assumed based on their estimated fair values as of the acquisition dates, with amounts exceeding fair value recognized as goodwill. Goodwill associated with the acquired businesses is attributable to the workforce of acquired businesses and expected synergies. Approximately $39.9 million of goodwill associated with the acquisition of PAETEC is expected to be deductible for tax purposes.

Supplemental Pro Forma Information (Unaudited) – PAETEC Acquisition - On November 30, 2011, we completed the acquisition of PAETEC. The amounts of PAETEC's revenue and net loss included in our consolidated statement of income for the nine month period ended September 30, 2012, and the revenue and net income from continuing operations of the combined entity for the nine month period ended September 30, 2011 had the acquisition occurred January 1, 2011, are as follows:

(Millions)	Revenue	Net (Loss) Income from Continuing Operations
PAETEC actual for nine month period ended September 30, 2012 (a)	$1,577.4	$(43.5)
Supplemental pro forma for the nine month period ended September 30, 2011 (b)	$4,660.1	$136.7

(a) During the first quarter of 2012, we suspended and modified certain PAETEC wholesale products, which represented approximately $16.0 million in revenue recognized in the nine month period ended September 30, 2012 that we do not expect to recur.

(b) Supplemental pro forma revenues for the nine month period ended September 30, 2011 include approximately $54.8 million of revenue related to certain PAETEC wholesale products that have been suspended and modified.

The pro forma information presents our historical results adjusted to include PAETEC, with the results prior to the merger closing date adjusted to include the pro forma effect of the elimination of transactions between us and PAETEC, the adjustment to revenue to align revenue policies, the adjustment to amortization expense associated with the estimated acquired fair value of intangible assets, the impact of merger and integration expenses related to the acquisition and the impact of tax benefits from PAETEC's loss from operations.

The pro forma results are presented for illustrative purposes only and do not reflect either the realization of potential cost savings or any related integration costs. Certain cost savings may result from the PAETEC merger, although there can be no assurance that cost savings will be achieved. These pro forma results do not purport to be indicative of the results that would have actually been obtained if the merger had occurred as of the date indicated, nor do the pro forma results intend to be a projection of results that may be obtained in the future.

4. Goodwill and Other Intangible Assets:

Goodwill represents the excess of cost over the fair value of net identifiable tangible and intangible assets acquired through various business combinations. The cost of acquired entities at the date of the acquisition is allocated to identifiable assets, and the excess of the total purchase price over the amounts assigned to identifiable assets has been

recorded as goodwill.

Changes in the carrying amount of goodwill were as follows:

(Millions)	
Balance at December 31, 2011	$4,301.7
Acquisition of PAETEC (a)	109.9
Balance at September 30, 2012	$4,411.6

(a) Adjustments to the carrying value of PAETEC's goodwill were attributable to adjustments in the fair values of assets acquired and liabilities assumed in the acquisition, as previously discussed in Note 3.

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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4. Goodwill and Other Intangible Assets, Continued:

As of January 1, 2012, we completed our annual impairment review of goodwill in accordance with authoritative guidance and determined that no write-down in carrying value was required. As discussed in Note 2, effective January 1, 2012, we have determined that we have one reporting unit to test for impairment. We assess goodwill impairment by evaluating the carrying value of shareholder's equity against the current fair market value of outstanding equity, which is determined to be equal to our current market capitalization plus a control premium of 20.0 percent. This premium is estimated through a review of recent market observable transactions involving telecommunication companies.

Intangible assets were as follows at:

(Millions)	September 30, 2012			December 31, 2011		
	Gross Cost	Accumulated Amortization	Net Carrying Value	Gross Cost	Accumulated Amortization	Net Carrying Value
Franchise rights	$1,285.1	$(146.9)	$1,138.2	$1,285.1	$(114.8)	$1,170.3
Customer lists (a)	1,914.0	(678.8)	1,235.2	1,939.0	(464.2)	1,474.8
Cable franchise rights	39.8	(25.6)	14.2	39.8	(24.7)	15.1
Other (a)	37.9	(31.5)	6.4	44.9	(19.8)	25.1
Balance	$3,276.8	$(882.8)	$2,394.0	$3,308.8	$(623.5)	$2,685.3

(a) Changes in the gross cost of customer lists and other intangible assets were associated with the acquisition of PAETEC, as previously discussed in Note 3.

Amortization expense for intangible assets subject to amortization was $85.7 million and $259.3 million for the three and nine month periods ended September 30, 2012, as compared to $50.3 million and $156.7 million for the same periods in 2011. Amortization expense for intangible assets is expected to be $84.8 million for the remainder of 2012. Amortization expense for intangible assets subject to amortization is estimated to be $291.2 million, $256.2 million, $223.1 million, $185.0 million and $157.2 million in 2013, 2014, 2015, 2016 and 2017, respectively.

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5. Long-term Debt and Capital Lease Obligations:

Long-term debt and capital lease obligations were as follows at:

(Millions)	September 30, 2012	December 31, 2011
Issued by Windstream Corporation:		
Senior secured credit facility, Tranche A2 – variable rates, due July 17, 2013	$20.1	$172.3
Senior secured credit facility, Tranche A3 – variable rates, due December 30, 2016	414.2	—
Senior secured credit facility, Tranche A4 – variable rates, due August 8, 2017	296.3	—
Senior secured credit facility, Tranche B – variable rates, due July 17, 2013	281.6	283.8
Senior secured credit facility, Tranche B2 – variable rates, due December 17, 2015	1,045.6	1,053.7
Senior secured credit facility, Tranche B3 – variable rates, due August 8, 2019	598.5	—
Senior secured credit facility, Revolving line of credit – variable rates, due December 17, 2015	—	920.0
Debentures and notes, without collateral:		
2013 Notes – 8.125%, due August 1, 2013	800.0	800.0
2017 Notes – 7.875%, due November 1, 2017	1,100.0	1,100.0
2018 Notes – 8.125%, due September 1, 2018	400.0	400.0
2019 Notes – 7.000%, due March 15, 2019	500.0	500.0
2020 Notes – 7.750%, due October 15, 2020	700.0	700.0
2021 Notes – 7.750%, due October 1, 2021	450.0	450.0
2022 Notes – 7.500%, due June 1, 2022	500.0	500.0
2023 Notes – 7.500%, due April 1, 2023	600.0	600.0
Issued by subsidiaries of the Company:		
Windstream Holdings of the Midwest, Inc. – 6.75%, due April 1, 2028	100.0	100.0
Cinergy Communications Company – 6.58%, due January 1, 2022	2.1	2.2
PAETEC 2017 Notes – 8.875%, due June 30, 2017	650.0	650.0
Debentures and notes, without collateral:		
Windstream Georgia Communications LLC – 6.50%, due November 15, 2013	20.0	20.0
PAETEC 2015 Notes – 9.500%, due July 15, 2015	—	300.0
PAETEC 2018 Notes – 9.875%, due December 1, 2018	450.0	450.0
Capital lease obligations	35.9	51.2
Premium on long-term debt, net	66.5	97.2
	9,030.8	9,150.4
Less current maturities	(1,182.5)	(213.7)
Total long-term debt and capital lease obligations	$7,848.3	$8,936.7

Senior Secured Credit Facilities

Effective August 8, 2012, we incurred new borrowings of $300.0 million of Tranche A4 senior secured credit facilities due August 8, 2017 and $600.0 million of Tranche B3 senior secured credit facilities due August 8, 2019. The additional term loan proceeds were used to repay our revolver borrowings and for general corporate purposes, thereby creating sufficient liquidity to repay the 2013 debt maturities. Debt issuance costs associated with the new borrowings were $16.6 million, which were recorded in other assets on the balance sheet and will be amortized into interest expense over the life of the borrowings.

Effective February 23, 2012, we amended and restated $150.4 million of the Tranche A2 senior secured credit facilities outstanding to Tranche A3 and extended the maturity to December 30, 2016. In addition, we incurred new borrowings of $280.0 million of Tranche A3 senior secured credit facilities, which will also be due December 30, 2016.

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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5. Long-term Debt and Capital Lease Obligations, Continued:

Revolving line of credit - During the first nine months of 2012, we borrowed $595.0 million under the revolving line of credit on our senior secured credit facility and later repaid $1,515.0 million. On March 18, 2011, we increased the capacity under our senior secured revolving credit facility from $750.0 million to $1,250.0 million. Letters of credit are deducted in determining the total amount available for borrowing under the revolving line of credit. Accordingly, the total amount outstanding under the letters of credit and the indebtedness incurred under the revolving line of credit may not exceed $1,250.0 million. Considering outstanding borrowings and letters of credit of $14.6 million, the amount available for borrowing under the revolving line of credit was $1,235.4 million at September 30, 2012.

The variable interest rate on our revolving line of credit ranged from 2.49 percent to 4.50 percent, and the weighted average rate on amounts outstanding was 2.52 percent during the first nine months of 2012, as compared to variable interest rates during the first nine months of 2011 which ranged from 1.52 percent to 4.50 percent with a weighted average rate on amounts outstanding of 2.50 percent. All $1,250.0 million available under the revolving line of credit will expire December 17, 2015.

Notes Issued by Subsidiaries

PAETEC 2015 Notes - In connection with our acquisition of PAETEC on November 30, 2011, we assumed the 9.500 percent notes due July 15, 2015 ("PAETEC 2015 Notes") with an aggregate principal amount of $300.0 million.

On January 3, 2012, we retired $150.0 million of the outstanding PAETEC 2015 Notes, in relation to our call for redemption announced on December 2, 2011. On February 21, 2012, we retired the remaining $150.0 million outstanding of the PAETEC 2015 Notes, in relation to our call for redemption announced on January 20, 2012. We paid total consideration of $1,048 per $1,000 aggregate principal amount of PAETEC 2015 Notes, plus accrued and unpaid interest to, but excluding, the redemption date. The redemption was made using borrowings on our revolving line of credit.

Premium on Long-term Debt, Net of Discounts

The premium on long-term debt, net of discounts is primarily due to the debt issuance premium recorded on the debt acquired in the PAETEC acquisition, partially offset by the net discount recorded on debt in the table above. The premium and discount balances are amortized over the life of the related debt instrument.

Debt Compliance

The terms of our credit facility and indentures include customary covenants that, among other things, require us to maintain certain financial ratios and restrict our ability to incur additional indebtedness. These financial ratios include a maximum leverage ratio of 4.50 to 1.0 and a minimum interest coverage ratio of 2.75 to 1.0. In addition, the covenants include restrictions on dividend and certain other types of payments. The terms of the indentures assumed in connection with the acquisition of PAETEC include restrictions on the ability of the subsidiary to incur additional indebtedness, including a maximum leverage ratio, with the most restrictive being 4.75 to 1.0. As of September 30, 2012, we were in compliance with all of our covenants.

In addition, certain of our debt agreements contain various covenants and restrictions specific to the subsidiary that is the legal counterparty to the agreement. Under our long-term debt agreements, acceleration of principal payments would occur upon payment default, violation of debt covenants not cured within 30 days, a change in control

including a person or group obtaining 50 percent or more of our outstanding voting stock, or breach of certain other conditions set forth in the borrowing agreements. We were in compliance with these covenants as of September 30, 2012.

Maturities for debt outstanding, excluding capital lease obligations, as of September 30, 2012 for each of the twelve month periods ended September 30, 2013, 2014, 2015, 2016 and 2017 were $1,165.1 million, $83.3 million, $89.9 million, $1,092.4 million and $1,127.6 million, respectively.

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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5. Long-term Debt and Capital Lease Obligations, Continued:

Loss (Gain) on Extinguishment of Debt

During the nine month period ended September 30, 2012, we retired all $300.0 million of the outstanding PAETEC 2015 Notes. The PAETEC 2015 Notes were purchased using borrowings on our revolving line of credit. The retirements were accounted for under the extinguishment method, and as a result we recognized a gain on extinguishment of debt of $1.9 million during the nine month period ended September 30, 2012.

During the nine month period ended September 30, 2011, we purchased $1,544.5 million of our 8.625 percent Senior Notes due August 1, 2016 ("2016 Notes") and all $400.0 million of our 7.750 percent Senior Notes due February 15, 2015 ("Valor Notes"). We financed these transactions with proceeds from the issuance of the 7.750 percent senior unsecured notes due October 15, 2020 ("2020 Notes"), the 7.750 percent senior unsecured notes due October 1, 2021 ("2021 Notes"), the 7.500 percent senior unsecured notes due April 1, 2023 ("2023 Notes") and borrowings from our revolving line of credit. These transactions allowed us to extend our existing debt maturities and lower our interest rates. The retirements were accounted for under the extinguishment method, and as a result we recognized a loss on extinguishment of debt of $20.5 million and $124.4 million during the three and nine month period ended September 30, 2011.

The loss (gain) on extinguishment of debt is as follows for the three and nine month periods ended September 30:

	Three Months Ended		Nine Months Ended	
(Millions)	2012	2011	2012	2011
2015 PAETEC Notes:				
Premium on early redemption	$—	$—	$14.3	$—
Unamortized premium on original issuance	—	—	(16.2)	—
Gain on early extinguishment for PAETEC 2015 Notes	—	—	(1.9)	—
2016 Notes:				
Premium on early redemption	—	15.2	—	92.7
Unamortized discount on original issuance	—	5.1	—	23.7
Third-party fees for early redemption	—	—	—	2.7
Unamortized debt issuance costs on original issuance	—	0.2	—	1.1
Loss on early extinguishment for 2016 Notes	—	20.5	—	120.2
Valor Notes:				
Premium on early redemption	—	—	—	10.3
Third-party fees for early redemption	—	—	—	0.4
Unamortized premium on original issuance	—	—	—	(6.5)
Loss on early extinguishment for Valor Notes	—	—	—	4.2
Total loss (gain) on early extinguishment of debt	$—	$20.5	$(1.9)	$124.4

Derivatives

We enter into interest rate swap agreements to mitigate the interest rate risk inherent in our variable rate senior secured credit facilities. We account for our derivative instruments using authoritative guidance for recognition, measurement and disclosures about derivative instruments and hedging activities, including when a derivative or other financial instrument can be designated as a hedge. This guidance requires recognition of all derivative instruments at fair value, and accounting for the changes in fair value depends on whether the derivative has been designated as, qualifies as and is effective as a hedge. We record changes in fair value of the effective portions of cash flow hedges

as a component of other comprehensive income in the current period. Any ineffective portion of our hedges is recognized in earnings in the current period.

5. Long-term Debt and Capital Lease Obligations, Continued:

In 2006, we entered into four pay fixed, receive variable interest rate swap agreements to serve as cash flow hedges of the interest rate risk inherent in our senior secured credit facilities. We renegotiated the four interest rate swap agreements on December 3, 2010, and again on August 21, 2012, each time lowering the fixed interest rate paid and extending the maturity.

As a result of the August 21, 2012 transaction, we reduced our fixed rate paid from 4.553 percent to 3.391 percent effective October 17, 2012. The fixed rate paid includes a component which serves to settle the liability existing on our swaps at the time of the transaction. The variable rate received resets on the seventeenth day of each month to the one-month London Interbank Offered Rate ("LIBOR"). Our swaps had a notional value of $962.5 million as of September 30, 2012, which will amortize to $900.0 million on July 17, 2013, where they will remain until maturity.

The current swaps are designated as cash flow hedges of the interest rate risk created by the variable rate cash flows paid on our senior secured credit facilities, which have varying maturity dates from July 17, 2013 to August 8, 2019. We are hedging probable variable cash flows which extend up to four years beyond the maturity of certain components of our variable rate debt. Consistent with past practice, we expect to extend or otherwise replace these components of our debt with variable rate debt.

We recognize all derivative instruments at fair value in the accompanying consolidated balance sheets as either assets or liabilities, depending on the rights or obligations under the related contracts. Changes in value of the effective portion are charged to accumulated other comprehensive income and reclassified into earnings as the hedged transaction affects earnings. Changes in value of the ineffective portion are charged to other (expense) income, net.

Set forth below is information related to our interest rate swap agreements:

(Millions, except for percentages)	September 30, 2012	December 31, 2011
Designated portion, measured at fair value:		
Other current liabilities	$30.0	$30.5
Other non-current liabilities	$98.5	$88.7
Accumulated other comprehensive loss		