

Hawaiian Telcom Holdco, Inc.
Form 10-Q
May 07, 2014
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended March 31, 2014

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: 001-34686

Hawaiian Telcom Holdco, Inc.

Edgar Filing: Hawaiian Telcom Holdco, Inc. - Form 10-Q

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

16-1710376
(I.R.S. Employer Identification No.)

1177 Bishop Street

Honolulu, Hawaii 96813

(Address of principal executive offices)

808-546-4511

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer
(Do not check if smaller
reporting company)

Smaller reporting company

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

Edgar Filing: Hawaiian Telcom Holdco, Inc. - Form 10-Q

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes No

As of May 7, 2014, 10,586,041 shares of the registrant's common stock were outstanding.

Table of Contents

Table of Contents

	Page
<u>Part I</u>	
<u>Financial Information</u>	
<u>Item 1</u>	3
<u>Condensed Consolidated Financial Statements (Unaudited)</u>	
<u>Item 2</u>	19
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	
<u>Item 3</u>	27
<u>Quantitative and Qualitative Disclosures About Market Risk</u>	
<u>Item 4</u>	28
<u>Controls and Procedures</u>	
<u>Part II</u>	
<u>Other Information</u>	
<u>Item 1</u>	29
<u>Legal Proceedings</u>	
<u>Item 1A</u>	29
<u>Risk Factors</u>	
<u>Item 5</u>	30
<u>Other Information</u>	
<u>Item 6</u>	31
<u>Exhibits</u>	

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****Hawaiian Telcom Holdco, Inc.****Condensed Consolidated Statements of Income****(Unaudited, dollars in thousands, except per share amounts)**

	Three Months Ended March 31,	
	2014	2013
Operating revenues	\$ 97,072	\$ 95,965
Operating expenses:		
Cost of revenues (exclusive of depreciation and amortization)	40,948	40,284
Selling, general and administrative	29,266	28,379
Depreciation and amortization	18,720	18,717
Total operating expenses	88,934	87,380
Operating income	8,138	8,585
Other income (expense):		
Interest expense	(4,188)	(5,540)
Interest income and other	10	15
Total other expense	(4,178)	(5,525)
Income before income tax provision	3,960	3,060
Income tax provision	1,592	1,212
Net income	\$ 2,368	\$ 1,848
Net income per common share -		
Basic	\$ 0.22	\$ 0.18
Diluted	\$ 0.21	\$ 0.17
Weighted average shares used to compute net income per common share -		
Basic	10,528,039	10,291,897
Diluted	11,271,827	10,890,917

See accompanying notes to condensed consolidated financial statements.

Table of Contents

Hawaiian Telcom Holdco, Inc.

Condensed Consolidated Statements of Comprehensive Income

(Unaudited, dollars in thousands)

	Three Months Ended	
	March 31,	
	2014	2013
Net income	\$ 2,368	\$ 1,848
Other comprehensive income (loss)-		
Unrealized holding losses arising during period	(3)	(19)
Retirement plan gain (loss)	(289)	222
Income tax credit (charge) on comprehensive income	117	(88)
Other comprehensive income (loss), net of tax	(175)	115
Comprehensive income	\$ 2,193	\$ 1,963

See accompanying notes to condensed consolidated financial statements.

Table of Contents**Hawaiian Telcom Holdco, Inc.****Condensed Consolidated Balance Sheets****(Unaudited, dollars in thousands, except per share amounts)**

	March 31, 2014	December 31, 2013
Assets		
Current assets		
Cash and cash equivalents	\$ 36,738	\$ 49,551
Receivables, net	33,050	34,521
Material and supplies	11,737	15,939
Prepaid expenses	3,445	3,724
Deferred income taxes	8,146	8,146
Other current assets	2,321	2,851
Total current assets	95,437	114,732
Property, plant and equipment, net	533,528	524,375
Intangible assets, net	39,500	40,225
Goodwill	12,104	12,104
Deferred income taxes	73,705	75,274
Other assets	10,841	11,305
Total assets	\$ 765,115	\$ 778,015
Liabilities and Stockholders' Equity		
Current liabilities		
Current portion of long-term debt	\$ 3,000	\$ 3,000
Accounts payable	34,533	40,228
Accrued expenses	13,594	18,787
Advance billings and customer deposits	15,912	16,122
Other current liabilities	6,500	6,412
Total current liabilities	73,539	84,549
Long-term debt	291,111	291,679
Employee benefit obligations	77,136	80,321
Other liabilities	8,055	8,454
Total liabilities	449,841	465,003
Commitments and contingencies (Note 12)		
Stockholders' equity		
Common stock, par value of \$0.01 per share, 245,000,000 shares authorized and 10,584,191 and 10,495,856 shares issued and outstanding at March 31, 2014 and December 31, 2013, respectively	106	105
Additional paid-in capital	167,937	167,869
Accumulated other comprehensive loss	(4,891)	(4,716)
Retained earnings	152,122	149,754
Total stockholders' equity	315,274	313,012
Total liabilities and stockholders' equity	\$ 765,115	\$ 778,015

Edgar Filing: Hawaiian Telcom Holdco, Inc. - Form 10-Q

See accompanying notes to condensed consolidated financial statements.

Table of Contents**Hawaiian Telcom Holdco, Inc.****Condensed Consolidated Statements of Cash Flows****(Unaudited, dollars in thousands)**

	Three Months Ended	
	March 31,	
	2014	2013
Cash flows from operating activities:		
Net income	\$ 2,368	\$ 1,848
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	18,720	18,717
Employee retirement benefits	(3,475)	(2,722)
Provision for uncollectibles	513	553
Stock based compensation	1,074	423
Deferred income taxes	1,685	1,297
Changes in operating assets and liabilities:		
Receivables	957	(825)
Material and supplies	459	(796)
Prepaid expenses and other current assets	810	605
Accounts payable and accrued expenses	(10,010)	(4,987)
Advance billings and customer deposits	(210)	448
Other current liabilities	89	2
Other	390	303
Net cash provided by operating activities	13,370	14,866
Cash flows from investing activities:		
Capital expenditures	(23,939)	(23,254)
Net cash used in investing activities	(23,939)	(23,254)
Cash flows from financing activities:		
Repayment of capital lease and installment liability	(489)	(163)
Repayment of debt including premium	(750)	(2,138)
Taxes paid related to net share settlement of equity awards	(1,005)	(362)
Net cash used in financing activities	(2,244)	(2,663)
Net change in cash and cash equivalents	(12,813)	(11,051)
Cash and cash equivalents, beginning of period	49,551	66,993
Cash and cash equivalents, end of period	\$ 36,738	\$ 55,942
Supplemental disclosure of cash flow information:		
Interest paid, net of amounts capitalized	\$ 3,824	\$ 5,236

See accompanying notes to condensed consolidated financial statements.

Table of Contents**Hawaiian Telcom Holdco, Inc.****Condensed Consolidated Statement of Changes in Stockholders Equity****(Unaudited, dollars in thousands)**

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders Equity
Balance, January 1, 2014	10,495,856	\$ 105	\$ 167,869	\$ (4,716)	\$ 149,754	\$ 313,012
Stock based compensation			1,074			1,074
Exercise of warrant agreement	13,511					
Common stock issued for stock compensation plans, net of shares withheld and withholding paid for employee taxes	74,824	1	(1,006)			(1,005)
Net income					2,368	2,368
Other comprehensive loss, net of tax				(175)		(175)
Balance, March 31, 2014	10,584,191	\$ 106	\$ 167,937	\$ (4,891)	\$ 152,122	\$ 315,274
Balance, January 1, 2013	10,291,897	\$ 103	\$ 165,941	\$ (28,450)	\$ 139,266	\$ 276,860
Stock based compensation			423			423
Common stock issued for stock compensation plans, net of shares withheld and withholding paid for employee taxes			(362)			(362)
Net income					1,848	1,848
Other comprehensive income, net of tax				115		115
Balance, March 31, 2013	10,291,897	\$ 103	\$ 166,002	\$ (28,335)	\$ 141,114	\$ 278,884

See accompanying notes to condensed consolidated financial statements.

Table of Contents

Hawaiian Telcom Holdco, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Description of Business

Business Description

Hawaiian Telcom Holdco, Inc. and subsidiaries (the Company) is the incumbent local exchange carrier for the State of Hawaii with an integrated telecommunications network. The Company offers a variety of telecommunication services to residential and business customers in Hawaii including local telephone, network access and data transport, long distance, Internet, television and wireless phone service. The Company also provides communications equipment sales and maintenance, data center colocation and network managed services.

Organization

The Company has one direct wholly-owned subsidiary, Hawaiian Telcom Communications, Inc. which has two direct wholly-owned subsidiaries Hawaiian Telcom, Inc. and Hawaiian Telcom Services Company, Inc. Hawaiian Telcom, Inc. operates the regulated local exchange carrier and Hawaiian Telcom Services Company, Inc. operates all other businesses.

2. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America and pursuant to rules and regulations of the U.S. Securities and Exchange Commission. Certain information and disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted and condensed. In the opinion of the Company's management, all adjustments (consisting of only normal and recurring accruals) have been made to present fairly the results of operations, comprehensive income (loss), financial position and cash flows for the periods presented. The results of operations for the periods presented are not necessarily indicative of the results to be expected for the full year. Although the Company believes that the disclosures are adequate to make the information presented not misleading, these financial statements should be read in conjunction with the Company's audited consolidated financial statements as of and for the year ended December 31, 2013.

Cash and Cash Equivalents

Edgar Filing: Hawaiian Telcom Holdco, Inc. - Form 10-Q

Cash and cash equivalents include cash and money market accounts with maturities at acquisition of three months or less. The majority of cash balances at March 31, 2014 are held in one bank in demand deposit accounts.

Supplemental Non-Cash Investing and Financing Activities

Accounts payable included \$13.3 million and \$3.0 million at March 31, 2014 and 2013, respectively, for additions to property, plant and equipment.

Taxes Collected from Customers

The Company presents taxes collected from customers and remitted to governmental authorities on a gross basis, including such amounts in the Company's reported operating revenues. Such amounts represent primarily Hawaii state general excise taxes and Hawaii Public Utility Commission fees. Such taxes and fees amounted to \$1.8 million for both the three months ended March 31, 2014 and 2013.

Table of Contents***Earnings per Share***

Basic earnings per share is based on the weighted effect of all common shares issued and outstanding, and is calculated by dividing earnings by the weighted average shares outstanding during the period. Diluted earnings per share is calculated by dividing earnings, adjusted for the effect, if any, from assumed conversion of all potentially dilutive common shares outstanding, by the weighted average number of common shares used in the basic earnings per share calculation plus the number of common shares that would be issued assuming conversion of all potentially dilutive common shares outstanding. The denominator used to compute basic and diluted earnings per share was as follows:

	Three Months Ended	
	March 31,	
	2014	2013
Basic earnings per share - weighted average shares	10,528,039	10,291,897
Effect of dilutive securities:		
Employee and director restricted stock units	124,012	139,264
Warrants	619,776	459,756
Diluted earnings per share - weighted average shares	11,271,827	10,890,917

The computation of weighted average dilutive shares outstanding excluded restricted stock units to acquire 86,608 shares of common stock for the three month period ended March 31, 2014. The unrecognized compensation on a per unit basis for these restricted stock units was greater than the average market price of the Company's common stock for the period presented. Therefore, the effect would be anti-dilutive. For the three month period ended March 31, 2013 the restricted stock units excluded were not significant.

3. SystemMetrics Corporation Acquisition

On September 30, 2013, the Company completed its acquisition of all of the voting stock of SystemMetrics Corporation (SystemMetrics) for \$16.3 million in cash, net of cash acquired and purchase price adjustments. Of the total purchase price, \$11.9 million was paid at closing with the balance subject to an earn-out over a three year period. Payment of the earn-out is contingent on SystemMetrics meeting certain performance metrics and continued employment of the SystemMetrics key executive. For financial reporting purposes, the earn-out will be accounted for as compensation expense as earned.

SystemMetrics provides virtual and physical data center colocation services in the State of Hawaii along with other telecommunication services that are complementary to the Company's operations.

The Company followed the acquisition method of accounting and allocated the purchase price to the tangible and intangible assets acquired and liabilities assumed based on their provisional fair values, and the estimates and assumptions are subject to change within the measurement period, which shall not be more than one year from the acquisition date. The measurement period remains open as of March 31, 2014 as the Company continues to evaluate additional information obtained related to the amount recognized for certain assets and estimated liabilities.

Edgar Filing: Hawaiian Telcom Holdco, Inc. - Form 10-Q

For the three months ended March 31, 2014, SystemMetrics revenue amounted to \$2.4 million and net income was less than \$0.1 million.

Table of Contents**4. Receivables**

Receivables consisted of the following (dollars in thousands):

	March 31, 2014		December 31, 2013
Customers and other	\$ 36,893	\$	38,463
Allowance for doubtful accounts	(3,843)		(3,942)
	\$ 33,050	\$	34,521

5. Long-Lived Assets

Property, plant and equipment consisted of the following (dollars in thousands):

	March 31, 2014		December 31, 2013
Property, plant and equipment	\$ 756,210	\$	729,364
Less accumulated depreciation	(222,682)		(204,989)
	\$ 533,528	\$	524,375

Depreciation expense amounted to \$18.0 million for both the three months ended March 31, 2014 and 2013.

In February 2013, the Company entered into an agreement to sell a parcel of land and warehouse not actively used in the Company's operations for a purchase price, as amended, of \$13.9 million. The sale was subject to due diligence by the buyer and approval of the Hawaii Public Utilities Commission (HPUC). The HPUC approval was received in May 2013 and the sale was consummated in June 2013.

The gross carrying amount and accumulated amortization of identifiable intangible assets are as follows (dollars in thousands):

	March 31, 2014			December 31, 2013		
Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	
Subject to amortization						

Edgar Filing: Hawaiian Telcom Holdco, Inc. - Form 10-Q

Customer relationships	\$	21,709	\$	9,688	\$	12,021	\$	21,709	\$	8,983	\$	12,726
Trade name and other		320		141		179		320		121		199
		22,029		9,829		12,200		22,029		9,104		12,925
Not subject to amortization												
Brand name		27,300				27,300		27,300				27,300
		27,300				27,300		27,300				27,300
	\$	49,329	\$	9,829	\$	39,500	\$	49,329	\$	9,104	\$	40,225

Table of Contents

Amortization expense amounted to \$0.7 million for both the three months ended March 31, 2014 and 2013. Estimated amortization expense for the next five years and thereafter is as follows (dollars in thousands):

2014 (remaining months)	\$	2,171
2015		2,498
2016		2,101
2017		1,703
2018		1,308
Thereafter		2,419
	\$	12,200

In conjunction with the acquisition of Wavecom Solutions Corporation, the Company adjusted the carrying value of goodwill in the first quarter of 2013. The revised goodwill amounted to \$1.6 million and is included in the telecommunications segment.

6. Accrued Expenses

Accrued expenses consisted of the following (dollars in thousands):

	March 31, 2014	December 31, 2013
Salaries and benefits	\$ 10,088	\$ 15,160
Interest	2,487	2,576
Other taxes	1,019	1,051
	\$ 13,594	\$ 18,787

7. Long-Term Debt

Long-term debt consists of the following (dollars in thousands):

	Interest Rate at March 31, 2014	Final Maturity	March 31, 2014	December 31, 2013
Term loan	5.00%	June 6, 2019	\$ 298,388	\$ 299,138
Original issue discount			(4,277)	(4,459)
			294,111	294,679
Current			3,000	3,000

Edgar Filing: Hawaiian Telcom Holdco, Inc. - Form 10-Q

Noncurrent	\$	291,111	\$	291,679
------------	----	---------	----	---------

The term loan outstanding at March 31, 2014 provides for interest at the Alternate Base Rate, a rate which is indexed to the prime rate with certain adjustments as defined, plus a margin of 3.00% or a Eurocurrency rate on deposits of one, two, three or six months but no less than 1.00% per annum plus a margin of 4.00%. The Company has selected the Eurocurrency rate as of March 31, 2014 resulting in an interest rate currently at 5.00%.

Table of Contents

The term loan provides for interest payments no less than quarterly. In addition, quarterly principal payments of \$0.8 million are required. The balance of the loan is due at maturity on June 6, 2019. The Company must prepay, generally within three months after year end, 50% or 25% of excess cash flow, as defined. The percent of excess cash flow required is dependent on the Company's leverage ratio. No excess cash flow payment was due for the year ended December 31, 2013. The Company must also make prepayments on loans in the case of certain events such as large asset sales.

The Company also has a revolving credit facility which matures on October 3, 2015. The facility has an available balance of \$30.0 million with no amounts drawn as of or for the periods ended March 31, 2014 and 2013. A commitment fee is payable quarterly to the lender under the facility. Interest on amounts outstanding is based on, at the Company's option, the bank prime rate plus a margin of 3.0% to 6.0% or the Eurocurrency rate for one, two, three or six month periods plus a margin of 4.0% to 5.5%. The margin is dependent on the Company's leverage, as defined in the agreement, at the time of the borrowing.

Maturities

The annual requirements for principal payments on long-term debt as of March 31, 2014 are as follows (dollars in thousands):

Year ended December 31,		
2014 (remainder of year)	\$	2,250
2015		3,000
2016		3,000
2017		3,000
2018		3,000
Thereafter		284,138
	\$	298,388

8. Employee Benefit Plans

The Company sponsors a defined benefit pension plan, with benefits frozen as of March 1, 2012, and postretirement health and life insurance benefits for union employees. The Company also sponsors a cash balance pension plan for nonunion employees, with benefits frozen as of April 1, 2007, and certain manageme