CINCINNATI BELL INC
Form 10-Q
August 08, 2006
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2006

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE TRANSITION PERIOD FROM ______ TO ______

COMMISSION FILE NUMBER: 1-8519

CINCINNATI BELL INC.

Ohio	**31-1056105**
(State of Incorporation)	**(I.R.S. Employer Identification No.)**

221 East Fourth Street, Cincinnati, Ohio 45202

(Address of principal executive offices) (Zip Code)

(513) 397-9900

(Registrant s telephone number, including area code)

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

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

At July 31, 2006, there were 246,934,247 common shares outstanding and 155,250 shares of 6 3/4% Cumulative Convertible Preferred Stock outstanding.

Table of Contents

TABLE OF CONTENTS

PART I. Financial Information

Description		Page
Item 1.	Financial Statements	
	Condensed Consolidated Statements of Operations (Unaudited) Three Months and Six Months Ended June 30, 2006 and 2005	1
	Condensed Consolidated Balance Sheets (Unaudited) June 30, 2006 and December 31, 2005	2
	Condensed Consolidated Statements of Cash Flows (Unaudited) Six Months Ended June 30, 2006 and 2005	3
	Notes to Condensed Consolidated Financial Statements (Unaudited)	4
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	22
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	30
Item 4.	Controls and Procedures	31

PART II. Other Information

Description		Page
Item 1.	Legal Proceedings	32
Item 1A.	Risk Factors	32
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	32
Item 3.	Defaults Upon Senior Securities	32
Item 4.	Submission of Matters to a Vote of Security Holders	32
Item 5.	Other Information	33
Item 6.	Exhibits	33
	Signatures	34

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in millions, except per share amounts)

(Unaudited)

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Revenue				
Services	$ 275.5	$ 271.4	$ 545.4	$ 541.5
Products	47.8	44.0	76.2	62.5
Total revenue	323.3	315.4	621.6	604.0
Costs and expenses				
Cost of services, excluding depreciation	93.6	89.1	188.4	176.4
Cost of products sold, excluding depreciation	51.9	44.6	85.2	66.5
Selling, general and administrative	61.7	57.4	120.0	115.5
Depreciation	34.3	48.4	68.1	91.4
Amortization	1.4		2.0	
Shareholder claim settlement			6.3	
Gain on sale of broadband assets	(2.9)		(2.9)	
Asset impairments and other charges	0.1		0.2	23.1
Total operating costs and expenses	240.1	239.5	467.3	472.9
Operating income	83.2	75.9	154.3	131.1
Minority interest expense (income)		(0.5)	0.4	(4.8)
Interest expense	40.3	49.6	79.8	100.1
Loss on extinguishment of debt				7.9
Other income, net	(0.1)	(0.7)	(0.2)	(0.2)
Income before income taxes	43.0	27.5	74.3	28.1
Income tax expense	18.7	57.3	35.9	61.1
Net income (loss)	24.3	(29.8)	38.4	(33.0)
Preferred stock dividends	2.6	2.6	5.2	5.2
Net income (loss) applicable to common shareowners	$ 21.7	$ (32.4)	$ 33.2	$ (38.2)
Basic and diluted earnings (loss) per common share	$ 0.09	$ (0.13)	$ 0.13	$ (0.16)
Weighted average common shares outstanding (millions)				
Basic	246.8	245.8	246.7	245.7
Diluted	252.4	245.8	251.9	245.7

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

1

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in millions, except share amounts)

(Unaudited)

	June 30, 2006	December 31, 2005
Assets		
Current assets		
Cash and cash equivalents	$ 26.6	$ 25.7
Receivables, less allowances of $14.0 and $14.3	141.8	160.9
Materials and supplies	27.7	19.8
Deferred income tax benefits, net	70.5	71.0
Prepaid expenses and other current assets	30.8	16.1
Total current assets	297.4	293.5
Property, plant and equipment, net	807.1	800.4
Goodwill	52.9	40.9
Intangible assets, net	104.0	61.3
Deferred income tax benefits, net	576.9	609.6
Other noncurrent assets	54.4	57.6
Total assets	$ 1,892.7	$ 1,863.3
Liabilities and Shareowners Deficit		
Current liabilities		
Current portion of long-term debt	$ 7.9	$ 11.3
Accounts payable	78.5	69.8
Current portion of unearned revenue and customer deposits	39.2	39.7
Accrued taxes	23.7	30.2
Accrued interest	54.1	50.8
Accrued payroll and benefits	31.6	33.6
Other current liabilities	44.4	42.1
Total current liabilities	279.4	277.5
Long-term debt, less current portion	2,065.2	2,073.4
Accrued pension and postretirement benefits	176.8	160.3
Other noncurrent liabilities	76.0	61.6
Total liabilities	2,597.4	2,572.8
Minority interest		28.2
Commitments and contingencies		
Shareowners deficit		
Preferred stock, 2,357,299 shares authorized, 155,250 shares (3,105,000 depositary shares) of 6 3/4% Cumulative Convertible Preferred Stock issued and outstanding at June 30, 2006 and December 31, 2005; liquidation preference $1,000 per share ($50 per depositary share)	129.4	129.4
Common shares, $.01 par value; 480,000,000 shares authorized; 255,125,556 and 255,049,733 shares issued; 246,933,663 and 247,163,452 outstanding at June 30, 2006 and December 31, 2005	2.6	2.6
Additional paid-in capital	2,925.8	2,929.9
Accumulated deficit	(3,566.1)	(3,604.5)

Accumulated other comprehensive loss	(49.6)	(49.6)
Common shares in treasury, at cost:		
8,191,893 and 7,886,281 shares at June 30, 2006 and December 31, 2005	(146.8)	(145.5)
Total shareowners deficit	(704.7)	(737.7)
Total liabilities and shareowners deficit	$ 1,892.7	$ 1,863.3

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

Table of Contents

Form 10-Q Part I Cincinnati Bell Inc.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in millions)

(Unaudited)

	Six Months Ended June 30, 2006	2005
Cash flows from operating activities		
Net income (loss)	$ 38.4	$ (33.0)
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Depreciation	68.1	91.4
Amortization	2.0	
Gain on sale of broadband assets	(2.9)	
Asset impairments and other charges	0.2	23.1
Loss on extinguishment of debt		7.9
Provision for loss on receivables	7.6	8.5
Noncash interest expense	2.5	15.5
Minority interest expense (income)	0.4	(4.8)
Deferred income tax expense, including valuation allowance change	32.4	61.0
Other, net	(0.1)	2.2
Changes in operating assets and liabilities, net of effects of acquisitions		
(Increase) decrease in receivables	9.4	(15.0)
Increase in prepaid expenses and other current assets	(21.8)	(11.1)
Increase in accounts payable	8.5	2.5
Decrease in accrued and other current liabilities	(5.1)	(13.3)
Increase in accrued pension and postretirement benefits	16.5	16.9
Change in other assets and liabilities, net	1.5	(0.6)
Net cash provided by operating activities	157.6	151.2
Cash flows from investing activities		
Capital expenditures	(74.6)	(71.0)
Acquisitions of business and remaining minority interest in CBW	(86.7)	
Other, net	2.0	
Net cash used in investing activities	(159.3)	(71.0)
Cash flows from financing activities		
Issuance of long-term debt		352.1
Increase in corporate credit facility, net	12.0	32.0
Repayment of debt	(5.7)	(442.0)
Debt issuance costs and consent fees		(21.0)
Issuance of common shares - exercise of stock options	0.7	1.7
Preferred stock dividends	(5.2)	(5.2)
Other, net	0.8	
Net cash provided by (used in) financing activities	2.6	(82.4)
Net increase (decrease) in cash and cash equivalents	0.9	(2.2)

Cash and cash equivalents at beginning of year	25.7	24.9
Cash and cash equivalents at end of period	$ 26.6	$ 22.7

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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Description of Business and Accounting Policies

The following represents a summary of the Company s business and accounting policies. A more detailed presentation can be found in the Company s 2005 Annual Report on Form 10-K.

Description of Business Cincinnati Bell Inc. (the Company) provides diversified telecommunications services through businesses in five segments: Local, Wireless, Hardware and Managed Services (HMS), Other, and Broadband. The Broadband segment no longer has substantive ongoing operations as a result of the sale of the related operating assets in 2003.

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

The adjustments referred to above are of a normal and recurring nature. Certain prior year amounts have been reclassified to conform to the current classifications with no effect on results of operations. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to SEC rules and regulations.

The Condensed Consolidated Balance Sheet as of December 31, 2005 was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. These Condensed Consolidated Financial Statements should be read in conjunction with the Company s 2005 Annual Report on Form 10-K. Operating results for the three and six month periods ended June 30, 2006 are not necessarily indicative of the results expected in subsequent quarters or for the year ending December 31, 2006.

Stock-Based Compensation In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 123(R), Share-Based Payment (SFAS 123(R)), which is a revision of Statement of Financial Accounting Standards No. 123, Accounting for Stock-based Compensation (SFAS 123), and supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be valued at fair value on the date of grant and to be expensed over the applicable vesting period. The Company adopted SFAS 123(R) on January 1, 2006 using the modified prospective application method. Under this method, SFAS 123(R) applies to new awards, awards modified, repurchased, or cancelled after January 1, 2006 and any unvested awards at that date. All outstanding stock option awards as of December 31, 2005 were fully vested and had no impact on the financial statements during the six months ended June 30, 2006.

During 2006 and in prior years, certain employees and directors of the Company were granted stock options and other stock-based awards under the Company s Long-Term Incentive Plans (Company LTIP). Under the Company LTIP, options are granted with exercise prices that are no less than the market value of the stock at the grant date. Generally, stock options have ten-year terms and vesting terms of three to five years. The following table summarizes stock option activity for the six months ended June 30, 2006:

(in thousands, except per share amounts)	Number of options	Weighted-average option prices	Weighted-average remaining contractual life in years	Aggregate intrinsic value
Outstanding at December 31, 2005	22,828	$ 11.28	5.8	
Granted	171	3.85		
Exercised	(236)	3.51		
Forfeited or expired	(1,802)	13.37		

Outstanding at June 30, 2006	20,961	$ 11.13	5.5	$ 2,327
Exercisable at June 30, 2006	20,865	$ 11.17	5.5	$ 2,273

Table of Contents

Form 10-Q Part I Cincinnati Bell Inc.

The weighted average fair values at the date of grant for options granted were $1.34 and $1.27 for the three months ended June 30, 2006 and 2005, respectively, and $1.21 and $1.30 for the six months ended June 30, 2006 and 2005, respectively. The weighted average fair values at the date of grant were estimated using the Black-Scholes option-pricing model with the following assumptions:

	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Expected volatility	32.0%	35.0%
Risk-free interest rate	4.6%	3.9%
Expected holding period - years	4	4
Expected dividends	0.0%	0.0%

The expected volatility assumption used in the Black-Scholes pricing model was based on historical volatility and adjusted for the Company s expectations of future volatility. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant. The expected holding period was estimated using the historical exercise behavior of employees and adjusted for abnormal activity. Expected dividends are based on the Company s history of paying dividends, as well as restrictions in place under the Company s debt covenants.

The Company s policy for graded vesting awards is to recognize compensation expense on a straight-line basis over the vesting period. The Company recognized compensation expense of $0.1 million related to option grants for both the three and six months ended June 30, 2006. As of June 30, 2006, there was $0.1 million of unrecognized compensation expense related to non-vested stock options. This expense will be recognized over a weighted average period of three years. During the six months ended June 30, 2006 and 2005, the total intrinsic value of stock options exercised was $0.1 million and $0.4 million, respectively.

The Company granted performance restricted stock to certain Company executives during the six months ended June 30, 2006. These grants provide for the recipients to receive up to 819,750 shares, which vest over three years and upon the achievement of certain performance-based objectives over the period 2006 to 2008. The fair value of the performance restricted stock on the date of grant was $4.29 per share. The Company granted 749,700 shares of performance restricted stock during the six months ended June 30, 2005, which vest over three years and upon the achievement of certain performance-based objectives over the period 2005 to 2007. Prior to January 1, 2006, the performance restricted stock was accounted for under APB 25. Upon the adoption of SFAS 123(R), the performance restricted stock is expensed based on its grant date fair value, or $4.30 per share, if it is probable that the performance conditions will be achieved. The Company recognized restricted stock compensation expense of $0.4 million for the three months and six months ended June 30, 2006 and $0.3 million and $0.6 million for the three months and six months ended June 30, 2005, respectively. As of June 30, 2006, there was $0.8 million of unrecognized compensation expense related to the non-vested performance restricted stock awards.

Prior to the adoption of SFAS 123(R), the Company applied APB 25 to account for its stock-based awards. The following table illustrates the effect on net loss and basic and diluted loss per share had the Company applied the fair value recognition provisions of SFAS 123:

(dollars in millions except per share amounts)	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Net loss as reported	$ (29.8)	$ (33.0)
Add: Stock-based compensation expense included in reported net income, net of related tax benefits	0.2	0.4
Deduct: Stock-based employee compensation expense determined under fair value method, net of related tax benefits	(1.1)	(2.2)
Pro forma net loss	$ (30.7)	$ (34.8)
Basic and diluted loss per share: As reported	$ (0.13)	$ (0.16)
Pro forma	(0.13)	(0.16)

Rebates The Company benefits from vendor rebate plans, particularly rebates on hardware sold by the HMS segment. The Company recognizes the rebates as a reduction to inventory cost upon purchase of the related equipment, and as an offset to costs of products sold upon sale of the related equipment to the customer. As of June 30, 2006 and December 31, 2005, the balance of rebates earned but not yet received from vendors totaled $9 million and $2 million, respectively, and is included in Prepaid expenses and other current assets on the balance sheet.

Recently Issued Accounting Standards In February 2006, the FASB issued Statement of Financial Accounting Standards No. 155, Accounting for Certain Hybrid Financial Instruments: an amendment of FASB Statements No. 133 and 140 (SFAS 155). The objective of the Statement is to simplify accounting for certain hybrid financial instruments, eliminate interim guidance in Statement 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets, and eliminate a restriction on the passive derivative instruments that a qualifying special-purpose entity may hold. This Statement is effective for all financial instruments acquired or issued after the beginning of the entity s first fiscal year that begins after September 15, 2006. Implementation of SFAS 155 is not expected to have a material impact on the Company s financial statements.

In July 2006, the FASB issued Financial Interpretation No. 48, Accounting for Uncertainty in Income Taxes. The Interpretation requires the realization of an uncertain income tax position must be more likely than not (i.e., greater than 50% likelihood of receiving a benefit) before it can be recognized in the financial statements. Further, the Interpretation prescribes the benefit to be recorded in the financial statements as the amount most likely to be realized assuming a review by the tax authorities having all relevant information and applying current conventions. The Interpretation also clarifies the financial statement classification of tax-related penalties and interest and sets forth new disclosures regarding unrecognized tax benefits. This Interpretation is effective for the first fiscal year that begins after December 15, 2006. The Company has not yet assessed the impact of this Interpretation on the Company s financial statements.

2. Acquisitions

Acquisition of Remaining Interest in Cincinnati Bell Wireless LLC

On February 14, 2006, Cingular Wireless Corporation (Cingular) exercised its contractual put right to require the Company to purchase Cingular s 19.9% membership interest in Cincinnati Bell Wireless LLC (CBW). As a result, the Company paid purchase consideration of $83.0 million in cash to Cingular and incurred transaction expenses of $0.2 million. CBW is now a wholly-owned subsidiary of the Company. The Company funded the purchase with its Corporate credit facility and available cash.

The transaction was accounted for as a step acquisition using the purchase method of accounting in accordance with Statement of Financial Accounting Standards No. 141, Business Combinations (SFAS 141). The Company applied the purchase price against minority interest and then allocated the remainder to identifiable tangible and intangible assets and liabilities acquired as follows:

(dollars in millions)	
Minority interest	$ 27.8
Intangible assets	42.1
Goodwill	10.2
Other	3.1
Total purchase price	$ 83.2

The purchase price allocation was based upon the estimated fair values as of February 14, 2006 of the tangible and intangible assets and liabilities. Estimated fair value was compared to the book value already recorded, and 19.9% of the excess of estimated fair value over book value was allocated to the respective tangible and intangible assets and liabilities. The excess purchase price over the minority interest and fair value ascribed to the tangible and intangible assets and liabilities was recorded as goodwill. The Company anticipates both the goodwill and intangible assets to be fully deductible for tax purposes. The preliminary purchase price allocation for this transaction may be adjusted upon completion of an appraisal of the related assets and liabilities of the business.

6

Table of Contents

The following table presents detail of the purchase price allocated to intangible assets of CBW as of the date of acquisition:

(dollars in millions)	Fair Value	Weighted Average Amortization Period
Intangible assets subject to amortization:		
Customer relationships - subscribers	$ 11.6	7 years
Customer relationships - collocation towers	2.6	15 years
Contractual right - license	0.7	1 year
	14.9	8 years
Intangible assets not subject to amortization:		
Licenses - owned	21.0	n/a
Trademarks	6.2	n/a
Total intangible assets	$ 42.1	

The estimated amortization expense for intangible assets subject to amortization follows:

(dollars in millions)	Amortization Expense
2006	$ 3.9
2007	3.0
2008	2.0
2009	1.4
2010	1.1
2011	0.9
Thereafter	2.6

The intangible asset for the relationship CBW has with its subscribers is being amortized using the sum-of-the-months digits method. Amortization of the customer relationship intangible asset associated with tower collocations utilizes a straight-line method. Tower collocation revenue is received from other wireless carriers for the placement of their radios on CBW towers. These amortization methods best reflect the estimated patterns in which the economic benefits will be consumed.

This acquisition has no effect on the Company s operating income, which historically has included 100% of CBW s operating income. However, for periods after the acquisition date, the 19.9% minority interest in the net income (loss) of Cincinnati Bell Wireless LLC was eliminated.

The unaudited financial information in the table below summarizes the results of operations of the Company, on a pro forma basis, as though the acquisition had occurred as of the beginning of the periods presented:

(dollars in millions, except per share amounts)	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Revenue	$ 323.3	$ 315.4	$ 621.6	$ 604.0
Net income (loss)	24.3	(31.5)	37.9	(38.8)
Earnings (loss) per share - basic and diluted	0.09	(0.14)	0.13	(0.18)

Automated Telecom Inc.

The Company purchased Automated Telecom Inc. (ATI) for a purchase price of $3.5 million in May 2006. ATI is based in Louisville, Kentucky and is a reseller of, and maintenance provider for, telephony equipment. The purchase price was primarily allocated to customer relationship intangible assets, deferred tax liabilities and goodwill. The financial results of ATI are included in the Company s Hardware and Managed Services segment and were immaterial to the Company s financial statements for the three and six months ended June 30, 2006. The preliminary purchase price allocation for this transaction may be adjusted upon completion of the Company s valuation of the related assets and liabilities of the business.

3. Earnings (Loss) Per Common Share

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

(in millions, except per share amounts)	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Numerator:				
Net income (loss)	$ 24.3	$ (29.8)	$ 38.4	$ (33.0)
Preferred stock dividends	2.6	2.6	5.2	5.2
Numerator for basic and diluted EPS	$ 21.7	$ (32.4)	$ 33.2	$ (38.2)
Denominator:				
Denominator for basic EPS - weighted average common shares outstanding	246.8	245.8	246.7	245.7
Stock options and warrants	5.1		4.8	
Stock-based compensation arrangements	0.5		0.4	
Denominator for diluted EPS	252.4	245.8	251.9	245.7
Basic and diluted earnings (loss) per common share	$ 0.09	$ (0.13)	$ 0.13	$ (0.16)

The assumed conversions to common stock of stock options, performance restricted stock, warrants, and the 6 $^{3}/4$% Cumulative Convertible Preferred Stock are excluded from the diluted EPS computations to the extent that these items, on an individual basis, have an anti-dilutive effect on diluted EPS.

4. Comprehensive Income (Loss)

(dollars in millions)	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Net income (loss)	$ 24.3	$ (29.8)	$ 38.4	$ (33.0)
Additional minimum pension liability		(0.4)		(0.6)
Comprehensive income (loss)	$ 24.3	$ (30.2)	$ 38.4	$ (33.6)

5. Debt

The Company s debt consists of the following:

(dollars in millions)	June 30, 2006	December 31, 2005
Current portion of long-term debt:		
Credit facility, tranche B term loan	$ 4.0	$ 4.0
Capital lease obligations	2.9	4.9
Other short-term debt	1.0	2.4
Current portion of long-term debt	7.9	11.3
Long-term debt, less current portion:		
Credit facility, revolver	12.0	
Credit facility, tranche B term loan	393.0	395.0
7 1/4% Senior Notes due 2013	500.0	500.0
8 3/8% Senior Subordinated Notes due 2014, $640 million face amount*	622.0	633.4
7% Senior Notes due 2015, $250 million face amount*	240.0	246.4
7 1/4% Senior Notes due 2023	50.0	50.0
Various Cincinnati Bell Telephone notes	230.0	230.0
Capital lease obligations	17.2	17.3
Other long-term debt	0.1	0.3
	2,064.3	2,072.4
Net unamortized premiums	0.9	1.0
Long-term debt, less current portion	2,065.2	2,073.4
Total debt	$ 2,073.1	$ 2,084.7

* The face amount of these notes has been adjusted to mark hedged debt to fair values at June 30, 2006 and December 31, 2005.

6. Restructuring Charges

2005 Restructuring

In late 2005, the Company incurred employee separation expense of $1.6 million related to the outsourcing of its directory assistance services. The reserve is included in Other current liabilities in the Condensed Consolidated Balance Sheets at June 30, 2006 and December 31, 2005, respectively. The following table illustrates the activity in this reserve from December 31, 2005 through June 30, 2006:

Type of costs (dollars in millions):	Balance December 31, 2005	Utilizations	Balance March 31, 2006	Utilizations	Balance June 30, 2006
Employee separation obligations	$ 1.5	$ (0.7)	$ 0.8	$ (0.1)	$ 0.7

Table of Contents

November 2001 Restructuring Plan

In November 2001, the Company adopted a restructuring plan which included initiatives to consolidate data centers, reduce the Company s expense structure, exit the network construction business, eliminate other non-strategic operations, and merge the digital subscriber line (DSL) and certain dial-up Internet operations into the Company s other operations. The Company completed the plan as of December 31, 2002, except for certain lease obligations, which are expected to continue through June 2015.

The following table illustrates the activity in this reserve from December 31, 2005 through June 30, 2006:

Type of costs (dollars in millions):	Balance December 31, 2005	Expense	Utilizations	Balance March 31, 2006	Expense	Utilizations	Balance June 30, 2006
Terminate contractual obligations	$ 8.2	$ 0.1	$ (0.5)	$ 7.8	$ 0.1	$ (0.4)	$ 7.5

At June 30, 2006, $1.4 million of the restructuring reserve balance was included in Other current liabilities, and $6.1 million was included in Other noncurrent liabilities in the Condensed Consolidated Balance Sheet. At December 31, 2005, $1.3 million of the restructuring reserve balance was included in Other current liabilities and $6.9 million was included in Other noncurrent liabilities in the Condensed Consolidated Balance Sheet.

7. Contingencies

In the normal course of business, the Company is subject to various regulatory and tax proceedings, lawsuits, claims and other matters. The Company believes adequate provision has been made for all such asserted and unasserted claims in accordance with accounting principles generally accepted in the United States. Such matters are subject to many uncertainties and outcomes that are not predictable with assurance.

In re Broadwing Inc. Securities Class Action Lawsuits, (Gallow v. Broadwing Inc., et al), U.S. District Court, Southern District of Ohio, Western Division, Case No. C-1-02-795

Between October and December 2002, five virtually identical class action lawsuits were filed against Broadwing Inc. and two of its former Chief Executive Officers in U.S. District Court for the Southern District of Ohio.

These complaints were filed on behalf of purchasers of the Company s securities between January 17, 2001 and May 20, 2002, inclusive, and alleged violations of Section 10(b) and 20(a) of the Securities and Exchange Act of 1934 by, inter alia, (1) improperly recognizing revenue associated with Indefeasible Right of Use (IRU) agreements; and (2) failing to write-down goodwill associated with the Company s 1999 acquisition of IXC Communications, Inc. The plaintiffs sought unspecified compensatory damages, attorney s fees, and expert expenses.

On December 30, 2002, the Local 144 Group filed a motion seeking consolidation of the complaints and appointment as lead plaintiff. By order dated October 29, 2003, Local 144 Nursing Home Pension Fund, Paul J. Brunner and Joseph Lask were named lead plaintiffs in a putative consolidated class action.

On December 1, 2003, lead plaintiffs filed their amended consolidated complaint on behalf of purchasers of the Company s securities between January 17, 2001 and May 20, 2002, inclusive. This amended complaint contained a number of new allegations. Cincinnati Bell Inc. was added as defendant in this amended filing. The Company s motion to dismiss was filed on February 6, 2004. Plaintiffs filed their opposition on April 2, 2004, and the Company filed its reply on May 17, 2004.

On September 24, 2004, Judge Walter Rice issued an Order granting in part and denying in part the Company s motion to dismiss. The Order indicated that a more detailed opinion would follow, which would provide detail regarding the portions of the case dismissed.

On April 28, 2006, the Company and plaintiffs entered into a Memorandum of Understanding (MOU), which sets forth an agreement in principle to settle this matter. For these lawsuits and the derivative complaint discussed below, the Company reserved $6.3 million in the first quarter of 2006 to reflect its anticipated contribution to the settlement fund and to cover other settlement-related expenses. Under the MOU agreement, the Company and certain of its insurance carriers will contribute a total of $36 million to settle the claims in this matter and obtain in exchange a release of all claims from the class members.

On July 12, 2006, the Company and plaintiffs entered into a definitive Stipulation and Agreement of Settlement reflecting the terms of the above-referenced MOU. On July 21, 2006, Judge Rice issued a Preliminary Order approving the notice and proof of claim forms to be mailed to class members and scheduling a Settlement Fairness Hearing on September 6, 2006. A final settlement of this matter is contingent upon the satisfaction of various conditions contained in the Stipulation and Agreement of Settlement as well as approval by the court.

In re Broadwing Inc. Derivative Complaint, (Garlich v. Broadwing Inc., et al), Hamilton County Court of Common Pleas, Case No. A0302720.

This derivative complaint was filed against Broadwing Inc. and ten of its current and former directors on April 9, 2003 alleging breaches of fiduciary duty arising out of the same allegations discussed in *In re Broadwing Inc. Securities Class Action Lawsuits* above. Pursuant to a stipulation between the parties, defendants were not required, absent further order by the Court, to answer, move, or otherwise respond to this complaint until 30 days after the federal court rendered a ruling on defendants motion to dismiss in *In re Broadwing Inc. Securities Class Action Lawsuits*.

On April 28, 2006, the Company and plaintiffs entered into a MOU, which sets forth an agreement in principle to settle this matter. For this derivative lawsuit and the lawsuits discussed above, the Company reserved $6.3 million in the first quarter of 2006 to reflect its anticipated contribution to the settlement fund and to cover other settlement-related expenses. On July 12, 2006, the Company and plaintiffs entered into a definitive Stipulation and Agreement of Settlement reflecting the terms of the MOU. The court has scheduled a Settlement Fairness Hearing on September 6, 2006. A final settlement of this matter is contingent upon the satisfaction of various conditions contained in the Stipulation and Agreement of Settlement as well as approval by the court.

In re Broadwing Inc. ERISA Class Action Lawsuits, (Kurtz v. Broadwing Inc., et al), U.S. District Court, Southern District of Ohio, Western Division, Case No. C-1-02-857.

Between November 18, 2002 and March 17, 2003, five putative class action lawsuits were filed against Broadwing Inc. and certain of its current and former officers and directors in the United States District Court for the Southern District of Ohio. Fidelity Management Investment Trust Company was also named as a defendant in these actions.

These cases, which purport to be brought on behalf of the Cincinnati Bell Inc. Savings and Security Plan, the Broadwing Retirement Savings Plan, and a class of participants in the Plans, generally allege that the defendants breached their fiduciary duties under the Employee Retirement Income Security Act of 1974 (ERISA) by improperly encouraging the Plan participant-plaintiffs to elect to invest in the Company stock fund within the relevant Plan and by improperly continuing to make employer contributions to the Company stock fund within the relevant Plan.

On February 22, 2006, the Company entered into a Stipulation and Agreement of Settlement of ERISA Actions (the Agreement) providing for the settlement of the consolidated case with no finding or admission of any wrongdoing by any of the defendants in the lawsuit. Under the Agreement, defendants are obligated to pay $11 million, which payment will be made on their behalf by their insurers, to a fund to settle the claims of, and obtain a release of all claims from, the class members. On March 13, 2006, the Court issued an order giving preliminary approval of the Agreement and scheduled a Settlement Fairness Hearing on June 22, 2006. The fairness hearing took place as scheduled on June 22, 2006. The parties are currently awaiting a final order from the Court. If the Agreement is given final approval by the Court, the Agreement will result in a dismissal of the case with prejudice.

Freedom Wireless vs. BCGI, et al U.S. District Court, District of Massachusetts, Case No. 05-110620-EFH.

On September 16, 2005, Freedom Wireless filed a patent infringement action against 24 wireless service providers, including CBW. The suit alleges that the defendant wireless service providers are in violation of a patent owned by Freedom Wireless. CBW obtained its rights to use the technology in question through Boston Communications Group Inc. (BCGI). BCGI has acknowledged its obligation to indemnify CBW in accordance with the terms of the license agreement. This lawsuit was preceded by a direct patent infringement suit against BCGI by Freedom Wireless, in which BCGI was found liable. BCGI is appealing that verdict. CBW is not certain that BCGI will prevail in its appeal, whether it will have sufficient financial resources to honor all of its indemnification obligations, or whether the judge would order injunctive relief that could force CBW to find an alternative prepaid billing platform. On July 21, 2006, BCGI issued a press release indicating that it had reached a settlement agreement with Freedom Wireless in the underlying patent infringement action. If the conditions of the settlement are satisfied, the agreement would result in the dismissal of all pending infringement actions with prejudice and would not have a material adverse effect on the Company s financial condition, results of operations, or cash flows.

8. Pension and Postretirement Plans

The following information relates to all Company noncontributory defined benefit pension plans, postretirement health care, and life insurance benefit plans. Approximately 10% of these costs were capitalized to property, plant, and equipment related to network construction in the Local segment for the three and six months ended June 30, 2006 and 2005. Pension and postretirement benefits expense are as follows:

	Pension Benefits		Postretirement and Other Benefits	
	Three Months Ended June 30,			
(dollars in millions)	**2006**	**2005**	**2006**	**2005**
Service cost	$ 2.1	$ 2.1	$ 1.0	$ 1.1
Interest cost on projected benefit obligation	6.9	6.8	4.8	5.8
Expected return on plan assets	(8.7)	(9.5)	(1.2)	(1.4)
Amortization of:				
Transition (asset)/obligation		(0.2)	1.0	1.0
Prior service cost	0.9	0.8	2.0	3.1
Actuarial loss	1.0	0.3	1.3	0.3
Total expense	$ 2.2	$ 0.3	$ 8.9	$ 9.9

	Pension Benefits		Postretirement and Other Benefits	
	Six Months Ended June 30,			
(dollars in millions)	**2006**	**2005**	**2006**	**2005**
Service cost	$ 4.3	$ 4.1	$ 1.9	$ 2.6
Interest cost on projected benefit obligation	13.7	13.7	9.6	11.7
Expected return on plan assets	(17.4)	(19.0)	(2.4)	(2.7)
Amortization of:				
Transition (asset)/obligation		(0.5)	2.1	2.1
Prior service cost	1.7	1.6	3.9	6.5
Actuarial loss	2.1	0.7	2.7	0.7
Total expense	$ 4.4	$ 0.6	$ 17.8	$ 20.9

The Company reclassified its pension intangible asset of $25.5 million at December 31, 2005 from Other noncurrent assets to Intangible assets, net on the Condensed Consolidated Balance Sheet to conform to the June 30, 2006 presentation.

Table of Contents

Form 10-Q Part I Cincinnati Bell Inc.

9. Business Segment Information

The Company is organized into five business segments: Local, Wireless, Hardware and Managed Services, Other, and Broadband, on the basis of offering distinct products and services. These segments are generally aligned with specific subsidiaries of the Company.

The Broadband segment no longer has any substantive, on-going operations because, in 2003, the Company sold substantially all of its broadband assets, which were reported in the Broadband segment. The Broadband segment previously provided data and voice communications services nationwide over approximately 18,700 route miles of fiber-optic transmission facilities.

Certain corporate administrative expenses have been allocated to segments based upon the nature of the expense and the relative size of the segment.

The Company s business segment information follows:

(dollars in millions)	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Revenue				
Local	$ 187.4	$ 189.6	$ 373.8	$ 379.7
Wireless	66.4	60.3	128.2	121.5
Hardware and Managed Services	58.2	54.5	97.0	81.6
Other	19.8	19.6	39.4	38.7
Intersegment	(8.5)	(8.6)	(16.8)	(17.5)
Total revenue	$ 323.3	$ 315.4	$ 621.6	$ 604.0
Intersegment revenue				
Local	$ 6.6	$ 6.1	$ 13.0	$ 12.6
Wireless	0.7	0.7	1.4	1.3
Hardware and Managed Services	0.3	1.0	0.7	2.1
Other	0.9	0.8	1.7	1.5
Total intersegment revenue	$ 8.5	$ 8.6	$ 16.8	$ 17.5
Operating income				
Local	$ 70.6	$ 70.1	$ 140.1	$ 140.1
Wireless	4.5	(1.5)	8.2	(21.7)
Hardware and Managed Services	3.8	4.3	6.1	6.7
Other	7.0	7.1	13.5	13.1
Broadband	2.3	1.4	1.8	2.6
Corporate and eliminations	(5.0)	(5.5)	(15.4)	(9.7)
Total operating income	$ 83.2	$ 75.9	$ 154.3	$ 131.1

	June 30, 2006	December 31, 2005
Assets		
Local	$ 712.7	$ 721.4
Wireless	317.6	274.2
Hardware and Managed Services	97.4	90.7

Other	89.1	101.4
Broadband	2.8	2.7
Corporate and eliminations	673.1	672.9
Total assets	$ 1,892.7	$ 1,863.3

Table of Contents

Form 10-Q Part I Cincinnati Bell Inc.

10. Supplemental Guarantor Information
Cincinnati Bell Telephone Notes

Cincinnati Bell Telephone LLC (CBT), a wholly owned subsidiary of Cincinnati Bell Inc. (the Parent Company), has $230.0 million in notes outstanding that are guaranteed by the Parent Company and no other subsidiaries of the Parent Company. The guarantee is full and unconditional. In the fourth quarter of 2005, Cincinnati Bell Public Communications merged into the Parent Company. Substantially all of the Parent Company s income and cash flow is generated by its subsidiaries. Generally, funds necessary to meet the Parent Company s debt service obligations are provided by distributions or advances from its subsidiaries.

The following information sets forth the condensed consolidating statements of operations and cash flows for the three months and six months ended June 30, 2006 and 2005 and condensed consolidating balance sheets of the Company as of June 30, 2006 and December 31, 2005 of (1) the Parent Company, as the guarantor (2) CBT, as the issuer, and (3) the non-guarantor subsidiaries on a combined basis:

Condensed Consolidating Statements of Operations

	Three Months Ended June 30, 2006				
(dollars in millions)	**Parent (Guarantor)**	**CBT**	**Other (Non-guarantors)**	**Eliminations**	**Total**
Revenue	$ 0.7	$ 187.4	$ 143.7	$ (8.5)	$ 323.3
Operating costs and expenses	5.0	116.8	126.8	(8.5)	240.1
Operating income (loss)	(4.3)	70.6	16.9		83.2
Equity in earnings of subsidiaries, net of tax	47.9			(47.9)	
Interest expense	36.0	3.8	9.1	(8.6)	40.3
Other expense (income), net	(8.7)	0.1	(0.1)	8.6	(0.1)
Income before income taxes	16.3	66.7	7.9	(47.9)	43.0
Income tax expense (benefit)	(8.0)	23.8	2.9		18.7
Net income	24.3	42.9	5.0	(47.9)	24.3
Preferred stock dividends	2.6				2.6
Net income applicable to common shareowners	$ 21.7	$ 42.9	$ 5.0	$ (47.9)	$ 21.7

	Three Months Ended June 30, 2005				
	Parent (Guarantor)	**CBT**	**Other (Non-guarantors)**	**Eliminations**	**Total**
Revenue	$ 1.4	$ 189.6	$ 133.0	$ (8.6)	$ 315.4
Operating costs and expenses	6.8	119.5	121.8	(8.6)	239.5
Operating income (loss)	(5.4)	70.1	11.2		75.9
Equity in earnings of subsidiaries, net of tax	2.2			(2.2)	
Interest expense	45.4	4.4	6.9	(7.1)	49.6
Other expense (income), net	(6.9)	(0.8)	(0.6)	7.1	(1.2)
Income (loss) before income taxes	(41.7)	66.5	4.9	(2.2)	27.5
Income tax expense (benefit)	(11.9)	30.7	38.5		57.3
Net income (loss)	(29.8)	35.8	(33.6)	(2.2)	(29.8)
Preferred stock dividends	2.6				2.6

Net income (loss) applicable to common shareowners	$ (32.4)	$ 35.8	$ (33.6)	$ (2.2)	$ (32.4)