

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

Application of Sprint Nextel Corporation) Case No. _____
for Approval of the Transfer of Control of)
Sprint Missouri, Inc., Sprint Long)
Distance, Inc. and Sprint Payphone)
Services, Inc. From Sprint Nextel)
Corporation to LTD Holding Company.)

TESTIMONY OF KEVIN P. COLLINS

ON

BEHALF OF

SPRINT NEXTEL CORPORATION

[PUBLIC VERSION]

AUGUST 23, 2005

1 **THIS TESTIMONY IS BEING PROVIDED SOLELY IN CONNECTION WITH THE**
2 **ABOVE-REFERENCED PROCEEDING AND MAY NOT BE RELIED UPON BY ANY**
3 **PERSON OR ENTITY FOR ANY OTHER PURPOSE**
4
5
6

7 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

8 **A.** My name is Kevin P. Collins. My business address is Houlihan, Lokey, Howard & Zukin
9 Financial Advisors, Inc, 245 Park Avenue, 19th Floor, New York, NY 10167.
10

11 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

12 **A.** I am employed as a managing director at Houlihan, Lokey, Howard & Zukin Financial
13 Advisors, Inc. ("HL"). HL is an international investment bank established in 1970. HL
14 provides a wide range of services, including mergers and acquisitions, financing,
15 financial opinions and advisory services, and financial restructuring. HL has rendered in
16 excess of one hundred opinions addressing the impact of transactions on the capital
17 adequacy of companies. These opinions have been accepted by boards of directors, by
18 lenders, by regulators and tested in legal proceedings. Attached hereto as Exhibit KPC-1
19 is a further description of HL as well as a summary of my personal experience.
20

21 **Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND**
22 **EXPERIENCE IN CORPORATE FINANCE.**

23 **A.** I have worked in investment banking providing financial advisory services, including
24 capital adequacy analysis, for the past 17 years. As a Managing Director in the New
25 York office of HL, I am the head of the financial advisory practice of that office, a
26 position that I've held for over ten years. My educational background includes a

1 Bachelor of Science degree from the State University of New York at Albany in 1979,
2 and a Masters in Business Administration from the University of Rochester in 1982 with
3 concentrations in Finance and Applied Economics.
4

5 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

6 **A.** HL has been asked to evaluate certain aspects of the separation of Sprint's incumbent
7 local wireline operations ("LTD Holding Company" or "Company") from its parent
8 company (as further described in the Application of Sprint Nextel Corporation ("Sprint")
9 for Approval of the Transfer of Control) from a financial point of view. In particular we
10 have performed an independent valuation of LTD Holding Company and analyzed
11 certain financial information regarding the capitalization of LTD Holding Company
12 subsequent to the separation and its impact on the ability of the Company to pay its debts
13 as they become due. Attached to my testimony as Exhibit KPC-2 is the "Report to Sprint
14 Nextel Corporation", which represents the complete analysis and valuation undertaken by
15 HL on behalf of Sprint ("Sprint Report"). The purpose of my testimony is to sponsor the
16 Sprint Report as part of the separation application to demonstrate the financial strength of
17 LTD Holding Company as an independent stand alone entity.
18

19 **Q. PLEASE SUMMARIZE THE DEVELOPMENT OF THE ANALYSIS AND**
20 **VALUATION CONTAINED IN THE REPORT.**

21 **A.** Although the separation will not take place until the receipt of all necessary approvals,
22 for purposes of our analysis, we have assumed that the Transaction will occur on June 1,
23 2006. To complete our valuation we have utilized projected financial statement

1 information regarding the expected financial condition of LTD Holding Company as of
2 June 1, 2006 supplied by LTD Holding Company management, and assumed economic,
3 market and financing conditions are the same as of today.
4

5 LTD Holding Company management provided financial projections for LTD Holding
6 Company through fiscal year 2007 approved by LTD Holding Company management as
7 part of their ongoing business operations (“Three Year Projections”) (Sprint Report,
8 Executive Summary - Tab 1, Contents of Report and Other Matters, page 3; Transaction
9 Overview - Tab 2, page 14 – fiscal years 2005-2007). Although we have not
10 independently verified the accuracy and completeness of the Three Year Projections or
11 their underlying assumptions, nothing has come to the attention of our personnel working
12 on this engagement during the course thereof that has caused us to believe, based on our
13 best professional judgment, that it was unreasonable for us to utilize and rely upon the
14 projections as part of our analysis.
15

16 In addition, HL independently undertook solely for purposes of this analysis to extend the
17 Three Year Projections to 2010. (Id.) The extension for 2008 to 2010 was not developed
18 by Sprint management and is not part of the projections approved by Sprint management:
19 nevertheless, Sprint does not believe that it is unreasonable for HL to utilize the extended
20 forecasts for purposes of its evaluation. HL developed the extension by trending from the
21 Three Year Projections utilizing publicly available information relating to
22 telecommunication industry and forecasts for use solely in the Cashflow Test, as
23 hereinafter defined.

1 Finally, we understand that Sprint has obtained indicative ratings for LTD Holding
2 Company from major ratings agencies.

3
4 **Q. WHAT ARE THE PRIMARY CONSIDERATIONS IN DETERMINING**
5 **WHETHER A COMPANY HAS ADEQUATE CAPITAL?**

6 **A.** The typical analysis of adequate capital examines both the value of a company's assets
7 relative to its liabilities, and its projected cash flows relative to its operating requirements
8 (Sprint Report, Methodology – Tab 4, Capital Tests Methodology, Reasonable Capital
9 Test, page 47). The analysis is conducted under the assumption that the transaction has
10 been consummated as proposed. The analysis we concluded can be summarized as
11 follows:

- 12 (a) The fair value of LTD Holding Company's assets in the
13 aggregate;
- 14
15 (b) Whether the fair value of LTD Holding Company's assets
16 would exceed its stated liabilities and identified contingent
17 liabilities (referred to as the "Balance Sheet Test");
- 18
19 (c) Whether LTD Holding Company should be able to pay its
20 debts as they become absolute and mature while (i)
21 continuing to generate sufficient cash to re-invest in the
22 business at a level indicated by the Company necessary to
23 maintain the current level of service, and (ii) paying
24 dividends in accordance with the planned dividend policy
25 which the Company believes is commensurate with
26 industry peers and after consideration of a commercially
27 reasonable level of refinancing (referred to as the
28 "Cashflow Test"); and
- 29
30 (d) Whether the capital remaining in LTD Holding Company
31 after the Transaction would be reasonable for the business
32 in which it is engaged, as management has indicated it is
33 proposed to be conducted following the consummation of
34 the Transaction (referred to as the "Reasonable Capital
35 Test").

1 The fair value of a company's assets is defined as "the amount that may be realized if a
2 company's aggregate assets (including goodwill) are sold in their entirety with reasonable
3 promptness in an arm's length transaction under present conditions for the sale of
4 comparable business enterprises, as such conditions can be reasonably evaluated."

5
6 Being "able to pay its debts as they become absolute and mature" means that, assuming
7 the transaction has been consummated as proposed, the company's financial forecasts
8 indicate positive cash flow for such period, including (and after giving effect to) the
9 payment of installments due under loans made pursuant to the indebtedness incurred in
10 the transaction, as such installments are scheduled at the close of the transaction, after
11 consideration of a commercially reasonable level of refinancing."

12
13 To assess whether the capital remaining in a company is not unreasonably small requires
14 a subjective analysis of the results of the Balance Sheet Test and the Cashflow Test. The
15 analysis includes consideration of various factors including: (i) the degree of sensitivity
16 to revenue growth or decline and margin assumptions demonstrated in the Cashflow Test;
17 (ii) the historical and expected volatility of asset values; (iii) the maturity structure of the
18 company's fixed obligations; (iv) the magnitude, timing, and nature of contingent
19 liabilities; (v) the prevalent capital structures within the industry; and (vi) the amount of
20 flexibility allowed by the financial covenants in the credit agreements. The size of LTD
21 Holding Company and the diversity of its wireline assets across eighteen states are
22 important factors in performing the Reasonable Capital test.

Q. WHAT METHODS ARE EMPLOYED TO ESTIMATE THE FAIR VALUE OF ASSETS OF A COMPANY?

A. We employed three approaches that are commonly used by investors and analysts in the valuation of companies (Sprint Report, Methodology – Tab 4, Valuation Methodology, pages 38-43).

First, in the Market Multiple Approach we derive valuation multiples from a group of comparable publicly traded companies. Upon a comparison of the subject company to the comparable companies across a number of qualitative and quantitative factors, we select multiples to apply in the valuation of the subject company.

Second, in the Comparable Transaction Approach we derive valuation multiples from precedent transactions within the industry representing the sale of comparable companies or assets. Similarly, based upon a comparison of the subject company to those companies involved in industry transactions, we select multiples to apply in the valuation of the subject company.

Finally, in the Discounted Cash Flow Approach, utilizing the financial projections prepared by management of the Company, we calculate the net present value of all future expected cash flows. Cash flows are discounted to the present at a risk-adjusted discount rate, which is measured as the industry weighted average cost of capital. At the final year of the projections, we estimate a terminal value using a valuation multiple in a similar fashion to the first two approaches. This terminal value is also discounted to the present.

1 The conclusion of the fair value of the Company (or its assets in the aggregate) is
2 determined by taking into consideration the indicated values from the above three
3 approaches.

4
5 **Q. IS BOOK VALUE OF EQUITY A RELEVANT INDICATOR OF FAIR VALUE**
6 **FOR THE COMPANY'S ASSETS?**

7 **A.** In this case, no. In certain situations, for example with financial institutions, book value
8 (or a multiple thereof) is often utilized in valuation analyses. However, for operating
9 companies, including telecommunication companies, book value of equity is often a
10 function of accounting conventions and historical accounting treatment and is not a
11 directly applicable figure for valuation purposes. Book value results from the myriad
12 accounting rules and often has no direct correlation to fair value. This can be observed in
13 the marketplace where companies with negative book equity values have positive and
14 substantial market equity values.

15
16 **Q. BASED ON THE CURRENT INTENTIONS OF SPRINT CORPORATION**
17 **REGARDING THE SEPARATION OF THE LOCAL TELECOMMUNICATIONS**
18 **DIVISION, INCLUDING THE ANTICIPATED DEBT AND DIVIDEND LEVELS**
19 **OF LTD HOLDING COMPANY, WHAT ARE YOUR SUMMARY**
20 **CONCLUSIONS?**

21 **A.** Based on our valuation analysis, the fair value of the assets of LTD Holding Company is
22 reasonably stated in the range of *** **BEGIN HIGHLY CONFIDENTIAL** [REDACTED]
23 **END HIGHLY CONFIDENTIAL***** to *** **BEGIN HIGHLY CONFIDENTIAL**

1 **END HIGHLY CONFIDENTIAL***** (Sprint Report, Valuation Analysis
2 - Tab 5, Valuation Summary, page 50). Further, it is our conclusion that LTD Holding
3 Company, assuming that the transaction is consummated as proposed, passes the
4 previously described tests relating to adequate capital. The estimated fair value of the
5 assets exceeds the pro forma debt *** **BEGIN HIGHLY CONFIDENTIAL** **END HIGHLY CONFIDENTIAL***** of \$7.3 billion. LTD
6 Holding Company should be able to pay its debts as they become absolute and mature,
7 after consideration of a commercially reasonable level of refinancing, while (i)
8 continuing to generate sufficient cash to re-invest in the business at a level indicated by
9 the Company necessary to maintain the current level of service, and (ii) paying dividends
10 in accordance with the planned dividend policy which the Company believes is
11 commensurate with industry peers. Finally, after review of the previously cited factors
12 we concluded the capital remaining in LTD Holding Company is not unreasonably small
13 for the business in which it is engaged (Sprint Report, Capital Tests – Tab 6, pages 65-
14 68).
15
16

17 **Q. IS THE ANTICIPATED LEVEL OF DEBT OF LTD HOLDING COMPANY**
18 **AFTER THE SEPARATION WITHIN THE LEVELS THAT CAN BE**
19 **OBSERVED FOR SIMILAR INDUSTRY PARTICIPANTS?**

20 **A.** Yes. Investors, analysts and rating agencies examine a number of leverage ratios when
21 assessing the creditworthiness of a company. These ratios often include (i) total debt to
22 EBITDA (earnings before interest, taxes, depreciation and amortization), (ii) fixed charge
23 coverage defined as (EBITDA-capital expenditures)/annual interest payments, and (iii)

1 total debt to enterprise value (defined as market value of equity, plus debt and preferred
2 stock, less cash). LTD Holding Company is expected to have a debt to EBITDA ratio of
3 approximately *** BEGIN HIGHLY CONFIDENTIAL [REDACTED] END HIGHLY
4 CONFIDENTIAL*** at the time of the separation. This is a *** BEGIN HIGHLY
5 CONFIDENTIAL [REDACTED] END HIGHLY CONFIDENTIAL*** of leverage as
6 compared to the selected comparable companies, which have an average debt to EBITDA
7 ratio of 3.7x. (Sprint Report, Executive Summary – Tab 1, Summary of Findings, page
8 8) Based on the forecasts for LTD Holding Company, EBITDA is expected to cover
9 fixed charges in 2006 by approximately *** BEGIN HIGHLY CONFIDENTIAL [REDACTED]
10 END HIGHLY CONFIDENTIAL***, (Sprint Report, Capital Tests – Tab 6, Summary
11 of Analyses, page 73) which is *** BEGIN HIGHLY CONFIDENTIAL [REDACTED]
12 END HIGHLY CONFIDENTIAL*** the average 3.2x fixed charge coverage ratio for
13 the comparable companies (Sprint Report, Telecommunications Industry Analysis - Tab
14 3, Comparable Companies Analysis, page 26). Based upon the midpoint of our valuation
15 range for LTD Holding Company, we estimate that at the time of the separation the
16 Company's debt will account for approximately *** BEGIN HIGHLY
17 CONFIDENTIAL [REDACTED] END HIGHLY CONFIDENTIAL*** of its capital.
18 (Sprint Report, Telecommunications Industry Analysis - Tab 3, Comparable Companies
19 Analysis, page 26). This is *** BEGIN HIGHLY CONFIDENTIAL [REDACTED]
20 [REDACTED] END HIGHLY CONFIDENTIAL*** the average debt to capital ratios for
21 the comparable companies of 46.1 percent. (Sprint Report, Telecommunications Industry
22 Analysis - Tab 3, Comparable Companies Analysis, page 26).

1 **Q. HOW DOES LTD HOLDING COMPANY'S ANTICIPATED DIVIDEND POLICY**
2 **FACTOR INTO THE ANALYSIS?**

3 **A.** LTD Holding Company currently anticipates paying approximately \$300 million per year
4 in dividends on its common stock (Sprint Report, Transaction Overview – Tab 2, page
5 13). Dividends are an important aspect of equity securities and LTD Holding Company's
6 dividend yield is expected to attract investors who are interested in current yield thereby
7 providing support for the stock price. Based on the forecasts for LTD Holding Company,
8 the Company is expected to have sufficient cash flows from operations to reinvest in its
9 business through capital expenditures, pay the dividend and make principal payments on
10 its debt. In fact, its dividend payout ratio (defined as the dividend payment as a
11 percentage of free cash flows after payment of interest, taxes and capital expenditures) is
12 projected to be in the range of *** **BEGIN HIGHLY CONFIDENTIAL** [REDACTED]
13 **END HIGHLY CONFIDENTIAL***** to *** **BEGIN HIGHLY CONFIDENTIAL** [REDACTED]
14 **END HIGHLY CONFIDENTIAL***** over the projection period, (Sprint
15 Report, Capital Tests – Tab 6, Summary of Analyses, page 73) which is *** **BEGIN**
16 **HIGHLY CONFIDENTIAL** [REDACTED] **END HIGHLY CONFIDENTIAL*****
17 than the median expected 2005 payout ratio for the comparable companies of 70 percent
18 (Sprint Report, Executive Summary - Tab 1, Summary of Findings, page 7).
19 Additionally, notwithstanding that equity investors will view the dividend payment
20 favorably, the dividend payment will be at the discretion of LTD Holding Company's
21 board of directors and the payment can be modified at any time.

1 **Q. DO YOU EXPECT THAT THE ANTICIPATED CAPITAL STRUCTURE WILL**
2 **LIMIT LTD HOLDING COMPANY'S ABILITY TO REINVEST IN ITS**
3 **BUSINESS?**

4 **A.** No. The management of LTD Holding Company has projected future capital expenditure
5 requirements. The aggregate capital expenditures in each of the next several years is
6 expected to be approximately *** **BEGIN HIGHLY CONFIDENTIAL** [REDACTED]
7 **END HIGHLY CONFIDENTIAL***** of revenues, which is *** **BEGIN HIGHLY**
8 **CONFIDENTIAL** [REDACTED] **END HIGHLY CONFIDENTIAL***** than the
9 average projected for 2005 for the comparable companies of approximately 13 percent of
10 revenues (Sprint Report, Executive Summary - Tab 3, Comparable Companies Analysis,
11 page 35). As discussed above, LTD Holding Company should have excess cash flows
12 beyond those needed for dividend payments should capital expenditure requirements be
13 higher than anticipated or if the Company has investment opportunities with favorable
14 economics.

15
16 **Q. WITH THE PROPOSED CAPITAL STRUCTURE, WILL LTD HOLDING**
17 **COMPANY BE IN A POSITION TO OBTAIN FUTURE FINANCING?**

18 **A.** The ability of a company to raise financing is a function of a number of factors,
19 including, but not limited to attractiveness of its business, leverage and capital market
20 conditions. Based on the Company's forecasts and assuming market conditions are
21 reasonably similar to those existing today, LTD Holding Company's leverage should
22 decline and it should maintain a substantial equity value. As an independent company

1 with a size that places it well within the Fortune 500, LTD Holding Company should
2 have numerous alternatives for accessing capital in the future
3

4 **Q. HOW HAS CURRENT AND FUTURE COMPETITION BEEN FACTORED**
5 **INTO THE ANALYSIS?**

6 **A.** The Company recognizes that its business has been and will continue to be subject to
7 competition from a number of competitive communication providers including wireless
8 voice and data providers, cable companies offering voice services and potentially other
9 competitors in the future. The expectation for future competition is factored into the
10 Company forecasts in which it has assumed access line *** **BEGIN HIGHLY**
11 **CONFIDENTIAL** [REDACTED] **END HIGHLY CONFIDENTIAL***** [REDACTED] *** **BEGIN**
12 **HIGHLY CONFIDENTIAL** [REDACTED] **END HIGHLY CONFIDENTIAL*****
13 (Sprint Report, Telecommunications Industry Analysis - Tab 3, Comparable Companies
14 Analysis, page 28) to *** **BEGIN HIGHLY CONFIDENTIAL** [REDACTED] **END**
15 **HIGHLY CONFIDENTIAL***** per year (Sprint Report, Capital Tests – Tab 6,
16 Summary of Analysis, page 72) over the 2005 to 2007 period, *** **BEGIN HIGHLY**
17 **CONFIDENTIAL** [REDACTED] **END HIGHLY CONFIDENTIAL***** certain of
18 its product offerings and *** **BEGIN HIGHLY CONFIDENTIAL** [REDACTED]
19 [REDACTED] **END HIGHLY CONFIDENTIAL***** its *** **BEGIN HIGHLY**
20 **CONFIDENTIAL** [REDACTED] **END HIGHLY CONFIDENTIAL***** DSL business.
21 While the Company plans to respond to these competitive threats to minimize the impact
22 to its business, the assumptions regarding competition in the Company's forecasts are
23 inherently embedded in our analysis. Further, to test less favorable potential outcomes

1 for the Company, we have tested cases with *** **BEGIN HIGHLY CONFIDENTIAL**
2 **END HIGHLY CONFIDENTIAL***** to competition and have
3 determined that the Company has reasonable cushion to underperform its forecasts yet
4 maintain a positive operating cash flow.

5 **Q. IN SUMMARY, WHAT IS YOUR VIEW REGARDING THE CURRENTLY**
6 **ANTICIPATED CAPITAL STRUCTURE OF LTD HOLDING COMPANY?**

7 **A.** In summary, based on an extensive review of the operations and financial condition of
8 LTD Holding Company, my knowledge and experience in both telecommunications and
9 corporate finance, and my valuation and financial analysis, and assuming that the
10 transaction is consummated as proposed, LTD Holding Company passes the three tests
11 relating to adequate capital as previously discussed. Further, neither the level of debt nor
12 the anticipated dividend policy should limit the Company's ability to reinvest at the
13 levels that the Company forecasts will be required to maintain its current or an improved
14 level of quality of service.

15
16 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

17 **A.** Yes, it does.

**BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI**

AFFIDAVIT OF KEVIN P. COLLINS

State of New York)
) ss:
County of New York)

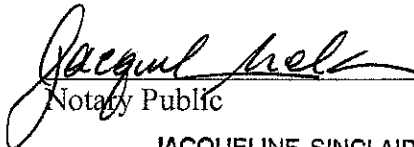
I, Kevin P. Collins being of lawful age and duly sworn, state the following:

1. I am currently representing the interests of Sprint Nextel Corporation in this proceeding.
2. I have participated in the preparation of the attached Testimony in question and answer form to be presented in the above entitled consolidated cases;
3. The answers in the attached Testimony were given by me; and,
4. I have knowledge of the matters set forth in such answers and that such matters are true and correct to the best of my knowledge and belief.



Kevin P. Collins

Subscribed and sworn to before me on this 17th day of August 2005.


Notary Public

My Appointment Expires:

10.31.07

JACQUELINE SINCLAIR
Notary Public, State of New York
No. 01SI6021470
Qualified in Queens County
Commission Expires 10.31.07