

QWEST CORP

FORM 10-Q (Quarterly Report)

Filed 8/12/1994 For Period Ending 6/30/1994

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended June 30, 1994

OR

☐ 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 1-3040

U S WEST Communications, Inc.

A Colorado Corporation IRS Employer No.
84-0273800

1801 California Street, Denver, Colorado 80202

Telephone Number (303) 896-3099

THE REGISTRANT, A WHOLLY-OWNED SUBSIDIARY OF U S WEST, INC., MEETS THE CONDITIONS SET FORTH IN GENERAL INSTRUCTION H(1) OF FORM 10-Q AND IS THEREFORE FILING THIS FORM WITH REDUCED DISCLOSURE FORMAT PURSUANT TO GENERAL INSTRUCTION H(2).

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__

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Form 10-Q - Part I U S WEST Communications, Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

(Dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	1994	1993	1994	1993
<hr/>				
OPERATING REVENUES				
Local service	\$1,016	\$963	\$2,001	\$1,900
Interstate access service	556	527	1,118	1,065
Intrastate access service	179	170	353	340
Long distance network service	345	355	696	711
Other services	147	136	293	276
	-----	-----	-----	-----
Total operating revenues	2,243	2,151	4,461	4,292
	-----	-----	-----	-----
OPERATING EXPENSES				
Employee-related costs	738	706	1,455	1,402
Other operating expenses	401	413	799	821
Taxes other than income taxes	98	96	195	192
Depreciation and amortization	470	459	935	901
	-----	-----	-----	-----
Total operating expenses	1,707	1,674	3,384	3,316
	-----	-----	-----	-----
Income from operations	536	477	1,077	976
Interest expense	81	100	161	199
Other income (expense)	17	(13)	31	(13)
	-----	-----	-----	-----
Income before income taxes and extraordinary item	472	364	947	764
Provision for income taxes	177	121	355	254
	-----	-----	-----	-----
Income before extraordinary item	295	243	592	510
Extraordinary item Early extinguishment of debt, net of tax	-	(50)	-	(50)
	-----	-----	-----	-----
NET INCOME	\$295	\$193	\$592	\$460
	=====	=====	=====	=====

See Notes to Consolidated Financial Statements.

CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

(Dollars in millions)	June 30, 1994	December 31 1993
ASSETS		
Current assets		
Cash and cash equivalents	\$56	\$67
Accounts receivable	1,420	1,391
Materials and supplies	121	108
Deferred tax asset	289	292
Other	64	59
	-----	-----
Total current assets	1,950	1,917
	-----	-----
Property, plant and equipment	28,494	28,012
Less: Accumulated depreciation	15,983	15,465
	-----	-----
Net property, plant and equipment	12,511	12,547
	-----	-----
Other	914	698
	-----	-----
Total assets	\$15,375	\$15,162
	=====	=====

See Notes to Consolidated Financial Statements.

Form 10-Q - Part I U S WEST Communications, Inc.

CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

(Dollars in millions)	June 30, 1994	December 31 1993
LIABILITIES AND SHAREOWNER'S EQUITY		
Current liabilities		
Short-term debt	\$1,301	\$1,260
Accounts payable	676	935
Employee compensation	284	303
Current portion of restructuring charge	399	421
Other	1,003	893
	-----	-----
Total current liabilities	3,663	3,812
	-----	-----
Long-term debt	4,250	4,092
Postretirement benefit obligation	2,354	2,593
Deferred taxes and credits	1,607	1,525
Shareowner's equity		
Common shares - one share without par value	7,103	6,742
Accumulated deficit	(3,602)	(3,602)
	-----	-----
Total shareowner's equity	3,501	3,140
	-----	-----
Total liabilities and shareowner's equity	\$15,375	\$15,162
	=====	=====

See Notes to Consolidated Financial Statements.

Form 10-Q - Part I U S WEST Communications, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(Dollars in millions)	Six Months Ended June 30,	
	1994	1993
<hr/>		
OPERATING ACTIVITIES		
Net income	\$592	\$460
Adjustments		
Depreciation and amortization	935	901
Deferred income taxes and amortization of investment tax credit	50	9
Changes in operating assets and liabilities		
Accounts receivable	(29)	(46)
Materials, supplies and other	(37)	(61)
Accounts payable and accrued liabilities	0	(35)
Funding of postretirement benefit obligation	(288)	(246)
Other - net	(21)	148
	-----	-----
Cash provided by operating activities	1,202	1,130
	-----	-----
INVESTING ACTIVITIES		
Expenditures for property, plant and equipment	(1,165)	(1,079)
Other - net	47	17
	-----	-----
Cash used for investing activities	(1,118)	(1,062)
	-----	-----
FINANCING ACTIVITIES		
Net proceeds from (repayments of) short-term debt	149	(39)
Proceeds from long-term debt	251	587
Repayments of long-term debt	(243)	(232)
Dividends paid	(612)	(497)
Equity infusions from parent	360	121
	-----	-----
Cash used for financing activities	(95)	(60)
	-----	-----
CASH AND CASH EQUIVALENTS		
Increase (decrease)	(11)	8
Beginning balance	67	53
	-----	-----
Ending balance	\$56	\$61
	=====	=====

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Dollars in millions)

A. Summary of Significant Accounting Policies

Consolidated Financial Statements

The consolidated financial statements have been prepared by U S WEST Communications, Inc. (the "Company") pursuant to the rules and regulations of the SEC (Securities and Exchange Commission). Certain information and footnote disclosures normally accompanying financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such SEC rules and regulations. In the opinion of the Company's management, the consolidated financial statements include all adjustments, consisting of only normal recurring adjustments, necessary to present fairly the financial information set forth therein. It is suggested that these consolidated financial statements be read in conjunction with the financial statements and notes thereto included in the Company's Form 10-K for the year ended December 31, 1993.

Certain reclassifications within the financial statements have been made to conform to the current year presentation.

Computer Software

The cost of computer software, whether purchased or developed internally, is charged to expense with two exceptions. Initial operating system software is capitalized and amortized over the life of the related hardware, and initial network applications software is capitalized and amortized over three years. Subsequent upgrades to capitalized software are expensed.

Research and Development

The Company recognized \$42, \$55 and \$56 for research and development expense in 1993, 1992 and 1991, respectively. Approximately half of this activity was conducted at Bell Communications Research, Inc. ("Bellcore"), one-seventh of which is owned by the Company.

B. Contingencies

There are pending regulatory actions in local regulatory jurisdictions which call for price decreases, refunds or both. In one such instance, the Utah Supreme Court has remanded a Utah Public Service ("PSC") order to the PSC for reconsideration, thereby establishing two exceptions to the rule against retroactive ratemaking: 1) unforeseen and extraordinary events and 2) misconduct. The Commission's initial order denied a refund request from inter-exchange carriers and other parties related to the Tax Reform Act of 1986. If the Commission finds that either of the exceptions apply, the Company could be liable for refunds, although at this time any such amount is not reasonably estimable since the case is still in the discovery process.

Item 2. Management's Analysis (Dollars in millions)

RESULTS OF OPERATIONS

Details of operations for the first six months of 1994, including a comparison to the prior year, are presented in the following table:

	1994	1993	% Change
Operating revenues	\$4,461	\$4,292	3.9
Operating expenses			
Employee-related costs	1,455	1,402	3.8
Other operating expenses	799	821	(2.7)
Taxes other than income taxes	195	192	1.6

Earnings before interest, taxes, depreciation and amortization, and other (EBITDA)	2,012	1,877	7.2
Depreciation and amortization	935	901	3.8
Interest expense	161	199	(19.1)
Other income (expense)	31	(13)	-

Income before income taxes and extraordinary item	947	764	24.0
Provision for income taxes	355	254	39.8

Income before extraordinary item	592	510	16.1
Extraordinary item, net of tax	-	(50)	-

Net income	\$592	\$460	28.7
=====			

The Company's volume growth resulted in a 7.2 percent increase in EBITDA (earnings before interest, taxes, depreciation and amortization, and other income (expense)). Excluding the effects of a \$32 gain on the sale of certain rural telephone exchanges in the first six months of 1994 and a charge of \$50 for the refinancing of debt in the same period last year, net income increased \$50 or 9.8 percent.

OPERATING REVENUES

In the table that follows, price changes primarily represent the aggregate effects of regulatory proceedings and growth represents increased market penetration through both increased access lines and additional sales to existing customers. Different regulatory commissions govern the interstate and intrastate jurisdictions, resulting in varying price and refund impacts.

Item 2. Management's Analysis (Dollars in millions)

OPERATING REVENUES (continued)						
	Price Changes	Lower (Higher) Refunds	Growth	Other	Increase (Decrease)	
					\$	%
Local service	\$ (3)	\$ -	\$ 104	\$ -	\$ 101	5.3
Interstate access	(22)	4	75	(4)	53	5.0
Intrastate access	(3)	(4)	20	-	13	3.8
Long distance	(3)	1	(13)	-	(15)	(2.1)
Other services	-	-	-	17	17	6.2
Total	\$ (31)	\$ 1	\$ 186	\$ 13	\$ 169	3.9

Local service revenues increased principally as a result of higher demand for services, as evidenced by an increase of 478,000 access lines, or 3.5 percent, during the last twelve months. Access line growth was 3.8 percent as adjusted for the sale of approximately 38,000 rural telephone access lines.

Increased demand for access services more than offset the effects of rate reductions. Billed access minutes of use increased 8.7 percent over the same period last year. Long distance network service revenues decreased principally due to the continuing effects of competition. Revenues from other services increased primarily as a result of continued market penetration in voice messaging services.

OPERATING EXPENSES

Employee-related costs increased over the prior year as a result of additional costs associated with customer service initiatives in the current year and a change in pension expense (resulting from changes in actuarial assumptions). Partially offsetting this increase was a reduction in postretirement benefits expense.

Other operating expenses decreased over the same period last year due to a reduction in general operating expenses including access charges paid to independent companies. Taxes other than income taxes remained essentially flat compared to the same period last year. Depreciation and amortization expense increased primarily due to the aggregate effects of a higher depreciable plant base and the discontinuance of Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation."

INTEREST EXPENSE AND OTHER

Interest expense decreased as a result of the refinancing of debt in the prior year to take advantage of lower interest rates. A reclassification of capitalized interest costs from other income (expense) also contributed to the decrease. Pursuant to the discontinuance of SFAS No. 71, interest capitalized as a component of plant construction is offset against interest expense.

Other income (expense) increased as a result of a pre-tax gain of \$50 from the sale of certain rural telephone exchanges in the first six months of 1994. Partially offsetting this gain was the reclassification of capitalized interest to a component of interest expense.

Item 2. Management's Analysis (Dollars in millions)**PROVISION FOR INCOME TAXES**

The effective tax rate was 37.5 percent in the first six months of 1994 compared to 33.3 percent in the same period last year. This increase is primarily a result of the effects of discontinuing the application of SFAS No. 71 in the third quarter of 1993, the 1993 federally-mandated increase in income tax rates and an increase in income before taxes.

OTHER ITEMS**Restructuring Charges**

The Company's 1993 third-quarter results included a \$880 million restructuring charge (pretax). The related restructuring plan is designed to provide faster, more responsive customer services while reducing the costs of providing these services. As part of the plan, the Company is developing new systems that will enable it to monitor networks to reduce the risk of service interruptions, activate telephone service on demand, provide automated inventory systems and centralize its service centers so that customers can have their telecommunications needs resolved with one phone call. The Company will also reduce its work force by approximately 9,000 employees (including the remaining employee reductions pursuant to the restructuring plan announced in 1991) by the end of 1996.

Following is a schedule of the costs included in the restructuring charge:

Employee separation	\$225
Real estate	130
Relocation	105
Retraining and other	60
Systems development	360

Total	\$880
	=====

Employee separation costs include severance payments, healthcare coverage and postemployment education benefits. Real estate costs include preparation costs for the new service centers. The relocation and retraining costs are related to moving employees to the sites of the new service centers and retraining employees on the new methods and systems required in the new, restructured mode of operation. Systems development includes the replacement of existing, single-purpose systems with new systems designed to provide integrated, end-to-end customer service. The work-force reductions would not be possible without the development and installation of the new systems which will eliminate the current, labor-intensive interfaces between existing systems.

The estimated annual cash expenditures relating to the 1993 restructuring plan are \$365, \$300 and \$215 in 1994, 1995 and 1996, respectively. In addition to these expenditures, the Company anticipates incremental capital expenditures related to the restructuring plan of \$450 over the three year life of the plan.

Item 2. Management's Analysis (Dollars in millions)

OTHER ITEMS (continued)

Restructuring Charges (continued)

Employee Separation:

The restructuring plan provides for annual employee reductions and separation amounts as follows:

Employee Reductions	1994*	1995	1996	Total
-----	-----	-----	-----	-----
Network - managerial	602	1,095	977	2,674
Network - occupational	865	1,227	978	3,070
All other - managerial	459	335	323	1,117
All other - occupational	1,022	812	322	2,156
-----	-----	-----	-----	-----
Total	2,948	3,469	2,600	9,017
=====	=====	=====	=====	=====

Separation Costs	1994*	1995	1996	Total
-----	-----	-----	-----	-----
Network - managerial	\$22	\$42	\$40	\$104
Network - occupational	14	28	25	67
All other - managerial	0	13	13	26
All other - occupational	1	19	8	28
-----	-----	-----	-----	-----
Subtotal	37	102	86	225
-----	-----	-----	-----	-----
Remaining 1991 reserve	56	-	-	56
-----	-----	-----	-----	-----
Total	\$93	\$102	\$86	\$281
=====	=====	=====	=====	=====

* 1994 includes the remaining employees and the separation amounts associated with the balance of the 1991 restructuring reserve at 12/31/93.

Systems Development:

The Company's existing information management systems were largely developed with analog technology for a monopoly environment. These systems are increasingly inadequate due to the effects of increased competition, new forms of regulation and changing technology which has driven consumer demand for new services which can be delivered quickly, reliably and economically. The sequential systems currently in place are slow, labor intensive and costly to maintain, and often cannot be adapted to support new product and service offerings, including future multimedia services envisioned by U S WEST.

Item 2. Management's Analysis (Dollars in millions)**OTHER ITEMS (continued)****Restructuring Charges (continued)****Systems Development (continued):**

The systems reengineering program in place involves development of new systems around the following core processes:

Service Delivery - to support faster and more accurate delivery of all products and services, including repair. These systems will permit one customer service representative to handle all Facets of a customer's requirements as contrasted to the numerous points of customer interface required today.

Service Assurance - for automation and centralization of the network, including earlier identification and more rapid resolution of network problems.

Capacity Provisioning - for integrated planning of future network capacity, including the installation of software- controllable service components.

The direct, incremental and nonrecurring systems development costs contained in the restructuring plan are comprised of the following annual amounts:

	1994	1995	1996	Total
	-----	-----	-----	-----
Service delivery systems	\$35	\$45	\$20	\$100
Service assurance systems	45	40	30	115
All other	25	55	65	145
	-----	-----	-----	-----
Total	\$105	\$140	\$115	\$360
	=====	=====	=====	=====

The majority of systems development labor will be supplied through the use of temporary employees and/or contractors. Additionally, the Company estimates that up to 100 employees with special skills will be hired in order to develop the software applications contemplated in the current plan. The labor cost for these employees included in the restructuring plan is approximately \$16 to \$18 over the life of the plan. While it is likely that a number of these employees will be retained after 1996 due to their specialized skills, it is planned that any related increase in headcount will be offset through other employee reductions.

Systems expenses charged to current operations consist of all costs associated with the information management function, including planning, developing, testing and maintaining data bases for general purpose computers, in addition to systems costs related to maintenance of telephone network applications. Key related administrative (i.e. general purpose) systems include customer service, order entry, billing and collection, accounts payable, payroll, human resources and property records. On-going systems costs comprised approximately six, six and five percent of the total operating expenses of the Company for 1993, 1992 and 1991, respectively. The Company expects systems costs charged to current operations as a percent of total operating expenses to approximate the current level throughout the life of the restructuring plan. However, systems costs could increase relative to other operating costs as the Company becomes more technology-dependent.

Item 2. Management's Analysis (Dollars in millions)

OTHER ITEMS (continued)

Restructuring Charges (continued)

Expenditures Under the Plan:

For the second quarter and six months ended June 30, 1994, the following amounts have been charged against the restructuring reserve:

Employee Separations	Second Quarter		Six Months	
	#	\$	#	\$
Network - managerial	35	\$1	55	\$2
Network - occupational	212	4	255	5
All other - managerial	63	2	133	6
All other - occupational	155	4	245	9
	-----	-----	-----	-----
Total	465	\$11	688	\$22
	=====	=====	=====	=====

Systems Development Costs	Second Quarter	Six Months
	\$	\$
	-----	-----
Service delivery systems	\$5	\$5
Service assurance systems	5	9
All other	5	9
	-----	-----
Total	\$15	\$23
	=====	=====

Other charges to the reserve were \$14, \$2 and \$2 for real estate, relocation, and retraining and other, respectively, for the six months ended June 30, 1994.

During the first half of the year, the Company was in the start-up phase of the restructuring plan. The Company expects that charges will accelerate over the remainder of 1994 as the Company continues consolidation of the customer service centers and development of the new systems. The rate of spending for the first six months of 1994 was slower than anticipated. While the original estimates for 1994 might not be fully realized, there are no significant changes to the plan in total. If the original estimates for 1994 are not fully realized, the impact on the financial statements will not be material.

The Company's 1991 restructuring plan, a pretax charge of \$240, was adopted to reduce the Company's work force by approximately 6,000 employees. Approximately \$34 of the 1991 restructuring charge was unused at June 30, 1994, as compared to \$56 remaining at December 31, 1993. The remaining balance of this reserve will be expended in 1994.

Item 2. Management's Analysis (Dollars in millions)

OTHER ITEMS (continued)

Regulatory Issues

On June 10, 1994, the U.S. Court of Appeals in Washington, D. C. overturned the Federal Communications Commission (FCC) requirement that local telephone companies allow physical collocation by third parties (competitive access providers), within their central offices, for the installation and operation of equipment that connects to the local telephone network. The court also ordered the FCC to reconsider its requirement that allows competitors to interconnect equipment to the local network from a point outside a central office. U S WEST is evaluating its options with respect to the provision of interconnection.

On June 15, 1994, a Seattle Federal District Court Judge ruled in favor of U S WEST's challenge to the constitutionality of the cable cross-ownership restriction in the 1994 Cable Act. The Act prevents telephone companies from providing cable TV service within their regions. U S WEST argued and the court agreed that the cable cross- ownership restriction violates its First Amendment right to free speech. U S WEST is evaluating its options in light of this ruling.

On June 20, 1994, the seven regional Bell Operating Companies (RBOCs) asked for a waiver from the divestiture court to the 1982 consent decree that broke up AT&T and created the RBOCs, which would allow them to provide wireless long-distance services. The consent decree restricts the RBOCs from providing long distance services as well as manufacturing. The request closely follows a recommendation by the Justice Department that the RBOCs be allowed to provide wireless long-distance services.

On June 30, 1994, the House of Representatives passed two landmark bills that together would substantially rewrite the 1934 Communications Act and replace the 1982 consent decree that broke up the "Bell System." The Senate is expected to consider pending telecommunications legislation, but it is not clear whether it will act on a bill before the current session of Congress ends.

Contingencies

There are pending regulatory actions in local regulatory jurisdictions which call for price decreases, refunds or both. In one such instance, the Utah Supreme Court has remanded a Utah Public Service ("PSC") order to the PSC for reconsideration, thereby establishing two exceptions to the rule against retroactive ratemaking: 1) unforeseen and extraordinary events and 2) misconduct. The Commission's initial order denied a refund request from interexchange carriers and other parties related to the Tax Reform Act of 1986. If the Commission finds that either of the exceptions apply, the Company could be liable for refunds, although at this time any such amount is not reasonably estimable since the case is still in the discovery process.

PART II - OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibits identified in parentheses below, on file with the Securities and Exchange Commission, are incorporated by reference as exhibits hereto.

Exhibit
Number

(12) Statement regarding computation of earnings to fixed charges ratio of U S WEST Communications, Inc.

(b) Reports on Form 8-K

No reports on Form 8-K were filed during the second quarter of 1994.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

U S WEST Communications, Inc.

August 12, 1994

/s/ David R. Laube

*David R. Laube
Vice President-Controller
and Treasurer*

EXHIBIT 12

U S WEST COMMUNICATIONS, Inc.
RATIO OF EARNINGS TO FIXED CHARGES
(Dollars in Millions)

	Quarter Ended	
	6/30/94	6/30/93
Income before income taxes and extraordinary item	\$472	\$364
Interest expense (net of amounts capitalized)	81	100
Interest factor on rentals (1/3)	18	16
Earnings	\$571	\$480
Interest expense	88	100
Interest factor on rentals (1/3)	18	16
Fixed charges	\$106	\$116
Ratio of earnings to fixed charges	5.39	4.14

	Year-to-Date	
	6/30/94	6/30/93
Income before income taxes and extraordinary item	\$947	\$764
Interest expense (net of amounts capitalized)	161	199
Interest factor on rentals (1/3)	36	33
Earnings	\$1,144	\$996
Interest expense	174	199
Interest factor on rentals (1/3)	36	33
Fixed charges	\$210	\$232
Ratio of earnings to fixed charges	5.45	4.29

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