

SHENANDOAH TELECOMMUNICATIONS CO/VA/  
Form 10-Q  
November 07, 2006

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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 September 30, 2006
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File No.: 000-09881

SHENANDOAH TELECOMMUNICATIONS COMPANY  
(Exact name of registrant as specified in its charter)

VIRGINIA  
(State or other jurisdiction of  
incorporation or organization)

54-1162807  
(I.R.S. Employer Identification No.)

500 Shentel Way, Edinburg, Virginia  
(Address of principal executive offices)  
(540) 984-4141

22824  
(Zip Code)

(Registrant's telephone number, including area code)

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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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

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

The number of shares of the registrant's common stock outstanding on October 31, 2006 was 7,740,810.

SHENANDOAH TELECOMMUNICATIONS COMPANY  
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**SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES**  
**UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**  
*(in thousands)*

| ASSETS  | September 30,<br>2006 | December 31,<br>2005 |
|---|-----------------------|----------------------|
| <b>Current Assets</b>                               |                       |                      |
| Cash and cash equivalents                           | \$ 15,073             | \$ 2,572             |
| Accounts receivable, net                            | 11,522                | 11,864               |
| Income taxes receivable                             |                       | 795                  |
| Materials and supplies                              | 2,772                 | 2,702                |
| Prepaid expenses and other                          | 1,966                 | 2,336                |
| Deferred income taxes                               | 482                   | 532                  |
| <b>Total current assets</b>                         | <b>31,815</b>         | <b>20,801</b>        |
| <b>Investments</b>                                  | <b>6,950</b>          | <b>7,365</b>         |
| <b>Property, Plant and Equipment</b>                |                       |                      |
| Plant in service                                    | 263,472               | 248,321              |
| Plant under construction                            | 6,939                 | 9,061                |
|   | 270,411               | 257,382              |
| Less accumulated amortization and depreciation      | 112,873               | 95,144               |
| <b>Net property, plant and equipment</b>            | <b>157,538</b>        | <b>162,238</b>       |
| <b>Other Assets</b>                                 |                       |                      |
| Intangible assets, net                              | 2,983                 | 3,346                |
| Cost in excess of net assets of businesses acquired | 10,103                | 10,103               |
| Deferred charges and other assets, net              | 1,307                 | 1,068                |
| <b>Net other assets</b>                             | <b>14,393</b>         | <b>14,517</b>        |
| <b>Total assets</b>                                 | <b>\$ 210,696</b>     | <b>\$ 204,921</b>    |

See accompanying notes to unaudited condensed consolidated financial statements.

(Continued)

**SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES**  
**UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**  
*(in thousands)*

| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>       | <b>September 30,<br/>2006</b> | <b>December 31,<br/>2005</b> |
|--|-------------------------------|------------------------------|
| <b>Current Liabilities</b>                       |                               |                              |
| Current maturities of long-term debt             | \$ 4,075                      | \$ 4,526                     |
| Accounts payable                                 | 5,991                         | 6,928                        |
| Advanced billings and customer deposits          | 4,818                         | 4,247                        |
| Accrued compensation                             | 1,731                         | 3,294                        |
| Income taxes payable                             | 316                           |                              |
| Accrued liabilities and other                    | 3,084                         | 3,746                        |
| <b>Total current liabilities</b>                 | <b>20,015</b>                 | <b>22,741</b>                |
| <b>Long-term debt, less current maturities</b>   | <b>22,947</b>                 | <b>31,392</b>                |
| <b>Other Long-Term Liabilities</b>               |                               |                              |
| Deferred income taxes                            | 23,495                        | 24,599                       |
| Pension and other                                | 3,155                         | 2,359                        |
| Deferred lease payable                           | 2,461                         | 2,230                        |
| <b>Total other liabilities</b>                   | <b>29,111</b>                 | <b>29,188</b>                |
| <b>Commitments and Contingencies</b>             |                               |                              |
| <b>Shareholders Equity</b>                       |                               |                              |
| Common stock                                     | 10,441                        | 8,128                        |
| Retained earnings                                | 128,286                       | 113,576                      |
| Accumulated other comprehensive (loss)           | (104)                         | (104)                        |
| <b>Total shareholders equity</b>                 | <b>138,623</b>                | <b>121,600</b>               |
| <b>Total liabilities and shareholders equity</b> | <b>\$ 210,696</b>             | <b>\$ 204,921</b>            |

See accompanying notes to unaudited condensed consolidated financial statements.

**SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES**  
**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME**
*(in thousands, except per share amounts)*

|  | Three Months Ended<br>September 30, |                 | Nine Months Ended<br>September 30, |                 |
|--|-------------------------------------|-----------------|------------------------------------|-----------------|
|  | 2006                                | 2005            | 2006                               | 2005            |
|  | (Restated)                          |                 | (Restated)                         |                 |
| Operating revenues   | \$ 42,594                           | \$ 37,314       | \$ 123,820                         | \$ 107,166      |
| Operating expenses:  |                                     |                 |                                    |                 |
| Cost of goods and services, exclusive of depreciation and amortization shown separately below          | 18,253                              | 15,446          | 52,691                             | 44,657          |
| Selling, general and administrative, exclusive of depreciation and amortization shown separately below | 11,801                              | 10,858          | 36,012                             | 31,609          |
| Depreciation and amortization  | 6,613                               | 5,354           | 20,266                             | 16,269          |
| <b>Total operating expenses</b>  | <b>36,667</b>                       | <b>31,658</b>   | <b>108,969</b>                     | <b>92,535</b>   |
| <b>Operating income</b>  | <b>5,927</b>                        | <b>5,656</b>    | <b>14,851</b>                      | <b>14,631</b>   |
| Other income (expense):  |                                     |                 |                                    |                 |
| Interest expense, net  | (599)                               | (777)           | (1,857)                            | (2,400)         |
| Gain (loss) on investments, net  | (48)                                | 55              | 10,681                             | (224)           |
| Non-operating income, net  | 227                                 | 211             | 659                                | 744             |
| Income before income taxes and cumulative effect of a change in accounting                             | 5,507                               | 5,145           | 24,334                             | 12,751          |
| Income tax expense   | 2,126                               | 2,044           | 9,547                              | 4,856           |
| Income before cumulative effect of a change in accounting  | 3,381                               | 3,101           | 14,787                             | 7,895           |
| Cumulative effect of a change in accounting, net of income taxes                                       |                                     |                 | (77)                               |                 |
| <b>Net income</b>  | <b>\$ 3,381</b>                     | <b>\$ 3,101</b> | <b>\$ 14,710</b>                   | <b>\$ 7,895</b> |
| Income (loss) per share:   |                                     |                 |                                    |                 |
| Basic net income (loss) per share:   |                                     |                 |                                    |                 |
| Income before cumulative effect of a change in accounting  | \$ 0.44                             | \$ 0.40         | \$ 1.92                            | \$ 1.03         |
| Cumulative effect of a change in accounting, net of income taxes                                       |                                     |                 | (0.01)                             |                 |
|  | <b>\$ 0.44</b>                      | <b>\$ 0.40</b>  | <b>\$ 1.91</b>                     | <b>\$ 1.03</b>  |
| Weighted average shares outstanding, basic   | 7,722                               | 7,666           | 7,702                              | 7,652           |
| Diluted net income (loss) per share:   |                                     |                 |                                    |                 |

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|  |    |       |    |       |    |        |    |       |
|--|----|-------|----|-------|----|--------|----|-------|
| Income before cumulative effect of a change in accounting        | \$ | 0.43  | \$ | 0.40  | \$ | 1.90   | \$ | 1.02  |
| Cumulative effect of a change in accounting, net of income taxes |    |       |    |       |    | (0.01) |    |       |
|  | \$ | 0.43  | \$ | 0.40  | \$ | 1.89   | \$ | 1.02  |
| Weighted average shares, diluted                                 |    | 7,778 |    | 7,810 |    | 7,764  |    | 7,728 |

See accompanying notes to unaudited condensed consolidated financial statements.

**SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES**  
**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
**AND COMPREHENSIVE INCOME**

(in thousands, except per share amounts)

|  | Shares | Common<br>Stock | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Total         |
|--|--------|-----------------|----------------------|--|---------------|
| Balance, December 31, 2004, as restated                                      | 7,630  | \$ 6,319        | \$ 106,373           | \$ 65  | \$ 112,757    |
| Comprehensive income:  |        |                 |                      |  |               |
| Net income   |        |                 | 10,735               |  | 10,735        |
| SERP additional minimum pension liability                                    |        |                 |                      | (104)  | (104)         |
| Net unrealized change in securities available-for-sale, net of tax of \$(40) |        |                 |                      | (65)   | (65)          |
| <b>Total comprehensive income</b>  |        |                 |                      |  | <b>10,566</b> |
| Dividends declared (\$0.46 per share)  |        |                 | (3,532)              |  | (3,532)       |
| Stock-based compensation   |        | 347             |                      |  | 347           |
| Common stock issued through exercise of incentive stock options              | 57     | 1,169           |                      |  | 1,169         |
| Excess tax benefit from stock options exercised                              |        | 293             |                      |  | 293           |
| Balance, December 31, 2005   | 7,687  | \$ 8,128        | \$ 113,576           | \$ (104)   | \$ 121,600    |
| Comprehensive income:  |        |                 |                      |  |               |
| Net income   |        |                 | 14,710               |  | 14,710        |
| <b>Total comprehensive income</b>  |        |                 |                      |  | <b>14,710</b> |
| Stock-based compensation   |        | 232             |                      |  | 232           |
| Conversion of liability classified awards to equity classified awards        |        | 1,013           |                      |  | 1,013         |
| Common stock issued through exercise of incentive stock options              | 41     | 868             |                      |  | 868           |
| Excess tax benefit from stock options exercised                              |        | 200             |                      |  | 200           |
| Balance, September 30, 2006  | 7,728  | \$ 10,441       | \$ 128,286           | \$ (104)   | \$ 138,623    |

See accompanying notes to unaudited condensed consolidated financial statements.

**SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES**  
**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

|  | Nine Months Ended<br>September 30, |                    |
|--|------------------------------------|--------------------|
|  | 2006                               | 2005               |
|  | (Restated)                         |                    |
| <b>Cash Flows from Operating Activities from Continuing Operations</b>                                       |                                    |                    |
| Net income   | \$ 14,710                          | \$ 7,895           |
| Adjustments to reconcile net income to net cash provided by operating activities from continuing operations: |                                    |                    |
| Cumulative effect of change in accounting principle  | 77                                 |                    |
| Depreciation   | 19,870                             | 15,928             |
| Amortization   | 395                                | 341                |
| Stock-based compensation expense   | 469                                | 811                |
| Deferred income taxes  | (1,054)                            | (1,707)            |
| Loss on disposal of assets   | 1,063                              | 258                |
| Net gain on disposal of investments  | (10,542)                           | (74)               |
| Net (income) loss from patronage and equity investments  | (208)                              | 84                 |
| Other  | (55)                               | (824)              |
| Changes in assets and liabilities:   |                                    |                    |
| (Increase) decrease in:  |                                    |                    |
| Accounts receivable  | 342                                | (359)              |
| Materials and supplies   | (70)                               | (599)              |
| Increase (decrease) in:  |                                    |                    |
| Accounts payable   | (937)                              | 2,018              |
| Deferred lease payable   | 231                                | 269                |
| Other prepaids, deferrals and accruals   | 915                                | 3,982              |
| <b>Net cash provided by operating activities from continuing operations</b>                                  | <b>\$ 25,206</b>                   | <b>\$ 28,023</b>   |
| <b>Cash Flows From Investing Activities</b>  |                                    |                    |
| Purchase and construction of plant and equipment, net of retirements   | \$ (16,165)                        | \$ (20,535)        |
| Purchase of investment securities  | (300)                              | (156)              |
| Proceeds from investment activities  | 11,464                             | 133                |
| Proceeds from sale of equipment  | 323                                | 94                 |
| <b>Net cash used in investing activities from continuing operations</b>                                      | <b>\$ (4,678)</b>                  | <b>\$ (20,464)</b> |

(Continued)



**SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES**  
**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

|   | Nine Months Ended<br>September 30, |                    |
|---|------------------------------------|--------------------|
|   | 2006                               | 2005               |
|   | <b>(Restated)</b>                  |                    |
| <b>Cash Flows From Financing Activities</b>   |                                    |                    |
| Principal payments on long-term debt  | \$ (7,717)                         | \$ (3,267)         |
| Net payments on lines of credit   | (1,178)                            | (12,000)           |
| Proceeds from exercise of incentive stock options                                       | 868                                | 701                |
| <b>Net cash used in financing activities from continuing operations</b>                 | <b>\$ (8,027)</b>                  | <b>\$ (14,566)</b> |
| Net cash provided by (used in) continuing operations                                    | \$ 12,501                          | \$ (7,007)         |
| Net cash provided by operating activities from discontinued operations (as revised) (1) |                                    | 5,000              |
| <b>Net increase (decrease) in cash and cash equivalents</b>                             | <b>\$ 12,501</b>                   | <b>\$ (2,007)</b>  |
| <b>Cash and cash equivalents:</b>   |                                    |                    |
| Beginning   | 2,572                              | 14,172             |
| Ending  | \$ 15,073                          | \$ 12,165          |
| <b>Supplemental Disclosures of Cash Flow Information</b>                                |                                    |                    |
| <b>Cash payments for:</b>   |                                    |                    |
| Interest paid   | \$ 1,877                           | \$ 2,388           |
| Income taxes  | \$ 9,278                           | \$ 3,798           |

(1) See Note 3 for further discussion on the revised disclosure of discontinued operations. See accompanying notes to unaudited condensed consolidated financial statements.

**SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

1. The interim condensed consolidated financial statements of Shenandoah Telecommunications Company and Subsidiaries (collectively, the Company ) are unaudited. In the opinion of management, all adjustments necessary for a fair presentation of the interim results have been reflected therein. All such adjustments were of a normal and recurring nature. These statements should be read in conjunction with the consolidated financial statements and related notes in the Company s Annual Report on Form 10-K for the year ended December 31, 2005. The balance sheet information at December 31, 2005 was derived from the audited December 31, 2005 consolidated balance sheet.

2. The Company s financial statements as of and for the years ended December 31, 2004 and 2003, including the beginning retained earnings for the year ended December 31, 2003, all quarters in 2004 and the first three quarters of the year ended December 31, 2005, were restated to correct errors relating to the Company s accounting for operating leases. While management believes that the impact of this error is not material to any previously issued financial statements, it determined that the cumulative adjustment required to correct this error was too large to record in 2005. The restated annual financial statements were included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005.

The Company s method of accounting for operating leases did not comply with the requirements of SFAS No. 13, Accounting for Leases and FASB Technical Bulletin No. 85-3, Accounting for Operating Leases with Scheduled Rent Increases. Historically, the Company has not assumed the exercise of available renewal options in accounting for operating leases. The Company has operating leases, primarily for cell sites owned by third parties, land leases for towers owned by the Company and leases with third parties for space on the Company s towers that have escalating rentals during the initial lease term and during succeeding optional renewal periods. In light of the Company s investment in each site, including acquisition costs and leasehold improvements, the Company determined that the exercise of certain renewal options was reasonably assured at the inception of the leases. Accordingly, the Company corrected its accounting to recognize rent expense on a straight-line basis over the initial lease term and renewal periods that are reasonably assured. Where the Company is the lessor, it recognizes revenue on a straight-line basis over the current term of the lease.

The impact of these restatements to the Company s statement of income for the three and nine months ended September 30, 2005, was a decrease to net income of \$57 thousand and \$171 thousand, respectively. The impact associated with correcting the Company s accounting for operating leases was an increase to lease expense of \$90 thousand and \$269 thousand, respectively, reflected in Cost of goods and services and a reduction in lease income of \$6 thousand and \$18 thousand, respectively, reflected in Operating revenues. The adjustments do not affect historical net cash flows from operating, investing or financing activities, future cash flows or the timing of payments under related leases.

In the Reclassifications column, in the tables presented below, certain amounts reported in prior period financial statements have been reclassified to conform to the current period presentation, with no effect on net income or shareholders equity.

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The reclassification and restatement adjustments to amounts previously presented in the consolidated statements of income are summarized below (in thousands except per share data):

Three Months Ended September 30, 2005

|                                     | Reported  | Reclassifications | Restatement Adjustments | Restated  |
|-------------------------------------|-----------|-------------------|-------------------------|-----------|
| Operating revenues                  | \$ 37,320 | \$                | \$ (6)                  | \$ 37,314 |
| Cost of goods and services          | 14,533    | 823               | 90                      | 15,446    |
| Selling, general and administrative | 11,681    | (823)             |                         | 10,858    |
| Depreciation and amortization       | 5,354     |                   |                         | 5,354     |
| Operating income                    | 5,752     |                   | (96)                    | 5,656     |
| Income tax provision                | 2,083     |                   | (39)                    | 2,044     |
| Net income                          | \$ 3,158  | \$                | \$ (57)                 | \$ 3,101  |
| Net income per share, basic         | \$ 0.41   | \$                | \$ (0.01)               | \$ 0.40   |
| Net income per share, diluted       | \$ 0.41   | \$                | \$ (0.01)               | \$ 0.40   |

Nine Months Ended September 30, 2005

|                                     | Reported   | Reclassifications | Restatement Adjustments | Restated   |
|-------------------------------------|------------|-------------------|-------------------------|------------|
| Operating revenues                  | \$ 107,184 | \$                | \$ (18)                 | \$ 107,166 |
| Cost of goods and services          | 41,405     | 2,983             | 269                     | 44,657     |
| Selling, general and administrative | 34,592     | (2,983)           |                         | 31,609     |
| Depreciation and amortization       | 16,269     |                   |                         | 16,269     |
| Operating income                    | 14,918     |                   | (287)                   | 14,631     |
| Income tax provision                | 4,973      |                   | (117)                   | 4,856      |
| Net income                          | \$ 8,066   | \$                | \$ (171)                | \$ 7,895   |
| Net income per share, basic         | \$ 1.05    | \$                | \$ (0.02)               | \$ 1.03    |
| Net income per share, diluted       | \$ 1.05    | \$                | \$ (0.02)               | \$ 1.02    |

3. Certain amounts reported in the prior period financial statements have been reclassified to conform to the current period presentation, with no effect on net income or shareholders' equity, including the following reclassifications and changes in presentation:

During the current period, the Company recorded commission expense to selling, general and administrative expense. During 2005, a portion of these costs were recorded to cost of goods and services. To conform to the current period presentation, for the three and nine months ended September 30, 2005, the Company reclassified \$0.8 million and \$3.0 million in commission expense from selling, general and administrative expense to cost of goods and services.

The Company has separately disclosed the operating portion of the cash flows attributable to its discontinued operations, which for the nine months ended September 30, 2005, was not separately disclosed. During the nine months ended September 30, 2005, there were no cash flows from investing or financing activities for discontinued operations. In 2006, there were no cash flows attributable to discontinued operations.

4. Operating revenues and income from operations for any interim period are not necessarily indicative of results that may be expected for the entire year.

5. Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standard No. 123, Share-Based Payment (Revised 2004) (SFAS 123(R)) using the modified prospective application transition method, which establishes accounting for stock-based awards exchanged for employee services. Accordingly, for equity classified awards, stock-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized over the requisite service period. For those tandem awards of stock options and stock appreciation rights (SARs) which are liability classified awards, fair value is calculated at the grant date and each subsequent reporting date during both the requisite service period and each subsequent period until settlement.



In periods prior to the adoption of SFAS 123(R), the Company accounted for its stock options granted under the Company Stock Incentive Plan (the Plan) by applying the intrinsic value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations, including Financial Accounting Standards Board (FASB) Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation, an interpretation of APB Opinion No. 25 issued in March 2000. Under this method, compensation expense was recorded on the date of the grant only if the current market price of the underlying stock exceeded the exercise price. SFAS No. 123, Accounting for Stock-Based Compensation established accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans. The Company provided the disclosures required under SFAS No. 123, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosures. No compensation expense was recognized under the Plan for years prior to 2004 since all such options were granted with an exercise price equal to the market price at the date of the grant. During the year ended December 31, 2004, the Company issued SARs which were accounted for as stock appreciation rights and, therefore, the Company recorded a liability for the related expense since it was assumed the awards will be settled in cash. Effective July 1, 2006, certain holders of 2004 SARs voluntarily relinquished their right to receive cash from the Company upon exercise. The fair value of these awards was calculated as of the date of modification and transferred from a liability to equity. These awards will, going forward, be accounted for as equity options. On March 21, 2005, the Company issued SARs with a net-share settlement feature. The cash-settlement feature was eliminated for the 2005 option grant. However, due to the net-share settlement feature, the Company accounted for these awards as stock appreciation rights and recognized compensation expense over the vesting period to the extent the current stock price exceeded the exercise price of the options. For both the 2004 and 2005 SARs grants, the adoption of SFAS 123(R) resulted in a change in the measurement of compensation expense from an intrinsic method to a fair value method.

The following table presents the effect on net income and net income per share as if the Company had applied the fair value recognition provisions of SFAS 123(R) to options granted under the Plan prior to the adoption. Disclosures for the three and nine months ended September 30, 2006 are not presented because stock-based payments were accounted for under SFAS 123(R)'s fair-value method during this period.

| (in thousands, except<br>per share amounts)   | Three Months<br>Ended<br>September 30,<br>2005<br>(Restated) | Nine Months<br>Ended<br>September 30,<br>2005<br>(Restated) |
|---|--|---|
| Net income  |  |   |
| As reported   | \$ 3,101   | \$ 7,895  |
| Add: Recorded stock-based compensation expense included in reported net income, net of related income tax effects |  |   |
| Deduct: Pro forma compensation expense, net of related income tax effects   | 7  | 48  |
| Pro forma   | \$ 3,094   | \$ 7,847  |
| Earnings per share, basic and diluted   |  |   |
| As reported, basic  | \$ 0.40  | \$ 1.03   |
| As reported, diluted  | 0.40   | 1.02  |
| Pro forma, basic  | 0.40   | 1.03  |
| Pro forma, diluted  | \$ 0.40  | \$ 1.02   |

The Company maintains a shareholder-approved Company Stock Incentive Plan approved in 1996 (the 1996 Plan), providing for the grant of incentive compensation to essentially all employees in the form of stock options. The 1996 Plan authorized grants of options to purchase up to 480,000 shares of common stock over a ten-year period beginning in 1996. The term of the 1996 Plan expired in February of 2006. During 2005, a new Company Stock Incentive Plan was approved, the 2005 Plan, under which 480,000 shares may be issued over a ten-year period beginning in 2005. The option price for all grants has been at the current market price at the time of the grant. Grants have generally provided that one-half of the options vest and become exercisable on each of the first and second anniversaries of the grant date, with the options expiring on the fifth anniversary of the grant date. In the year ended December 31, 2003, the Company also issued a grant pursuant to which the options are vested over a five-year period beginning on the third anniversary of the grant date. The participant may exercise 20% of the total grant after each anniversary date from the

third through the seventh year, with the options expiring on the tenth anniversary of the grant date. In the years ended December 31, 2005 and 2004, the Company also made grants pursuant to which the options are vested over a four-year period beginning on the third anniversary of the grant date. The participants may exercise 25% of the total grant after each anniversary date from the third through the sixth year, with the options expiring on the seventh anniversary of the grant date. The Company did not grant any options during the first nine months of 2006.

The impact of initially applying SFAS 123(R) is recognized as of the effective date using the modified prospective method. Under the modified prospective method the Company recognized stock-based compensation expense from January 1, 2006, as if the fair value based accounting method had been used to account for all outstanding unvested employee awards granted in prior years. Results of prior periods have not been restated. The effect of recording stock-based compensation for the three and nine month periods ended September 30, 2006 was as follows:

| (in thousands, except per share amounts)       | Three Months Ended September 30, 2006 | Nine Months Ended September 30, 2006 | Three Months Ended September 30, 2005 | Nine Months Ended September 30, 2005 |
|--|---------------------------------------|--------------------------------------|---------------------------------------|--------------------------------------|
| Stock-based compensation expense               | \$ (3)                                | \$ 344                               | \$ 212                                | \$ 811                               |
| Cumulative effect of change in accounting      |                                       | 125                                  |                                       |                                      |
| Total stock compensation expense               | (3)                                   | 469                                  | 212                                   | 811                                  |
| Tax effect on stock-based compensation expense | (1)                                   | 182                                  | 81                                    | 315                                  |
| Net effect on net income                       | \$ (2)                                | \$ 287                               | \$ 131                                | \$ 496                               |

Effect on net income per share:

|                   |    |           |           |           |
|-------------------|----|-----------|-----------|-----------|
| Basic and diluted | \$ | \$ (0.04) | \$ (0.02) | \$ (0.07) |
|-------------------|----|-----------|-----------|-----------|

For the three and nine month periods ended September 30, 2005, stock-based compensation expense was recorded under APB Opinion No. 25.

As required by SFAS 123(R), management has made an estimate of expected forfeitures and is recognizing compensation costs only for those awards expected to vest. For outstanding options previously classified as a liability and which continue to be classified as a liability under SFAS 123(R), the Company recognized the effect of initially re-measuring the liability from its intrinsic value to its fair value as a cumulative effect of a change in accounting principle. The cumulative effect of initially adopting SFAS 123(R) was \$77 thousand, net of the tax effect. During the three and nine months ended September 30, 2006, the total cash received as a result of employee stock option exercises was \$0.3 million and \$0.9 million, respectively, and the actual tax benefit realized for the tax deductions was \$45,000 and \$200,000, respectively.

The fair value of each option grant is estimated using a Black-Scholes option pricing model with the following weighted average assumptions:

|                          | Three Months Ended September 30, |        | Nine Months Ended September 30, |        |
|--------------------------|----------------------------------|--------|---------------------------------|--------|
|                          | 2006                             | 2005   | 2006                            | 2005   |
| Expected term (in years) | 2.50                             | 3.50   | 2.62                            | 3.50   |
| Volatility               | 36.10%                           | 45.73% | 39.85%                          | 45.73% |
| Risk free rate           | 4.63%                            | 4.30%  | 4.97%                           | 4.30%  |
| Expected dividends       | 1.04%                            | 1.42%  | 1.01%                           | 1.42%  |

For the three and nine months ended September 30, 2006, the assumptions were used to calculate the fair value of the options classified as a liability. The fair value of options classified as a liability is calculated at the grant date and each subsequent reporting date until the options are settled.

Volatility is based on the historical volatility of the price of the Company's stock over the expected term of the options. The expected term represents the period of time that the options granted are expected to be outstanding. The risk free rate is based on the U.S. Treasury yield curve, in effect at the date the fair value of the options is calculated, with an equivalent term.



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The following table summarizes option activity for the first nine months of 2006:

|                                | Options  | Weighted<br>Average Grant<br>Price Per Option |
|--------------------------------|----------|---|
| Outstanding December 31, 2005  | 240,863  | \$ 24.73                                      |
| Granted                        |          |   |
| Cancelled                      | (3,302)  | 28.96   |
| Exercised                      | (16,394) | 18.47   |
| Outstanding March 31, 2006     | 221,167  | 25.13   |
| Granted                        |          |   |
| Cancelled                      | (20,560) | 24.88   |
| Exercised                      | (13,717) | 23.85   |
| Outstanding June 30, 2006      | 186,890  | 25.26   |
| Granted                        |          |   |
| Cancelled                      | (11,485) | 38.45   |
| Exercised                      | (12,862) | 22.98   |
| Outstanding September 30, 2006 | 162,543  | \$ 24.50                                      |

The following table summarizes information about stock options outstanding at September 30, 2006:

|      | Exercise<br>Prices | Options<br>Outstanding | Option Life<br>Remaining | Options<br>Exercisable |
|------|--------------------|------------------------|--------------------------|------------------------|
| 2002 | \$ 17.59           | 15,701                 | .5 years                 | 15,701                 |
| 2003 | \$ 17.98-22.01     | 42,554                 | 1.5 to 6.75 years        | 26,554                 |
| 2004 | \$ 24.25-24.90     | 50,908                 | 2.5 to 5.25 years        | 35,908                 |
| 2005 | \$ 30.29           | 53,380                 | 3.5 years                | 26,690                 |
|      |                    | 162,543                |                          | 104,853                |

There were options for 162,543 shares outstanding at September 30, 2006 at a weighted average exercise price of \$24.50 per share, an aggregate intrinsic value of \$3.1 million and a weighted-average remaining contractual life of 3.3 years. There were options for 104,853 shares exercisable at September 30, 2006 at a weighted average exercise price of \$23.35 per share, an aggregate intrinsic value of \$2.1 million and a weighted-average remaining contractual life of 2.4 years. The aggregate intrinsic value represents the total pretax intrinsic value, based on the Company's average closing stock price of \$43.59 during the nine months ended September 30, 2006.

The total fair value of options vested during the three and nine months ended September 30, 2006 was \$0 and \$1.0 million, respectively. The total intrinsic value of options exercised during the three and nine months ended September 30, 2006 was \$0.3 million and \$1.0 million, respectively. The options-based liabilities paid during the three and nine months ended September 30, 2006 was \$0 and \$43 thousand, respectively.

As of September 30, 2006, the total compensation cost related to nonvested options not yet recognized is \$0.3 million which will be recognized over a weighted-average period of 2.9 years.



6. Basic net income per share was computed on the weighted average number of shares outstanding. Diluted net income per share was computed under the treasury stock method, assuming the conversion as of the beginning of the period, for all dilutive stock options. The adjustments to net income reflect the impact of compensation related to stock appreciation rights recorded in the respective periods, and the impact of the pro forma compensation expense, both net of the income tax effect.

7. SFAS Statement No. 131, Disclosures about Segments of an Enterprise and Related Information, establishes standards for reporting information about operating segments. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating

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decision makers. The Company has six reportable segments, which the Company operates and manages as strategic business units organized geographically and by lines of business: (1) PCS, (2) Telephone, (3) Converged Services (NTC), (4) Mobile, (5) Holding and (6) Other.

Prior to the September 30, 2005 quarterly report, the Company reported 11 segments, however, beginning with the September 30, 2005 quarterly report, the Company reported six segments with the following segments combined into Other : ShenTel Service Company, Shenandoah Cable Television Company, Shenandoah Network Company, Shenandoah Long Distance Company, ShenTel Communications Company, Shentel Wireless Company and Converged Services of West Virginia. During the third quarter of 2005, Shenandoah Valley Leasing Company changed its name to Shentel Wireless Company to reflect the activities associated with the Company's Wireless Broadband Group. The Company believes that the new presentation will allow for a more meaningful discussion of the segment results.

The results for the three and nine months ended September 30, 2005 have been restated to reflect the correction of certain errors in the Company's accounting for operating leases. See Note 2 for additional discussion.

The PCS segment, as a Sprint PCS Affiliate of Sprint Nextel, provides digital wireless service to a portion of a four-state area covering the region from Harrisburg, York and Altoona, Pennsylvania, to Harrisonburg, Virginia.

The Telephone segment provides both regulated and unregulated telephone services and leases fiber optic facilities primarily throughout the northern Shenandoah Valley.

The Converged Services segment provides local and long distance voice, video and internet services on an exclusive and non-exclusive basis to MDU communities (primarily off-campus college student housing) throughout the southeastern United States including Virginia, North Carolina, Maryland, South Carolina, Georgia, Florida, Tennessee and Mississippi. Converged Services includes NTC, purchased by the Company on November 30, 2004.

The Mobile segment provides tower rental space to affiliates and non-affiliates in the Company's PCS markets and paging services throughout the northern Shenandoah Valley.

Selected financial data for each segment is as follows:

Three Months Ended September 30, 2006

(in thousands)

|  | PCS           | Telephone    | Converged<br>Services<br>(NTC) | Mobile       | Holding | Other        | Eliminations   | Consolidated<br>Totals |
|--|---------------|--------------|--------------------------------|--------------|---------|--------------|----------------|------------------------|
| <b>External revenues</b>   |               |              |                                |              |         |              |                |                        |
| Service revenues   | \$ 18,803     | \$ 1,601     | \$ 2,230                       | \$           | \$      | \$ 2,828     | \$             | \$ 25,462              |
| Access charges   | 33            | 2,804        |                                |              |         |              |                | 2,837                  |
| Travel/roaming revenue   | 9,074         |              |                                |              |         |              |                | 9,074                  |
| Facilities and tower lease   |               | 907          |                                | 839          |         | 458          |                | 2,204                  |
| Equipment  | 1,114         | 8            |                                |              |         | 111          |                | 1,233                  |
| Other  | 483           | 772          | 184                            | 81           |         | 264          |                | 1,784                  |
| <b>Total external revenues</b>   | <b>29,507</b> | <b>6,092</b> | <b>2,414</b>                   | <b>920</b>   |         | <b>3,661</b> |                | <b>42,594</b>          |
| <b>Internal revenues</b>   |               | <b>1,462</b> |                                | <b>420</b>   |         | <b>641</b>   | <b>(2,523)</b> |                        |
| <b>Total operating revenues</b>  | <b>29,507</b> | <b>7,554</b> | <b>2,414</b>                   | <b>1,340</b> |         | <b>4,302</b> | <b>(2,523)</b> | <b>42,594</b>          |
| <b>Operating expenses</b>  |               |              |                                |              |         |              |                |                        |
| Cost of goods and services,<br>exclusive of depreciation<br>and amortization shown<br>separately below | 13,580        | 1,712        | 1,970                          | 410          | 2       | 2,753        | (2,174)        | 18,253                 |
| Selling, general and<br>administrative, exclusive of   | 7,822         | 1,149        | 1,272                          | 195          | 589     | 1,123        | (349)          | 11,801                 |

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|  |          |          |            |        |        |          |         |          |
|--|----------|----------|------------|--------|--------|----------|---------|----------|
| depreciation and amortization shown separately below |          |          |            |        |        |          |         |          |
| Depreciation and amortization                        | 3,581    | 1,163    | 1,113      | 216    | 17     | 523      |         | 6,613    |
| Total operating expenses                             | 24,983   | 4,024    | 4,355      | 821    | 608    | 4,399    | (2,523) | 36,667   |
| Operating income (loss)                              | 4,524    | 3,530    | (1,941)    | 519    | (608)  | (97)     |         | 5,927    |
| Non-operating income (expense)                       | 52       | 176      | (9)        |        | 845    | 11       | (896)   | 179      |
| Interest expense                                     | (221)    | (63)     | (326)      | (141)  | (565)  | (179)    | 896     | (599)    |
| Income taxes   | (1,785)  | (1,378)  | 483        | (143)  | 580    | 117      |         | (2,126)  |
| Net income (loss)                                    | \$ 2,570 | \$ 2,265 | \$ (1,793) | \$ 235 | \$ 252 | \$ (148) | \$      | \$ 3,381 |

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Three Months Ended September 30, 2005 (Restated)

(in thousands)

|  | PCS             | Telephone       | Converged<br>Services<br>(NTC) | Mobile        | Holding        | Other        | Eliminations   | Consolidated<br>Totals |
|--|-----------------|-----------------|--------------------------------|---------------|----------------|--------------|----------------|------------------------|
| <b>External revenues</b>   |                 |                 |                                |               |                |              |                |                        |
| Service revenues   | \$ 16,015       | \$ 1,640        | \$ 2,260                       | \$            | \$             | \$ 2,709     | \$             | \$ 22,624              |
| Access charges   |                 | 2,716           |                                |               |                |              |                | 2,716                  |
| Travel/roaming revenue   | 7,386           |                 |                                |               |                |              |                | 7,386                  |
| Facilities and tower lease   |                 | 993             |                                | 790           |                | 315          |                | 2,098                  |
| Equipment  | 920             | 5               |                                |               |                | 230          |                | 1,155                  |
| Other  | 290             | 687             | 37                             | 43            |                | 278          |                | 1,335                  |
| <b>Total external revenues</b>   | <b>24,611</b>   | <b>6,041</b>    | <b>2,297</b>                   | <b>833</b>    |                | <b>3,532</b> |                | <b>37,314</b>          |
| Internal revenues  |                 | 1,107           |                                | 348           |                | 699          | (2,154)        |                        |
| <b>Total operating revenues</b>  | <b>24,611</b>   | <b>7,148</b>    | <b>2,297</b>                   | <b>1,181</b>  |                | <b>4,231</b> | <b>(2,154)</b> | <b>37,314</b>          |
| <b>Operating expenses</b>  |                 |                 |                                |               |                |              |                |                        |
| Cost of goods and services,<br>exclusive of depreciation<br>and amortization shown<br>separately below             | 10,725          | 1,679           | 2,126                          | 387           |                | 2,358        | (1,829)        | 15,446                 |
| Selling, general and<br>administrative, exclusive of<br>depreciation and<br>amortization shown<br>separately below | 7,035           | 1,270           | 1,182                          | 136           | 384            | 1,176        | (325)          | 10,858                 |
| Depreciation and<br>amortization   | 3,181           | 1,080           | 448                            | 178           | 16             | 451          |                | 5,354                  |
| <b>Total operating expenses</b>  | <b>20,941</b>   | <b>4,029</b>    | <b>3,756</b>                   | <b>701</b>    | <b>400</b>     | <b>3,985</b> | <b>(2,154)</b> | <b>31,658</b>          |
| Operating income (loss)  | 3,670           | 3,119           | (1,459)                        | 480           | (400)          | 246          |                | 5,656                  |
| <b>Non-operating income</b>  |                 |                 |                                |               |                |              |                |                        |
| (expense)  | 4               | 99              | 12                             | 45            | 1,018          | 12           | (924)          | 266                    |
| Interest expense   | (448)           | (108)           | (270)                          | (80)          | (652)          | (143)        | 924            | (777)                  |
| Income taxes   | (1,240)         | (1,199)         | 738                            | (283)         | 14             | (74)         |                | (2,044)                |
| <b>Net income (loss)</b>   | <b>\$ 1,986</b> | <b>\$ 1,911</b> | <b>\$ (979)</b>                | <b>\$ 162</b> | <b>\$ (20)</b> | <b>\$ 41</b> | <b>\$</b>      | <b>\$ 3,101</b>        |

Nine Months Ended September 30, 2006

(in thousands)

|                            | PCS       | Telephone | Converged<br>Services<br>(NTC) | Mobile | Holding | Other    | Eliminations | Consolidated<br>Totals |
|----------------------------|-----------|-----------|--------------------------------|--------|---------|----------|--------------|------------------------|
| <b>External revenues</b>   |           |           |                                |        |         |          |              |                        |
| Service revenues           | \$ 54,928 | \$ 4,875  | \$ 7,437                       | \$     | \$      | \$ 8,427 | \$           | \$ 75,667              |
| Access charges             | 101       | 8,508     |                                |        |         |          |              | 8,609                  |
| Travel/roaming revenue     | 24,188    |           |                                |        |         |          |              | 24,188                 |
| Facilities and tower lease |           | 2,887     |                                | 2,571  |         | 1,432    |              | 6,890                  |

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|  |          |           |            |        |         |          |         |           |
|--|----------|-----------|------------|--------|---------|----------|---------|-----------|
| Equipment  | 3,149    | 22        |            |        |         | 422      |         | 3,593     |
| Other  | 1,149    | 2,306     | 425        | 149    |         | 844      |         | 4,873     |
| <hr/>  |          |           |            |        |         |          |         |           |
| Total external revenues  | 83,515   | 18,598    | 7,862      | 2,720  |         | 11,125   |         | 123,820   |
| Internal revenues  |          | 4,243     |            | 1,228  |         | 1,933    | (7,404) |           |
| <hr/>  |          |           |            |        |         |          |         |           |
| Total operating revenues   | 83,515   | 22,841    | 7,862      | 3,948  |         | 13,058   | (7,404) | 123,820   |
| <hr/>  |          |           |            |        |         |          |         |           |
| Operating expenses   |          |           |            |        |         |          |         |           |
| Cost of goods and services, exclusive of depreciation and amortization shown separately below          | 38,306   | 5,323     | 6,209      | 1,212  | 6       | 8,097    | (6,462) | 52,691    |
| Selling, general and administrative, exclusive of depreciation and amortization shown separately below | 23,416   | 3,566     | 3,880      | 522    | 1,755   | 3,815    | (942)   | 36,012    |
| Depreciation and amortization  | 10,634   | 3,588     | 3,761      | 622    | 52      | 1,609    |         | 20,266    |
| <hr/>  |          |           |            |        |         |          |         |           |
| Total operating expenses   | 72,356   | 12,477    | 13,850     | 2,356  | 1,813   | 13,521   | (7,404) | 108,969   |
| <hr/>  |          |           |            |        |         |          |         |           |
| Operating income (loss)  | 11,159   | 10,364    | (5,988)    | 1,592  | (1,813) | (463)    |         | 14,851    |
| <hr/>  |          |           |            |        |         |          |         |           |
| Non-operating income (expense)   |          |           |            |        |         |          |         |           |
| Interest expense   | (1,107)  | (191)     | (811)      | (301)  | (1,782) | (459)    | 2,794   | (1,857)   |
| Income taxes   | (4,204)  | (8,067)   | 2,196      | (513)  | 700     | 341      |         | (9,547)   |
| <hr/>  |          |           |            |        |         |          |         |           |
| Cumulative effect of change in accounting, net of tax  | (11)     | (27)      | (21)       | (1)    | (2)     | (15)     |         | (77)      |
| <hr/>  |          |           |            |        |         |          |         |           |
| Net income (loss)  | \$ 6,024 | \$ 13,075 | \$ (4,618) | \$ 788 | \$ 8    | \$ (567) | \$      | \$ 14,710 |
| <hr/>  |          |           |            |        |         |          |         |           |

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Nine Months Ended September 30, 2005 (Restated)

(in thousands)

|  | PCS             | Telephone       | Converged<br>Services<br>(NTC) | Mobile        | Holding         | Other         | Eliminations   | Consolidated<br>Totals |
|--|-----------------|-----------------|--------------------------------|---------------|-----------------|---------------|----------------|------------------------|
| <b>External revenues</b>   |                 |                 |                                |               |                 |               |                |                        |
| Service revenues   | \$ 45,860       | \$ 4,879        | \$ 6,853                       | \$            | \$              | \$ 7,974      | \$             | \$ 65,566              |
| Access charges   |                 | 8,085           |                                |               |                 |               |                | 8,085                  |
| Travel/roaming revenue   | 20,099          |                 |                                |               |                 |               |                | 20,099                 |
| Facilities and tower lease   |                 | 2,970           |                                | 2,336         |                 | 938           |                | 6,244                  |
| Equipment  | 2,540           | 12              |                                |               |                 | 489           |                | 3,041                  |
| Other  | 893             | 2,094           | 70                             | 115           |                 | 959           |                | 4,131                  |
| <b>Total external revenues</b>   | <b>69,392</b>   | <b>18,040</b>   | <b>6,923</b>                   | <b>2,451</b>  |                 | <b>10,360</b> |                | <b>107,166</b>         |
| Internal revenues  |                 | 3,026           |                                | 1,028         |                 | 1,875         | (5,929)        |                        |
| <b>Total operating revenues</b>  | <b>69,392</b>   | <b>21,066</b>   | <b>6,923</b>                   | <b>3,479</b>  |                 | <b>12,235</b> | <b>(5,929)</b> | <b>107,166</b>         |
| <b>Operating expenses</b>  |                 |                 |                                |               |                 |               |                |                        |
| Cost of goods and services,<br>exclusive of depreciation<br>and amortization shown<br>separately below             | 32,041          | 4,855           | 5,096                          | 1,026         |                 | 6,621         | (4,982)        | 44,657                 |
| Selling, general and<br>administrative, exclusive of<br>depreciation and<br>amortization shown<br>separately below | 20,507          | 3,973           | 3,257                          | 435           | 1,037           | 3,347         | (947)          | 31,609                 |
| Depreciation and<br>amortization   | 9,240           | 3,285           | 1,805                          | 530           | 47              | 1,362         |                | 16,269                 |
| <b>Total operating expenses</b>  | <b>61,788</b>   | <b>12,113</b>   | <b>10,158</b>                  | <b>1,991</b>  | <b>1,084</b>    | <b>11,330</b> | <b>(5,929)</b> | <b>92,535</b>          |
| Operating income (loss)  | 7,604           | 8,953           | (3,235)                        | 1,488         | (1,084)         | 905           |                | 14,631                 |
| <b>Non-operating income</b>  |                 |                 |                                |               |                 |               |                |                        |
| (expense)  | 4               | 188             | 18                             | 112           | 2,734           | 29            | (2,565)        | 520                    |
| Interest expense   | (1,273)         | (255)           | (730)                          | (204)         | (2,116)         | (387)         | 2,565          | (2,400)                |
| Income taxes   | (2,391)         | (3,333)         | 1,572                          | (654)         | 187             | (237)         |                | (4,856)                |
| <b>Net income (loss)</b>   | <b>\$ 3,944</b> | <b>\$ 5,553</b> | <b>\$ (2,375)</b>              | <b>\$ 742</b> | <b>\$ (279)</b> | <b>\$ 310</b> | <b>\$</b>      | <b>\$ 7,895</b>        |

The Company's assets by segment are as follows:

In thousands  
(unaudited)

|                    | September 30,<br>2006 | December 31,<br>2005 | September 30,<br>2005 |
|--------------------|-----------------------|----------------------|-----------------------|
|                    |                       |                      | (Restated)            |
| PCS                | \$ 73,288             | \$ 81,796            | \$ 72,742             |
| Telephone          | 62,888                | 59,873               | 62,532                |
| Converged Services | 24,235                | 27,107               | 24,598                |

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|                            |            |            |            |
|----------------------------|------------|------------|------------|
| Mobile                     | 15,422     | 20,039     | 19,075     |
| Holding                    | 132,432    | 143,308    | 142,586    |
| Other                      | 22,489     | 23,154     | 22,703     |
|                            | <hr/>      |            |            |
| Combined totals            | 330,754    | 355,277    | 344,236    |
| Inter-segment eliminations | (120,058)  | (150,356)  | (136,701)  |
|                            | <hr/>      |            |            |
| Consolidated totals        | \$ 210,696 | \$ 204,921 | \$ 207,535 |
|                            | <hr/>      |            |            |

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8. Comprehensive income includes net income along with net unrealized gains and losses on the Company's available-for-sale investments, net of the related income tax effect. The following is a summary of comprehensive income for the periods indicated:

| In thousands (unaudited) | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--------------------------|-------------------------------------|------------|------------------------------------|------------|
|                          | 2006                                | 2005       | 2006                               | 2005       |
|                          |                                     | (Restated) |                                    | (Restated) |
| Net income               | \$ 3,381                            | \$ 3,101   | \$ 14,710                          | \$ 7,895   |
| Net unrealized loss      |                                     | (41)       |                                    | (65)       |
| Comprehensive income     | \$ 3,381                            | \$ 3,060   | \$ 14,710                          | \$ 7,830   |

9. The following table presents pension cost for the periods presented:

| In thousands (unaudited)                        | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |        |
|---|-------------------------------------|--------|------------------------------------|--------|
|   | 2006                                | 2005   | 2006                               | 2005   |
| Net periodic benefit cost recognized:           |                                     |        |                                    |        |
| Service cost                                    | \$ 311                              | \$ 223 | \$ 933                             | \$ 669 |
| Interest cost                                   | 251                                 | 211    | 753                                | 633    |
| Expected return                                 | (234)                               | (198)  | (702)                              | (594)  |
| Amortization of unrecognized loss               | 42                                  | 23     | 126                                | 69     |
| Amortization of unrecognized prior service cost | 20                                  | 17     | 60                                 | 51     |
| Total   | \$ 390                              | \$ 276 | \$ 1,170                           | \$ 828 |

10. On August 4, 2005, the board of directors of the Rural Telephone Bank (the RTB) adopted a number of resolutions for the purpose of dissolving the RTB as of October 1, 2005. The Company held 10,821,770 shares of Class B and Class C RTB Common Stock (\$1.00 par value) which was reflected on the Company's balance sheet at December 31, 2005, at \$796,000 under the cost method. During the first quarter of 2006, the Company recognized a gain of approximately \$6.4 million, net of tax, related to the dissolution of the RTB and the redemption of the stock. In April 2006, the Company received \$11.3 million in proceeds from the RTB.

11. On August 12, 2005, Sprint Corporation and Nextel Communications, Inc. merged to form Sprint Nextel Corporation. Nextel and its affiliate Nextel Partners, Inc. (which was acquired by Sprint Nextel on June 26, 2006) are providers of digital wireless communications services in the Company's PCS service area. Certain transactions resulting from, or potential effects of, the Sprint Nextel merger discussed below could adversely affect our PCS business as well as our overall results of operations.

The Company's PCS subsidiary is one of a number of companies we refer to as the Sprint PCS Affiliates, which had entered into substantially similar management and affiliation agreements with Sprint Communications Company L.P. The agreements, including the agreement with Shentel, were with several Sprint entities. In connection with the Sprint Nextel merger, a number of the Sprint PCS Affiliates filed suit against Sprint Nextel alleging that the merger would result in a breach of the exclusivity provisions of their agreements with Sprint Nextel. Some of these legal proceedings are pending. In addition, since the Sprint Nextel merger was announced, Sprint Nextel has acquired several of the Sprint PCS Affiliates.

Prior to the Sprint Nextel merger, the Company and Sprint Nextel entered into a forbearance agreement setting forth Sprint Nextel's agreement to observe specified limitations in operating Nextel's wireless business in the Company's PCS service area. The agreement also set forth the Company's agreement not to initiate litigation or seek certain injunctive or equitable relief against Sprint Nextel under certain circumstances, in each case during the period in which the agreement remains in effect. The agreement provided that the statute of limitations on any claims that Shentel might have against Sprint Nextel would be tolled while the agreement remained in effect. Nextel Partners was added to a July 19, 2006



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amendment to the forbearance agreement between the Company and Sprint Nextel. The forbearance agreement automatically expired on August 4, 2006 in accordance with its terms upon the Court of Chancery of the State of Delaware's issuance of a decision with respect to the pending litigation by some Sprint PCS Affiliates against Sprint Nextel; however, Sprint Nextel has stated that it will continue to comply with the terms of the forbearance agreement. On September 20, 2006, Judge Thomas P. Quinn issued his final order with respect to the claim of iPCS, Inc.'s subsidiary, iPCS Wireless, Inc., against Sprint Nextel in the Circuit Court of Cook County, Illinois. Judge Quinn

ordered Sprint to cease owning, operating, and managing the Nextel wireless network in the iPCS Service Area, and gave Sprint 180 days to comply. On October 13, 2006, the Appellate Court of Illinois for the First Judicial District issued a stay of Judge Quinn's order pending a decision on appeal. The Company is reviewing the courts' decisions and considering the implications, if any, for the Company.

The Company believes that a significant portion of its PCS service area overlaps the service area operated by Nextel Partners under the Nextel brand. On June 26, 2006, Sprint Nextel acquired Nextel Partners. As long as Nextel Partners continues to be operated by Sprint Nextel as a separate business using the Nextel platform, the Company's ability to fully realize any of the benefits from the merger of Sprint and Nextel may be limited. Further, the continued operation by Sprint Nextel of Nextel Partners as a competing network could have a negative impact on the Company's results of operations.

The Company has had discussions with Sprint Nextel regarding the continuation of their long-term relationship, the impact of the Sprint Nextel merger, and potential changes to the management agreement necessary to reflect the merger of Sprint and Nextel Communications and the acquisition of Nextel Partners by Sprint Nextel. As a result of the Sprint Nextel merger, Sprint Nextel may require the Company to meet additional program requirements, which the Company anticipates would significantly increase capital expenditures and operating expenses. To date, the Company has been unable to arrive at a mutually acceptable agreement with Sprint Nextel concerning such potential changes. Accordingly, the Company is currently considering other alternatives in its ongoing discussions with Sprint Nextel, including the possible sale of its PCS business. The Company is unable to predict whether or on what terms it would be able to implement a sale of its PCS business, or the ultimate resolution of its discussions with Sprint Nextel concerning its relationship with Sprint Nextel, or the impact of any such sale or other action on its financial condition or future operating results or prospects.

12. In October, 2006, the Company declared a regular cash dividend of \$0.48 per share, and a special cash dividend of \$0.27 per share, to be paid December 1, 2006, to holders of record as of November 15, 2006. The Company expects to pay approximately \$5.8 million. The special cash dividend is a distribution of a portion of the gain on the liquidation of the RTB stock in the first quarter of 2006.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*This management's discussion and analysis includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. When used in this report, the words anticipate, believe, estimate, expect, intend, plan and similar expressions as they relate to Shenandoah Telecommunications Company or its management are intended to identify these forward-looking statements. All statements regarding Shenandoah Telecommunications Company's expected future financial position and operating results, business strategy, financing plans, forecasted trends relating to the markets in which Shenandoah Telecommunications Company operates and similar matters are forward-looking statements. We cannot assure you that the Company's expectations expressed or implied in these forward-looking statements will turn out to be correct. The Company's actual results could be materially different from its expectations because of various factors, including those discussed below and elsewhere in this quarterly report and under the caption Risk Factors in the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2005. The following management's discussion and analysis should be read in conjunction with the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2005, including the financial statements and related notes included therein.*

*Unless indicated otherwise, dollar amounts fifty thousand and over have been rounded to the nearest hundred thousand dollars and dollar amounts of less than fifty thousand have been rounded to the nearest thousand dollars.*

**General**

*Overview.* Shenandoah Telecommunications Company is a diversified telecommunications company providing both regulated and unregulated telecommunications services through its wholly owned subsidiaries. These subsidiaries provide local exchange telephone services and wireless personal communications services (as a Sprint PCS Affiliate of Sprint Nextel), as well as cable television, video, Internet and data services, long distance, sale of telecommunications equipment, fiber optics facilities, paging and leased tower facilities. The Company has the following six reporting segments, which it operates and manages as strategic business units organized geographically and by lines of business:

wireless personal communications services, or PCS, as a Sprint PCS Affiliate, through Shenandoah Personal Communications Company;

telephone, which involves the provision of regulated and non-regulated telephone services, through Shenandoah Telephone Company;

converged services, which involves the provision of data, video, voice and long-distance services, through Shentel Converged Services, Inc. and NTC Communications, LLC;

mobile, which involves the provision of tower leases and paging services, through Shenandoah Mobile Company;

holding, which involves the provision of investments and management services to its subsidiaries, through Shenandoah Telecommunications Company; and

other, which involves the provision of Internet, cable television, network facility leasing, long-distance, CLEC, and wireless broadband services, through ShenTel Service Company, Shenandoah Cable Television Company, Shenandoah Network Company, Shenandoah Long Distance Company, ShenTel Communications Company, Converged Services of West Virginia and Shentel Wireless Company.

During the third quarter of 2005, Shenandoah Valley Leasing Company changed its name to Shentel Wireless Company to record the activities associated with the Company's Wireless Broadband Group.

The Company is the exclusive provider of wireless mobility communications network products and services on the 1900 MHz band under the Sprint brand from Harrisonburg, Virginia to Harrisburg, York and Altoona, Pennsylvania. The Company refers to the Chambersburg, Pennsylvania; Hagerstown, Maryland; Martinsburg, West Virginia; and Harrisonburg and Winchester, Virginia markets as its Quad States markets. The Company refers to the Altoona, Harrisburg, and York, Pennsylvania markets as its Central Penn markets. The Company's primary service area for the

telephone, cable television and long-distance business is Shenandoah County, Virginia. The county is a rural area in northwestern Virginia, with a population of approximately 39,000 inhabitants, which has increased by approximately 4,000 since 2000. While a number of new housing developments are being planned for Shenandoah County, the Company believes that the potential for significant numbers of additional wireline customers in the Shenandoah County operating area is limited. In 2002, the Company established a competitive local exchange carrier in Virginia to provide services on a limited basis.

As a result of the November 30, 2004 acquisition of the 83.9% of NTC Communications, L.L.C. ( NTC ) that the Company did not already own, the Company, through its subsidiary Shentel Converged Services, provides local and long distance voice, video and Internet services on an exclusive and non-exclusive basis to MDU communities, consisting primarily of off-campus college student housing throughout the southeastern United States including Virginia, North Carolina, Maryland, South Carolina, Georgia, Florida, Tennessee and Mississippi.

The Company sells and leases equipment, mainly related to the services it provides. The Company participates in emerging services and technologies by investment in technology venture funds and direct investment in non-affiliated companies.

On May 10, 2006, Shenandoah Telecommunications Company through its subsidiary, Shenandoah Mobile Company, filed an application to participate in FCC Spectrum Auction #66 for Advanced Wireless Services ( AWS ). The AWS spectrum, located in the 1710-1755 and 2110-2155 MHz bands in the mid-atlantic and southeastern United States, is designated for fixed and mobile terrestrial wireless applications using bandwidth that is sufficient for the provision of a variety of applications including those using voice and data content.

On July 7, 2006, the application was approved and on July 17, 2006, a refundable upfront payment of \$4.7 million was submitted on behalf of Shenandoah Mobile Company. The auction began on August 9, 2006. The Company was unsuccessful in its bidding for the AWS spectrum, and on September 12, 2006, the Company received a refund of its deposit.

*Restatement of Financial Results.* The Company's financial statements as of and for the years ended December 31, 2004 and 2003, including the beginning retained earnings for the year ended December 31, 2003, all quarters in 2004 and the first three quarters of the year ended December 31, 2005, were restated to correct errors relating to the Company's accounting for operating leases. While management believes that the impact of this error is not material to any previously issued financial statements, it determined that the cumulative adjustment required to correct this error was too large to record in 2005.

The Company's method of accounting for operating leases did not comply with the requirements of SFAS No. 13, Accounting for Leases and FASB Technical Bulletin No. 85-3, Accounting for Operating Leases with Scheduled Rent Increases. Historically, the Company has not assumed the exercise of available renewal options in accounting for operating leases. The Company has operating leases, primarily for cell sites owned by third parties, land leases for towers owned by the Company and leases with third parties for space on the Company's towers that have escalating rentals during the initial lease term and during succeeding optional renewal periods. In light of the Company's investment in each site, including acquisition costs and leasehold improvements, the Company determined that the exercise of certain renewal options was reasonably assured at the inception of the leases. Accordingly, the Company has corrected its accounting to recognize rent expense on a straight-line basis over the initial lease term and renewal periods that are reasonably assured. Where the Company is the lessor, it will recognize revenue on a straight-line basis over the current term of the lease.

See Note 2 to the Company's unaudited condensed consolidated financial statements appearing elsewhere in this report for additional information.

The following management's discussion and analysis, for the three and nine months ended September 30, 2005, reflects the effects of the restatements.

**Additional Information About the Company's Business**

The following table shows selected operating statistics of the Company for the most recent five quarters.

|  | Sept. 30,<br>2006 | June 30,<br>2006 | Mar. 31,<br>2006 | Dec. 31,<br>2005 | Sept. 30,<br>2005 |
|--|-------------------|------------------|------------------|------------------|-------------------|
| Telephone Access Lines                               | 24,849            | 24,935           | 24,988           | 24,740           | 24,811            |
| Cable Television Subscribers                         | 8,478             | 8,555            | 8,629            | 8,684            | 8,677             |
| Dial-up Internet Subscribers                         | 10,714            | 11,512           | 12,069           | 12,498           | 13,273            |
| DSL Subscribers                                      | 5,967             | 5,373            | 5,089            | 4,748            | 4,062             |
| Retail PCS Subscribers                               | 141,594           | 134,559          | 129,124          | 122,975          | 116,460           |
| Wholesale PCS Users (1)                              | 42,264            | 40,013           | 39,798           | 38,726           | 33,848            |
| Long Distance Subscribers                            | 10,523            | 10,458           | 10,431           | 10,418           | 10,318            |
| Fiber Route Miles                                    | 620               | 618              | 616              | 616              | 579               |
| Total Fiber Miles                                    | 33,612            | 33,444           | 33,367           | 33,201           | 29,734            |
| Long Distance Calls (000) (2)                        | 7,045             | 7,003            | 6,745            | 6,686            | 6,808             |
| Total Switched Access Minutes (000)                  | 77,848            | 76,019           | 74,361           | 75,209           | 74,515            |
| Originating Switched Access Minutes (000)            | 23,421            | 22,484           | 22,541           | 21,807           | 20,627            |
| Employees (full time equivalents)                    | 380               | 382              | 391              | 387              | 375               |
| CDMA Base Stations (sites)                           | 331               | 328              | 325              | 311              | 301               |
| Towers (100 foot and over)                           | 99                | 97               | 94               | 85               | 82                |
| Towers (under 100 foot)                              | 13                | 13               | 13               | 13               | 13                |
| PCS Market POPS (000) (3)                            | 2,268             | 2,242            | 2,236            | 2,236            | 2,199             |
| PCS Covered POPS (000) (3)                           | 1,750             | 1,728            | 1,704            | 1,704            | 1,658             |
| PCS Ave. Monthly Retail Churn % (4)                  | 1.9%              | 1.9%             | 1.9%             | 1.9%             | 2.1%              |
| Converged Services (NTC) Properties Served (5)       | 108               | 106              | 108              | 109              | 108               |
| Converged Services (NTC) Bulk Accounts (6)           | 45                | 41               | 40               | 41               | 41                |
| Converged Services (NTC) Retail Accounts (7) (8)     | 15,337            | 8,477            | 9,937            | 10,009           | 10,945            |
| Converged Services (NTC) Video Service Users (8)     | 8,539             | 7,374            | 8,415            | 8,461            | 8,424             |
| Converged Services (NTC) Telephone Service Users (8) | 5,741             | 8,797            | 9,766            | 9,914            | 9,843             |
| Converged Services (NTC) Network/Internet Users (8)  | 22,881            | 18,719           | 22,783           | 22,901           | 22,433            |

- (1) Wholesale PCS Users are private label subscribers with numbers homed in the Company's wireless network service area.
- (2) Originated by customers of the Company's Telephone subsidiary.
- (3) POPS refers to the estimated population of a given geographic area and is based on information purchased by Sprint Nextel from Geographic Information Services. Market POPS are those within a market area which the Company is authorized to serve under its Sprint PCS affiliate agreements, and Covered POPS are those covered by the network's service area.
- (4) PCS Ave. Monthly Churn is the average of the three monthly subscriber turnover, or churn calculations for the period.
- (5) Indicates MDU complexes where NTC provides service.
- (6) Service is provided under a single contract with the property owner who typically provides service to tenants as part of their lease.
- (7) Service is provided under contract with individual subscribers.
- (8) Bulk and retail subscribers combined by service type. The variations in users between quarters reflect the impact of the cycles of the academic year.

### Significant Transactions

On August 4, 2005, the board of directors of the Rural Telephone Bank (the RTB) adopted a number of resolutions for the purpose of dissolving the RTB as of October 1, 2005. The Company held 10,821,770 shares of Class B and Class C RTB Common Stock (\$1.00 par value) which was reflected on the Company's balance sheet at December 31, 2005, at \$796,000 under the cost method. During the first quarter of 2006, the Company recognized a gain of approximately \$6.4 million, net of tax, related to the dissolution of the RTB and the redemption of the stock. In April 2006, the Company received \$11.3 million in proceeds from the RTB.

### Results of Continuing Operations

#### Three and Nine Months Ended September 30, 2006 Compared with the Three and Nine Months Ended September 30, 2005

#### Consolidated Results

The results for the three and nine months ended September 30, 2005, have been restated to reflect the correction of certain errors in the Company's accounting for operating leases. See Note 2 to the unaudited condensed consolidated financial statements appearing elsewhere in this report for additional information.

The Company's consolidated results for the third quarter and the first nine months of 2006 and 2005 are summarized as follows:

| (in thousands)         | Three Months Ended<br>September 30, |            | Change   |      | Nine Months Ended<br>September 30, |            | Change    |       |
|------------------------|-------------------------------------|------------|----------|------|------------------------------------|------------|-----------|-------|
|                        | 2006                                | 2005       | \$       | %    | 2006                               | 2005       | \$        | %     |
|                        |                                     | (Restated) |          |      |                                    | (Restated) |           |       |
| Operating revenues     | \$ 42,594                           | \$ 37,314  | \$ 5,280 | 14.2 | \$ 123,820                         | \$ 107,166 | \$ 16,654 | 15.5  |
| Operating expenses     | 36,667                              | 31,658     | 5,009    | 15.8 | 108,969                            | 92,535     | 16,434    | 17.8  |
| Operating income       | 5,927                               | 5,656      | 271      | 4.8  | 14,851                             | 14,631     | 220       | 1.5   |
| Other income (expense) | (420)                               | (511)      | 91       | 17.8 | 9,483                              | (1,880)    | 11,363    | 604.4 |
| Net income             | \$ 3,381                            | \$ 3,101   | \$ 280   | 9.0  | \$ 14,710                          | \$ 7,895   | \$ 6,815  | 86.3  |

#### Operating revenues

For the three and nine months ended September 30, 2006, operating revenue increased \$5.3 million, or 14.2%, and \$16.7 million, or 15.5%, respectively, compared to the same periods in 2005. The increase was primarily due to the growth in the Company's PCS segment. For the three and nine months ended September 30, 2006, PCS operating revenues increased \$4.9 million, or 19.9%, and \$14.1 million, or 20.4%, respectively, Telephone operating revenues increased \$0.4 million, or 5.7%, and \$1.8 million, or 8.4%, respectively, and Converged Services operating revenues increased \$0.1 million, or 5.1%, and \$0.9 million, or 13.6%, respectively.

#### Operating expenses

For the three and nine months ended September 30, 2006, operating expenses increased \$5.0 million, or 15.8%, and \$16.4 million, or 17.8%, respectively, compared to the same periods in 2005. The increase was primarily due to the increases in the Company's PCS and Converged Services segments. For the three and nine months ended September 30, 2006, PCS operating expenses increased \$4.0 million, or 19.3%, and \$10.6 million, or 17.1%, respectively, and Converged Services operating expenses increased \$0.6 million, or 15.9%, and \$3.7 million, or 36.3%, respectively.

#### Other income (expense)

For the three and nine months ended September 30, 2006, other income increased \$0.1 million, or 17.8%, and \$11.4 million, or 604.4%, respectively. The increase for the nine months was primarily due to the Company recognizing a first quarter 2006 gain of approximately \$10.5 million related to the dissolution of the RTB, and the redemption of the stock.

**Net income**

For the three and nine months ended September 30, 2006, net income increased \$0.3 million, or 9.0%, and \$6.8 million, or 86.3%, respectively, primarily due to the Company recognizing a first quarter 2006 gain of approximately \$6.4 million, net of tax, related to the dissolution of the RTB, and the redemption of the stock.

**Segment Results**

The restatement discussed in Note 2 to the unaudited condensed consolidated financial statements appearing elsewhere in this report, is reflected in those segments affected by the restatement, which are the PCS segment and the Mobile segment. The other segments, Telephone, Converged Services, Holding and other were not affected by the restatement.

**PCS**

| (in thousands)   | Three Months Ended<br>September 30, |           | Change   |      | Nine Months Ended<br>September 30, |           | Change   |      |
|--|-------------------------------------|-----------|----------|------|------------------------------------|-----------|----------|------|
|  | 2006                                | 2005      | \$       | %    | 2006                               | 2005      | \$       | %    |
|  | (Restated)                          |           |          |      | (Restated)                         |           |          |      |
| Segment operating revenues   |                                     |           |          |      |                                    |           |          |      |
| Wireless service revenue   | \$ 18,803                           | \$ 16,015 | \$ 2,788 | 17.4 | \$ 54,928                          | \$ 45,860 | \$ 9,068 | 19.8 |
| Travel and roaming revenue   | 9,074                               | 7,386     | 1,688    | 22.9 | 24,188                             | 20,099    | 4,089    | 20.3 |
| Equipment revenue  | 1,114                               | 920       | 194      | 21.1 | 3,149                              | 2,540     | 609      | 24.0 |
| Other revenue  | 516                                 | 290       | 226      | 77.9 | 1,250                              | 893       | 357      | 40.0 |
| Total segment operating revenues   | 29,507                              | 24,611    | 4,896    | 19.9 | 83,515                             | 69,392    | 14,123   | 20.4 |
| Segment operating expenses   |                                     |           |          |      |                                    |           |          |      |
| Cost of goods and services, exclusive of depreciation and amortization shown separately below          | 13,580                              | 10,725    | 2,855    | 26.6 | 38,306                             | 32,041    | 6,265    | 19.6 |
| Selling, general and administrative, exclusive of depreciation and amortization shown separately below | 7,822                               | 7,035     | 787      | 11.2 | 23,416                             | 20,507    | 2,909    | 14.2 |
| Depreciation and amortization  | 3,581                               | 3,181     | 400      | 12.6 | 10,634                             | 9,240     | 1,394    | 15.1 |
| Total segment operating expenses   | 24,983                              | 20,941    | 4,042    | 19.3 | 72,356                             | 61,788    | 10,568   | 17.1 |
| Segment operating income   | \$ 4,524                            | \$ 3,670  | \$ 854   | 23.3 | \$ 11,159                          | \$ 7,604  | \$ 3,555 | 46.8 |

The results for the three and nine months ended September 30, 2005 have been restated to reflect the correction of certain errors in the Company's accounting for operating leases. See Note 2 to the unaudited condensed consolidated financial statements appearing elsewhere in this report for additional information. The effect of these restatements on the PCS segment's operating income for the three and nine months ended September 30, 2005, was to increase the cost of goods and services and decrease segment operating income by \$46 thousand and \$140 thousand, respectively.

Shenandoah PCS Company, as a Sprint PCS Affiliate of Sprint Nextel, provides digital wireless service to a portion of a four-state area covering the region from Harrisburg, York and Altoona, Pennsylvania, to Harrisonburg, Virginia.

The Company receives revenues from Sprint Nextel for subscribers that obtain service in the Company's network coverage area and other Sprint Nextel subscribers that use the Company's network when they use PCS service within the Company's service area. The Company relies on Sprint Nextel to provide timely, accurate and complete information for the Company to record the appropriate revenue and expenses for each financial period.

The Company had 331 PCS base stations in service at September 30, 2006, compared to 301 base stations in service at September 30, 2005. The increase in base stations was the result of supplementing network capacity and further extending coverage along more heavily traveled secondary roads in the Company's market areas.

Through Sprint Nextel, the Company receives revenue from wholesale resellers of wireless PCS service. These resellers pay a flat rate per minute of use for all traffic their subscribers generate on the Company's network. The Company's cost to handle this traffic is the incremental cost to provide the necessary network capacity.



For the three and nine months ended September 30, 2006, travel and roaming revenues (including the long distance and 3G data portions of such traffic), net of travel and roaming costs, contributed \$3.4 million and \$9.8 million to operating income, up from the \$3.3 million and \$8.9 million contribution for the comparable 2005 periods. The Company's travel receivable minutes for the three and nine months ended September 30, 2006 increased 11.5% to 97.3 million and 12.8% to 275.1 million, respectively, and the travel payable minutes increased by 14.6% to 73.3 million and 13.9% to 203.0 million, respectively, compared to the same periods in 2005. The increases in travel minutes receivable and payable are primarily the result of an increase in usage of the Company's network facilities by subscribers based in other markets and growth in subscribers in the Company's markets using PCS service outside of the Company's service area.

For the three and nine months ended September 30, 2006, on a per-subscriber basis, the Company's average of travel payable minutes decreased to 177 minutes per month and 171 minutes per month, respectively, which represented a decrease of 9 minutes per month and 10 minutes per month from the same periods in 2005.

The Company's average PCS retail customer turnover, or churn rate, was 1.9% in the third quarter of 2006 and 2.1% in the third quarter of 2005. For the three and nine months ended September 30, 2006, there was an increase in PCS bad debt expense to 4.8% and 4.0%, respectively, of PCS service revenues compared to 3.9% and 3.5%, respectively, in the same periods in 2005. Although management continues to monitor receivables, collection efforts and new subscriber credit ratings, there is no certainty that the bad debt expense will not continue to increase in the future.

The Company receives and pays travel fees for inter-market usage of the network by Sprint wireless subscribers not homed in a market in which they may use the service. Sprint and its PCS Affiliates pay the Company for the use of its network by their wireless subscribers, while the Company pays Sprint Nextel and its PCS Affiliates reciprocal fees for Company subscribers using other segments of the network not operated by the Company. The rates paid on inter-market travel are currently \$0.058 per minute for voice and \$0.002 per kilobyte for data and will remain at this rate through December 31, 2006. In addition, Sprint Nextel provides the Company with billing, collections, customer care, and other back office operations for which the Company pays Sprint Nextel a fee (the Customer Care Fee). Sprint Nextel has proposed reductions to the travel fees and increases in the Customer Care Fees effective January 1, 2007 which if adopted would have a material and substantial negative impact on the Company's and the PCS segment's Operating Revenues and Net Income. Under its agreements with Sprint Nextel, the Company may request that Sprint Nextel substantiate these changes and demand an audit, and if the parties are unable to agree on revised pricing, submit the matter to arbitration.

### **Operating revenues**

For the three and nine months ended September 30, 2006, wireless service revenues from retail customers increased \$2.8 million, or 17.4%, and \$9.1 million, or 19.8%, respectively. Wireless service revenue is recorded net of 8% retained by Sprint Nextel in accordance with the terms of the management agreement. As of September 30, 2006, the Company had 141,594 retail PCS subscribers compared to 116,460 subscribers at September 30, 2005. The PCS operation added 7,035 net retail subscribers in the third quarter of 2006 compared to 4,401 net retail subscribers added in the third quarter of 2005. In addition, net wholesale users increased by 2,251 during the third quarter of 2006 compared to 1,115 added in the third quarter of 2005.

For the three and nine months ended September 30, 2006, PCS travel and roaming revenues increased \$1.7 million, or 22.9%, and \$4.1 million, or 20.3%, respectively. The travel and roaming revenue increase resulted from an increase in travel usage by Sprint Nextel and other Sprint PCS Affiliates on the Company's network. For the third quarter of 2006, the travel rate the Company received from Sprint Nextel was \$0.058 per minute, which was the same rate as in the third quarter of 2005.

For the three and nine months ended September 30, 2006, PCS equipment revenues increased \$0.2 million, or 21.1%, and \$0.6 million, or 24.0%, respectively. The increase was primarily due to the addition of new PCS subscribers in the third quarter of 2006 and more subscribers upgrading their handsets to access new features provided with the service. The effect of these factors was offset in part by a lower average price received for handset equipment during the second quarter of 2006.

### **Cost of goods and services**

For the three and nine months ended September 30, 2006, cost of PCS goods and services increased \$2.9 million, or 26.6%, and \$6.3 million, or 19.6%, respectively. For the three and nine months ended September 30, 2006, PCS travel

costs increased \$1.6 million, or 34.9%, to \$6.0 million and \$3.5 million, or 28.0%, to \$16.0 million, respectively. The travel costs increased due to an increase in travel minutes used by the Company's subscribers on the Sprint Nextel or Sprint PCS Affiliate networks not operated by the Company.

For the three and nine months ended September 30, 2006, cost of goods and services experienced additional increases, for rent expense of \$0.1 million and \$0.5 million, respectively, network costs of \$0.9 million and \$1.4 million, respectively and PCS long distance costs of \$0.1 million and \$0.2 million, respectively. The increase in network service costs reflects the \$750,000 settlement received from Verizon in the third quarter of 2005, which was recorded as a reduction of network costs at that time.

### Selling, general and administrative

For the three and nine months ended September 30, 2006, selling, general and administrative costs increased \$0.8 million, or 11.2%, and \$2.9 million, or 14.2%, respectively. The increase was primarily attributable to an increase in the amount paid to Sprint Nextel for the administration of the customer base of \$0.4 million and \$1.1 million, respectively, due to an increase in customers, an increase in commissions paid to Radio Shack Corporation of \$0.2 million and \$0.8 million, respectively, an increase of \$0.3 million and \$1.0 million, respectively, for commissions paid to other national and local third-party retailers, and an increase in bad debt expense of \$0.3 million and \$0.6 million, respectively. These increases were offset by a decrease in allocated shared services costs of \$0.4 million in the nine month period.

### Telephone

| (in thousands)   | Three Months Ended |                    | Change        |              | Nine Months Ended  |                    | Change          |             |
|--|--------------------|--------------------|---------------|--------------|--------------------|--------------------|-----------------|-------------|
|  | September 30, 2006 | September 30, 2005 | \$            | %            | September 30, 2006 | September 30, 2005 | \$              | %           |
| Segment operating revenues   |                    |                    |               |              |                    |                    |                 |             |
| Service revenue - wireline   | \$ 1,716           | \$ 1,733           | \$ (17)       | (1.0)        | \$ 5,157           | \$ 5,144           | \$ 13           | 0.3         |
| Access revenue   | 3,274              | 3,058              | 216           | 7.1          | 9,821              | 9,080              | 741             | 8.2         |
| Facilities lease revenue   | 1,656              | 1,589              | 67            | 4.2          | 5,169              | 4,507              | 662             | 14.7        |
| Equipment revenue  | 8                  | 5                  | 3             | 60.0         | 22                 | 12                 | 10              | 83.3        |
| Other revenue  | 900                | 763                | 137           | 18.0         | 2,672              | 2,323              | 349             | 15.0        |
| <b>Total segment operating revenues</b>  | <b>7,554</b>       | <b>7,148</b>       | <b>406</b>    | <b>5.7</b>   | <b>22,841</b>      | <b>21,066</b>      | <b>1,775</b>    | <b>8.4</b>  |
| Segment operating expenses   |                    |                    |               |              |                    |                    |                 |             |
| Cost of goods and services, exclusive of depreciation and amortization shown separately below          | 1,712              | 1,679              | 33            | 2.0          | 5,323              | 4,855              | 468             | 9.6         |
| Selling, general and administrative, exclusive of depreciation and amortization shown separately below | 1,149              | 1,270              | (121)         | (9.5)        | 3,566              | 3,973              | (407)           | (10.2)      |
| Depreciation and amortization  | 1,163              | 1,080              | 83            | 7.7          | 3,588              | 3,285              | 303             | 9.2         |
| <b>Total segment operating expenses</b>  | <b>4,024</b>       | <b>4,029</b>       | <b>(5)</b>    | <b>(0.1)</b> | <b>12,477</b>      | <b>12,113</b>      | <b>364</b>      | <b>3.0</b>  |
| <b>Segment operating income</b>  | <b>\$ 3,530</b>    | <b>\$ 3,119</b>    | <b>\$ 411</b> | <b>13.2</b>  | <b>\$ 10,364</b>   | <b>\$ 8,953</b>    | <b>\$ 1,411</b> | <b>15.8</b> |

Shenandoah Telephone Company provides both regulated and unregulated telephone services and leases fiber optic facilities throughout the northern Shenandoah Valley and northern Virginia. The telephone segment's results were not affected by the restatement discussed in Note 2 to the consolidated financial statements appearing elsewhere in this report.

During the third quarter of 2006, the Company's telephone access line count declined by 86 access lines. Although new housing starts in the Company's local telephone area resulted in a net increase of 109 access lines during the first nine months of 2006, the trend over past periods has been a decline in subscribers, principally due to consumer migration to wireless and DSL services from traditional telephone services. The construction of new homes within Shenandoah County appears to have moderated. Based on industry experience, however, the Company anticipates that the long-term trend toward declining telephone subscriber counts may dominate for the foreseeable future.

**Operating Revenues**

For the three and nine months ended September 30, 2006, total switched minutes of use on the local telephone network increased by 4.5% and 7.3%, respectively, compared to 2005. The mix of minutes that terminate to wireless carriers

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compared to total minutes were 51.6% and 50.6% for the three and nine months ended September 30, 2005, respectively, and 51.4% and 51.0% for the three and nine months ended September 30, 2006, respectively.

For the three and nine months ended September 30, 2006, access revenues increased \$0.2 million, or 7.1%, and \$0.7 million, or 8.2%, respectively, primarily due to a \$0.1 million and \$0.3 million, respectively, increase in DSL wholesale revenue billed to Shentel Service Company and a \$0.3 million increase in the nine month period in revenue administered by the National Exchange Carrier Association (NECA).

For the three and nine months ended September 30, 2006, facilities lease revenue increased \$0.1 million, or 4.2%, and \$0.7 million, or 14.7%, respectively, due to additional fiber capacity being leased during the first nine months of 2006 compared to the first nine months of 2005.

### Cost of goods and services

For the nine months ended September 30, 2006, cost of goods and services increased \$0.5 million, or 9.6%, primarily due to increases in network maintenance and repair expenses.

### Converged Services

| (in thousands)   | Three Months Ended |                   | Change          |               | Nine Months Ended  |                   | Change            |               |
|--|--------------------|-------------------|-----------------|---------------|--------------------|-------------------|-------------------|---------------|
|  | September 30, 2006 | 2005              | \$              | %             | September 30, 2006 | 2005              | \$                | %             |
| <b>Segment operating revenues</b>  |                    |                   |                 |               |                    |                   |                   |               |
| Service revenue - wireline   | \$ 2,230           | \$ 2,260          | \$ (30)         | (1.3)         | \$ 7,437           | \$ 6,853          | \$ 584            | 8.5           |
| Other revenue  | 184                | 37                | 147             | 397.3         | 425                | 70                | 355               | 507.1         |
| <b>Total segment operating revenues</b>  | <b>2,414</b>       | <b>2,297</b>      | <b>117</b>      | <b>5.1</b>    | <b>7,862</b>       | <b>6,923</b>      | <b>939</b>        | <b>13.6</b>   |
| <b>Segment operating expenses</b>  |                    |                   |                 |               |                    |                   |                   |               |
| Cost of goods and services, exclusive of depreciation and amortization shown separately below          | 1,970              | 2,126             | (156)           | (7.3)         | 6,209              | 5,096             | 1,113             | 21.8          |
| Selling, general and administrative, exclusive of depreciation and amortization shown separately below | 1,272              | 1,182             | 90              | 7.6           | 3,880              | 3,257             | 623               | 19.1          |
| Depreciation and amortization  | 1,113              | 448               | 665             | 148.4         | 3,761              | 1,805             | 1,956             | 108.4         |
| <b>Total segment operating expenses</b>  | <b>4,355</b>       | <b>3,756</b>      | <b>599</b>      | <b>15.9</b>   | <b>13,850</b>      | <b>10,158</b>     | <b>3,692</b>      | <b>36.3</b>   |
| <b>Segment operating (loss)</b>  | <b>\$ (1,941)</b>  | <b>\$ (1,459)</b> | <b>\$ (482)</b> | <b>(33.0)</b> | <b>\$ (5,988)</b>  | <b>\$ (3,235)</b> | <b>\$ (2,753)</b> | <b>(85.1)</b> |

The Converged Services segment primarily consists of the operations of NTC, which provides local and long distance voice, data and video services on an exclusive and non-exclusive basis to MDU communities throughout the southeastern United States including Virginia, North Carolina, Maryland, South Carolina, Georgia, Florida, Tennessee and Mississippi. The Converged Services segment's results were not affected by the restatement detailed in Note 2 to the consolidated financial statements appearing elsewhere in this report.

The number of NTC properties served was unchanged at 108 properties as of September 30, 2006 and 2005. The Company continues to focus on integrating NTC's operations by evaluating the MDU portfolio and eliminating the smaller unprofitable properties, while signing new contracts for properties that offer a better profit potential. The Company also capitalized approximately \$0.9 million during 2006 to improve its customer service interface and billing systems to support the Converged Services segment.

### Operating revenues

For the nine months ended September 30, 2006, service revenues increased \$0.6 million, or 8.5%, as a result of the growth in the number of customers served, as compared to the same period in 2005. The decline for the three month period in service revenue resulted from fewer students using phone services, combined with lost revenue from four MDU's that did not renew contracts expiring during the quarter ended September 30, 2006, as previously reported. Service revenues consist of voice, video and data services at MDU properties in the southeastern

United States.

For the three and nine months ended September 30, 2006 other revenues increased \$0.1 million, or 397.3%, and \$0.4 million, or 507.1%, respectively, primarily due to an increase in activation fees.

### **Operating expenses**

The Company records its employee costs and other shared expenses in a subsidiary, Shentel Management Company. These costs and expenses are then allocated to each of the respective subsidiaries under an arrangement approved by the Virginia State Corporation Commission. Between 2005 and 2006, due to changes in the allocation formulas (updated twice annually); additional direct labor devoted to Converged Services projects (such as the customer interface/billing system project, roll-out of new properties, and equipment upgrades and maintenance issues); and additional management focus on the Converged Services segment, \$1.3 million in additional expenses have been allocated to Converged Services in 2006 compared to 2005. The PCS segment has been the largest beneficiary of this change in allocation, as it has been allocated \$1.0 million less in 2006 than in 2005. These costs are reflected primarily in cost of goods and services and selling, general and administrative expenses in the table above.

### **Cost of goods and services**

Cost of goods and services reflects the cost of purchasing video and voice services, the network costs to provide Internet services to customers and network maintenance and repair. For the nine months ended September 30, 2006, cost of goods and services increased \$1.1 million, or 21.8%, due to a loss on asset disposals of \$0.4 million, an increase in allocated costs (as described above) of \$0.5 million, and an increase in third party maintenance costs of \$0.3 million. The decrease of \$0.2 million in the third quarter of 2006 compared to 2005 reflects a decrease in network costs of \$0.3 million, offset by losses on asset disposals of \$0.2 million in the 2006 quarter. The Company continues to focus on eliminating redundant processes and integrating the operation to reduce the costs of operation.

### **Selling, general and administrative**

For the three and nine months ended September 30, 2006, selling, general and administrative expense increased \$0.1 million, or 7.6%, and \$0.6 million, or 19.1%, respectively. The increase resulted largely from training and testing related to the customer interface/billing system improvement undertaken for the student move-in during the third quarter of 2006, offset by a decrease in professional services expense from the 2005 third quarter and nine month periods.

### **Depreciation and amortization**

For the three and nine months ended September 30, 2006, depreciation and amortization expense increased \$0.7 million, or 148.4%, and \$2.0 million, or 108.4%, respectively, compared to the same periods in 2005, due primarily to a fourth quarter 2005 change in depreciable lives; during the second quarter of 2006, the Company also recorded \$0.6 million in depreciation expense for four MDU s that notified the Company that they did not intend to renew their contracts for service; and in the third quarter of 2006, the Company shortened the depreciable lives of certain phone system assets it expects to replace in late 2007.

**Mobile**

| (in thousands)   | Three Months Ended<br>September 30, |               | Change       |             | Nine Months Ended<br>September 30, |                 | Change        |             |
|--|-------------------------------------|---------------|--------------|-------------|------------------------------------|-----------------|---------------|-------------|
|  | 2006                                | 2005          | \$           | %           | 2006                               | 2005            | \$            | %           |
|  | (Restated)                          |               |              |             | (Restated)                         |                 |               |             |
| Segment operating revenues   |                                     |               |              |             |                                    |                 |               |             |
| Tower lease revenue-affiliate  | \$ 420                              | \$ 348        | \$ 72        | 20.7        | \$ 1,228                           | \$ 1,028        | \$ 200        | 19.5        |
| Tower lease revenue-non-affiliate  | 839                                 | 790           | 49           | 6.2         | 2,571                              | 2,336           | 235           | 10.1        |
| Other revenue  | 81                                  | 43            | 38           | 88.4        | 149                                | 115             | 34            | 29.1        |
| <b>Total segment operating revenues</b>  | <b>1,340</b>                        | <b>1,181</b>  | <b>159</b>   | <b>13.5</b> | <b>3,948</b>                       | <b>3,479</b>    | <b>469</b>    | <b>13.5</b> |
| Segment operating expenses   |                                     |               |              |             |                                    |                 |               |             |
| Cost of goods and services,<br>exclusive of depreciation and<br>amortization shown separately below          | 410                                 | 387           | 23           | 5.9         | 1,212                              | 1,026           | 186           | 18.1        |
| Selling, general and administrative,<br>exclusive of depreciation and<br>amortization shown separately below | 195                                 | 136           | 59           | 43.4        | 522                                | 435             | 87            | 20.0        |
| Depreciation and amortization  | 216                                 | 178           | 38           | 21.3        | 622                                | 530             | 92            | 17.4        |
| <b>Total segment operating expenses</b>  | <b>821</b>                          | <b>701</b>    | <b>120</b>   | <b>17.1</b> | <b>2,356</b>                       | <b>1,991</b>    | <b>365</b>    | <b>18.3</b> |
| <b>Segment operating income</b>  | <b>\$ 519</b>                       | <b>\$ 480</b> | <b>\$ 39</b> | <b>8.1</b>  | <b>\$ 1,592</b>                    | <b>\$ 1,488</b> | <b>\$ 104</b> | <b>7.0</b>  |

The Mobile company provides tower rental space to affiliated and non-affiliated companies in the Company's PCS markets and paging services throughout the northern Shenandoah Valley.

The results for the three and nine months ended September 30, 2005 have been restated to reflect the correction of certain errors in the Company's accounting for operating leases. See Note 2 to the unaudited condensed consolidated financial statements appearing elsewhere in this report for additional information. The effect of these restatements on the Mobile segment's operating income, for the three and nine months ended September 30, 2005, was to decrease tower lease revenue-non-affiliate by \$6 thousand and \$18 thousand, respectively, increase cost of goods and services by \$44 thousand and \$129 thousand, respectively, and decrease segment operating income by \$50 thousand and \$147 thousand, respectively.

At September 30, 2006, the Mobile segment had 110 towers and 153 non-affiliate tenants compared to 93 towers and 145 non-affiliate tenants at September 30, 2005.

For the three and nine months ended September 30, 2006, the Mobile Company did not have any additional significant changes from the prior period that can not be explained by the increases in towers and tenants.

## Liquidity and Capital Resources

The Company has four principal sources of funds available to meet the financing needs of its operations, capital projects, debt service, investments and potential dividends. These sources include cash flows from operations, cash and cash equivalents, the liquidation of investments and borrowings. Management routinely considers the alternatives available to determine what mix of sources are best suited for the long-term benefit of the Company.

*Sources and Uses of Cash.* The Company generated \$25.2 million of net cash from operations in the nine months ended September 30, 2006 compared to \$28.0 million in the comparable period of 2005. The decrease in net cash from operations primarily resulted from the payment of taxes associated with the gain on the sale of RTB stock in 2006.

*Indebtedness.* As of September 30, 2006, the Company's indebtedness totaled \$27.0 million, with an annualized overall weighted average interest rate of approximately 7.5%. As of September 30, 2006, the Company was in compliance with the covenants in its credit agreements.

On August 4, 2005, the board of directors of the Rural Telephone Bank (the RTB) adopted a number of resolutions for the purpose of dissolving the RTB as of October 1, 2005. The Company held 10,821,770 shares of Class B and Class C RTB Common Stock (\$1.00 par value) which was reflected on the Company's balance sheet at December 31, 2005, at \$796,000 under the cost method. During the first quarter of 2006, the Company recognized a gain of approximately \$6.4 million, net of tax, related to the dissolution of the RTB and the redemption of the stock. In April 2006, the Company received \$11.3 million in proceeds from the RTB.

During the quarter ended September 30, 2006, the Company paid off approximately \$4.5 million of long term debt payable to the RTB and the Rural Utilities Service (RUS) (not including the interest free RUS Development Loan of \$200,000 outstanding principal). No prepayment penalties were incurred in connection with the pay-off of these balances.

*Off-Balance Sheet Transactions.* The Company has no off-balance sheet arrangements and has not entered into any transactions involving unconsolidated, limited purpose entities or commodity contracts.

*Capital Commitments.* During the second quarter of 2006, the Company revised its capital expenditures budgeted for 2006 from a total of \$43.6 million to approximately \$20 million, primarily due to delaying certain expenditures budgeted in the PCS segment. The 2006 revised budget included approximately \$4.6 million for additional PCS base stations, additional towers and switch upgrades to enhance the PCS network. Approximately \$5.3 million was budgeted for NTC's network upgrades and new apartment complex build outs, improvements and replacements, approximately \$3.6 million for the telephone operations and approximately \$6.5 million for technology upgrades and other capital needs. For the 2006 nine month period, the Company has spent, or has committed to spend, \$18.3 million on capital projects. The Company has projected total 2006 capital spending of approximately \$23 million, with PCS and NTC accounting for most of the increase in spending.

In October, 2006, the Company declared a regular cash dividend of \$0.48 per share, and a special cash dividend of \$0.27 per share, to be paid December 1, 2006, to holders of record as of November 15, 2006. The Company expects to pay approximately \$5.8 million. The special cash dividend is a distribution of a portion of the gain on the liquidation of the RTB stock in the first quarter of 2006.

The Company believes that cash on hand, cash flow from operations and borrowings expected to be available under the Company's existing revolving credit facility will provide sufficient cash to enable the Company to fund its planned capital expenditures, make scheduled principal and interest payments, meet its other cash requirements and maintain compliance with the terms of its financing agreements for at least the next 12 months. Thereafter, capital expenditures will likely continue to be required to provide increased capacity to meet the Company's expected growth in demand for its products and services. The actual amount and timing of the Company's future capital requirements may differ materially from the Company's estimate depending on the demand for its products and new market developments and opportunities. The Company currently expects that it will fund its future capital expenditures primarily with cash from operations and with borrowings.

These events include, but are not limited to; changes in overall economic conditions, regulatory requirements, changes in technologies, availability of labor resources and capital, changes in the Company's relationship with Sprint Nextel, cancellations or non-renewal of NTC contracts and other conditions. The PCS subsidiary's operations are dependent



upon Sprint Nextel's ability to execute certain functions such as billing, customer care, and collections; the subsidiary's ability to develop and implement successful marketing programs and new products and services, and the subsidiary's ability to effectively and economically manage other operating activities under the Company's agreements with Sprint Nextel. The Company's ability to attract and maintain a sufficient customer base is also critical to its ability to maintain a positive cash flow from operations. The foregoing events individually or collectively could affect the Company's results. The Company continues to assess the impact of the planned merger of Sprint Nextel and Nextel Partners on the Company's operations.

The Company has had discussions with Sprint Nextel regarding the continuance of their long-term relationship, the impact of the Sprint Nextel merger and potential changes to the management agreement necessary to reflect the merger of Sprint Corporation and Nextel Communications, Inc. and the acquisition of Nextel Partners, Inc. by Sprint Nextel. As a result of the Sprint Nextel merger, Sprint Nextel may require the Company to meet additional program requirements, which the Company anticipates would increase capital expenditures and operating expenses. To date, the Company has been unable to arrive at a mutually acceptable agreement with Sprint Nextel concerning such potential changes. Accordingly, the Company is now going to consider other alternatives in discussions with Sprint Nextel including the possible sale of its PCS business. The Company is unable to predict whether or on what terms it would be able to implement a sale of its PCS business, the ultimate resolution of its discussions with Sprint Nextel concerning its relationship, or the impact of any such action on its financial condition or future operating results or prospects.

The Company receives and pays travel fees for inter-market usage of the network by Sprint wireless subscribers not homed in a market in which they may use the service. Sprint and its PCS Affiliates pay the Company for the use of its network by their wireless subscribers, while the Company pays Sprint Nextel and its PCS Affiliates reciprocal fees for Company subscribers using other segments of the network not operated by the Company. The rates paid on inter-market travel are currently \$0.058 per minute for voice and \$0.002 per kilobyte for data and will remain at this rate through December 31, 2006. In addition, Sprint Nextel provides the Company with billing, collections, customer care, and other back office operations for which the Company pays Sprint Nextel a fee (the Customer Care Fee). Sprint Nextel has proposed reductions to the travel fees and increases in the Customer Care Fees effective January 1, 2007 which if adopted would have a material and substantial negative impact on the Company's and the PCS segments Operating Revenues and Net Income. Under its agreements with Sprint Nextel, the Company may request that Sprint Nextel substantiate these changes and demand an audit, and if the parties are unable to agree on revised pricing, submit the matter to arbitration.

#### **Employee Stock Options**

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standard No. 123, Share-Based Payment (Revised 2004) (SFAS 123(R)) using the modified prospective application transition method, which establishes accounting for stock-based awards exchanged for employee services. Accordingly, for equity classified awards, stock-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized over the requisite service period. For those tandem awards of stock options and stock appreciation rights (SARs) which are liability classified awards, fair value is calculated at the grant date and each subsequent reporting date during both the requisite service period and each subsequent period until settlement.

See Note 5 to the Company's unaudited condensed consolidated financial statements for additional information.

#### **Recently Issued Accounting Standards**

In December 2004, the FASB issued SFAS 123(R), which is a revision of SFAS No. 123, Accounting for Stock-Based Compensation. SFAS 123(R) replaces SFAS No. 123, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and amends SFAS No. 95, Statement of Cash Flows. The approach in SFAS 123(R) is similar to the approach described in SFAS No. 123, however, SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure will no longer be an alternative. SFAS 123(R) was effective for the Company beginning January 1, 2006. The Company recorded a cumulative effect of a change in accounting principle of approximately \$0.1 million as a result of implementing SFAS 123(R) in the first quarter 2006.

In March 2005, the FASB issued FASB Interpretation (FIN) No. 47 Accounting for Conditional Asset Retirement Obligations an Interpretation of FASB Statement No. 143 (FIN No. 47). FIN No. 47 clarifies the timing of liability recognition for legal obligations associated with the retirement of a tangible long-lived asset when the timing and/or method of settlement are conditional on a future event. FIN No. 47 was effective for the Company as of December 31,

2005. The adoption of FIN No. 47 did not have a material impact on the Company's consolidated results of operations or financial position.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections* a replacement of APB Opinion No. 20 and FASB Statement No. 3 ( SFAS No. 154 ). This Statement replaces APB Opinion No. 20, *Accounting Changes* and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*, and changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS No. 154 applies to all voluntary changes in an accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. SFAS No. 154 was effective for accounting changes and error corrections occurring in fiscal years beginning after December 15, 2005.

In July 2006, the FASB issued FIN 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of FASB Statement No. 109. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the enterprise's financial statements in accordance with FASB Statement No. 109. FIN 48 is effective for fiscal years beginning after December 15, 2006. We are currently evaluating the provisions of FIN 48 and we expect to adopt FIN 48 on January 1, 2007.

In September 2006, the SEC released Staff Accounting Bulletin No. 108 ( SAB 108 ). SAB 108 provides guidance regarding the process of quantifying financial statement misstatements when the error involves prior periods and was not previously considered material to such prior periods. SAB 108 allows a registrant to correct the prior period portion of such errors by adjusting the beginning balance of retained earnings as of the beginning of the first fiscal year ending after November 15, 2006. The Company is evaluating the provisions of SAB 108, but does not expect that applying SAB 108 would have a material effect upon the Company's results of operations or financial condition.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and other Postretirement Plans* an amendment of FASB Statements No. 87, 88, 106 and 132 (R) ( SFAS 158 ). SFAS 158 requires an employer to recognize in its statement of financial position the overfunded or underfunded status of a defined benefit postretirement plan. For the Company, implementation of FAS 158, which is effective as of the end of this fiscal year, is expected to result in an increase in reported liabilities offset by a reduction of accumulated other comprehensive income.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company's market risks relate primarily to changes in interest rates on instruments held for other than trading purposes. The Company's interest rate risk involves three components. The first component is outstanding debt with variable rates. As of September 30, 2006, the Company has no variable rate debt outstanding. The Company's debt has fixed rates through maturity. A 10.0% increase in interest rates would decrease the fair value of the Company's total debt by approximately \$0.6 million, while the estimated fair value of the fixed rate debt was approximately \$26.3 million as of September 30, 2006.

The second component of interest rate risk consists of temporary excess cash, which is primarily invested in overnight repurchase agreements and Treasury bills with a maturity of less than 90 days. The cash is currently invested in short-term investment vehicles that have limited interest rate risk. Management continues to evaluate the most beneficial use of these funds.

The third component of interest rate risk is marked increases in interest rates that may adversely affect the rate at which the Company may borrow funds for growth in the future. Management does not believe that this risk is currently significant because the Company's existing sources of liquidity are adequate to provide cash for operations, payment of debt and near-term capital projects.

Management does not view market risk as having a significant impact on the Company's results of operations, although future results could be adversely affected if interest rates were to increase significantly for an extended period and the Company were to require external financing. General economic conditions affected by regulatory changes, competition or other external influences may pose a higher risk to the Company's overall results.

As of September 30, 2006, the Company has \$6.9 million invested in privately held companies directly or through investments with portfolio managers. Most of the companies are in an early stage of development and significant increases in interest rates could have an adverse impact on their results, ability to raise capital and viability. The Company's market risk is limited to the funds previously invested and an additional \$0.4 million committed under contracts the Company has signed with portfolio managers.

**ITEM 4. CONTROLS AND PROCEDURES**  
**Evaluation of Disclosure Controls and Procedures**

The Company's management, with the participation of the Company's President and Chief Executive Officer, who is its principal executive officer, and the Company's Executive Vice President and Chief Financial Officer, who is its principal financial officer, conducted an evaluation of the Company's disclosure controls and procedures, as defined by Rule 13a-15(e) under the Securities Exchange Act of 1934, as of September 30, 2006. As previously disclosed under Item 9A. Controls and Procedures in the Company's Form 10-K for its fiscal year ended December 31, 2005, the Company identified material weaknesses in its internal control over financial reporting in accounting for leases and in the calculation of the income tax provision. As further disclosed in that report, and as discussed below, the Company is remediating the two material weaknesses, but the remediation and testing related to these weaknesses had not been completed as of September 30, 2006. As a result of such material weaknesses, the Company's principal executive officer and its principal financial officer concluded that the Company's disclosure controls and procedures were not effective as of September 30, 2006.

**Changes in Internal Control Over Financial Reporting**

During the third fiscal quarter of 2006, there were changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting as follows:

To remediate the two material weaknesses in internal control over financial reporting disclosed under Item 9A. Controls and Procedures in the Company's Form 10-K for its fiscal year ended December 31, 2005, the Company is continuing to implement and refine review procedures for existing leases and new leases and is establishing review procedures over the selection of appropriate assumptions and factors affecting lease accounting during the quarter covered by this report. With respect to its accounting for income taxes, the Company is continuing to take steps to ensure that the personnel assigned to such accounting responsibilities have the necessary skills, knowledge and resources. Furthermore, the Company is reviewing its policies and procedures to provide adequate supervisory review of the analysis of income tax accounting amounts.

The Company finalized the establishment of controls, new procedures and processes around the accounting for leases during the third quarter of 2006. These controls have not been tested as of this filing, but will be evaluated for the year ended December 31, 2006. Additionally, due to the complexities of accounting for income taxes, the Company has outsourced its income tax provision calculation, and related income tax work, to a third party. The Company recognizes the need for tax expertise to be available to handle the tax implications for various transactions and processes. The Company modified its controls, processes and policies to include the services provided by the third party, although the controls have not been evaluated as of the filing date of this Form 10-Q.

**Other Matters Relating to Internal Control Over Financial Reporting**

Under the Company's agreements with Sprint Nextel, Sprint Nextel provides the Company with billing, collections, customer care, certain network operations and other back office services for the PCS operation. As a result, Sprint Nextel remitted to the Company approximately 67% of the Company's total operating revenues for the three months ended September 30, 2006, while approximately 27% of the total operating expenses reflected in the Company's consolidated financial statements for such period relate to charges by or through Sprint Nextel for expenses such as billing, collections and customer care, roaming expense, long-distance, and travel. Due to this relationship, the Company necessarily relies on Sprint Nextel to provide accurate, timely and sufficient data and information to properly record the Company's revenues, expenses and accounts receivable, which underlie a substantial portion of the Company's periodic financial statements and other financial disclosures.

Information provided by Sprint Nextel includes reports regarding the subscriber accounts receivable in the Company's markets. Sprint Nextel provides the Company with monthly accounts receivable, billing and cash receipts information on a market level, rather than a subscriber level. The Company reviews these various reports to identify discrepancies or errors. Under the Company's agreements with Sprint Nextel, the Company is entitled to only a portion of the receipts, net of items such as taxes, government surcharges, certain allocable write-offs and the 8% of revenue retained by Sprint Nextel. Because of the Company's reliance on Sprint Nextel for financial information, the Company must depend on Sprint Nextel to design adequate internal controls with respect to the processes established to provide this data and information to the Company and Sprint Nextel's other Sprint PCS affiliate network partners. To address this issue, Sprint Nextel engages an independent registered public accounting firm to perform a periodic evaluation of these

controls and to provide a Report on Controls Placed in Operation and Tests of Operating Effectiveness for Affiliates under guidance provided in Statement of Auditing Standards No. 70 ( SAS 70 reports ). Historically, the report was provided to the Company on a semi-annual basis and covered a six-month period. The most recent report covers the period from April 1, 2005 to September 30, 2005. The most recent report indicated there were no material issues that would adversely affect the information used to support the recording of the revenues and expenses provided by Sprint Nextel related to the Company's relationship with Sprint Nextel. Sprint Nextel has informed the Company that it will not furnish the Company with a semi-annual SAS 70 report for the six-month period from October 1, 2005 through March 31, 2006, but instead will provide a SAS 70 report and review for the nine-month period ending September 30, 2006, and then a subsequent report for the two month period ended November 30, 2006. Management is monitoring information provided by Sprint Nextel for anomalies and unexpected variances that are not explained by PCS business metrics.

PART II. **OTHER INFORMATION**

ITEM 1A. **Risk Factors**

References in this Item 1A to we, us and our are to Shenandoah Telecommunications Company and its consolidated subsidiaries.

As previously discussed, our actual results could differ materially from our forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed below. These and many other factors described in this report and in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 could adversely affect our operations, performance and financial condition.

*The continued operation of Nextel Partners by Sprint Nextel as a competing network to the Company could have a negative impact on our results of operations and may limit our ability to fully realize any benefits of the merger of Sprint and Nextel.*

On August 12, 2005, Sprint Corporation and Nextel Communications, Inc. merged to form Sprint Nextel Corporation. Nextel and its affiliate Nextel Partners, Inc. are providers of digital wireless communications services in our PCS service area. Certain transactions resulting from, or potential effects of, the Sprint Nextel merger discussed below could adversely affect our PCS business as well as our overall results of operations.

Our PCS subsidiary is one of a number of companies we refer to as the Sprint PCS Affiliates, which had entered into substantially similar management and affiliation agreements with Sprint Communications Company L.P. The agreements, including the agreement with Shentel, were with several Sprint entities. In connection with the Sprint Nextel merger, a number of the Sprint PCS Affiliates filed suit against Sprint Nextel alleging that the merger would result in a breach of the exclusivity provisions of their agreements with Sprint Nextel. A number of these legal proceedings are pending. In addition, since the Sprint Nextel merger was announced, Sprint Nextel has acquired several of the Sprint PCS Affiliates.

Prior to the Sprint Nextel merger, we and Sprint Nextel entered into a forbearance agreement setting forth Sprint Nextel's agreement to observe specified limitations in operating Nextel's wireless business in our PCS service area. The agreement also set forth the Company's agreement not to initiate litigation or seek certain injunctive or equitable relief against Sprint Nextel under certain circumstances, in each case during the period in which the agreement remains in effect. The agreement provided that the statute of limitations on any claims that Shentel might have against Sprint Nextel would be tolled while the agreement remained in effect. Nextel Partners was added to a July 19, 2006 amendment to the forbearance agreement between the Company and Sprint Nextel. The forbearance agreement automatically expired on August 4, 2006 in accordance with its terms upon the Court of Chancery of the State of Delaware's issuance of a decision with respect to the pending litigation by some Sprint PCS Affiliates against Sprint Nextel. The Company is reviewing the court's decision and considering the implications, if any, for the Company.

We believe that a significant portion of our PCS service area overlaps the service area operated by Nextel Partners under the Nextel brand. On June 26, 2006, Sprint Nextel acquired Nextel Partners. As long as Nextel Partners continues to be operated by Sprint Nextel as a separate business using the Nextel platform, our ability to fully realize any of the benefits from the merger of Sprint and Nextel may be limited. Further, the continued operation by Sprint Nextel of Nextel Partners as a competing network could have a negative impact on our results of operations.

We have had discussions with Sprint Nextel regarding the continuation of our long-term relationship, the impact of the Sprint Nextel merger, and potential changes to the management agreement necessary to reflect the merger of Sprint and Nextel Communications and the acquisition of Nextel Partners by Sprint Nextel. As a result of the Sprint Nextel merger, Sprint Nextel may require us to meet additional program requirements, which we anticipate would significantly increase capital expenditures and operating expenses. To date, we have been unable to arrive at a mutually acceptable agreement with Sprint Nextel concerning such potential changes. Accordingly, we are currently considering other alternatives in our ongoing discussions with Sprint Nextel, including the possible sale of our PCS business. We are unable to predict whether or on what terms we would be able to implement a sale of our PCS business, or the ultimate resolution of our discussions with Sprint Nextel concerning our relationship with Sprint Nextel, or the impact of any such sale or other action on our financial condition or future operating results or prospects.

*Our access revenue may be adversely impacted by legislative or regulatory actions, or technology developments, that decrease access rates or exempt certain traffic from paying for access to our regulated telephone network.*

The Federal Communications Commission is currently reviewing the issue of access charges as well as an overhaul of intercarrier compensation. An unfavorable change may have an adverse effect on the Company's telephone operations.

**Telephone Competition.** There has been a trend for incumbent local exchange carriers to see a decrease in access lines due to the effect of wireless and wireline competition and the elimination of second lines dedicated to dial-up Internet as customers migrate to broadband connections. Although the Company has not seen a material reduction in its number of access lines to date, and reported a slight increase during the 2006 nine month period, the dominating nationwide trend has been a decline in the number of access lines. There is a significant risk that a downward trend could have a material adverse effect on the Company's telephone operations in the future.

**Fiber Facilities.** The Company's revenue from fiber leases may be adversely impacted by price competition for these facilities. The Company monitors each of its fiber lease customers to minimize the risk related to this business.

**Cable Franchising.** The Company operates the cable television system in Shenandoah County, Virginia. The Company has seen increased competition from satellite providers that are larger and have cost advantages over the Company in the procurement of programming. The continued success of the satellite television providers may have an adverse impact on the Company's cable television results.

In 2006, the State of Virginia adopted legislation to make it easier for companies to obtain local franchises to provide cable television service. In addition, Congress is currently considering legislation which would either eliminate the requirement for a local cable television franchise or substantially reduce the cost of obtaining or competing with a local franchise. Any such change, while making it easier for the Company to expand its NTC and cable television business, may also result in increased competition for such businesses.

**Access to Property.** Within our Converged Services business, many of our contracts contain exclusive provisions which have been negotiated with the owner of the MDU or with a property owner's association. In some jurisdictions, franchised cable operators and incumbent local exchange carriers have been able to use state or local access laws to gain access to property over the owner's objection and in derogation of any competing provider's exclusive contractual right to serve the property. These mandatory access statutes typically empower only franchise cable operators and/or carriers of last resort to force access to an MDU or community and provide residential service regardless of the owner's objections. Thus, in jurisdictions where such a mandatory access provision has been enacted, a franchised cable operator or a carrier of last resort may be able to access an MDU or fiber-to-the-home community and provide service in competition with us, regardless of whether we have an exclusive service agreement with the owner.

**Net Neutrality.** Although the broadband Internet services industry has largely remained unregulated, there has been legislative and regulatory interest in adopting so-called "net neutrality" principles that could, among other things, prohibit service providers from slowing or blocking access to certain content, applications, or services available on the Internet and otherwise limit their ability to manage their networks efficiently and develop new products and services. The FCC last year adopted a non-binding policy statement expressing its view that consumers are entitled to access lawful Internet content and to run applications and use services of their choice, subject to the needs of law enforcement. If some form of net neutrality legislation or regulations were adopted, it could impair the Company's ability to effectively manage its broadband network and explore enhanced service options for customers.

ITEM 4. **Submission of Matters to a Vote of Security Holders**

None

ITEM 6. **Exhibits**

- (a) The following exhibits are filed with this Quarterly Report on Form 10-Q:
  - 31.1 Certification of the President and Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.
  - 31.2 Certification of the Executive Vice President and Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.
  - 32 Certifications pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. 1350.

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.

SHENANDOAH TELECOMMUNICATIONS COMPANY  
(Registrant)

*/s/ Earle A. MacKenzie*

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Earle A. MacKenzie, Executive Vice President and Chief Financial Officer

Date: November 7, 2006



EXHIBIT INDEX

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