

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the

DOCKET NO. UT-051291

Request of Sprint Nextel Corporation for an Order Declining to Assert Jurisdiction Over or, in the Alternative, Application of Sprint Nextel Corporation for Approval of the Transfer of Control of United Telephone Company of the Northwest and Sprint Long Distance, Inc. From Sprint Nextel Corporation to LTD Holding Company.

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

**DIRECT TESTIMONY OF GLENN R. DANIEL
ON BEHALF OF SPRINT NEXTEL CORPORATION**

**AUGUST 26, 2005
RESUBMITTED NOVEMBER 1, 2005**

**HIGHLY CONFIDENTIAL
PER PROTECTIVE ORDER IN DOCKET NO. UT-051291**

[REDACTED VERSION]

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

2 **A.** My name is Glenn R. Daniel. My business address is Houlihan, Lokey, Howard & Zukin
3 Financial Advisors, Inc, One Sansome Street, 17th Floor, San Francisco, CA 94104.

4
5 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

6 **A.** I am employed as a Managing Director at Houlihan, Lokey, Howard & Zukin Financial
7 Advisors, Inc. (“HL”). HL is an international investment bank established in 1970. HL
8 provides a wide range of services, including mergers and acquisitions, financing,
9 financial opinions and advisory services, and financial restructuring. HL has rendered in
10 excess of one hundred opinions addressing the impact of transactions on the capital
11 adequacy of companies. These opinions have been accepted by boards of directors, by
12 lenders, by regulators and tested in legal proceedings. Attached hereto as Exhibit
13 GRD-2 is a further description of HL as well as a summary of my personal experience.

14
15 **Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND**
16 **EXPERIENCE IN CORPORATE FINANCE.**

17 **A.** I have worked in investment banking providing financial advisory services, including
18 capital adequacy analysis, for the past 17 years. As a Managing Director in the San
19 Francisco office of HL, I direct San Francisco regional office operations, supervise
20 financial opinion and corporate finance engagements, and I am a senior member of the
21 firm’s Technology Group. My educational background includes a B.A. in Economics and
22 German, with distinction, from the University of Wisconsin. I have earned an M.S. in

1 Finance from the University of Wisconsin, Graduate School of Business, and I am also a
2 Chartered Financial Analyst and registered NASD General Securities Principal.

3
4 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

5 **A.** HL has been asked to evaluate certain aspects of the separation of Sprint's incumbent
6 local wireline operations ("LTD Holding Company" or "Company") from its parent
7 company (as further described in the Application of Sprint Nextel Corporation ("Sprint")
8 for Approval of the Transfer of Control) from a financial point of view. In particular we
9 have performed an independent valuation of LTD Holding Company and analyzed
10 certain financial information regarding the capitalization of LTD Holding Company
11 subsequent to the separation and its impact on the ability of the Company to pay its debts
12 as they become due. Attached to my testimony as Exhibit GRD-3 is the "Report to Sprint
13 Nextel Corporation", which represents the complete analysis and valuation undertaken by
14 HL on behalf of Sprint ("Sprint Report"). The purpose of my testimony is to sponsor the
15 Sprint Report as part of the separation application to demonstrate the financial strength of
16 LTD Holding Company as an independent stand alone entity.

17
18 **Q. PLEASE SUMMARIZE THE DEVELOPMENT OF THE ANALYSIS AND**
19 **VALUATION CONTAINED IN THE REPORT.**

20 Although the separation will not take place until the receipt of all necessary approvals,
21 for purposes of our analysis, we have assumed that the Transaction will occur on June 1,
22 2006. To complete our valuation we have utilized projected financial statement
23 information regarding the expected financial condition of LTD Holding Company as of

1 June 1, 2006 supplied by LTD Holding Company management, and assumed economic,
2 market and financing conditions are the same as of today.

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

14
15 In addition, HL independently undertook solely for purposes of this analysis to extend the
16 Three Year Projections to 2010. (Id.) The extension for 2008 to 2010 was not developed
17 by Sprint management and is not part of the projections approved by Sprint management:
18 nevertheless, Sprint does not believe that it is unreasonable for HL to utilize the extended
19 forecasts for purposes of its evaluation. HL developed the extension by trending from the
20 Three Year Projections utilizing publicly available information relating to
21 telecommunication industry and forecasts for use solely in the Cashflow Test, as
22 hereinafter defined.

23

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").

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

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

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

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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

1 of the projections, we estimate a terminal value using a valuation multiple in a similar
2 fashion to the first two approaches. This terminal value is also discounted to the present.

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

7
8 **Q. IS BOOK VALUE OF EQUITY A RELEVANT INDICATOR OF FAIR VALUE**
9 **FOR THE COMPANY'S ASSETS?**

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

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

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

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

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

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

16
17 **Q. HOW DOES LTD HOLDING COMPANY'S ANTICIPATED DIVIDEND POLICY**
18 **FACTOR INTO THE ANALYSIS?**

19 **A.** LTD Holding Company currently anticipates paying approximately \$300 million per year
20 in dividends on its common stock (Sprint Report, Transaction Overview – Tab 2, page
21 13). Dividends are an important aspect of equity securities and LTD Holding Company's
22 dividend yield is expected to attract investors who are interested in current yield thereby
23 providing support for the stock price. Based on the forecasts for LTD Holding Company,

1 the Company is expected to have sufficient cash flows from operations to reinvest in its
2 business through capital expenditures, pay the dividend and make principal payments on
3 its debt. In fact, its dividend payout ratio (defined as the dividend payment as a
4 percentage of free cash flows after payment of interest, taxes and capital expenditures) is
5 projected to be in the range of [REDACTED] to [REDACTED] over the projection period, (Sprint
6 Report, Capital Tests – Tab 6, Summary of Analyses, page 73) which is [REDACTED]
7 than the median expected 2005 payout ratio for the comparable companies of 70 percent
8 (Sprint Report, Executive Summary - Tab 1, Summary of Findings, page 7).

9 Additionally, notwithstanding that equity investors will view the dividend payment
10 favorably, the dividend payment will be at the discretion of LTD Holding Company's
11 board of directors and the payment can be modified at any time.

12
13 **Q. DO YOU EXPECT THAT THE ANTICIPATED CAPITAL STRUCTURE WILL**
14 **LIMIT LTD HOLDING COMPANY'S ABILITY TO REINVEST IN ITS**
15 **BUSINESS?**

16 **A.** No. The management of LTD Holding Company has projected future capital expenditure
17 requirements. The aggregate capital expenditures in each of the next several years is
18 expected to be approximately [REDACTED] of revenues, which is [REDACTED] than
19 the average projected for 2005 for the comparable companies of approximately 13
20 percent of revenues (Sprint Report, Executive Summary - Tab 3, Comparable Companies
21 Analysis , page 35). As discussed above, LTD Holding Company should have excess
22 cash flows beyond those needed for dividend payments should capital expenditure

1 requirements be higher than anticipated or if the Company has investment opportunities
2 with favorable economics.

3
4 **Q. WITH THE PROPOSED CAPITAL STRUCTURE, WILL LTD HOLDING**
5 **COMPANY BE IN A POSITION TO OBTAIN FUTURE FINANCING?**

6 **A.** The ability of a company to raise financing is a function of a number of factors,
7 including, but not limited to attractiveness of its business, leverage and capital market
8 conditions. Based on the Company's forecasts and assuming market conditions are
9 reasonably similar to those existing today, LTD Holding Company's leverage should
10 decline and it should maintain a substantial equity value. As an independent company
11 with a size that places it well within the Fortune 500, LTD Holding Company should
12 have numerous alternatives for accessing capital in the future.

13
14 **Q. HOW HAS CURRENT AND FUTURE COMPETITION BEEN FACTORED**
15 **INTO THE ANALYSIS?**

16 **A.** The Company recognizes that its business has been and will continue to be subject to
17 competition from a number of competitive communication providers including wireless
18 voice and data providers, cable companies offering voice services and potentially other
19 competitors in the future. The expectation for future competition is factored into the
20 Company forecasts in which it has assumed access line [REDACTED] from [REDACTED] (Sprint
21 Report, Telecommunications Industry Analysis - Tab 3, Comparable Companies
22 Analysis, page 28) to [REDACTED] per year (Sprint Report, Capital Tests – Tab 6,
23 Summary of Analysis, page 72) over the 2005 to 2007 period, [REDACTED] certain

1 of its product offerings and [REDACTED] its [REDACTED] DSL business. While the
2 Company plans to respond to these competitive threats to minimize the impact to its
3 business, the assumptions regarding competition in the Company's forecasts are
4 inherently embedded in our analysis. Further, to test less favorable potential outcomes
5 for the Company, we have tested cases with [REDACTED] to competition and have
6 determined that the Company has reasonable cushion to underperform its forecasts yet
7 maintain a positive operating cash flow.

8
9 **Q. IN SUMMARY, WHAT IS YOUR VIEW REGARDING THE CURRENTLY**
10 **ANTICIPATED CAPITAL STRUCTURE OF LTD HOLDING COMPANY?**

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

19
20 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

21 **A.** Yes, it does.