Hawaiian Telcom Holdco, Inc.
Form 10-Q
November 08, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended September 30, 2012

OR

o 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.

(Exact name of registrant as specified in its charter)

Delaware	**16-1710376**
(State or other jurisdiction of incorporation or organization)	(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 x No o

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 x No o

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

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

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 x No o

As of November 8, 2012, 10,290,130 shares of the registrant s common stock were outstanding.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Hawaiian Telcom Holdco, Inc.

Condensed Consolidated Statements of Operations

(Unaudited, dollars in thousands, except per share amounts)

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Operating revenues	$ 96,647	$ 97,040	$ 288,910	$ 296,290
Operating expenses:				
Cost of revenues (exclusive of depreciation and amortization)	41,176	39,055	121,407	121,585
Selling, general and administrative	26,547	28,066	82,567	88,584
Depreciation and amortization	18,023	17,086	51,965	47,603
Total operating expenses	85,746	84,207	255,939	257,772
Operating income	10,901	12,833	32,971	38,518
Other income (expense):				
Interest expense	(5,490)	(6,364)	(16,890)	(18,858)
Loss on early extinguishment of debt			(5,112)	
Interest income and other	10	21	28	51
Total other expense	(5,480)	(6,343)	(21,974)	(18,807)
Income before reorganization items and income tax benefit	5,421	6,490	10,997	19,711
Reorganization items		(70)		880
Income before income tax benefit	5,421	6,560	10,997	18,831
Income tax benefit	(194)	(813)	(346)	(813)
Net income	$ 5,615	$ 7,373	$ 11,343	$ 19,644
Net income per common share -				
Basic	$ 0.55	$ 0.73	$ 1.11	$ 1.94
Diluted	$ 0.52	$ 0.68	$ 1.06	$ 1.80

Weighted average shares used to compute net income per common share -				
Basic	10,246,335	10,138,795	10,230,719	10,138,358
Diluted	10,708,454	10,775,318	10,658,517	10,921,717

See accompanying notes to condensed consolidated financial statements.

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Hawaiian Telcom Holdco, Inc.

Condensed Consolidated Statements of Comprehensive Income

(Unaudited, dollars in thousands)

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Net income	$ 5,615	$ 7,373	$ 11,343	$ 19,644
Other comprehensive income (loss), net of tax -				
Unrealized holding gains (losses) arising during period	(1)	7	(2)	(7)
Retirement plan	260		33,648	
Other comprehensive income (loss), net of tax	259	7	33,646	(7)
Comprehensive income	$ 5,874	$ 7,380	$ 44,989	$ 19,637

See accompanying notes to condensed consolidated financial statements.

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Hawaiian Telcom Holdco, Inc.

Condensed Consolidated Balance Sheets

(Unaudited, dollars in thousands, except per share amounts)

	September 30, 2012	December 31, 2011
Assets		
Current assets		
Cash and cash equivalents	$ 65,409	$ 82,063
Receivables, net	36,738	37,712
Material and supplies	10,343	8,190
Prepaid expenses	5,331	4,107
Other current assets	3,503	2,127
Total current assets	121,324	134,199
Property, plant and equipment, net	491,863	482,371
Intangible assets, net	38,698	40,745
Other assets	9,379	4,457
Total assets	$ 661,264	$ 661,772
Liabilities and Stockholders Equity		
Current liabilities		
Current portion of long-term debt	$ 3,000	$ 2,600
Accounts payable	30,340	24,785
Accrued expenses	18,414	23,811
Advance billings and customer deposits	15,652	14,672
Other current liabilities	3,945	3,649
Total current liabilities	71,351	69,517
Long-term debt	292,959	297,400
Employee benefit obligations	110,779	155,428
Other liabilities	3,700	3,231
Total liabilities	478,789	525,576
Commitments and contingencies (Note 12)		
Stockholders equity		
Common stock, par value of $0.01 per share, 245,000,000 shares authorized and 10,246,635 and 10,190,526 shares issued and outstanding at September 30, 2012 and December 31, 2011, respectively	102	102
Additional paid-in capital	165,618	164,328
Accumulated other comprehensive loss	(23,872)	(57,518)
Retained earnings	40,627	29,284
Total stockholders equity	182,475	136,196
Total liabilities and stockholders equity	$ 661,264	$ 661,772

See accompanying notes to condensed consolidated financial statements.

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Hawaiian Telcom Holdco, Inc.

Condensed Consolidated Statements of Cash Flows

(Unaudited, dollars in thousands)

	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Cash flows from operating activities:		
Net income	$ 11,343	$ 19,644
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	51,965	47,603
Loss on early extinguishment of debt	5,112	
Employee retirement benefits	(11,001)	(7,846)
Provision for uncollectibles	2,526	1,507
Reorganization items		880
Stock based compensation	1,343	1,489
Changes in operating assets and liabilities:		
Receivables	(1,552)	1,884
Material and supplies	(2,153)	(103)
Prepaid expenses and other current assets	(2,600)	3,491
Accounts payable and accrued expenses	1,768	(8,960)
Advance billings and customer deposits	980	(858)
Other current liabilities	296	974
Other	1,021	(1,059)
Net cash provided by operating activities before reorganization items	59,048	58,646
Operating cash flows used by reorganization items		(2,222)
Net cash provided by operating activities	59,048	56,424
Cash flows from investing activities:		
Capital expenditures	(61,019)	(55,156)
Net cash used in investing activities	(61,019)	(55,156)
Cash flows from financing activities:		
Repayment of debt including premium	(306,000)	
Proceeds from borrowing	295,500	
Loan refinancing costs	(4,130)	
Taxes paid related to net share settlement of equity awards	(53)	
Proceeds from sale of common stock		50
Repayments of capital lease		(582)
Net cash used in financing activities	(14,683)	(532)
Net change in cash and cash equivalents	(16,654)	736
Cash and cash equivalents, beginning of period	82,063	81,647
Cash and cash equivalents, end of period	$ 65,409	$ 82,383
Supplemental disclosure of cash flow information:		
Interest paid, net of amounts capitalized	$ 17,054	$ 18,858
Non-cash investing activities - receipt of equipment for settlement of receivable for capital lease		2,250

See accompanying notes to condensed consolidated financial statements.

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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, 2012	10,190,526	$ 102	$ 164,328	$ (57,518)	$ 29,284	$ 136,196
Stock based compensation			1,343			1,343
Common stock issued for stock compensation plans, net of shares withheld and withholding paid for employee taxes	56,109		(53)			(53)
Net income					11,343	11,343
Other comprehensive income (loss), net of tax				33,646		33,646
Balance, September 30, 2012	10,246,635	$ 102	$ 165,618	$ (23,872)	$ 40,627	$ 182,475
Balance, January 1, 2011	10,135,063	$ 101	$ 162,169	$ 13,393	$ 3,129	$ 178,792
Stock based compensation			1,489			1,489
Sale of common stock under warrant agreement	4,021		50			50
Net income					19,644	19,644
Other comprehensive income (loss), net of tax				(7)		(7)
Balance, September 30, 2011	10,139,084	$ 101	$ 163,708	$ 13,386	$ 22,773	$ 199,968

See accompanying notes to condensed consolidated financial statements.

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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, 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. 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 financial position, the results of operations 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, 2011.

Cash and Cash Equivalents

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 September 30, 2012 are held in one bank in demand deposit accounts.

Supplemental Non-Cash Investing and Financing Activities

Accounts payable included $2.4 million and $0.7 million at September 30, 2012 and 2011, 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 $1.6 million and $5.3 million for the three and nine months ended September 30, 2012 and $1.6 million and $5.0 million for the three and nine months ended September 30, 2011, respectively.

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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 September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Basic earnings per share - weighted average shares	10,246,335	10,138,795	10,230,719	10,138,358
Effect of dilutive securities:				
Employee and director restricted stock units	124,301	133,122	124,871	145,556
Warrants	337,818	503,401	302,927	637,803
Diluted earnings per share - weighted average shares	10,708,454	10,775,318	10,658,517	10,921,717

The computation of weighted average dilutive shares outstanding excluded restricted stock units to acquire 18,610 shares and 18,612 shares of common stock for the three month and nine month periods ended September 30, 2012, respectively. 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.

3. Reorganization Items

Reorganization items represent expense or income amounts that were recognized as a direct result of the Company s Chapter 11 filing and are presented separately in the condensed consolidated statements of operations. Such items consist of professional fees related to legal, financial advisory and other professional costs directly associated with the reorganization process and amounted to a reimbursement of $0.1 million and an expense of $0.9 million for the three and nine months ended September 30, 2011, respectively. The Company emerged from Chapter 11 in October 2010 but continued to incur reorganization related expenses until December 2011 as the Chapter 11 cases were not closed until January 2012.

Net cash paid for reorganization items, consisting of professional and other fees, amounted to $2.2 million for the nine months ended September 30, 2011.

4. Receivables

Receivables consisted of the following (dollars in thousands):

	September 30, 2012	December 31, 2011
Customers and other	$ 41,898	$ 40,636
Allowance for doubtful accounts	(5,160)	(2,924)
	$ 36,738	$ 37,712

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5. Long-Lived Assets

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

	September 30, 2012	December 31, 2011
Property, plant and equipment	$ 606,710	$ 548,838
Less accumulated depreciation and amortization	(114,847)	(66,467)
	$ 491,863	$ 482,371

Depreciation expense amounted to $17.3 million and $49.9 million for the three and nine months ended September 30, 2012, respectively. Depreciation expense amounted to $16.3 million and $45.8 million for the three and nine months ended September 30, 2011, respectively.

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

	September 30, 2012			December 31, 2011		
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Subject to amortization customer relationships	$ 17,000	$ 5,602	$ 11,398	$ 17,000	$ 3,555	$ 13,445
Not subject to amortization brand name	27,300		27,300	27,300		27,300
	$ 44,300	$ 5,602	$ 38,698	$ 44,300	$ 3,555	$ 40,745

Amortization expense amounted to $0.7 million and $2.1 million for the three and nine months ended September 30, 2012, respectively. Amortization expense amounted to $0.8 million and $1.8 million for the three and nine months ended September 30, 2011, respectively. Estimated amortization expense for the next five years and thereafter is as follows (dollars in thousands):

2012 (remaining months)	$ 683
2013	2,421
2014	2,112
2015	1,803
2016	1,494
Thereafter	2,885
	$ 11,398

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6. Accrued Expenses

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

	September 30, 2012	December 31, 2011
Salaries and benefits	$ 13,864	$ 17,519
Interest	3,675	4,875
Other taxes	875	1,417
	$ 18,414	$ 23,811

7. Long-Term Debt

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

	Interest Rate at September 30, 2012	Final Maturity	September 30, 2012	December 31, 2011
Term loan	7.00%	February 28, 2017	$ 300,000	$
Term loan repaid	NA	NA		300,000
Original issue discount			(4,041)	
			295,959	300,000
Current			3,000	2,600
Noncurrent			$ 292,959	$ 297,400

The term loan outstanding at September 30, 2012 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 4.75% or a Eurocurrency rate on deposits of one, two, three or six months but no less than 1.25% per annum plus a margin of 5.75%. The Company has selected the Eurocurrency rate as of September 30, 2012 resulting in a nominal interest rate currently at 7.00%.

The term loan provides for interest payments no less than quarterly. In addition, quarterly principal payments are required beginning December 2012 of $0.8 million with the balance of the loan due at maturity on February 28, 2017. 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. The Company must also make prepayments on loans in the case of certain events such as large asset sales.

In connection with the February 2012 refinancing of the term loan debt, the Company paid a premium on the repayment of the old term loan of $6.0 million. In addition, the Company paid $4.1 million in underwriting fees and legal costs. The premium on repayment of debt, and underwriting fees and legal costs were accounted for in accordance with accounting standards for modification of debt instruments with different terms. The Company compared each syndicated lenders loan under the old term loan with the syndicated lenders loan under the new term loans. For loans under the new term loan that were substantially different, the Company recognized the exchange of debt instruments as a debt extinguishment. For loans under the new term loan that were not substantially different, the Company accounted for the exchange of debt instruments as a modification. As a result of the refinancing, the Company capitalized $5.0 million of the premium on the repayment of debt and refinancing fees and expensed the remainder resulting in a loss on early extinguishment of debt of $5.1 million.

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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 ending September 30, 2012 and 2011. 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.

The obligations under the bank facilities are guaranteed by the Company and each subsidiary with certain exceptions. In addition, the bank credit facilities are collateralized by substantially all of the Company s assets.

The bank credit facilities contain various negative and affirmative covenants that restrict, among other things, incurrence of additional indebtedness, payment of dividends, redemptions of stock, other distributions to shareholders and sales of assets. In addition, there are financial covenants consisting of an interest coverage ratio, leverage ratio and a maximum level of capital expenditures.

Maturities

The annual requirements for principal payments on long-term debt as of September 30, 2012 are as follows (dollars in thousands):

Year ended December 31,		
2012 (remainder of year)	$	750
2013		3,000
2014		3,000
2015		3,000
2016		3,000
2017		287,250
	$	300,000

8. Employee Benefit Plans

The Company sponsors a defined benefit pension plan and postretirement medical and life insurance benefits for union employees. The Company also sponsors a cash balance pension plan for nonunion employees.

As further discussed in Note 12, the Company implemented new terms of employment for union employees effective January 1, 2012. The terms of employment include a provision for a freeze of pension benefits related to service and wage increases effective March 1, 2012. In January 2012, the union filed an unfair labor practices charge with the National Labor Relations Board (NLRB) regarding the implementation of the terms of employment. In May 2012, the NLRB dismissed the complaint. The union appealed the dismissal of the complaint to the NLRB General Counsel. The appeal was denied in August 2012.

The Company amended its union pension plan on January 24, 2012 for the freeze of benefits effective March 1, 2012. This resulted in a reduction of the projected benefit obligation by $30.2 million which is the difference between the accumulated benefit obligation and projected benefit obligation at that date. The liability as of January 24, 2012 was measured using a discount rate of 4.54%. The union pension trust assets were also measured as of this date. The reduction in the net recorded liability of $33.4 million was used to offset actuarial losses previously recognized in the accumulated other comprehensive loss. In addition, the periodic benefit cost was reduced to reflect that there is no future service cost for the union pension plan beginning March 1, 2012.

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The Company accrues the costs of pension and postretirement benefits over the period from the date of hire until the date the employee becomes fully eligible for benefits. The following provides the components of benefit costs for the three and nine months ended September 30, 2012 and 2011 (dollars in thousands):

Pension

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Service cost	$ (50)	$ 1,821	$ 1,488	$ 5,463
Interest cost	2,557	2,708	7,493	8,124
Expected asset return	(2,890)	(2,943)	(8,601)	(8,829)
Amortization of loss	131		373	
Net periodic benefit cost	$ (252)	$ 1,586	$ 753	$ 4,758

Other Postretirement Benefits

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Service cost	$ 221	$ 229	$ 724	$ 687
Interest cost	576	514	1,772	1,542
Amortization of (gain) loss	7	(99)	88	(297)
Net periodic benefit cost	$ 804	$ 644	$ 2,584	$ 1,932

The Company previously disclosed in its consolidated financial statements for the year ended December 31, 2011 that it expected to contribute $16.1 million to its pension plan in 2012. As of September 30, 2012, the Company has contributed $13.0 million. The Company presently anticipates contributing $1.1 million during the remainder of 2012. Certain changes in federal law have reduced the level of required contributions.

9. Income Taxes

The income tax provision differs from the amounts determined by applying the statutory federal income tax rate of 34% to the income before income tax provision for the following reasons (dollars in thousands):

	Three Months Ended	Nine Months Ended

	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Income tax provision at statutory rate	$ 1,843	$ 2,230	$ 3,739	$ 6,403
Increase (decrease) resulting from:				
Permanent difference		(8,351)		(8,351)
State income taxes, net of federal income tax	137	262	208	753
Valuation allowance	(2,174)	5,046	(4,293)	382