

Hawaiian Telcom Holdco, Inc.
Form 10-Q
November 03, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended September 30, 2016

OR

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

For the transition period from _____ to _____

Commission File Number: 001-34686

Hawaiian Telcom Holdco, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

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

1177 Bishop Street

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Honolulu, Hawaii 96813

(Address of principal executive offices)

808-546-4511

(Registrant's telephone number, including area code)

Not Applicable

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

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

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

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

Large Accelerated Filer [] Accelerated Filer [X] Non-Accelerated Filer [] Smaller reporting company []
(Do not check if smaller reporting company)

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

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

As of November 3, 2016, 11,513,279 shares of the registrant's common stock were outstanding.

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PART I — FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)

Hawaiian Telcom Holdco, Inc.

Condensed Consolidated Statements of Income (Loss)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Operating revenues	\$ 97,848	\$ 100,905	\$ 296,183	\$ 294,208
Operating expenses:				
Cost of revenues (exclusive of depreciation and amortization)	41,903	41,013	124,987	120,415
Selling, general and administrative	29,206	33,146	88,625	92,645
Depreciation and amortization	23,036	22,551	67,479	65,772
Total operating expenses	94,145	96,710	281,091	278,832
Operating income	3,703	4,195	15,092	15,376
Other income (expense):				
Interest expense	(4,156)	(4,148)	(12,879)	(12,651)
Interest income and other	—	4	—	15
Total other expense	(4,156)	(4,144)	(12,879)	(12,636)
Income (loss) before income tax provision (benefit)	(453)	51	2,213	2,740
Income tax provision (benefit)	(174)	(54)	892	1,204
Net income (loss)	\$ (279)	\$ 105	\$ 1,321	\$ 1,536
Net income (loss) per common share -				
Basic	\$ (0.02)	\$ 0.01	\$ 0.11	\$ 0.14
Diluted	\$ (0.02)	\$ 0.01	\$ 0.11	\$ 0.14
Weighted average shares used to compute net income (loss) per common share -				
Basic	11,512,280	11,040,299	11,499,947	10,844,478
Diluted	11,512,280	11,318,641	11,539,828	11,275,655

See accompanying notes to condensed consolidated financial statements.

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Hawaiian Telcom Holdco, Inc.

Condensed Consolidated Statements of Comprehensive Loss

(Unaudited, dollars in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income (loss)	\$ (279)	\$ 105	\$ 1,321	\$ 1,536
Other comprehensive loss:				
Unrealized holding loss arising during period	—	(1)	—	(1)
Retirement plan loss	(8,674)	(8,786)	(8,179)	(6,711)
Income tax benefit on comprehensive loss	3,315	3,357	3,126	2,565
Other comprehensive loss, net of tax	(5,359)	(5,430)	(5,053)	(4,147)
Comprehensive loss	\$ (5,638)	\$ (5,325)	\$ (3,732)	\$ (2,611)

See accompanying notes to condensed consolidated financial statements.

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Hawaiian Telcom Holdco, Inc.

Condensed Consolidated Balance Sheets

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

	September 30, 2016	December 31, 2015
Assets		
Current assets		
Cash and cash equivalents	\$ 20,650	\$ 30,312
Receivables, net	28,488	32,736
Material and supplies	8,217	8,499
Prepaid expenses	5,343	4,068
Other current assets	2,666	2,102
Total current assets	65,364	77,717
Property, plant and equipment, net	593,370	579,107
Intangible assets, net	33,254	34,828
Goodwill	12,104	12,104
Deferred income taxes, net	91,610	89,896
Other assets	5,985	6,043
Total assets	\$ 801,687	\$ 799,695
Liabilities and Stockholders' Equity		
Current liabilities		
Current portion of long-term debt	\$ 3,000	\$ 3,000
Accounts payable	50,844	44,841
Accrued expenses	15,656	14,491
Advance billings and customer deposits	15,324	17,551
Other current liabilities	6,070	5,932
Total current liabilities	90,894	85,815
Long-term debt	281,927	283,046
Employee benefit obligations	106,346	104,597
Other liabilities	17,185	18,538
Total liabilities	496,352	491,996
Commitments and contingencies (Note 11)		
Stockholders' equity		
Common stock, par value of \$0.01 per share, 245,000,000 shares authorized and 11,512,502 and 11,466,398 shares issued and outstanding at September 30, 2016 and December 31, 2015, respectively	115	115
Additional paid-in capital	179,387	178,019
Accumulated other comprehensive loss	(34,441)	(29,388)
Retained earnings	160,274	158,953
Total stockholders' equity	305,335	307,699
Total liabilities and stockholders' equity	\$ 801,687	\$ 799,695

See accompanying notes to condensed consolidated financial statements.

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Hawaiian Telcom Holdco, Inc.

Condensed Consolidated Statements of Cash Flows

(Unaudited, dollars in thousands)

	Nine Months Ended September 30, 2016	2015
Cash flows from operating activities:		
Net income	\$ 1,321	\$ 1,536
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	67,479	65,772
Deferred financing amortization	1,533	1,436
Employee retirement benefits	(6,430)	(3,315)
Provision for uncollectible receivables	2,908	2,640
Stock based compensation	1,722	1,087
Deferred income taxes	1,412	1,633
Changes in operating assets and liabilities:		
Receivables	1,340	(3,558)
Material and supplies	282	211
Prepaid expenses and other current assets	(1,839)	(2,538)
Accounts payable and accrued expenses	6,067	(3,222)
Advance billings and customer deposits	(2,227)	4,054
Other current liabilities	(600)	(693)
Other	(22)	552
Net cash provided by operating activities	72,946	65,595
Cash flows from investing activities:		
Capital expenditures	(78,334)	(76,732)
	—	400

Funds released from restricted cash account		
Net cash used in investing activities	(78,334)	(76,332)
Cash flows from financing activities:		
Proceeds from exercise of warrant	—	3,342
Proceeds from installment financing	1,698	2,779
Repayment of capital lease and installment financing	(2,680)	(3,083)
Repayment of debt	(2,250)	(2,250)
Refinancing and loan amendment costs	(688)	(150)
Taxes paid related to net share settlement of equity awards	(354)	(941)
Net cash used in financing activities	(4,274)	(303)
Net change in cash and cash equivalents	(9,662)	(11,040)
Cash and cash equivalents, beginning of period	30,312	39,885
Cash and cash equivalents, end of period	\$ 20,650	\$ 28,845
Supplemental disclosure of cash flow information:		
Interest paid, net of amounts capitalized	\$ 9,938	\$ 11,234

See accompanying notes to condensed consolidated financial statements.

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Hawaiian Telcom Holdco, Inc.

Condensed Consolidated Statement of Changes in Stockholders' Equity

(Unaudited, dollars in thousands)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders' Equity
Balance, January 1, 2016	11,466,398	\$ 115	\$ 178,019	\$ (29,388)	\$ 158,953	\$ 307,699
Stock based compensation	—	—	1,722	—	—	1,722
Common stock issued for stock compensation plans, net of shares withheld and withholding paid for employee taxes	46,104	—	(354)	—	—	(354)
Net income	—	—	—	—	1,321	1,321
Other comprehensive loss, net of tax	—	—	—	(5,053)	—	(5,053)
Balance, September 30, 2016	11,512,502	\$ 115	\$ 179,387	\$ (34,441)	\$ 160,274	\$ 305,335
Balance, January 1, 2015	10,673,292	\$ 107	\$ 170,521	\$ (23,947)	\$ 157,853	\$ 304,534
Stock based compensation	—	—	1,087	—	—	1,087
Exercise of warrant agreement	376,333	4	3,338	—	—	3,342
Common stock issued for stock compensation plans, net of shares withheld and withholding paid for employee taxes	73,255	—	(941)	—	—	(941)
Net income	—	—	—	—	1,536	1,536
Other comprehensive loss, net of tax	—	—	—	(4,147)	—	(4,147)

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Balance, September 30, 2015	11,122,880	\$ 111	\$ 174,005	\$ (28,094)	\$ 159,389	\$ 305,411
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See accompanying notes to condensed consolidated financial statements.

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Hawaiian Telcom Holdco, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Description of Business

Business Description

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

Organization

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

2. Basis of Presentation

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

December 31, 2015.

Cash and Cash Equivalents

Cash and cash equivalents include cash and money market accounts with maturities at acquisition of three months or less. The majority of cash balances at September 30, 2016 are held in one bank in demand deposit accounts. During the nine months ended September 30, 2015, funds amounting to \$0.4 million in a restricted cash account, held in conjunction with a lease agreement provision, were released and deposited into unrestricted cash.

Supplemental Non-Cash Investing and Financing Activities

Accounts payable included \$21.7 million and \$14.5 million at September 30, 2016 and 2015, respectively, for additions to property, plant and equipment.

Taxes Collected from Customers

The Company presents taxes collected from customers and remitted to governmental authorities on a gross basis, including such amounts in the Company's reported operating revenues. Such amounts represent primarily Hawaii state general excise taxes and Hawaii Public Utility Commission fees. Such taxes and fees amounted to \$2.1 million and \$6.4 million for the three and nine months ended September 30, 2016, and \$2.1 million and \$6.1 million for the three and nine months ended September 30, 2015, respectively.

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Earnings (loss) per Share

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Basic earnings (loss) per share - weighted average shares	11,512,280	11,040,299	11,499,947	10,844,478
Effect of dilutive securities:				
Employee and director restricted stock units	—	19,045	39,881	76,058
Warrants	—	259,297	—	355,119
Diluted earnings (loss) per share - weighted average shares	11,512,280	11,318,641	11,539,828	11,275,655

The computation of weighted average dilutive shares outstanding excluded grants of restricted stock units convertible into 227,888 shares and 8,319 shares of common stock for the three and nine months ended September 30, 2016, respectively, and 84,259 shares of common stock for the three months ended September 30, 2015. For the three months ended September 30, 2016, the Company incurred a net loss so the restricted stock units are anti-dilutive to the computation of net loss per share. For the other periods presented, the unrecognized compensation on a per unit basis for these restricted stock units was greater than the average market price of the Company's common stock for the period presented. For the nine months ended September 30, 2015, there were no restricted stock units that were anti-dilutive to earnings per share.

Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (the "FASB") issued a new accounting standard which provides guidance for revenue recognition which was amended most recently in May 2016. The most recent amendments provide revised guidance on when to record revenue gross as the principal or net as the agent in accordance with the new revenue standard's control principal and, provide for narrow scope modifications and practical expedients. The new standard, along with the amendments which must be adopted at the same time as the new standard, is effective for the Company in the first quarter of 2018 with either full retrospective or modified retrospective adoption permitted. The modified retrospective approach requires a cumulative effect adjustment to

retained earnings as of the beginning of the first reporting period for which the new accounting guidance is effective. Early adoption is allowed from the first quarter of 2017. The Company is currently evaluating the impact of the adoption of this accounting standard on the Company's consolidated financial statements and financial statement disclosures. As this process is still ongoing, the effect of adoption is not yet known.

In February 2016, the FASB issued a new standard for accounting for leases. The new standard requires lessees to recognize a right-of-use asset and a lease liability on the balance sheet for all leases with the exception of short-term leases. For lessees, leases will continue to be classified as either operating or finance leases in the income statement. Lessor accounting is similar to the current model but updated to align with certain changes to the lessee model. The new standard must be adopted using the modified retrospective approach. The updated standard is effective for the Company beginning in the first quarter of 2019. Early adoption is permitted. The Company is currently evaluating the effect that the new standard will have on the Company's consolidated financial statements and financial statement disclosures.

In March 2016, the FASB issued a new standard that simplifies the accounting for employee share-based payment transactions. The new standard impacts the accounting for related income taxes, forfeitures and statutory tax withholding requirements as well as the classification of certain related payments in the statement of cash flows. The new accounting guidance is effective for the Company in the first quarter of 2017 with early adoption permitted. The adoption method required is specified as retrospective, modified retrospective or prospective for each of the various

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accounting provisions impacted by this new standard. The Company is evaluating the effect of the new guidance on the Company's consolidated financial statements and financial statement disclosures.

In June 2016, the FASB issued amended guidance on accounting for the impairment of financial instruments. The standard requires adoption of an impairment model known as the current expected credit loss model that is based on expected losses rather than incurred losses. For the Company, it is anticipated this will impact primarily the accounting for credit losses on trade receivables. The new standard is effective for the Company in the first quarter of 2020 with early adoption permitted from the first quarter of 2019. The provisions of the new standard expected to impact the Company must be adopted using the modified retrospective approach. The Company is evaluating the effect of the guidance on the Company's consolidated financial statements and financial statement disclosures.

3. Receivables

Receivables consisted of the following (dollars in thousands):

	September 30, 2016	December 31, 2015
Customers and other	\$ 32,467	\$ 36,667
Allowance for doubtful accounts	(3,979)	(3,931)
	\$ 28,488	\$ 32,736

4. Long-Lived Assets

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

	September 30, 2016	December 31, 2015
Property, plant and equipment cost	\$ 1,014,803	\$ 937,927

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Less accumulated depreciation	421,433	358,820
	\$ 593,370	\$ 579,107

Depreciation expense amounted to \$22.5 million and \$65.9 million for the three and nine months ended September 30, 2016, respectively. Depreciation expense amounted to \$22.0 million and \$63.9 million for the three and nine months ended September 30, 2015, respectively.

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

	September 30, 2016		Net Carrying Value	December 31, 2015		Net Carrying Value
	Gross Carrying Value	Accumulated Amortization		Gross Carrying Value	Accumulated Amortization	
Subject to amortization:						
Customer relationships	\$ 21,709	\$ 15,783	\$ 5,926	\$ 21,709	\$ 14,238	\$ 7,471
Trade name and other	320	292	28	320	263	57
	22,029	16,075	5,954	22,029	14,501	7,528
Not subject to amortization:						
Brand name	27,300	—	27,300	27,300	—	27,300
	27,300	—	27,300	27,300	—	27,300
	\$ 49,329	\$ 16,075	\$ 33,254	\$ 49,329	\$ 14,501	\$ 34,828

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Amortization expense amounted to \$0.5 million and \$1.6 million for the three and nine months ended September 30, 2016, respectively. Amortization expense amounted to \$0.6 million and \$1.9 million for the three and nine months ended September 30, 2015, respectively. Estimated amortization expense for the next five years and thereafter is as follows (dollars in thousands):

Year ended December 31,	
2016 (remaining months)	\$ 526
2017	1,703
2018	1,307
2019	930
2020	574
Thereafter	914
	\$ 5,954

5. Accrued Expenses and Other Current Liabilities

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

	September	December
	30,	31,
	2016	2015
Salaries and benefits	\$ 11,988	\$ 12,185
Interest	2,675	1,262
Other taxes	993	1,044
	\$ 15,656	\$ 14,491

Other current liabilities consisted of the following (dollars in thousands):

	September	December
	30,	31,
	2016	2015
Other postretirement benefits, current	\$ 2,929	\$ 2,929
Installment financing contracts, current	2,226	1,849
Other	915	1,154

\$ 6,070 \$ 5,932

6. Long-Term Debt

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

	Interest Rate		September 30, 2016	December 31, 2015
	at September 30, 2016	Final Maturity		
Term loan	5.25	% June 6, 2019	\$ 290,888	\$ 293,138
Debt issue costs and original issue discount			(5,961)	(7,092)
			284,927	286,046
Current			3,000	3,000
Noncurrent			\$ 281,927	\$ 283,046

The term loan outstanding at September 30, 2016 provides for interest at the Alternate Base Rate, a rate which is indexed to the prime rate with certain adjustments as defined, plus a margin of 3.25% or a Eurocurrency rate on deposits of one, two, three or six months but no less than 1.00% per annum plus a margin of 4.25%. The Company has selected the Eurocurrency rate as of September 30, 2016 resulting in an interest rate currently at 5.25%. The interest rate margin is subject to a further increase of 0.25% should there be a downgrade in the Company's credit rating.

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The term loan provides for interest payments no less than quarterly. In addition, quarterly principal payments of \$0.8 million are required. The balance of the loan is due at maturity on June 6, 2019. The Company must prepay, generally within three months after year end, up to 75% of excess cash flow, as defined. The percent of excess cash flow required is dependent on the Company's leverage ratio. There was no excess cash flow payment due for the year ended December 31, 2015. The Company must also make prepayments on loans in the case of certain events such as large asset sales.

In May 2016, the Company amended the term loan allowing for a revised leverage ratio financial covenant. The amendment modifies the maximum allowed leverage ratio, as defined, for the four consecutive fiscal quarters ended from June 30, 2016 to September 30, 2017 to 3.00:1.00, from December 31, 2017 to September 30, 2018 to 2.75:1.00, and from December 31, 2018 and each subsequent quarter to 2.50:1.00. In conjunction with the amendment, the Company paid a fee to the lenders of \$0.4 million and such fee was deferred as financing related costs. The Company concluded that the amended lenders' term loans were not substantially different than the lenders' term loans prior to amendment. In addition, the Company paid an arrangement fee and legal costs amounting to \$0.3 million. Such fees were expensed as incurred in the second quarter of 2016.

The Company also has a revolving credit facility which matures on December 6, 2018. The facility has an available balance of \$30.0 million with no amounts drawn as of or for the periods ended Septemb