

HICKORY TECH CORP  
Form 10-Q  
November 09, 2012

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 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, 2012

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 0-13721

HICKORY TECH CORPORATION  
(Exact name of registrant as specified in its charter)

Minnesota  
(State or other jurisdiction of  
incorporation or organization)

41-1524393  
(I.R.S. Employer  
Identification No.)

221 East Hickory Street  
Mankato, Minnesota 56002-3248  
(Address of principal executive offices and zip code)

(800) 326-5789  
(Registrant's telephone number, including area code)

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

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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 the 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  Smaller reporting company

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

The total number of shares of the Registrant's common stock outstanding as of November 2, 2012: 13,527,537.

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## Part I Financial Information

## Item 1. Financial Statements

HICKORY TECH CORPORATION  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited)

	Three Months Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
(Dollars in thousands, except share and per share amounts)				
		(Restated)	(Restated)	
Operating revenue:				
Equipment	\$12,915	\$14,269	\$38,954	\$31,499
Services	32,898	30,975	97,660	92,475
Total operating revenue	45,813	45,244	136,614	123,974
Costs and expenses:				
Cost of sales, excluding depreciation and amortization	10,906	12,223	33,664	27,146
Cost of services, excluding depreciation and amortization	16,358	14,738	47,589	44,244
Selling, general and administrative expenses	7,123	6,147	21,270	19,419
Depreciation and amortization	6,869	5,794	19,795	17,155
Total costs and expenses	41,256	38,902	122,318	107,964
Operating income	4,557	6,342	14,296	16,010
Other income and expense:				
Interest and other income	3	26	37	50
Interest expense	(1,625)	(2,880)	(4,635)	(5,199)
Total other (expense)	(1,622)	(2,854)	(4,598)	(5,149)
Income before income taxes	2,935	3,488	9,698	10,861
Income tax provision	1,194	1,355	3,925	4,034
Net income	\$1,741	\$2,133	\$5,773	\$6,827
Basic earnings per share	\$0.13	\$0.16	\$0.43	\$0.51
Weighted average common shares outstanding	13,511,009	13,394,225	13,483,358	13,363,874
Diluted earnings per share	\$0.13	\$0.16	\$0.43	\$0.51
Weighted average common and equivalent shares outstanding	13,526,875	13,409,414	13,498,268	13,376,261

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Dividends per share	\$0.14	\$0.135	\$0.42	\$0.405
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The accompanying notes are an integral part of the consolidated financial statements.

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HICKORY TECH CORPORATION  
STATEMENT OF COMPREHENSIVE INCOME  
(Unaudited)

	Three Months Ended September 30		Nine Months Ended September 30	
	2012	2011 (Restated)	2012	2011 (Restated)
(Dollars in thousands)				
Net Income	\$1,741	\$2,133	\$5,773	\$6,827
Other comprehensive income:				
Post-retirement benefit plan:				
Amounts included in net periodic benefit cost:				
Net actuarial loss	203	107	473	321
Prior service credit	(19 )	(13 )	(57 )	(41 )
Transition asset	15	15	45	45
Adjustment to post-retirement benefit plan	-	-	(1,034 )	-
Income tax expense	(80 )	(45 )	228	(130 )
Change in post-retirement benefit plan	119	64	(345 )	195
Comprehensive Income	\$1,860	\$2,197	\$5,428	\$7,022

The accompanying notes are an integral part of the consolidated financial statements.

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HICKORY TECH CORPORATION  
CONSOLIDATED BALANCE SHEETS  
(Unaudited)

(Dollars in thousands except share and per share amounts)	September 30, 2012	December 31, 2011 (Restated)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$10,051	\$13,057
Receivables, net of allowance for doubtful accounts of \$289 and \$436	27,493	25,317
Inventories	7,294	9,297
Income taxes receivable	1,027	498
Deferred income taxes, net	1,559	1,559
Prepaid expenses	2,612	1,801
Other	1,085	964
Total current assets	51,121	52,493
Investments	3,210	4,277
Property, plant and equipment	424,782	396,816
Accumulated depreciation	(247,979 )	(242,886 )
Property, plant and equipment, net	176,803	153,930
Other assets:		
Goodwill	29,028	27,303
Intangible assets, net	5,034	2,314
Deferred costs and other	3,554	3,669
Total other assets	37,616	33,286
<b>Total assets</b>	<b>\$268,750</b>	<b>\$243,986</b>
<b>LIABILITIES &amp; SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$4,952	\$4,661
Extended term payable	14,008	6,920
Deferred revenue	4,832	6,251
Accrued expenses and other	9,645	10,175
Current maturities of long-term obligations	1,636	1,407
Total current liabilities	35,073	29,414
Long-term liabilities:		
Debt obligations, net of current maturities	135,519	118,828
Accrued income taxes	142	154
Deferred revenue	1,045	1,131
Financial derivative instruments	2,764	2,469
Accrued employee benefits and deferred compensation	19,968	18,166
Deferred income taxes	30,281	30,627
Total long-term liabilities	189,719	171,375

Total liabilities	224,792	200,789
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value, \$.10 stated value		
Shares authorized: 100,000,000		
Shares issued and outstanding: 13,527,537 in 2012 and 13,396,176 in 2011	1,353	1,340
Additional paid-in capital	16,661	15,683
Retained earnings	30,424	30,309
Accumulated other comprehensive (loss)	(4,480 )	(4,135 )
Total shareholders' equity	43,958	43,197
Total liabilities and shareholders' equity	\$268,750	\$243,986

The accompanying notes are an integral part of the consolidated financial statements.

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**HICKORY TECH CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)

(Dollars in thousands)	Nine Months Ended September 30	
	2012	2011 (Restated)
<b>OPERATING ACTIVITIES:</b>		
Net income	\$5,773	\$6,827
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	19,795	17,155
Accrued patronage refunds	(527 )	(389 )
Stock based compensation	555	725
Loss on financial derivative instruments	295	1,629
Other	1,410	743
Changes in operating assets and liabilities, net of effect from acquired net assets		
Receivables	(2,130 )	(9,988 )
Prepaid expenses	(810 )	(480 )
Inventories	2,116	(719 )
Accounts payable and accrued expenses	(771 )	2,625
Deferred revenue, billings and deposits	(1,511 )	774
Income taxes	(643 )	6,498
Other	1,745	(602 )
Net cash provided by operating activities	25,297	24,798
<b>INVESTING ACTIVITIES:</b>		
Additions to property, plant and equipment	(21,761 )	(14,798 )
Broadband stimulus grant received	2,941	666
Acquisition of IdeaOne Telecom	(28,180 )	-
Proceeds from sale of assets	1	120
Net cash (used in) investing activities	(46,999 )	(14,012 )
<b>FINANCING ACTIVITIES:</b>		
Borrowings on extended term payable arrangement	41,370	46,438
Payments on extended term payable arrangement	(34,281 )	(42,061 )
Borrowings on credit facility	22,000	147,700
Payments on credit facility and capital lease obligations	(5,170 )	(146,117 )
Proceeds from issuance of common stock	435	467
Change in cash overdraft	-	(238 )
Stock repurchase	-	(325 )
Dividends paid	(5,658 )	(5,407 )
Net cash provided by financing activities	18,696	457
Net increase (decrease) in cash and cash equivalents	(3,006 )	11,243
Cash and cash equivalents at beginning of the period	13,057	73
Cash and cash equivalents at the end of the period	\$10,051	\$11,316
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid for interest	\$4,453	\$3,273

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Net cash paid (received) for income taxes	\$4,568	\$(2,464 )
Non-cash investing and financing activities:		
Property, plant and equipment acquired with capital leases	\$90	\$64
Change in other comprehensive (loss) from post-retirement benefits	\$(345 )	\$195

The accompanying notes are an integral part of the consolidated financial statements.

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HICKORY TECH CORPORATION  
September 30, 2012

Item 1. Condensed Notes to Consolidated Financial Statements (Unaudited)

Note 1. Basis of Presentation and Consolidation

The accompanying unaudited condensed consolidated financial statements of HickoryTech Corporation and its subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and disclosures normally included in annual financial statements prepared in accordance with GAAP have been omitted or condensed pursuant to such rules and regulations. In the opinion of management, the unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal and recurring accruals) considered necessary for the fair presentation of the financial statements and present fairly the results of operations, financial position and cash flows for the interim periods presented as required by Regulation S-X, Rule 10-01. These unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto, together with our audited consolidated financial statements and notes thereto contained in our Amendment No. 1 on Form 10-K/A for year ended December 31, 2011.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expenses and related disclosures at the date of the financial statements and during the reporting period. Actual results could differ from these estimates. The results of operations for the interim periods presented are not necessarily indicative of the results that may be expected for the fiscal year as a whole or any other interim period.

Our consolidated financial statements report the financial condition and results of operations for HickoryTech Corporation and its subsidiaries in three business segments: Fiber and Data, Equipment and Telecom. Inter-company transactions have been eliminated from the consolidated financial statements.

Cost of Sales (excluding depreciation and amortization)

Cost of sales for the Equipment Segment are primarily for equipment and materials associated with the installation of products for customers. Labor associated with installation work is not included in this category, but is included in cost of services (excluding depreciation and amortization) described below.

Cost of Services (excluding depreciation and amortization)

Cost of services includes all costs related to delivery of communication services and products for all segments. These operating costs include all costs of performing services and providing related products including engineering, customer service, billing and collections, network monitoring and transport costs.

Selling, General and Administrative Expenses

Selling, general and administrative expenses include direct and indirect selling expenses, advertising and all other general and administrative costs associated with the operations of the business.

Recent Accounting Developments

We reviewed all significant newly issued accounting pronouncements and determined they are either not applicable to our business or that no material effect is expected on our financial position, results of operations or disclosures.

Note 2. Restatement

We are restating our previously reported financial information for the quarter and year-to-date periods ended September 30, 2011 to change our accounting for interest rate swap agreements under ASC 815, "Derivatives and Hedging."

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ASC 815 requires that all derivative instruments be recorded on the balance sheet as either an asset or a liability measured at its fair value, and that changes in the derivatives fair value be recognized in earnings unless specific hedge accounting criteria are met. We applied the method of cash flow hedge accounting under ASC 815 to account for the interest rate swap agreements that allowed us to record changes in the instruments' fair value in other comprehensive income (the "cash flow" method). We recently concluded that the interest rate swap agreements did not qualify for the cash flow method because the documentation was not in place at the inception of the hedge as well as on an ongoing basis. This change reverses the fair value adjustments that were made in other comprehensive income to be recognized in earnings.

Although the swaps do not qualify for the cash flow method under ASC 815, there is no effect on cash flows from operating, investing, or financing activities for these changes. The change in the accounting treatment has not impacted the economics of the interest rate swap agreements.

The following table details the impact of the restatement on the Company's Statement of Operations and Balance Sheets for the periods ended September 30, 2011.

(Dollars in thousands, except share data)

Statement of Operations Data:	Three Months Ended September 30, 2011			Nine Months Ended September 30, 2011		
	As Reported	Restatement	Restated	As Reported	Restatement	Restated
Operating income	\$ 6,342	\$ -	\$ 6,342	\$ 16,010	\$ -	\$ 16,010
Other income and expense:						
Interest and other income	26	-	26	50	-	50
Interest expense	(1,487 )	(1,393 )	(2,880 )	(3,570 )	(1,629 )	(5,199 )
Total other (expense)	(1,461 )	(1,393 )	(2,854 )	(3,520 )	(1,629 )	(5,149 )
Income before income taxes	4,881	(1,393 )	3,488	12,490	(1,629 )	10,861
Income tax provision	1,910	(555 )	1,355	4,683	(649 )	4,034
Net income	\$ 2,971	\$ (838 )	\$ 2,133	\$ 7,807	\$ (980 )	\$ 6,827
Other comprehensive income, net of taxes	\$ (774 )	\$ 838	\$ 64	\$ (785 )	\$ 980	\$ 195
Total comprehensive income	\$ 2,197	\$ -	\$ 2,197	\$ 7,022	\$ -	\$ 7,022
Basic earnings per share	\$ 0.22	\$ (0.06 )	\$ 0.16	\$ 0.58	\$ (0.07 )	\$ 0.51
Diluted earnings per share	\$ 0.22	\$ (0.06 )	\$ 0.16	\$ 0.58	\$ (0.07 )	\$ 0.51

#### As of December 31, 2011

Balance Sheet Data:	As		
	Reported	Restatement	Restated
Shareholders' equity:			
Common stock	\$ 1,340	\$ -	\$ 1,340
Additional paid-in capital	15,683	-	15,683
Retained earnings	31,797	(1,488 )	30,309

Accumulated other comprehensive income (loss)	(5,623 )	1,488	(4,135 )
Total shareholders' equity	\$ 43,197	\$ -	\$ 43,197

### Note 3. Earnings and Cash Dividends per Common Share

Basic earnings per share (EPS) are computed by dividing net income by the weighted average number of shares of common stock outstanding during the applicable period. Shares used in the EPS dilution calculation are based on the weighted average number of shares of common stock outstanding during the period increased by potentially dilutive common shares. Potentially dilutive common shares include stock options and stock subscribed under the HickoryTech Corporation Amended and Restated Employee Stock Purchase Plan (ESPP). Dilution is determined using the treasury stock method.

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	Three Months Ended September		Nine Months Ended September	
	2012	30 2011	2012	30 2011
(Dollars in thousands, except share and earnings per share amounts)		(Restated)		(Restated)
Net Income	\$ 1,741	\$ 2,133	\$ 5,773	\$ 6,827
Weighted average shares outstanding	13,511,009	13,394,225	13,483,358	13,363,874
Stock options (dilutive only)	15,316	13,310	14,628	11,272
Stock subscribed (ESPP)	550	1,879	282	1,115
Total dilutive shares outstanding	13,526,875	13,409,414	13,498,268	13,376,261
Earnings per share:				
Basic and Diluted	\$ 0.13	\$ 0.16	\$ 0.43	\$ 0.51
Dividends per share	\$ 0.14	\$ 0.135	\$ 0.42	\$ 0.405

Options to purchase 78,900 and 179,250 shares for the three months ended September 30, 2012 and 2011, respectively and 78,900 and 195,250 shares for the nine months ended September 30, 2012 and 2011, respectively were not included in the computation of diluted EPS, because their effect on diluted EPS would have been anti-dilutive.

Cash dividends are based on the number of common shares outstanding at their respective record dates. The number of shares outstanding as of the record date for the first three quarters of 2012 and 2011, respectively, are as follows:

Shares outstanding on record date	2012	2011
First quarter (February 15)	13,409,941	13,311,817
Second quarter (May 15)	13,479,677	13,358,971
Third quarter (August 15)	13,494,599	13,383,012

Dividends per share are based on the quarterly dividend per share as declared by the HickoryTech Board of Directors. HickoryTech paid dividends of \$0.14 and \$0.135 per share in the third quarter of 2012 and 2011, respectively. During the first nine months of 2012 and 2011, shareholders have elected to reinvest \$223,000 and \$204,000, respectively, of dividends into HickoryTech common stock pursuant to the HickoryTech Corporation Dividend Reinvestment Plan.

#### Note 4. Acquisition

On March 1, 2012, we acquired all of the membership units of IdeaOne Telecom Group, LLC. for cash consideration of \$28,180,000 expanding our business and broadband services in the Fargo, North Dakota market. The acquisition was funded with existing liquidity through cash reserves of \$6,180,000 and \$22,000,000 of term loan debt which is integrated with our senior credit facility.

The table below sets forth the provisional estimates of fair value of the assets acquired, liabilities assumed and goodwill. The difference between the fair value of the consideration transferred and net assets acquired resulted in goodwill of \$1,725,000. The fair value of the property and equipment, intangible assets and other assets and liabilities was determined based on level 3 inputs.

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(Dollars in thousands)	2012
Property and equipment	\$ 23,077
Accounts receivable	310
Identifiable intangible assets:	
Customer relationships and contracts	3,200
Trade name	100
Goodwill	1,725
Other assets	273
Liabilities	(505 )
Total cash consideration	\$ 28,180

Goodwill from our acquisition is a result of the value of acquired employees along with the expected synergies from the combination of IdeaOne Telecom and our operations. IdeaOne Telecom operations have been integrated with and goodwill is recorded within our Fiber and Data Segment. Goodwill resulting from this acquisition is deductible for tax purposes.

Of the identified intangible assets above, customer relationships and contracts have useful lives between four and seven years and the trade name has a useful life of two years. Useful lives for identifiable intangible assets were estimated at the time of the acquisition based on the period of time from which we expect to derive benefits from the identifiable intangible assets. The identifiable intangible assets are amortized using the straight-line method, which reflects the pattern in which the assets are consumed.

Acquisition related expenses of \$510,000 were reflected in selling, general and administrative expenses in results for the fourth quarter ended December 31, 2011. In 2012, acquisition related expenses were insignificant and are reflected in selling, general and administrative expenses. The Company has expensed all acquisition related costs except those related to the incremental debt. The costs incurred related to the incremental term debt financing have been capitalized and are amortized over the life of the debt facility using the effective interest rate method.

The amount of IdeaOne revenue and net income included in our Consolidated Statements of Operations for the nine months ended September 30, 2012, and the following unaudited pro forma consolidated results of operations for the nine months ended September 30, 2012 and 2011, have been prepared as if the acquisition of IdeaOne had occurred at January 1, 2011:

(unaudited)			Diluted
(Dollars in thousands)	Revenue	Net Income	Earnings
Actual from March 1, 2012 to September 30, 2012	\$7,441	\$500	Per Share
Supplemental pro forma for the nine months ended September 30, 2012	\$138,731	\$5,860	\$0.04
Supplemental pro forma for the nine months ended September 30, 2011	\$132,876	\$7,074	\$0.43
			\$0.53

The proforma results are presented for illustrative purposes and are not intended to be indicative of the results that would have actually been obtained if the merger had occurred as of the date indicated, nor do the pro forma results intend to be a projection of future results that may be obtained.

#### Note 5. Goodwill and Other Intangible Assets

The carrying value of our goodwill and intangible assets increased during the first quarter of 2012 due to our acquisition of IdeaOne Telecom which closed on March 1, 2012. Goodwill was \$29,028,000 as of September 30, 2012 compared to \$27,303,000 at December 31, 2011. We have goodwill in all three of our operating units: Fiber and Data

Segment goodwill resulted from our acquisition of IdeaOne Telecom in 2012, CP Telecom in 2009 and Enventis Telecom in 2005. Equipment Segment goodwill also resulted from our acquisition of Enventis Telecom and Telecom Segment goodwill resulted from our acquisition of Heartland Telecommunications in 1997.

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(Dollars in thousands)	September 30, 2012	December 31, 2011
Fiber and Data	\$5,384	\$3,659
Equipment	\$596	\$596
Telecom	\$23,048	\$23,048

The components of intangible assets are as follows:

(Dollars in thousands)	Useful Lives	As of September 30, 2012		As of December 31, 2011	
		Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Definite-Lived Intangible Assets					
Customer relationships	1 - 8 years	\$ 8,499	\$ 5,192	\$ 5,299	\$ 4,746
Other intangibles	1 - 5 years	2,930	1,203	2,830	1,069
<b>Total</b>		<b>\$ 11,429</b>	<b>\$ 6,395</b>	<b>\$ 8,129</b>	<b>\$ 5,815</b>

Amortization expense related to the definite-lived intangible assets was \$580,000 and \$265,000 for the nine months ended September 30, 2012 and 2011, respectively. Total estimated amortization expense for the remaining three months of 2012 and the five years subsequent to 2012 is as follows: 2012 (October 1 – December 31) – \$223,000; 2013 - \$893,000; 2014 - \$762,000; 2015 - \$629,000; 2016 - \$567,000; 2017 - \$554,000.

#### Note 6. Fair Value of Financial Instruments

The fair value of cash and cash equivalents, net accounts receivables and payables, other short-term monetary assets and liabilities was estimated by management to approximate fair value due to the relatively short period of time to maturity for these instruments.

The fair value estimate for our long-term debt is based on the overall weighted average interest rates and maturity compared to rates and terms currently available in the long-term financing markets. The fair value estimate of our interest rate swaps represent the net present value of future cash flows based on projections of the three-month LIBOR rate over the life of each swap. Our interest rate swaps are recognized at fair value under the long-term liabilities on the Consolidated Balance Sheets as of September 30, 2012 and December 31, 2011.

The fair value and carrying value of our long-term debt, after deducting current maturities and our interest rate swaps are as follows at September 30, 2012 and December 31, 2011:

(Dollars in thousands)	Input Level	September 30, 2012		December 31, 2011	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term debt	2	\$135,519	\$138,816	\$118,828	\$122,886
Interest rate swaps	2	\$2,764	\$2,764	\$2,469	\$2,469

#### Note 7. Debt and Other Obligations

Our long-term obligations as of September 30, 2012 were \$135,519,000, excluding current maturities of \$1,420,000 on debt and \$216,000 on current maturities of capital leases. Long-term obligations as of December 31, 2011 were \$118,828,000 excluding current maturities of \$1,200,000 on debt and \$207,000 of capital leases.

On August 11, 2011, we entered into a \$150,000,000 credit agreement with a syndicate of nine banks that matures on December 31, 2016. The credit facility is comprised of a \$30,000,000 revolving credit component (\$29,965,000 available to borrow as of September 30, 2012; \$35,000 is reserved for outstanding letters of credit) and a \$120,000,000 term loan component. On March 1, 2012 we borrowed an additional \$22,000,000 of incremental term loan debt under our existing credit facility to fund our acquisition of IdeaOne Telecom.

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The term loans are structured in a Term Loan B facility. The outstanding principal balance of (the initial) Term Loan is \$116,800,000 as of September 30, 2012 and requires us to make quarterly principal payments of \$300,000. The outstanding principal balance of the Incremental Term is \$19,890,000 as of September 30, 2012 and requires us to make quarterly principal payments of \$55,000. There was no outstanding principal balance under the revolving credit component as of September 30, 2012 and the revolving credit component does not require quarterly principal payments. Any remaining amounts outstanding on the revolving credit component and Term Loans will be due at maturity on December 31, 2016.

The term loan component has a provision whereby we periodically receive patronage capital refunds. Patronage refunds are recorded as an offset to interest expense and amounted to \$527,000 in the first nine months of 2012 compared to \$389,000 in the first nine months of 2011.

At September 30, 2012 we are in full compliance with specified financial ratios and tests required by our credit facility. The credit facility includes allowances for continued payment of dividends and specific limits on common stock repurchases. The banks in our credit facility syndicate provided a waiver of our specific breaches in representations provided to them regarding GAAP related to the financial information restatement. For additional information refer to the November 6, 2012 8-K SEC filing.

Our obligations under the credit facility are secured by a first-priority lien on the property and assets, tangible and intangible, of Hickory/Tech and its current subsidiaries, which includes total assets except for the Equipment Segment accounts receivable and inventory. We have also given a first-priority pledge of the capital stock of our current subsidiaries to secure the credit facility. The credit facility contains certain restrictions that, among other things, limit or restrict our ability to create liens or encumbrances; incur additional debt; issue stock; make asset sales, transfers, or dispositions; and engage in mergers and acquisitions, pay dividends or purchase/redeem Company stock over specified maximum values.

The credit facility requires us to enter in or maintain effective interest rate protection agreements on at least 50% of the Term Loans outstanding balance for a period ending August 2013 to manage our exposure to interest rate fluctuations. We currently have interest rate swap agreements, effectively fixing the LIBOR rate portion of the interest rate on \$72,000,000 of our variable interest debt. Additional information on our interest-rate swap agreements can be found under Note 8 "Financial Derivative Instruments."

#### Note 8. Financial Derivative Instruments

We utilize interest-rate swap agreements to manage our exposure to interest rate fluctuations on a portion of our variable-interest rate debt. Our interest-rate swaps increase or decrease the amount of cash paid for interest depending on the increase or decrease of interest required on the variable rate debt. We have effectively changed our exposure to varying cash flows on the variable-rate portion of our debt into fixed-rate cash flows. We do not enter into derivative instruments for any purpose other than to manage interest rate exposure. That is, we do not engage in interest rate speculation using derivative instruments.

We account for derivatives in accordance with FASB ASC Topic 815, "Derivatives and Hedging." ASC 815 requires that all derivative instruments be recorded on the balance sheet as either an asset or a liability measured at its fair value, and that changes in the derivatives' fair value be recognized in earnings unless specific hedge accounting criteria are met. Our financial derivative instruments are not designated as hedges as of the end of and during the periods presented.

The fair value of our interest rate swap agreements were determined based on Level 2 inputs. Listed below are the interest-rate swap agreements which lock in our interest rates on existing variable-interest rate debt.

Interest-Rate Swap Agreement Effective Dates	Coverage Amount	Rate	
September 2011 - September 2014	\$24,000,000	1.66	%
September 2011 - March 2015	\$24,000,000	1.91	%
September 2011 - September 2015	\$24,000,000	2.14	%

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The fair value of our derivatives at September 30, 2012 and December 31, 2011 are recorded as financial derivative instruments under the long-term liabilities section of our balance sheet. The fair value of our derivatives at September 30, 2012 and December 31, 2011 is a net liability of \$2,764,000 and \$2,469,000, respectively. The change in the fair value of financial derivative instruments is recognized in earnings in that period. The table below illustrates the effect of derivative instruments on consolidated operations for the periods ended September 30, 2012 and 2011, respectively.

(Dollars in thousands)		Increase/(Decrease) in Interest Expense		Increase/(Decrease) in Interest Expense	
		Three Months Ended September 30		Nine Months Ended September 30	
Derivative Instruments Hedging Relationships	Location of Financial Impact of Derivatives into Income	2012	2011 (Restated)	2012	2011 (Restated)
Interest Rate Contracts	Interest Expense	\$ 131	\$ 1,393	\$ 295	\$ 1,629

#### Note 9. Extended Term Payable

Enterprise Integration Services, Inc., a wholly owned subsidiary of HickoryTech, has an \$18,000,000 wholesale financing agreement with a financing company to fund equipment purchases from certain approved vendors. Advances under this financing arrangement are collateralized by the assets of our Equipment Segment and a guaranty of an amount up to \$2,500,000 by HickoryTech. The agreement requires Enterprise Integration Services to maintain specific levels of collateral relative to the outstanding balance due, provide selected monthly financial information, and make all payments when due or on demand in the event of a collateral shortfall, among other requirements. A default on the financing agreement by Enterprise Integration Services would require HickoryTech to perform under the guaranty. The financing agreement provides 60 day, interest-free payment terms for working capital and can be terminated at any time by either party. The balance outstanding under the financing arrangement was \$14,008,000 and \$6,920,000 at September 30, 2012 and December 31, 2011, respectively. The balance fluctuates quarter to quarter based on timing of customer orders. These balances are classified as current liabilities in the accompanying Balance Sheets and are excluded from our debt financing per our senior credit agreement.

#### Note 10. Employee Post-Retirement Benefits

HickoryTech provides post-retirement health care and life insurance benefits for eligible employees. We are currently not funding these post-retirement benefits, but have accrued these liabilities. We are required to recognize the funded status of our post-retirement benefit plans on our consolidated balance sheet and recognize as a component of accumulated other comprehensive income (loss), net of tax, the gains and losses and prior service costs or credit that arise during the period but are not recognized as components of net periodic benefit cost. New employees are not eligible for post-retirement health care and life insurance benefits.

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(Dollars in thousands)	Three Months Ended September 30		Nine Months Ended September 30	
	2012	2011	2012	2011
Components of net periodic benefit cost				
Service cost	\$ 150	\$ 127	\$ 450	\$ 381
Interest cost	188	200	564	600
Expected return on plan assets	-	-	-	-
Amortization of transition obligation	15	15	45	45
Amortization of prior service cost	(19 )	(14 )	(57 )	(42 )
Recognized net actuarial loss	135	107	405	321
Net periodic benefit cost	\$ 469	\$ 435	\$	