

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

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark one)

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

For the quarterly period ended September 30, 2014

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-34686

**Hawaiian Telcom Holdco, Inc.**

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(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

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

**1177 Bishop Street**

**Honolulu, Hawaii 96813**

(Address of principal executive offices)

**808-546-4511**

(Registrant's telephone number, including area code)

**Not Applicable**

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

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

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

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

Large Accelerated Filer

Accelerated Filer

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

Smaller reporting company

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

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

As of November 10, 2014, 10,673,103 shares of the registrant's common stock were outstanding.

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Table of Contents

**Table of Contents**

	<b>Page</b>	
<u>Part I</u>	<u>Financial Statements</u>	
<u>Item 1</u>	<u>Condensed Consolidated Financial Statements (Unaudited)</u>	3
<u>Item 2</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	21
<u>Item 3</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	32
<u>Item 4</u>	<u>Controls and Procedures</u>	33
<u>Part II</u>	<u>Other Information</u>	
<u>Item 1</u>	<u>Legal Proceedings</u>	34
<u>Item 1A</u>	<u>Risk Factors</u>	34
<u>Item 5</u>	<u>Other Information</u>	35
<u>Item 6</u>	<u>Exhibits</u>	36

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Operating revenues	\$ 97,252	\$ 97,682	\$ 291,109	\$ 290,643
Operating expenses:				
Cost of revenues (exclusive of depreciation and amortization)	42,621	41,829	124,858	122,073
Selling, general and administrative	28,294	27,965	86,280	84,860
Gain on sale of property				(6,546)
Depreciation and amortization	19,717	19,974	57,321	58,532
Total operating expenses	90,632	89,768	268,459	258,919
Operating income	6,620	7,914	22,650	31,724
Other income (expense):				
Interest expense	(4,103)	(4,089)	(12,401)	(14,712)
Loss on early extinguishment of debt				(3,660)
Interest income and other	13	7	27	28
Total other expense	(4,090)	(4,082)	(12,374)	(18,344)
Income before income tax provision	2,530	3,832	10,276	13,380
Income tax provision	1,014	1,771	4,155	5,521
Net income	\$ 1,516	\$ 2,061	\$ 6,121	\$ 7,859
Net income per common share -				
Basic	\$ 0.14	\$ 0.20	\$ 0.58	\$ 0.76
Diluted	\$ 0.13	\$ 0.18	\$ 0.54	\$ 0.71
Weighted average shares used to compute net income per common share -				
Basic	10,586,690	10,337,488	10,567,036	10,321,905
Diluted	11,311,691	11,206,159	11,329,328	11,096,177

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See accompanying notes to condensed consolidated financial statements.

Table of Contents

**Hawaiian Telcom Holdco, Inc.**

**Condensed Consolidated Statements of Comprehensive Income**

(Unaudited, dollars in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net income	\$ 1,516	\$ 2,061	\$ 6,121	\$ 7,859
Other comprehensive income (loss) -				
Unrealized holding gains (losses) arising during period	(3)	6	(4)	(22)
Retirement plan (gain) loss	43	222	(202)	667
Income tax credit (charge) on comprehensive income	(17)	(88)	83	(263)
Other comprehensive income (loss), net of tax	23	140	(123)	382
Comprehensive income	\$ 1,539	\$ 2,201	\$ 5,998	\$ 8,241

See accompanying notes to condensed consolidated financial statements.

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

	September 30, 2014	December 31, 2013
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 31,693	\$ 49,551
Receivables, net	33,378	34,521
Material and supplies	10,146	15,939
Prepaid expenses	4,779	3,724
Deferred income taxes	7,968	8,146
Other current assets	3,218	2,851
Total current assets	91,182	114,732
Property, plant and equipment, net	553,467	524,375
Intangible assets, net	38,051	40,225
Goodwill	12,104	12,104
Deferred income taxes	70,765	75,274
Other assets	9,935	11,305
Total assets	\$ 775,504	\$ 778,015
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities		
Current portion of long-term debt	\$ 3,000	\$ 3,000
Accounts payable	45,378	40,228
Accrued expenses	15,877	18,787
Advance billings and customer deposits	16,072	16,122
Other current liabilities	7,222	6,412
Total current liabilities	87,549	84,549
Long-term debt	289,985	291,679
Employee benefit obligations	69,966	80,321
Other liabilities	6,949	8,454
Total liabilities	454,449	465,003
Commitments and contingencies (Note 12)		
Stockholders' equity		
Common stock, par value of \$0.01 per share, 245,000,000 shares authorized and 10,587,105 and 10,495,856 shares issued and outstanding at September 30, 2014 and December 31, 2013, respectively	106	105
Additional paid-in capital	169,913	167,869
Accumulated other comprehensive loss	(4,839)	(4,716)
Retained earnings	155,875	149,754
Total stockholders' equity	321,055	313,012
Total liabilities and stockholders' equity	\$ 775,504	\$ 778,015



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See accompanying notes to condensed consolidated financial statements.

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

	<b>Nine Months Ended September 30,</b>	
	<b>2014</b>	<b>2013</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 6,121	\$ 7,859
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	57,321	58,532
Loss on early extinguishment of debt		3,660
Gain on sale of property		(6,546)
Employee retirement benefits	(10,557)	(10,324)
Provision for uncollectibles	2,493	2,003
Stock based compensation	3,066	1,886
Deferred income taxes	4,770	6,018
Changes in operating assets and liabilities:		
Receivables	(1,350)	(4,142)
Material and supplies	(685)	(3,916)
Prepaid expenses and other current assets	(1,421)	(1,064)
Accounts payable and accrued expenses	1,296	(2,064)
Advance billings and customer deposits	(50)	323
Other current liabilities	(568)	106
Other	1,380	2,446
Net cash provided by operating activities	61,816	54,777
<b>Cash flows from investing activities:</b>		
Capital expenditures	(76,474)	(69,809)
Acquisitions		(11,858)
Proceeds on sale of property		13,118
Net cash used in investing activities	(76,474)	(68,549)
<b>Cash flows from financing activities:</b>		
Repayment of capital lease and installment financing	(2,014)	(406)
Repayment of debt including premium	(2,250)	(302,333)
Proceeds from installment financing	2,085	
Proceeds from borrowing		298,500
Loan refinancing costs		(3,442)
Taxes paid related to net share settlement of equity awards	(1,021)	(426)
Net cash used in financing activities	(3,200)	(8,107)
Net change in cash and cash equivalents	(17,858)	(21,879)
Cash and cash equivalents, beginning of period	49,551	66,993
Cash and cash equivalents, end of period	\$ 31,693	\$ 45,114
<b>Supplemental disclosure of cash flow information:</b>		
Interest paid, net of amounts capitalized	\$ 11,033	\$ 14,416

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See accompanying notes to condensed consolidated financial statements.

Table of Contents**Hawaiian Telcom Holdco, Inc.****Condensed Consolidated Statement of Changes in Stockholders Equity**

(Unaudited, dollars in thousands)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders Equity
Balance, January 1, 2014	10,495,856	\$ 105	\$ 167,869	\$ (4,716)	\$ 149,754	\$ 313,012
Stock based compensation			3,066			3,066
Exercise of warrant	15,361					
Common stock issued for stock compensation plans, net of shares withheld and withholding paid for employee taxes	75,888	1	(1,022)			(1,021)
Net income					6,121	6,121
Other comprehensive loss, net of tax				(123)		(123)
Balance, September 30, 2014	10,587,105	\$ 106	\$ 169,913	\$ (4,839)	\$ 155,875	\$ 321,055
Balance, January 1, 2013	10,291,897	\$ 103	\$ 165,941	\$ (28,450)	\$ 139,266	\$ 276,860
Stock based compensation			1,886			1,886
Exercise of warrant	297					
Common stock issued for stock compensation plans, net of shares withheld and withholding paid for employee taxes	46,543		(426)			(426)
Net income					7,859	7,859
Other comprehensive income, net of tax				382		382
Balance, September 30, 2013	10,338,737	\$ 103	\$ 167,401	\$ (28,068)	\$ 147,125	\$ 286,561

See accompanying notes to condensed consolidated financial statements.



Table of Contents

**Hawaiian Telcom Holdco, Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**1. Description of Business**

*Business Description*

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

*Organization*

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

**2. Basis of Presentation**

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

*Cash and Cash Equivalents*

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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, 2014 are held in one bank in demand deposit accounts.

### *Supplemental Non-Cash Investing and Financing Activities*

Accounts payable included \$15.1 million and \$6.2 million at September 30, 2014 and 2013, respectively, for additions to property, plant and equipment.

### *Taxes Collected from Customers*

The Company presents taxes collected from customers and remitted to governmental authorities on a gross basis, including such amounts in the Company's reported operating revenues. Such amounts represent primarily Hawaii state general excise taxes and Hawaii Public Utility Commission fees. Such taxes and fees amounted to \$1.9 million and \$5.5 million for the three and nine months ended September 30, 2014 and \$1.9 million and \$5.6 million for the three and nine months ended September 30, 2013, respectively.

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Basic earnings per share - weighted average shares	10,586,690	10,337,488	10,567,036	10,321,905
Effect of dilutive securities:				
Employee and director restricted stock units	122,530	173,405	153,752	166,461
Warrants	602,471	695,266	608,540	607,811
Diluted earnings per share - weighted average shares	11,311,691	11,206,159	11,329,328	11,096,177

No restricted stock units were deemed anti-dilutive and excluded from the computation of diluted earnings per share for the three and nine months ended September 30, 2014 and 2013.

***Recent Accounting Pronouncements***

In May 2014, the Financial Accounting Standards Board ( FASB ) issued a new accounting standard which provides guidance for revenue recognition. The new accounting standard will supersede the current revenue recognition requirements and most industry-specific guidance. The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The standard will be effective for the Company in the first quarter of 2017 and either full retrospective or modified retrospective adoption is permitted. Early adoption is not permitted. The Company is currently evaluating the impact of the adoption of this accounting standard on the consolidated financial statements.

In August 2014, the FASB issued an accounting standard with new guidance on management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related disclosures. Management must evaluate whether it is probable that known conditions or events, considered in the aggregate, would raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued. If such conditions or events are identified, the standard requires management's mitigation plans to alleviate the doubt or a statement of the substantial doubt about the entity's ability to continue as a going concern to be disclosed in the financial statements. The standard is effective for fiscal years and interim periods beginning after December 15, 2016 with early adoption permitted. The adoption of this standard is not expected to impact the consolidated financial statements.

**3. SystemMetrics Corporation Acquisition**



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

Table of Contents

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

The Company followed the acquisition method of accounting and allocated the purchase price to the tangible and intangible assets acquired and liabilities assumed based on their provisional fair values, and the estimates and assumptions were subject to change within the measurement period. There were no changes made to the allocation of the purchase price in 2014. The measurement period was considered closed as of June 30, 2014.

For the three months ended September 30, 2014, SystemMetrics revenue amounted to \$2.5 million and the net loss amounted to \$0.2 million. For the nine months ended September 30, 2014, SystemMetrics revenue amounted to \$7.2 million and the net loss was \$0.4 million.

The following unaudited pro forma results of operations are provided for the three and nine months ended September 30, 2013 as if the acquisition of SystemMetrics occurred on January 1, 2012. The pro forma combined results of operations have been prepared by adjusting the historical results of the Company to include the historical results of SystemMetrics. Adjustments were made to the historical results for the purchase price allocation to adjust depreciation and amortization, to eliminate the interest on certain debt financing which was not assumed in the purchase, to eliminate certain intercompany revenue between the entities and to reallocate the transaction related expenses from the 2013 to the 2012 periods.

These supplemental pro forma results of operations are provided for illustrative purposes only and do not purport to be indicative of the actual results that would have been achieved by the combined company for the periods presented or that may be achieved by the combined company in the future. The pro forma results of operations do not include any costs savings or synergies that resulted, or will result, from the acquisition or any estimated costs that will be incurred to integrate SystemMetrics. Future results may vary significantly from the results reflected in this pro forma financial information because of future events and transactions as well as other factors.

The pro forma results are as follows (dollars in thousands):

	<b>For the Three Months Ended September 30, 2013</b>	<b>For the Nine Months Ended September 30, 2013</b>
Revenues	\$ 99,649	\$ 296,443
Expenses	91,610	264,808
Operating income	8,039	31,635
Other income (expense)	(4,082)	(18,344)
Income before income tax benefit	3,957	13,291
Income tax expense	1,301	4,970
Net income	\$ 2,656	\$ 8,321



Table of Contents**4. Receivables**

Receivables consisted of the following (dollars in thousands):

	September 30, 2014	December 31, 2013
Customers and other	\$ 37,252	\$ 38,463
Allowance for doubtful accounts	(3,874)	(3,942)
	\$ 33,378	\$ 34,521

**5. Long-Lived Assets**

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

	September 30, 2014	December 31, 2013
Property, plant and equipment	\$ 812,423	\$ 729,364
Less accumulated depreciation	(258,956)	(204,989)
	\$ 553,467	\$ 524,375

Depreciation expense amounted to \$19.0 million and \$55.1 million for the three and nine months ended September 30, 2014, respectively. Depreciation expense amounted to \$19.3 million and \$56.5 million for the three and nine months ended September 30, 2013, respectively.

In February 2013, the Company entered into an agreement to sell a parcel of land and warehouse not actively used in the Company's operations for a purchase price, as amended, of \$13.9 million. The sale was subject to due diligence by the buyer and approval of the Hawaii Public Utilities Commission (HPUC). The HPUC approval was received in May 2013 and the sale was consummated in June 2013. The net proceeds, net of commissions and other costs paid through escrow of \$0.8 million, amounted to \$13.1 million. A gain on the sale of \$6.5 million was recognized in the second quarter of 2013 as management concluded the land sold was not grouped with the assets subject to the composite depreciation method. The HPUC approval requires the Company to spend \$0.3 million on training employees on broadband telecommunication deployment and operation. In addition, the HPUC approval provides for the Company to make improvements to its broadband network in an amount equal to the net proceeds less the training cost commitment. The planned training expenses and network capital spending are being recognized as the costs are incurred.

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Table of Contents

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

	September 30, 2014			December 31, 2013		
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
<b>Subject to amortization</b>						
Customer relationships	\$ 21,709	\$ 11,096	\$ 10,613	\$ 21,709	\$ 8,983	\$ 12,726
Trade name and other	320	182	138	320	121	199
	22,029	11,278	10,751	22,029	9,104	12,925
<b>Not subject to amortization</b>						
Brand name	27,300		27,300	27,300		27,300
	27,300		27,300	27,300		27,300
	\$ 49,329	\$ 11,278	\$ 38,051	\$ 49,329	\$ 9,104	\$ 40,225

Amortization expense amounted to \$0.7 million and \$2.2 million for the three and nine months ended September 30, 2014, respectively. Amortization expense amounted to \$0.7 million and \$2.0 million for the three and nine months ended September 30, 2013, respectively. Estimated amortization expense for the next five years and thereafter is as follows (dollars in thousands):

2014 (remaining months)	\$ 722
2015	2,498
2016	2,101
2017	1,703
2018	1,308
Thereafter	2,419
	\$ 10,751

**6. Accrued Expenses**

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

	September 30, 2014	December 31, 2013
Salaries and benefits	\$ 12,317	\$ 15,160
Interest	2,557	2,576
Other taxes	1,003	1,051
	\$ 15,877	\$ 18,787



Table of Contents**7. Long-Term Debt**

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

	<b>Interest Rate at September 30, 2014</b>	<b>Final Maturity</b>	<b>September 30, 2014</b>	<b>December 31, 2013</b>
Term loan	5.00%	June 6, 2019	\$ 296,888	\$ 299,138
Original issue discount			(3,903)	(4,459)
			292,985	294,679
Current			3,000	3,000
Noncurrent			\$ 289,985	\$ 291,679

The term loan outstanding at September 30, 2014 provides for interest at the Alternate Base Rate, a rate which is indexed to the prime rate with certain adjustments as defined, plus a margin of 3.00% or a Eurocurrency rate on deposits of one, two, three or six months but no less than 1.00% per annum plus a margin of 4.00%. The Company has selected the Eurocurrency rate as of September 30, 2014 resulting in an interest rate currently at 5.00%.

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

The Company also has a revolving credit facility which matures on October 3, 2015. The facility has an available balance of \$30.0 million with no amounts drawn as of or for the periods ended September 30, 2014 and 2013. A commitment fee is payable quarterly to the lender under the facility. Interest on amounts outstanding is based on, at the Company's option, the bank prime rate plus a margin of 3.0% to 6.0% or the Eurocurrency rate for one, two, three or six month periods plus a margin of 4.0% to 5.5%. The margin is dependent on the Company's leverage, as defined in the agreement, at the time of the borrowing.

***Refinancing***

In June 2013, the Company refinanced its term loan debt. The Company paid a premium on the repayment of the old term loan of \$3.0 million. In addition, the Company paid \$3.4 million in underwriting fees and legal costs. The premium on repayment of debt, existing original issue discount, existing deferred financing costs, underwriting fees and legal costs were accounted for in accordance with accounting standards for modification of debt instruments with different terms. The Company compared each syndicated lenders' loan under the old term loan with the syndicated lenders' loan under the new term loans. For loans under the new term loan that were substantially different, the Company recognized the exchange of debt instruments as a debt extinguishment. For loans under the new term loan that were not substantially different, the Company accounted for the exchange of debt instruments as a modification. As a result of the refinancing, the Company deferred \$2.7 million of financing

related costs and recognized a loss on early extinguishment of debt of \$3.7 million.



Table of Contents

***Maturities***

The annual requirements for principal payments on long-term debt as of September 30, 2014 are as follows (dollars in thousands):

<b>Years ended December 31,</b>		
2014 (remainder of year)	\$	750
2015		3,000
2016		3,000
2017		3,000
2018		3,000
Thereafter		284,138
	\$	296,888

***Capitalized Interest***

Interest capitalized by the Company amounted to \$0.3 million and \$0.8 million for the three and nine months ended September 30, 2014, respectively. Interest capitalized by the Company amounted to \$0.3 million and \$0.9 million for the three and nine months ended September 30, 2013, respectively.

**8. Employee Benefit Plans**

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

The following provides the components of benefit costs (income) for the three and nine months ended September 30, 2014 and 2013 (dollars in thousands):

Pension

<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
<b>September 30,</b>		<b>September 30,</b>	
<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>

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Interest cost	\$	2,208	\$	2,055	\$	6,624	\$	6,166
Expected asset return		(3,178)		(2,934)		(9,534)		(8,804)
Amortization of loss		29		148		87		444
Net periodic benefit income	\$	(941)	\$	(731)	\$	(2,823)	\$	(2,194)

Other Postretirement Benefits

	Three Months Ended September 30,		Nine Months Ended September 30,					
	2014	2013	2014	2013				
Service cost	\$	230	\$	277	\$	691	\$	832
Interest cost		602		516		1,805		1,548
Amortization of loss		15		74		45		223
Net periodic benefit cost	\$	847	\$	867	\$	2,541	\$	2,603

Table of Contents

The Company previously disclosed in its consolidated financial statements for the year ended December 31, 2013 that it expected to contribute \$13.1 million to its pension plan in 2014. As of September 30, 2014, the Company has contributed \$8.7 million. The Company contributed an additional \$1.0 million in October 2014 for a total of \$9.7 million for the year. No additional contributions are expected for 2014. The amount contributed for the year is less than originally anticipated because of recent changes in the plan funding rules.

**9. Income Taxes**

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

	<b>Three Months Ended September 30, 2014</b>		<b>Nine Months Ended September 30, 2014</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Income tax at federal rate	\$ 860	\$ 1,303	\$ 3,494	\$ 4,549
Increase (decrease) resulting from:				
State income taxes, net of federal income tax	101	33	411	461
Permanent differences	178	539	780	850
Capital goods excise tax credit	(125)	(104)	(530)	(339)
<b>Total income tax expense</b>	<b>\$ 1,014</b>	<b>\$ 1,771</b>	<b>\$ 4,155</b>	<b>\$ 5,521</b>

The Company evaluates its tax positions for liability recognition. As of September 30, 2014, the Company had no unrecognized tax benefits. No interest or penalties related to tax assessments were recognized in the Company's condensed consolidated statements of operations for the three and nine months ended September 30, 2014 or 2013. All tax years from 2010 remain open for both federal and Hawaii state purposes.

**10. Stock Compensation**

The Company has an equity incentive plan. The Compensation Committee of the Company's Board of Directors may grant awards under the plan in the form of incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock, restricted stock units and other stock-based awards. The maximum number of shares issuable under the equity incentive plan is 1,400,000 shares. All grants under the equity incentive plan will be issued to acquire shares at the fair value on date of grant.

Table of Contents

As of September 30, 2014, all awards were restricted stock units. Activity with respect to outstanding restricted stock units for the nine months ended September 30, 2014 and 2013 was as follows:

	Shares	Weighted- Average Grant-Date Fair Value
<b>2014</b>		
Nonvested at January 1, 2014	260,734	\$ 18
Granted	155,146	31
Vested	(111,037)	25
Forfeited	(7,221)	23
Nonvested at September 30, 2014	297,622	\$ 24
<b>2013</b>		
Nonvested at January 1, 2013	223,224	\$ 15
Granted	181,330	20
Vested	(67,233)	17
Forfeited	(22,918)	17
Nonvested at September 30, 2013	314,403	\$ 17

The Company recognized compensation expense of \$1.0 million and \$3.1 million for the three and nine months ended September 30, 2014, respectively. The Company recognized compensation expense of \$0.7 million and \$1.9 million for the three and nine months ended September 30, 2013, respectively. The fair value as of the vesting date for the restricted stock units that vested during the nine months ended September 30, 2014 and 2013 was \$2.7 million and \$1.3 million, respectively. Upon vesting, unit holders have the option to net share-settle to cover the required withholding tax and the remaining amount is converted into an equivalent number of shares of common stock. The total shares withheld were 35,147 and 20,692 for the nine months ended September 30, 2014 and 2013, respectively, and were based on the value of the restricted stock units as determined by the Company's closing stock price on the date of vesting. Total payments for the employees' tax obligations to the tax authorities amounted to \$1.0 million and \$0.4 million for the nine months ended September 30, 2014 and 2013, respectively. Other than reimbursements for tax withholdings, there was no cash received under all share-based arrangements. In March 2014, the terms of certain restricted stock units were modified which resulted in the restricted stock units vesting as of the date of the modification. The Company recognized the incremental value of \$0.6 million as additional expense in the first quarter of 2014.

## 11. Stockholders Equity

### *Warrants*

In 2010, the Company issued warrants to purchase 1,481,055 shares of common stock for \$14.00 per share. The warrants to purchase shares may be exercised anytime from January 26, 2011 to the maturity on October 28, 2015. The warrants may be exercised on a cashless basis whereby additional warrants are tendered in lieu of payment for the exercise price. During the nine months ended September 30, 2014 and 2013, warrants were exercised on a cashless basis resulting in the issuance of 15,361 shares and 297 shares of common stock, respectively.



Table of Contents

*Accumulated Other Comprehensive Income (Loss)*

The components of accumulated other comprehensive income (loss) are as follows (dollars in thousands):

	Unrealized Gain (Loss) on Investments	Retirement Plans	Total
<b>2014</b>			
January 1, 2014	\$ (60)	\$ (4,656)	\$ (4,716)
Other comprehensive income (loss) for 2014	(4)	(119)	(123)
September 30, 2014	\$ (64)	\$ (4,775)	\$ (4,839)
<b>2013</b>			
January 1, 2013	\$ (36)	\$ (28,414)	\$ (28,450)
Other comprehensive income (loss) for 2013	(22)	404	382
September 30, 2013	\$ (58)	\$ (28,010)	\$ (28,068)

Reclassifications out of other comprehensive income (loss) for the three and nine months ended September 30, 2014 and 2013 were as follows (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
<b>Retirement plans</b>				
Amortization of (gain) loss	43	222	(202)	667
Income tax credit (charge) on comprehensive income	(17)	(88)	83	(263)
Net of tax	\$ 26	\$ 134	\$ (119)	\$ 404

The amortization of (gain) loss was recognized primarily in selling, general and administrative expense for the periods ended September 30, 2014 and 2013.

**12. Commitments and Contingencies**

*Trans-Pacific Submarine Cable*

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In August 2014, the Company joined several other telecommunication companies to form a consortium to build and operate a trans-Pacific submarine cable system. The total system cost is expected to be \$245 million and is primarily composed of a supply contract with the lead contractor. The Company will invest \$25 million over the multi-year construction period for a fractional ownership in the system. The investment is expected to be \$2.5 million in 2014, \$10.2 million in 2015, \$10.5 million in 2016 and \$1.8 million in 2017. In addition, the Company will construct a cable landing station in Hawaii and provide cable landing services in exchange for additional system capacity. The value of this capacity is estimated at \$5.0 million. The system is expected to be operational in December 2016.

Table of Contents

***Power Purchase Agreement***

In July 2014, the Company entered into a power purchase agreement to acquire all of the power generated from solar photovoltaic systems that are to be installed by a third party on selected company properties. The agreement provides for all power generated to be purchased at a fixed price over a 25 year term. Based on planned solar installations and expected power generated, the Company estimates it will purchase power amounting to \$0.7 million in 2015. Power purchased in future years will be dependent on the level of photovoltaic units installed by the third party and the power generated.

***Tropical Storm Iselle***

On August 8, 2014, Tropical Storm Iselle made landfall in the State of Hawaii with the most significant damage occurring on the east side of the island of Hawaii. The cost of replacement of the Company's damaged outside plant is estimated to amount to \$2.5 million as of September 30, 2014. The Company is insured but there are limitations based on proximity of poles and lines to other Company property and based on deductibles determined by insured location as well as by event. As of September 30, 2014, the Company has not recognized a recovery in the condensed consolidated financial statements. The expense attributed to the storm recognized in the condensed consolidated statements of income after cost capitalization amounted to \$0.9 million for the three and nine months ended September 30, 2014.

***Puna Lava Flow***

A lava flow from Kilauea volcano is impacting the Puna district on the island of Hawaii. The Company has been monitoring the progress of the lava flow and has contingency plans to reduce disruption to its services in the area. These plans are subject to change depending on the direction and advancement of the lava flow which has been unpredictable. It is not possible at this time to estimate what loss, if any, to Company facilities will be incurred as a result of the lava flow.

***Collective Bargaining Agreement***

The Company has a collective bargaining agreement with the International Brotherhood of Electrical Workers Local 1357 (IBEW) with an effective date of January 1, 2013 for a term of five years. The agreement covers approximately half of the Company's work force.

***Third Party Claims***

In the normal course of conducting its business, the Company is involved in various disputes with third parties, including vendors and customers. The outcome of such disputes is generally uncertain and subject to commercial negotiations. The Company periodically assesses its liabilities in connection with these matters and records reserves for those matters where it is probable that a loss has been incurred and the loss



can be reasonably estimated. Based on management's most recent assessment, the Company believes that the risk of loss in excess of liabilities recorded is not material for all outstanding claims and disputes and the ultimate outcome of such matters will not have a material adverse effect on the Company's results of operations, cash flows or financial position.

***Litigation***

The Company is involved in litigation arising in the normal course of business. The outcome of litigation is not expected to have a material adverse impact on the Company's condensed consolidated financial statements.

**13. Fair Value of Financial Instruments**

The following method and assumptions were used to estimate the fair value of each class of financial instruments for which it is practical to estimate the fair value.

Cash and cash equivalents, accounts receivable and accounts payable The carrying amount approximates fair value. The valuation is based on settlements of similar financial instruments all of which are short-term in nature and generally settled at or near cost. Cash is measured at Level 1.

Table of Contents

Investment securities The fair value of investment securities is based on quoted market prices. Investment securities are included in other assets on the condensed consolidated balance sheets.

Debt The fair value of debt is based on the value at which the debt is trading among holders.

The estimated fair value of financial instruments is as follows (dollars in thousands):

	Carrying Value		Fair Value
<b>September 30, 2014</b>			
Assets - investment in U.S. Treasury obligations	\$ 807	\$	807
Liabilities - long-term debt (carried at amortized cost)	292,985		298,372
<b>December 31, 2013</b>			
Assets - investment in U.S. Treasury obligations	\$ 807	\$	807
Liabilities - long-term debt (carried at amortized cost)	294,679		299,886

***Fair Value Measurements***

Fair value for accounting purposes is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price).

Accounting standards establish a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement).

Assets measured at fair value on a recurring basis represent investment securities included in other assets. Liabilities carried at amortized cost with fair value disclosure on a recurring basis represent long-term debt. A summary is as follows (dollars in thousands):

	September 30, 2014		December 31, 2013
<b>Asset value measurements using:</b>			
Quoted prices in active markets for identical assets (Level 1)	\$ 807	\$	807
Significant other observable inputs (Level 2)			
Significant unobservable inputs (Level 3)			

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\$ 807 \$ 807

Liability value measurements using:

Quoted prices in active markets for identical liabilities (Level 1)	\$	\$
Significant other observable inputs (Level 2)	298,372	299,886
Significant unobservable inputs (Level 3)		
	\$ 298,372	\$ 299,886

**14. Segment Information**

The Company operates in two reportable segments of telecommunications and data center colocation. This conclusion is based on how resources are allocated and performance is assessed by the Chief Executive Officer, the Company's chief operating decision maker. The telecommunications segment provides local voice services, long distance voice services, high-speed internet and video. In addition, the segment provides network access which includes data transport. Various related telephony services are provided including equipment and managed services. The data center colocation segment provides physical colocation, virtual colocation and various related telephony services.

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### Table of Contents

In the fourth quarter of 2013, the Company reevaluated its reportable segments. This was prompted by the acquisition of SystemMetrics and the Company's current strategic focus. Previously, the Company presented a wireline and other segment (which was primarily wireless services). With the diminishing significance of the wireless segment, the Company no longer provides separate wireless information to the Company's chief operating decision maker. Both these segments are now combined into the telecommunications segment. Prior to the acquisition of SystemMetrics on September 30, 2013, the Company did not have data center colocation operations. Hence, the Company had a single reportable segment prior to September 30, 2013 under the revised reportable segment structure.

The following table provides operating financial information for the Company's reportable segments for the three and nine months ended September 30, 2014 (dollars in thousands):

	Tele- communications	Data Center Colocation	Intersegment Elimination	Total
<b>Three months ended September 30, 2014</b>				
Operating revenues	\$ 95,040	\$ 2,485	\$ (273)	\$ 97,252
Depreciation and amortization	19,298	419		19,717
Operating income (loss)	6,723	(103)		6,620
<b>Nine months ended September 30, 2014</b>				
Operating revenues	\$ 284,617	\$ 7,213	\$ (721)	\$ 291,109
Depreciation and amortization	56,078	1,243		57,321
Operating income (loss)	22,888	(238)		22,650
Capital expenditures	76,949	468		77,417

Intersegment revenue represents primarily network access services provided by the telecommunications segment for data center colocation. For the three and nine months ended September 30, 2014 total operating income above reconciles to the condensed consolidated statement of income as follows:

	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2014
Operating income	\$ 6,620	\$ 22,650
Corporate other expense	(4,090)	(12,374)
Income before income tax provision	\$ 2,530	\$ 10,276

The following table provides information on the Company's revenue, net of intersegment eliminations, by product group (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Local voice and other retail services	\$ 63,694	\$ 65,485	\$ 189,583	\$ 193,003

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Network access services	31,073	32,197	94,313	97,640
Data center colocation	2,485		7,213	
	\$ 97,252	\$ 97,682	\$ 291,109	\$ 290,643

Table of Contents

**Item 2. Management's Discussion and Analysis of  
Financial Condition and Results of Operations**

**Forward-Looking Statements**

This quarterly report contains forward-looking statements. These statements relate to future events or our future financial performance (including our anticipated cost structure) and involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as may, should, expects, intends, plans, anticipates, believes, estimates, predicts, potential, continues, assumption or the use of other comparable terminology. These statements (including statements related to our anticipated cost structure) are only predictions. Actual events or results may differ materially from those anticipated or projected due to a number of factors. These factors include, but are not limited to:

- failures in critical back-office systems and IT infrastructure or a breach of our cyber security systems;
- our ability to fund capital expenditures for network enhancements;
- our ability to maintain arrangements with third-party service providers;
- changes in regulations and legislation applicable to providers of telecommunications services;
- changes in demand for our products and services;
- our ability to retain experienced personnel;
- economic conditions in Hawaii;
- technological changes affecting the telecommunications industry; and
- our indebtedness could adversely affect our financial condition.

These and other factors may cause our actual results to differ materially from any forward-looking statement. Refer to our Annual Report on Form 10-K for a detailed discussion of risks that could materially adversely affect our business, financial condition or results of operations. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also materially adversely affect our business operations.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. These forward-looking statements are made as of the date of issuance of these quarterly condensed

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consolidated financial statements, we assume no obligation to update or revise them or to provide reasons why actual results may differ.

We do not undertake any responsibility to release any revisions to these forward-looking statements to take into account events or circumstances that occur after the date of issuance of these quarterly condensed consolidated financial statements. Additionally, we do not undertake any responsibility to update you on the occurrence of any unanticipated events which may cause actual results to differ from those expressed or implied by the forward-looking statements contained in this quarterly report.

### **Background**

In the following discussion and analysis of financial condition and results of operations, unless the context otherwise requires, we, us or the Company refers, collectively, to Hawaiian Telcom Holdco, Inc. and its subsidiaries.

Table of Contents

**Segments and Sources of Revenue**

We operate in two reportable segments (telecommunication and data center colocation) based on how resources are allocated and performance is assessed by our chief operating decision maker. Our chief operating decision maker is our Chief Executive Officer.

In the fourth quarter of 2013, we reevaluated our reportable segments. This was prompted by the acquisition of SystemMetrics and our current strategic focus. Previously, we presented a wireline and other segment (which was primarily wireless services). With the diminishing significance of the wireless segment, we no longer provide separate wireless information to our chief operating decision maker. Both these segments are now combined into the telecommunications segment. Prior to the acquisition of SystemMetrics on September 30, 2013, we did not have data center colocation operations. Hence, we were in a single segment prior to September 30, 2013 under the revised reportable segment structure.

***Telecommunications***

The telecommunications segment derives revenue from the following sources:

**Local Telephone Services** We receive revenue from providing local exchange telephone services. These revenues include monthly charges for basic service, local private line services and enhanced calling features such as voice mail, caller ID and 3-way calling.

**Network Access Services** We receive revenue for access to our network for wholesale carrier data, business customer data including Dedicated Internet Access, switched carrier access and subscriber line charges imposed on end users. Switched carrier access revenue compensates us for origination, transport and termination of calls for long distance and other interexchange carriers.

**Long Distance Services** We receive revenue from providing long distance services to our customers.

**High-Speed Internet ( HSI ) Services** We provide HSI to our residential and business customers.

**Video Services** Our video services marketed as Hawaiian Telcom TV is an advanced entertainment service.

**Equipment and managed services** We provide installation and maintenance of customer premise equipment as well as managed service for customer telephone and IT networks.



Wireless We receive revenue from wireless services, including the sale of wireless handsets and other wireless accessories.

*Data Center Colocation*

The data center colocation segment provides physical colocation, virtual colocation and various related telephony services.

Table of Contents**Results of Operations for the Three and Nine Months Ended September 30, 2014 and 2013***Operating Revenues*

The following tables summarize our volume information (lines or subscribers) as of September 30, 2014 and 2013, and our operating revenues for the three and nine months ended September 30, 2014 and 2013. For comparability, we also present volume information as of September 30, 2014 compared to June 30, 2014.

Previously, revenues from business VoIP customers for equipment usage and other ancillary services were classified as other revenue. Because all of these revenues relate to providing local telephone service to the customer, they are now presented as local voice services. Comparative information for prior periods, including the first quarter of 2014, has been modified to conform to the current period presentation.

**Volume Information**

As of September 30, 2014 compared to September 30, 2013

	September 30, 2014	September 30, 2013	Number	Change	Percentage
<b>Voice access lines</b>					
Residential	173,656	190,013	(16,357)		-8.6%
Business	189,207	194,623	(5,416)		-2.8%
Public	3,954	4,246	(292)		-6.9%
	366,817	388,882	(22,065)		-5.7%
<b>High-Speed Internet lines</b>					
Residential	92,265	90,253	2,012		2.2%
Business	19,552	19,163	389		2.0%
Wholesale	853	986	(133)		-13.5%
	112,670	110,402	2,268		2.1%
<b>Long distance lines</b>					
Residential	109,702	119,096	(9,394)		-7.9%
Business	78,207	79,320	(1,113)		-1.4%
	187,909	198,416	(10,507)		-5.3%
<b>Video services</b>					
Subscribers	25,766	15,796	9,970		63.1%
Homes Enabled	152,000	111,000	41,000		36.9%



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Table of Contents

As of September 30, 2014 compared to June 30, 2014

	September 30, 2014	June 30, 2014	Number	Change	Percentage
<b>Voice access lines</b>					
Residential	173,656	177,953	(4,297)		-2.4%
Business	189,207	190,754	(1,547)		-0.8%
Public	3,954	4,028	(74)		-1.8%
	366,817	372,735	(5,918)		-1.6%
<b>High-Speed Internet lines</b>					
Residential	92,265	91,405	860		0.9%
Business	19,552	19,465	87		0.4%
Wholesale	853	866	(13)		-1.5%
	112,670	111,736	934		0.8%
<b>Long distance lines</b>					
Residential	109,702	112,231	(2,529)		-2.3%
Business	78,207	78,522	(315)		-0.4%
	187,909	190,753	(2,844)		-1.5%
<b>Video services</b>					
Subscribers	25,766	23,101	2,665		11.5%
Homes Enabled	152,000	142,000	10,000		7.0%

Table of Contents**Operating Revenues (dollars in thousands)**

For Three Months

	Three Months Ended September 30,		Amount	Change	
	2014	2013			Percentage
<b>Telecommunications</b>					
Local voice services	\$ 32,668	\$ 34,665	\$ (1,997)		-5.8%
<b>Network access services</b>					
Business data	6,470	6,282	188		3.0%
Wholesale carrier data	14,416	14,850	(434)		-2.9%
Subscriber line access charge	8,786	9,442	(656)		-6.9%
Switched carrier access	1,401	1,623	(222)		-13.7%
	31,073	32,197	(1,124)		-3.5%
Long distance services	5,554	6,091	(537)		-8.8%
High-Speed Internet	10,909	9,999	910		9.1%
Video	6,531	3,717	2,814		75.7%
Equipment and managed services	4,818	7,228	(2,410)		-33.3%
Wireless	515	676	(161)		-23.8%
Other	2,699	3,109	(410)		-13.2%
	94,767	97,682	(2,915)		-3.0%
Data center colocation	2,485		2,485		NA
	\$ 97,252	\$ 97,682	\$ (430)		-0.4%
<b>Channel</b>					
Business	\$ 41,728	\$ 42,739	\$ (1,011)		-2.4%
Consumer	37,141	35,298	1,843		5.2%
Wholesale	15,817	16,473	(656)		-4.0%
Other	2,566	3,172	(606)		-19.1%
	\$ 97,252	\$ 97,682	\$ (430)		-0.4%

Table of Contents

For Nine Months

	Nine Months Ended September 30,		Amount	Change	
	2014	2013			Percentage
<b>Telecommunications</b>					
Local voice services	\$ 98,806	\$ 104,896	\$ (6,090)		-5.8%
<b>Network access services</b>					
Business data	19,806	18,885	921		4.9%
Wholesale carrier data	43,082	45,123	(2,041)		-4.5%
Subscriber line access charge	26,985	28,507	(1,522)		-5.3%
Switched carrier access	4,440	5,125	(685)		-13.4%
	94,313	97,640	(3,327)		-3.4%
Long distance services	17,176	18,804	(1,628)		-8.7%
High-Speed Internet	32,206	29,495	2,711		9.2%
Video	16,759	8,784	7,975		90.8%
Equipment and managed services	14,030	19,724	(5,694)		-28.9%
Wireless	1,646	2,084	(438)		-21.0%
Other	8,960	9,216	(256)		-2.8%
	283,896	290,643	(6,747)		-2.3%
Data center colocation	7,213		7,213		NA
	\$ 291,109	\$ 290,643	\$ 466		0.2%
<b>Channel</b>					
Business	\$ 126,308	\$ 126,158	\$ 150		0.1%
Consumer	109,312	104,794	4,518		4.3%
Wholesale	47,523	50,248	(2,725)		-5.4%
Other	7,966	9,443	(1,477)		-15.6%
	\$ 291,109	\$ 290,643	\$ 466		0.2%

The decrease in local voice services revenues was caused primarily by the decline of voice access lines. Continued competition in the telecommunications industry has increasingly resulted in customers using technologies other than traditional phone lines for voice and data. Residential customers are increasingly using wireless services in place of traditional wireline phone services as well as moving local voice service to VoIP technology offered by competitors. Generally, VoIP technology offered by cable providers is less expensive than traditional wireline phone service, requiring us to respond with more competitive pricing. Additionally, Competitive Local Exchange Carriers (CLECs) and our cable competitor continue to focus on business customers and selling services to our customer base.

In an effort to slow the rate of line loss, we are continuing retention and acquisition programs, and are increasingly focusing efforts on bundling of services. We have instituted various saves tactics designed to focus on specific circumstances where we believe customer churn is controllable. These tactics include targeted offers to at risk customers as well as other promotional tools designed to enhance customer retention. We also emphasize win-back and employee referral programs. Additionally, we are intensifying our efforts relative to developing tools and training to enhance our customer service capability to improve customer retention and growth.

Business data revenues for the three and nine months ended September 30, 2014 increased when compared to the prior year periods because of business win-backs and increasing bandwidth needs from our customers. Wholesale carrier data revenue declined for the three and nine months ended September 30, 2014 compared to the prior year periods. For the nine month period this was caused, in part, because of one-time service termination and other fees amounting to \$0.8 million in 2013. In addition, certain carriers have replaced older legacy circuits with more cost

effective alternatives. The impact of the decline in voice access lines is reflected in subscriber line access charges and switched carrier access charges.

Table of Contents

The decrease in long distance revenue was primarily because of the decline in long distance lines and customers moving to wireless and VoIP based technologies for long distance calling.

HSI revenues increased when compared to the prior year as a result of year-over-year increases in total HSI subscribers as well as premium pricing on higher bandwidth offerings.

We are continuing the roll out of Hawaiian Telcom TV on the island of Oahu focusing on the delivery of superior service and an ongoing excellent customer experience. Our volume is ramping up as more homes become enabled for video service. We expect to expand both the availability and the capabilities of our Hawaiian Telcom TV service over the next several years through additional capital investment and innovation.

Equipment and managed services sales have decreased because of fewer sales and installations of customer premise equipment for certain large institutional customers during the three and nine months ended September 30, 2014 compared to the same periods in the prior year. Revenue from equipment sales varies from period to period based on the volume of large installation projects. The volume of such projects has declined in recent quarters as customers chose more hosted solutions in lieu of purchasing equipment. The outlook for future periods is uncertain.

Wireless revenues and other service revenues decreased as we attempted to focus our marketing efforts on other segments of our business.

Data center colocation revenues are the result of the acquisition of SystemMetrics on September 30, 2013.

***Operating Costs and Expenses***

The following tables summarize our costs and expenses for the three and nine months ended September 30, 2014 compared to the costs and expenses for the three and nine months ended September 30, 2013 (dollars in thousands):

For Three Months

	Three Months Ended September 30,		Amount	Change	Percentage
	2014	2013			
Cost of revenues (exclusive of depreciation and amortization)	\$ 42,621	\$ 41,829	\$	792	1.9%
Selling, general and administrative expenses	28,294	27,965		329	1.2%



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Depreciation and amortization	19,717	19,974	(257)	-1.3%
	\$ 90,632	\$ 89,768	\$ 864	1.0%

Table of Contents

For Nine Months

	Nine Months Ended September 30,		Amount	Change	
	2014	2013		Amount	Percentage
Cost of revenues (exclusive of depreciation and amortization)	\$ 124,858	\$ 122,073	\$ 2,785	2.3%	
Selling, general and administrative expenses	86,280	84,860	1,420	1.7%	
Gain on sale of property		(6,546)	6,546	-100.0%	
Depreciation and amortization	57,321	58,532	(1,211)	-2.1%	
	\$ 268,459	\$ 258,919	\$ 9,540	3.7%	

There were no operations for the data center colocation segment through September 30, 2013 as it was newly acquired on September 30, 2013. Hence, a discussion of results of operations for the data center colocation segment comparing 2014 to 2013 would not be meaningful given that the number of months of operations is not equivalent. However, explanations have been provided below to the extent that the data center colocation segment significantly impacted the comparison of results of operations between periods for all segments.

The Company's total headcount as of September 30, 2014 was 1,388 compared to 1,382 as of September 30, 2013. Employee related costs are included in both cost of revenues and selling, general and administrative expenses.

Cost of revenues consists of costs we incur to provide our products and services including those for operating and maintaining our networks, installing and maintaining customer premise equipment, and cost of services sold directly associated with various products. Cost of revenues for the three and nine month periods ended September 30, 2014 increased when compared to the prior year periods because of expenses attributed to the damage caused by Tropical Storm Iselle of \$0.9 million. In addition, for the nine months ended September 30, 2014 we incurred wages of \$1.4 million for employees of SystemMetrics which was acquired on September 30, 2013.

Selling, general and administrative expenses include costs related to sales and marketing, information systems and other administrative functions. The expenses for the three months ended September 30, 2014 were comparable to the same period in the prior year. For the nine months ended September 30, 2014, the increase was because of additional advertising expense of \$1.5 million for the promotion of Hawaiian Telcom TV.

In 2013, we sold a parcel of land and warehouse not actively used in our operations for a purchase price, as amended, of \$13.9 million. A gain on the sale of \$6.5 million was recognized in the second quarter of 2013. The HPUC approval of the sale provides we spend \$0.3 million on training employees on broadband telecommunication deployment and operation. In addition, the HPUC approval provides for the balance of the sales price to be used for improvement of our broadband network.

Depreciation and amortization for the three and nine month periods ended September 30, 2014 was lower than the same periods in the prior year because of certain assets becoming fully depreciated near the end of 2013.



Table of Contents**Other Income and (Expense)**

The following tables summarize other income (expense) for the three and nine months ended September 30, 2014 and 2013 (dollars in thousands).

## For Three Months

	Three Months Ended September 30,		Amount	Change	Percentage
	2014	2013			
Interest expense	\$ (4,103)	\$ (4,089)	\$	(14)	0.3%
Interest income and other	13	7		6	85.7%
	\$ (4,090)	\$ (4,082)	\$	(8)	0.2%

## For Nine Months

	Nine Months Ended September 30,		Amount	Change	Percentage
	2014	2013			
Interest expense	\$ (12,401)	\$ (14,712)	\$	2,311	-15.7%
Loss on early extinguishment of debt		(3,660)		3,660	-100.0%
Interest income and other	27	28		(1)	-3.6%
	\$ (12,374)	\$ (18,344)	\$	5,970	-32.5%

Interest expense decreased for the nine month period primarily because of the lower interest rates on the debt which was refinanced in the second quarter of 2013. Interest capitalized was comparable between years for all periods presented.

In connection with the refinancing of debt in the second quarter of 2013, we incurred charges of \$3.7 million which consisted of the loss on the repayment of the old debt and certain refinancing costs.

**Income Tax Provision**

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We had effective tax rates of 40.1% and 40.4% for the three and nine months ended September 30, 2014, respectively. We had effective tax rates of 46.2% and 41.3% for the three and nine months ended September 30, 2013, respectively. The income tax provision for the quarter ended September 30, 2013 included additional income attributed primarily to our recognizing certain tax attributes for income tax purposes. We consider a variety of factors in determining the effective tax rate, including our forecasted full-year pretax results, the U.S. federal statutory rate, expected nondeductible expenses and estimated state taxes.

As of December 31, 2013, net operating losses available for carry forward through 2033 amounted to \$60.0 million for federal purposes and \$66.3 million for state purposes. Availability of net operating losses in future periods may be subject to additional limitations if there is a deemed change in control for income tax reporting purposes. Such change in control will be determined for income tax reporting purposes based on future changes in stock ownership.

Table of Contents

**Liquidity and Capital Resources**

As September 30, 2014, we had cash of \$31.7 million. From an ongoing operating perspective, our cash requirements in 2014 consist of supporting the development and introduction of new products, capital expenditure projects, pension funding obligations and other changes in working capital. A combination of cash-on-hand and cash generated from operating activities will be used to fund our cash requirements.

We have continued to take actions to conserve cash and improve liquidity. Efforts have also been taken to generate further operating efficiencies and focus on expense management. We have focused on improving operating results, including efforts to simplify product offerings, improve our customer service experience and increase our revenue enhancement activities. There can be no assurance that these additional actions will result in improved overall cash flow. We continue to have sizable retirement obligations for our existing employee base. Any sustained declines in the value of pension trust assets or higher levels of pension lump sum benefit payments will increase the magnitude of future plan contributions.

Agreements with the Hawaii Public Utilities Commission and the debt agreements of Hawaiian Telcom Communications, Inc. limit the ability of our subsidiaries to pay dividends to the parent company and restrict the net assets of all of our subsidiaries. This can limit our ability to pay dividends to our shareholders. As the parent company has no operations, debt or other obligations, this restriction has no other immediate impact on our operations.

***Cash Flows for Nine Months Ended September 30, 2014 and 2013***

Our primary source of funds continues to be cash generated from operations. We use the net cash generated from operations to fund network expansion and modernization. We expect that our capital spending requirements will continue to be financed through internally generated funds. We also expect to use cash generated in future periods for debt service. Additional debt or equity financing may be needed to fund additional development activities or to maintain our capital structure to ensure financial flexibility.

Net cash provided by operations amounted to \$61.8 million for the nine months ended September 30, 2014. Our cash flows from operations are impacted by our results of operations, changes in working capital and payments on certain long-term pension liabilities. Net cash provided by operations amounted to \$54.8 million for the nine months ended September 30, 2013. The increase in cash provided by operations was because of improved management of working capital.

Cash used in investing activities was \$76.5 million for the nine months ended September 30, 2014 and was comprised of capital expenditures. Cash used in investing activities included capital expenditures of \$69.8 million for the nine months ended September 30, 2013. The level of capital expenditures for 2014 is expected to be in the high-\$90 million range which is higher than 2013 as we invest in systems to support new product introductions and transform our network to enable next-generation technologies.

Cash financing activities for the nine months ended September 30, 2014 include installment financing and debt repayment activity. For the nine months ended September 30, 2013 cash financing activities include the impact of the 2013 refinancing of our debt.

*Outstanding Debt and Financing Arrangements*

As of September 30, 2014, we had outstanding \$296.9 million in aggregate long-term debt with a maturity date of June 2019. We do not expect to generate the necessary cash flow from operations to repay the facility in its entirety by the maturity date and repayment is dependent on our ability to refinance the credit facility at reasonable terms. The ability to refinance the indebtedness at reasonable terms before maturity cannot be assured.

Table of Contents

***Contractual Obligations***

In August 2014, we joined several other telecommunication companies to form a consortium to build and operate a trans-Pacific submarine cable system. The total system cost is expected to be \$245 million and is primarily composed of a supply contract with the lead contractor. We will invest \$25 million over the multi-year construction period for a fractional ownership in the system. The investment is expected to be \$2.5 million in 2014, \$10.2 million in 2015, \$10.5 million in 2016 and \$1.8 million in 2017.

During the nine months ended September 30, 2014, the Company's future contractual obligations have not changed materially from the amounts disclosed as of December 31, 2013 in our Form 10-K other than the agreement to invest in the trans-Pacific submarine cable system for the amounts described above.

We do not maintain any off balance sheet financing or other arrangements.

**Critical Accounting Policies and Estimates**

The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in consolidated financial statements. Changes in these estimates and assumptions are considered reasonably possible and may have a material effect on the condensed consolidated financial statements and thus actual results could differ from the amounts reported and disclosed herein. The Company's critical accounting policies that require the use of estimates and assumptions were discussed in detail in our Annual Report on Form 10-K for the year ended December 31, 2013, and have not changed materially from that discussion.



Table of Contents

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

As of September 30, 2014, our floating rate obligations consisted of \$296.9 million of debt outstanding under our term loan facility. Accordingly, our earnings and cash flow are affected by changes in interest rates. Based on our borrowings at September 30, 2014 and assuming a 1.0 percentage point increase or decrease in the average interest rate under these borrowings, we estimate that our annual interest expense would increase or decrease by approximately \$3.0 million.

Table of Contents

**Item 4. Controls and Procedures**

**Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures**

Eric K. Yeaman, Chief Executive Officer, and Robert F. Reich, Chief Financial Officer, have evaluated the disclosure controls and procedures of Hawaiian Telcom Holdco, Inc. (the Company) as of September 30, 2014. Based on their evaluations, as of September 30, 2014, they have concluded that the disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective in ensuring that information required to be disclosed by the Company in reports the Company files or submits under the Securities Exchange Act of 1934:

(1) is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and

(2) is accumulated and communicated to the Company's management, including the Company's principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

**Changes in Internal Control over Financial Reporting**

There have been no changes in internal control over financial reporting during the quarter ended September 30, 2014 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Certifications**

The certifications attached hereto as Exhibits 31.1, 31.2, 32.1 and 32.2 should be read in conjunction with the disclosures set forth herein.

Table of Contents

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

Other than ordinary routine litigation incidental to the business, we are not involved in any material pending legal proceedings that are likely to have a material adverse effect on us.

**Item 1A. Risk Factors**

See Part I, Item 1a, Risk Factors, of our 2013 Annual Report for a detailed discussion of risk factors related to our business, results of operations and financial condition.

Table of Contents

**Item 5. Other Information.**

Hawaiian Telcom Holdco, Inc. issued a press release on November 10, 2014 announcing its 2014 third quarter earnings. This information, attached as Exhibit 99.1, is being furnished to the SEC pursuant to Item 2.02 of Form 8-K.

Table of Contents

**Item 6. Exhibits**

See Exhibit Index following the signature page of this Report.

Table of Contents

**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.

HAWAIIAN TELCOM HOLDCO, INC.

November 10, 2014

/s/ Eric K. Yeaman  
Eric K. Yeaman  
Chief Executive Officer

November 10, 2014

/s/ Robert F. Reich  
Robert F. Reich  
Senior Vice President and Chief Financial Officer

Table of Contents

**EXHIBIT INDEX**

31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.1	Press Release dated November 10, 2014 announcing third quarter earnings.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document