

HICKORY TECH CORP  
Form 10-Q  
August 06, 2013  
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 June 30, 2013

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 41-1524393  
(State or other jurisdiction of incorporation or organization) (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 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 August 2, 2013: 13,544,964.

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TABLE OF CONTENTS

PART I Financial Information

<u>Item 1. Financial Statements</u>	<u>3</u>
<u>Consolidated Statements of Income (Unaudited) for the Three and Six Months Ended June 30, 2013 and 2012</u>	<u>3</u>
<u>Consolidated Statements of Comprehensive Income (Unaudited) for the Three and Six Months Ended June 30, 2013 and 2012</u>	<u>4</u>
<u>Consolidated Balance Sheets (Unaudited) as of June 30, 2013 and December 31, 2012</u>	<u>5</u>
<u>Consolidated Statements of Cash Flows (Unaudited) for the Six Months Ended June 30, 2013 and 2012</u>	<u>6</u>
<u>Notes to Consolidated Financial Statements (Unaudited)</u>	<u>7</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>19</u>
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	<u>31</u>
<u>Item 4. Controls and Procedures</u>	<u>31</u>

PART II Other Information

<u>Item 1. Legal Proceedings</u>	<u>32</u>
<u>Item 1A. Risk Factors</u>	<u>32</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>32</u>
<u>Item 3. Defaults Upon Senior Securities</u>	<u>33</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>33</u>
<u>Item 5. Other Information</u>	<u>33</u>
<u>Item 6. Exhibit Listing</u>	<u>33</u>
<u>Signatures</u>	<u>34</u>
Exhibits	35

Table of Contents

## Part I Financial Information

## Item 1. Financial Statements

HICKORY TECH CORPORATION  
CONSOLIDATED STATEMENTS OF INCOME  
(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30		June 30	
(Dollars in thousands, except share and per share amounts)	2013	2012	2013	2012
Operating revenue:				
Equipment	\$ 12,910	\$ 10,740	\$ 28,274	\$ 26,039
Services	34,231	33,117	67,636	64,762
Total operating revenue	47,141	43,857	95,910	90,801
Costs and expenses:				
Cost of sales, excluding depreciation and amortization	10,860	9,292	24,082	22,758
Cost of services, excluding depreciation and amortization	16,971	15,905	33,570	31,231
Selling, general and administrative expenses	7,047	7,441	14,496	14,147
Asset impairment	5	-	638	-
Depreciation and amortization	7,252	6,732	14,261	12,926
Total costs and expenses	42,135	39,370	87,047	81,062
Operating income	5,006	4,487	8,863	9,739
Other income and expense:				
Interest and other income	13	14	15	34
Interest expense	(1,131)	) (1,599)	) (2,270)	) (3,010)
Total other (expense)	(1,118)	) (1,585)	) (2,255)	) (2,976)
Income before income taxes	3,888	2,902	6,608	6,763
Income tax provision	1,567	1,164	2,661	2,731
Net income	\$ 2,321	\$ 1,738	\$ 3,947	\$ 4,032
Basic earnings per share	\$ 0.17	\$ 0.13	\$ 0.29	\$ 0.30
Weighted average common shares outstanding	13,531,007	13,404,628	13,543,690	13,377,209
Diluted earnings per share	\$ 0.17	\$ 0.13	\$ 0.29	\$ 0.30
Weighted average common and equivalent shares outstanding	13,576,967	13,454,707	13,584,749	13,433,277
Dividends per share	\$ 0.145	\$ 0.14	\$ 0.29	\$ 0.28

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



Table of Contents

HICKORY TECH CORPORATION  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(Unaudited)

	Three Months		Six Months	
	Ended		Ended	
	June 30		June 30	
(Dollars in thousands)	2013	2012	2013	2012
Net income	\$2,321	\$1,738	\$3,947	\$4,032
Other comprehensive income:				
Interest rate swaps:				
Changes in designated interest rate swaps	65	-	60	-
Income tax (expense)	(26 )	-	(24 )	-
Unrealized holding gain on interest rate swaps	39	-	36	-
Post-retirement benefit plan:				
Amounts included in net periodic benefit cost:				
Net actuarial loss	120	135	240	270
Prior service credit	(236 )	(19 )	(472 )	(38 )
Transition obligation	-	15	-	30
Adjustment to post-retirement benefit plan	-	(1,034)	-	(1,034)
Income tax expense (benefit)	46	360	92	308
Change in post-retirement benefit plan	(70 )	(543 )	(140 )	(464 )
Other comprehensive (loss) income	(31 )	(543 )	(104 )	(464 )
Comprehensive income	\$2,290	\$1,195	\$3,843	\$3,568

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

4

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Table of Contents

HICKORY TECH CORPORATION  
CONSOLIDATED BALANCE SHEETS  
(Unaudited)

(Dollars in thousands except share and per share amounts)	June 30, 2013	December 31, 2012
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$5,197	\$8,305
Receivables, net of allowance for doubtful accounts of \$264 and \$278	27,346	22,530
Inventories	6,312	8,379
Income taxes receivable	1,025	596
Deferred income taxes, net	1,623	1,887
Prepaid expenses	2,599	2,092
Other	917	1,399
Total current assets	45,019	45,188
Investments	3,408	3,213
Property, plant and equipment	448,535	437,623
Accumulated depreciation and amortization	(267,930)	(254,664)
Property, plant and equipment, net	180,605	182,959
Other assets:		
Goodwill	29,028	29,028
Intangible assets, net	4,328	4,811
Deferred costs and other	3,002	3,105
Total other assets	36,358	36,944
Total assets	\$265,390	\$268,304
<b>LIABILITIES &amp; SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$3,332	\$5,818
Extended term payable	10,867	8,115
Deferred revenue	5,598	7,362
Accrued expenses and other	9,326	10,881
Current maturities of long-term obligations	1,655	1,648
Total current liabilities	30,778	33,824
Long-term liabilities:		
Debt obligations, net of current maturities	134,324	135,133
Accrued income taxes	221	236
Deferred revenue	2,864	1,085
Financial derivative instruments	1,838	2,432
Accrued employee benefits and deferred compensation	12,634	12,481
Deferred income taxes	34,196	34,265
Total long-term liabilities	186,077	185,632

Total liabilities	216,855	219,456
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value, \$.10 stated value		
Shares authorized: 100,000,000		
Shares issued and outstanding: 13,516,441 in 2013 and 13,519,131 in 2012	1,352	1,352
Additional paid-in capital	15,730	15,950
Retained earnings	30,998	30,987
Accumulated other comprehensive income	455	559
Total shareholders' equity	48,535	48,848
Total liabilities and shareholders' equity	\$265,390	\$268,304

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

5

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Table of Contents

HICKORY TECH CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

(Dollars in thousands)	Six Months Ended	
	2013	2012
<b>OPERATING ACTIVITIES:</b>		
Net income	\$3,947	\$4,032
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	14,261	12,926
Asset impairment	638	-
Accrued patronage refunds	(353 )	(345 )
Stock based compensation	429	375
Loss on financial derivative instruments	46	164
Excess tax benefit	(100 )	-
Other	515	773
Changes in operating assets and liabilities, net of effect from acquired net assets		
Receivables	(4,888 )	4,070
Prepaid expenses	(507 )	(401 )
Inventories	2,282	4,350
Accounts payable and accrued expenses	(4,686 )	(3,679 )
Deferred revenue, billings and deposits	15	(683 )
Income taxes	(453 )	(203 )
Other	743	137
Net cash provided by operating activities	11,889	21,516
<b>INVESTING ACTIVITIES:</b>		
Additions to property, plant and equipment	(13,117)	(10,969)
Broadband stimulus grant received	831	1,426
Redemption of investments	-	1,415
Acquisition of IdeaOne Telecom	-	(26,337)
Purchase of short-term investments	-	(2,998 )
Proceeds from sale of assets	114	-
Net cash (used in) investing activities	(12,172)	(37,463)
<b>FINANCING ACTIVITIES:</b>		
Borrowings on extended term payable arrangement	32,231	22,772
Payments on extended term payable arrangement	(29,479)	(21,501)
Borrowings on credit facility	-	22,000
Payments on credit facility and capital lease obligations	(821 )	(2,344 )
Proceeds from issuance of common stock	355	163
Stock repurchase	(1,275 )	-
Dividends paid	(3,936 )	(3,769 )
Excess tax benefit	100	-
Net cash (used in) provided by financing activities	(2,825 )	17,321
Net (decrease) increase in cash and cash equivalents	(3,108 )	1,374

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Cash and cash equivalents at beginning of the period	8,305	13,057
Cash and cash equivalents at the end of the period	\$5,197	\$14,431
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$2,960	\$2,868
Net cash paid for income taxes	\$2,763	\$2,934
Non-cash investing and financing activities:		
Property, plant and equipment acquired with capital leases	\$19	\$14

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

Table of Contents

HICKORY TECH CORPORATION

June 30, 2013

Item 1. Notes to Consolidated Financial Statements (Unaudited)

Note 1. Basis of Presentation and Consolidation

The accompanying unaudited consolidated financial statements of HickoryTech Corporation and its subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States of America ("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 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 consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto, together with the audited consolidated financial statements and notes thereto contained in our Form 10-K for the year ended December 31, 2012.

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 may 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. Intercompany transactions have been eliminated from the consolidated financial statements.

Cost of Sales (excluding depreciation and amortization)

Cost of sales for the Equipment Segment is 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

In the first quarter of 2013, the FASB issued ASU 2013-02 to improve the disclosure of reclassifications out of accumulated other comprehensive income. The Update requires an entity to provide information about the amounts

reclassified out of accumulated other comprehensive income by component. Also, an entity is required to present significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income (only if the amount reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period) either on the face of the statement where net income is presented or in the notes. Our adoption of this guidance did not have a material impact on our disclosures or consolidated financial statements.

We reviewed other recently 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.

Table of Contents

## Note 2. Earnings and Dividends per Share

Basic earnings per share ("EPS") is calculated by dividing net income by the weighted average number of shares of common stock outstanding during the applicable period. Shares used in the diluted earnings per share calculation are based on the weighted average number of shares outstanding during the period increased by potentially dilutive common equivalent shares. Potentially dilutive common shares include stock options, stock subscribed under the HickoryTech Corporation Amended and Restated Employee Stock Purchase Plan ("ESPP"), retention stock awards and stock awarded under the Long-Term Executive Incentive Program ("LTEIP"). Dilution is determined using the treasury stock method. The Company does not use the two-class method to report its earnings per share. The two-class method includes an earnings allocation formula that determines earnings per share for common stock and restricted stock issued under the LTEIP, which participate in dividends. However, the application of this method would result in an immaterial change in earnings per share and is therefore not presented.

(Dollars in thousands, except share and earnings per share amounts)	Three Months Ended June 30		Six Months Ended June 30	
	2013	2012	2013	2012
Net income	\$2,321	\$1,738	\$3,947	\$4,032
Weighted average shares outstanding	13,531,007	13,404,628	13,543,690	13,377,209
Stock options (dilutive only)	5,896	12,493	5,320	14,664
Stock subscribed (ESPP)	-	-	-	-
Retention awards	16,775	16,414	13,980	20,029
Stock subscribed (LTEIP)	23,289	21,172	21,759	21,375
Total dilutive shares outstanding	13,576,967	13,454,707	13,584,749	13,433,277
Earnings per share:				
Basic and diluted	\$0.17	\$0.13	\$0.29	\$0.30
Dividends per share	\$0.145	\$0.14	\$0.29	\$0.28

Options to purchase 77,150 and 83,900 shares for the three months ended June 30, 2013 and 2012, respectively, and 82,150 and 78,900 shares for the six months ended June 30, 2013 and 2012, respectively, were not included in the computation of diluted EPS, because their effect on earnings per share 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 and second quarters of 2013 and 2012, respectively, are as follows:

Shares outstanding on record date	2013	2012
First quarter (February 15)	13,586,903	13,409,941
Second quarter (May 15)	13,559,043	13,479,677

Dividends per share are based on the quarterly dividend per share as declared by the HickoryTech Board of Directors. HickoryTech paid dividends of \$0.145 and \$0.14 per share in the second quarter of 2013 and 2012, respectively. During the first six months of 2013 and 2012, shareholders have elected to reinvest \$154,000 and \$147,000, respectively, of dividends into HickoryTech common stock pursuant to the HickoryTech Corporation Dividend Reinvestment Plan.

In the three and six months ended June 30, 2013, we acquired and retired 71,638 and 124,285 shares, respectively, of HickoryTech common stock.

Note 3. Acquisition

On March 1, 2012, we acquired IdeaOne Telecom Group, LLC for cash consideration of \$26,337,000 expanding our business and broadband services in the Fargo, North Dakota market. The acquisition was funded with existing liquidity through cash reserves of \$4,337,000 and \$22,000,000 of term loan debt which is integrated with our senior credit facility. In addition, we assumed and paid liabilities of the acquired company using additional cash reserves of \$1,843,000 on the closing date of the acquisition.

Table of Contents

## Note 4. Long-Lived Assets

We review long-lived assets, including intangible assets subject to amortization, for impairment if certain events or changes in circumstances indicate impairment may be present. Impairment exists if the carrying value of a long-lived asset exceeds the sum of the undiscounted future cash flows expected to result from the use and eventual disposal of the asset at the date it is tested. If the carrying value is no longer recoverable based upon the undiscounted future cash flows of the asset, an impairment equal to the difference between the carrying amount and the fair value of the asset is recognized.

In the first quarter of 2013, an impairment test was performed in response to indicators that the carrying amount of certain customer relationship intangible assets and property, plant and equipment related to providing wireless Internet to customers in the Fargo, North Dakota market may not be recoverable due to our decision to phase out this service. During the impairment review, we determined the carrying value of these particular intangibles, property and equipment were impaired. Fair value was calculated using the income approach of valuation. The income approach utilizes the discounted cash flow method. It requires the use of estimates and judgments about the future income expected to be derived from the use or ownership of an asset.

In the first quarter of 2013, an impairment charge of \$633,000 was recognized within our Fiber and Data Segment. Minor adjustments to fully recognize the impairment on all related assets resulted in an additional \$5,000 impairment charge in the second quarter to bring the final year-to-date impairment recognition to \$638,000. There were no such charges in 2012.

## Note 5. Goodwill and Other Intangible Assets

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 resulted from our acquisition of Enventis Telecom and Telecom Segment goodwill resulted from our acquisition of Heartland Telecommunications in 1997. The tax deductible portion of goodwill is \$26,964,000.

	June 30,	December
(Dollars in thousands)	2013	31, 2012
Fiber and Data	\$5,384	\$ 5,384
Equipment	\$596	\$ 596
Telecom	\$23,048	\$ 23,048

The components of intangible assets are as follows:

(Dollars in thousands)	Useful Lives	June 30, 2013		December 31, 2012	
		Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Definite-lived intangible assets					
Customer relationships	1 - 8 years	\$8,459	\$ 5,716	\$8,499	\$ 5,368
Other intangibles	1 - 5 years	2,930	1,345	2,930	1,250
Total		\$11,389	\$ 7,061	\$11,429	\$ 6,618

In the first quarter of 2013, we reduced the carrying value of the customer relationships by \$40,000. This impairment loss was directly related to our decision to no longer provide wireless Internet service in the Fargo, North Dakota market. See Note 4 "Long-Lived Assets."

Amortization expense related to the definite-lived intangible assets was \$443,000 and \$357,000 for the six months ended June 30, 2013 and 2012, respectively. Total estimated amortization expense for the remaining six months of 2013 and the five years subsequent to 2013 is as follows: 2013 (July 1 – December 31) – \$440,000; 2014 - \$749,000; 2015 - \$616,000; 2016 - \$565,000; 2017 - \$554,000; 2018 - \$554,000.



Table of Contents

## Note 6. Fair Value of Financial Instruments

Fair value of financial and non-financial assets and liabilities is the price that would be received for an asset or paid to transfer a liability (exit price) in an orderly transaction between market participants. The three levels of the fair value hierarchy for assessing the inputs used in fair value measurements are as follows:

- Level 1 – quoted prices in active markets for identical assets and liabilities
- Level 2 – observable inputs other than quoted prices in active markets for identical assets and liabilities
- Level 3 – unobservable inputs in which there is little or no market data available and require the entity to develop its own assumptions

The highest priority is given to quoted prices in active markets for identical assets and liabilities (Level 1) and the lowest priority is given to unobservable inputs (Level 3).

The carrying value of cash and cash equivalents, net accounts receivables, payables, and 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.

Our long-term debt credit agreement allows us to select short-term LIBOR pricing options, which we have elected. Therefore, the carrying amounts of our long-term debt approximate its fair value. 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. It also incorporates credit valuation adjustments to appropriately reflect both our own non-performance risk and the non-performance risk of the respective counterparties. See Note 8 "Financial Derivative Instruments" for further discussion regarding our interest rate swaps.

The fair value and carrying value of our investments, long-term debt, after deducting current maturities, and our interest rate swaps are as follows at June 30, 2013 and December 31, 2012:

(Dollars in thousands)	Input Level	June 30, 2013		December 31, 2012	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
Investments	2	\$3,408	\$3,408	\$3,213	\$3,213
Long-term debt	2	\$134,324	\$134,324	\$135,133	\$135,133
Interest rate swaps	2	\$1,838	\$1,838	\$2,432	\$2,432

## Note 7. Debt and Other Obligations

Our long-term obligations as of June 30, 2013 were \$134,324,000, excluding current maturities of \$1,420,000 on debt and \$235,000 on current maturities of capital leases. Long-term obligations as of December 31, 2012 were \$135,133,000 excluding current maturities of \$1,420,000 on debt and \$228,000 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 (\$29,980,000 available to borrow as of June 30, 2013; \$20,000 is reserved for outstanding letters of credit) and a \$120,000,000 term loan component (\$115,900,000 outstanding as of June 30, 2013). On March 1, 2012 we borrowed an additional \$22,000,000 of incremental term loan debt (\$19,725,000 outstanding as of June 30, 2013) as an extension of our existing credit facility to fund our acquisition of IdeaOne Telecom.

The term loans are structured in a Term Loan B facility. Under the terms of our credit facility we are required to make quarterly principal payments of \$300,000 on the initial Term Loan and quarterly principal payments of \$55,000 on the

Incremental Term Loan. The revolving credit component does not require quarterly principal payments.

The term loan component has a provision whereby we periodically receive patronage capital refunds from our lender. Patronage refunds are recorded as an offset to interest expense and amounted to \$353,000 in the first six months of 2013 compared to \$345,000 in the first six months of 2012.

10

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Table of Contents

At June 30, 2013, 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.

Our obligations under the credit facility are secured by a first-priority lien on the property and assets, tangible and intangible, of HickoryTech and its current subsidiaries, which includes total assets with the exception of the Equipment Segment accounts receivable and inventory and assets purchased or constructed through Federal funding, reflecting the National Telecommunications Information Administration ("NTIA") federal interest in Broadband Technology Opportunities Program ("BTOP") grant-funded network. 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 certain 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 in 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. We have effectively changed our exposure to varying cash flows on the variable-rate portion of our debt into fixed-rate cash flows, therefore reducing the impact of interest rate changes on future cash interest payments. We do not enter into derivative instruments for any purpose other than to manage interest rate exposure. 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 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. If a derivative is designated as a hedge, the effective portion of changes in the fair value of derivatives is recorded as a component of accumulated other comprehensive income (loss) in shareholders' equity, net of tax, which is subsequently, reclassified into earnings when the underlying hedged transaction is recognized in earnings. Amounts related to our derivatives will be reclassified from accumulated other comprehensive income to interest expense as interest payments are accrued or made on our variable rate debt. The estimated amount expected to be reclassified as an increase to interest expense within the next twelve months is \$42,000 at June 30, 2013. The ineffective portion of the fair value of derivatives is recognized directly in earnings. Hedge ineffectiveness is attributable to the swaps having a non-zero fair value at the time they were designated. If we were to terminate our interest rate swap positions, any related balance in accumulated other comprehensive income (loss) would immediately be recognized in earnings or reclassified into earnings as the interest payments are made dependent on the facts and circumstances of the termination. The changes in the fair value of derivatives that are not designated as hedges are recognized immediately in earnings. As of January 1, 2013 our interest rate swaps were designated as cash flow hedging instruments. As of December 31, 2012 our interest rate swaps were not designated as hedging instruments.

Listed below are the interest rate swap agreements outstanding as of June 30, 2013 which were designated as cash flow hedges of interest rate risk and have the effect of locking our interest rates on a portion of our existing variable interest rate debt.

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Interest Rate Swap Agreement Effective Dates	Notional	
	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%

11

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Table of Contents

The following tables present the fair value of our derivative instruments included in our Consolidated Balance Sheets as of June 30, 2013 and December 31, 2012.

	<u>Derivative Assets</u>		<u>Derivative Liabilities</u>	
	Fair Value as of			
	June 30, 2013	December 31, 2012	June 30, 2013	December 31, 2012
Derivatives Designated as Cash Flow Hedges				
Interest rate derivatives				
Balance sheet location	Financial Derivative Instruments	Financial Derivative Instruments	Financial Derivative Instruments	Financial Derivative Instruments
Pay-fixed swaps	\$-	\$ -	\$1,838	\$ -

	<u>Derivative Assets</u>		<u>Derivative Liabilities</u>	
	Fair Value as of			
	June 30, 2013	December 31, 2012	June 30, 2013	December 31, 2012
Derivatives Not Designated as Cash Flow Hedges				
Interest rate derivatives				
Balance sheet location	Financial Derivative Instruments	Financial Derivative Instruments	Financial Derivative Instruments	Financial Derivative Instruments
Pay-fixed swaps	\$-	\$ -	\$-	\$ 2,432

The tables below illustrate the effect of derivative instruments on consolidated operations for the three and six month periods ended June 30, 2013 and 2012. Our derivative instruments were designated as cash flow hedges for the periods ended June 30, 2013. For the periods ended June 30, 2012 our derivative instruments were not designated as hedges.

	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)		Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	
			2013	2012	2013	2012
Derivatives Designated as Cash Flow Hedges						
For the quarter ended June 30,						

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Interest rate derivatives

Pay-fixed swaps	\$ (41 )	\$ -	Interest expense	\$ 25	\$ -	Interest expense	\$ (6 )	\$ -
				Amount of			Amount of	
				Gain or			Gain or	
				(Loss)			(Loss)	
				Recognized			Recognized	
				in Income			in Income	
				on			on	
				Derivative			Derivative	
				(Ineffective			(Ineffective	
				Portion			Portion and	
				and Amount			Amount Excluded from	
				Excluded			Amount	
				from			Excluded	
				Effectiveness			from	
				Testing)			Effectiveness	
				Testing)			Testing)	
Derivatives Designated as Cash				2013	2012		2013	2012
Flow Hedges					(Effective Portion)			
For the six months ended June								
30,								
Interest rate								
derivatives								
Pay-fixed swaps	\$ (15 )	\$ -	Interest expense	\$ 46	\$ -	Interest expense	\$ 1	\$ -

Table of Contents

Derivatives Not Designated as Cash Flow Hedges For the quarter ended June 30,	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)		Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)		Location of Gain or (Loss) Recognized in Income on Derivative	Amount of Gain or (Loss) Recognized in Income on Derivative	
	2013	2012		2013	2012		2013	2012
Interest rate derivatives								
Pay-fixed swaps	\$ -	\$ -	Interest expense	\$ -	\$ -	Interest expense	\$ -	\$ (117)
Derivatives Not Designated as Cash Flow Hedges For the six months ended June 30,	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)		Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)		Location of Gain or (Loss) Recognized in Income on Derivative	Amount of Gain or (Loss) Recognized in Income on Derivative	
	2013	2012		2013	2012		2013	2012
Interest rate derivatives								
Pay-fixed swaps	\$ -	\$ -	Interest expense	\$ -	\$ -	Interest expense	\$ -	\$ (164)

## 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 inventory and accounts receivable of our Equipment Segment and a guarantee of an amount up to \$2,500,000 by HickoryTech. The agreement requires Enterprise Integration Services, Inc. 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, Inc. would require HickoryTech to perform under the guarantee. 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 \$10,867,000 and \$8,115,000 at June 30, 2013 and December 31, 2012, respectively. The balance fluctuates on a quarterly basis dependent upon timing of customer orders. These balances are classified as current liabilities in the accompanying Consolidated Balance Sheets and are not considered part of our debt financing.

## 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 or losses and prior service costs or credit that arise during the period but are not recognized as components of net periodic benefit cost. Employees hired on or after January 1, 2007 are not eligible for post-retirement health care and life insurance benefits.

	Three		Six Months	
	Months		Months	
	Ended		Ended	
	June 30		June 30	
(Dollars in thousands)	2013	2012	2013	2012
Components of net periodic benefit cost				
Service cost	\$67	\$150	\$134	\$300
Interest cost	120	188	240	376
Expected return on plan assets	-	-	-	-
Amortization of transition obligation	-	15	-	30
Amortization of prior service credits	(236)	(19)	(472)	(38)
Recognized actuarial loss	120	135	240	270
Net periodic benefit cost	\$71	\$469	\$142	\$938



Table of Contents

## Note 11. Inventories

The inventory value in the Fiber and Data Segment and the Telecom Segment are comprised of raw materials to be consumed in capital projects and finished goods to be used in the delivery of services at the customer premise. The inventory value in the Equipment Segment is primarily comprised of finished goods in our warehouse or in transit to customer locations. The inventory level in the Equipment Segment is subject to the fluctuations in the equipment sales activity and the timing of individual customer orders and installations.

Inventory balances by segment are as follows:

	June 30, 2013	December 31, 2012
(Dollars in thousands)		
Fiber and Data	\$ 884	\$ 665
Equipment	\$ 4,095	\$ 6,201
Telecom	\$ 1,333	\$ 1,513

## Note 12. Accumulated Other Comprehensive Income (Loss)

The table below illustrates the effect on certain line items of net income of the amounts reclassified out of each component of accumulated other comprehensive income ("AOCI") for the three and six months ended June 30, 2013.

(Dollars in thousands)	Amounts Reclassified from AOCI		Affected Line Item in the Where Net Income is Presented
	Three Months Ended June 30, 2013	Six Months Ended June 30, 2013	
Details about AOCI Components			
Gains and losses on cash flow hedges			
Interest rate contracts	\$ 25 (10 )	\$ 46 (18 )	Interest expense )Income tax provision
	\$ 15	\$ 28	Net of tax
Amortization of benefit pension items			
Prior service costs	\$ 236	\$ 472	Selling, general and administrative expenses
Actuarial gains (losses)	(120)	(240 )	)Selling, general and administrative expenses
	116	232	Total before tax
	(46 )	(92 )	)Income tax provision
	\$ 70	\$ 140	Net of tax
Total reclassifications of period	\$ 85	\$ 168	Net of tax

## Note 13. Income Taxes

The effective income tax rate from operations for the second quarter of 2013 and 2012 was 40.3% and 40.1%, respectively. The effective tax rate from operations differs from the federal statutory rate primarily due to state income taxes.

As of June 30, 2013, we had unrecognized tax benefits totaling \$218,000 (net of tax) excluding interest. The amount of the unrecognized tax benefits, if recognized, that would affect the effective income tax rates of future periods is \$199,000. Due to expirations of statute of limitations, it is reasonably possible that the total amount of unrecognized tax benefits will not decrease during the next 12 months.

We file consolidated income tax returns in the United States federal jurisdiction and combined or separate income tax returns in various state jurisdictions. In general, we are no longer subject to United States federal income tax examinations for the years prior to 2009 except to the extent of losses utilized in subsequent years.

Table of Contents

## Note 14. Stock Compensation

Our stock award plans provide for granting non-qualified stock options, stock awards and restricted stock awards to employees. We recognize stock compensation charges related to stock award plans based on management's best estimates and assumptions that the performance and service requirements of the plan will be achieved. Such compensation charges are recorded based upon the grant date fair value or settlement date fair value (as applicable) of our stock and are recognized over the requisite service period specified by the specific award plans. Share-based compensation expense includes amounts recognized related to the Company Employee Stock Purchase Plan. This plan allows participating employees to acquire shares of common stock at 85% of the average closing price for the five days previous to the purchase date. Stock-based compensation expense was \$429,000 and \$375,000, respectively, in the six months ended June 30, 2013 and 2012. This includes compensation expense for share-based payment awards granted prior to, but not vested as of June 30, 2013. As of June 30, 2013, we had not yet recognized compensation expense related to non-vested awards totaling \$1,524,000. The weighted average period over which this compensation expense will be recognized is 2.39 years.

## 1993 Stock Award Plan

## Long-Term Executive Incentive Program

We carry obligations of \$740,000 and \$1,028,000 as of June 30, 2013 and December 31, 2012 respectively, related to liability classified awards under the LTEIP that will be settled in company common stock in future periods.

Non-vested restricted stock activity for the six months ended June 30, 2013 is depicted in the table below. Granted shares represent non-vested shares issued to settle an obligation under the LTEIP plan during the period.

	Shares	Weighted Average Fair Value
Non-vested at January 1	32,447	\$ 3.43
Granted/settled	68,699	\$ 9.83
Vested	(72,621)	\$ 6.97
Forfeited	-	\$ -
Non-vested at June 30	28,525	\$ 9.83

## Employee Stock Retention

Under this program, designated employees can earn shares of common stock if they complete a requisite service period which typically ranges from 11 to 36 months. Compensation expense related to the Employee Stock Retention program is recognized over the requisite service period.

Retention stock activity for the six months ended June 30, 2013 is as follows:

	Shares	Weighted Average Fair Value
Non-vested at January 1	11,150	\$ 10.28
Granted	33,950	\$ 8.76
Vested	-	\$ -

Forfeited	(800 )	\$ 10.57
Non-vested at June 30	44,300	\$ 9.07

#### Stock Option

Stock options granted may be exercised no later than ten years after the date of grant, with one-third of the options vesting each year. The fair value of each option award is estimated on the date of the grant using a Black-Scholes option valuation model.

15

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Table of Contents

A summary of stock option activity for the six months ended June 30, 2013 is as follows:

	Options	Weighted Average Exercise Price
Outstanding at January 1	143,817	\$ 9.95
Granted	-	\$ -
Exercised	(21,667 )	\$ 8.44
Forfeited	-	\$ -
Expired	(15,000 )	\$ 8.93
Outstanding at June 30	107,150	\$ 10.40
Exercisable at June 30	103,816	\$ 10.45

In the six months ended June 30, 2013, we received \$183,000 in cash related to stock options exercised during the period.

#### Note 15. Quarterly Segment Financial Summary

Our operations are conducted in three segments: (i) Fiber and Data, (ii) Equipment and (iii) Telecom.

Our Fiber and Data Segment serves wholesale, enterprise and commercial business customers with advanced data, Internet, voice and voice over Internet Protocol ("VoIP") services. With our IP network and communication expertise, we are able to provide both custom and broad network solutions which can be extended beyond our regional network through interconnections to provide end-to-end national connectivity. The Fiber and Data Segment includes revenue from Ethernet, Private Line, Multi-Protocol Label Switching ("MPLS"), Data Center, Dedicated Internet and our hosted VoIP SingleLink services. We own, lease or utilize long-term indefeasible rights of use ("IRU") agreements for the operation of our network. Fiber and Data services are marketed throughout our core regions: northern Minnesota and the Minneapolis-Saint Paul metropolitan area, southern Minnesota, Des Moines, Iowa and Fargo, North Dakota.

Our Equipment Segment provides equipment solutions and support for a broad spectrum of business customers ranging in size from medium to large enterprise. Our equipment business plans, designs and implements networks utilizing emerging technology including: TelePresence Video, Unified Communications and Data Center solutions in collaboration with industry-leading partners. We provide a comprehensive set of services including: Advisory, Implementation, Development and Support. Our Total Care support team provides a proactive approach to monitor and support customer networks, unified communications environment and data centers as well as a single-point-of-contact for the support of applications, systems and infrastructure. Equipment sales and services are marketed primarily in our Minnesota core regions and specifically the Minneapolis-Saint Paul metropolitan area.

Our Telecom Segment provides bundled residential and business services including high-speed Internet, broadband services, digital TV, local voice and long distance services in our legacy telecom service area. Telecom is comprised of the operation of both incumbent local exchange carrier ("ILEC") and competitive local exchange carrier ("CLEC") operations. Our ILEC operations provide services in 13 south central Minnesota communities and 13 rural northwest Iowa communities. Our CLEC operation provides services in south central Minnesota and near Des Moines, Iowa. We own our network in both the ILEC and CLEC exchanges. The Telecom Segment, through National Independent Billing, Inc. ("NIBI"), also provides data processing and related billing services to HickoryTech and external communication providers including wireline, wireless and entertainment providers.

Table of Contents

Segment information for the three and six months ended June 30, 2013 and 2012 is as follows:

(Dollars in thousands)	Fiber and			Corporate and	
Three Months Ended June 30, 2013	Data	Equipment	Telecom	Eliminations	Consolidated
Revenue from unaffiliated customers	\$ 16,779	\$ 15,116	\$ 15,246	\$ -	\$ 47,141
Intersegment revenue	213	-	571	(784 )	-
Total operating revenue	16,992	15,116	15,817	(784 )	47,141
Asset impairment	5	-	-	-	5
Depreciation and amortization	2,922	124	4,198	8	7,252
Operating income (loss)	2,249	934	1,876	(53 )	5,006
Interest expense	-	-	6	1,125	1,131
Income tax provision (benefit)	912	378	761	(484 )	1,567
Net income (loss)	1,340	555	1,118	(692 )	2,321
Total assets	112,582	24,964	116,313	11,531	265,390
Property, plant and equipment, net	93,964	2,202	84,340	99	180,605
Additions to property, plant and equipment	2,970	403	3,131	12	6,516

(Dollars in thousands)	Fiber and			Corporate and	
Three Months Ended June 30, 2012	Data	Equipment	Telecom	Eliminations	Consolidated
Revenue from unaffiliated customers	\$ 15,177	\$ 12,864	\$ 15,816	\$ -	\$ 43,857
Intersegment revenue	193	-	444	(637 )	-
Total operating revenue	15,370	12,864	16,260	(637 )	43,857
Depreciation and amortization	2,551	71	4,085	25	6,732
Operating income (loss)	2,284	399	1,993	(189 )	4,487
Interest expense	-	-	9	1,590	1,599
Income tax provision (benefit)	925	160	809	(730 )	1,164
Net income (loss)	1,359	239	1,186	(1,046 )	1,738
Total assets	103,611	14,753	121,064	25,158	264,586
Property, plant and equipment, net	84,216	1,433	88,424	77	174,150
Additions to property, plant and equipment	3,603	117	2,203	-	5,923

(Dollars in thousands)	Fiber and			Corporate and	
Six Months Ended June 30, 2013	Data	Equipment	Telecom	Eliminations	Consolidated
Revenue from unaffiliated customers	\$ 33,250	\$ 32,353	\$ 30,307	\$ -	\$ 95,910
Intersegment revenue	426	-	1,144	(1,570 )	-
Total operating revenue	33,676	32,353	31,451	(1,570 )	95,910
Asset impairment	638	-	-	-	638
Depreciation and amortization	5,718	209	8,319	15	14,261
Operating income (loss)	3,887	1,755	3,481	(260 )	8,863
Interest expense	-	-	14	2,256	2,270

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Income tax provision (benefit)	1,589	715	1,416	(1,059 )	2,661
Net income (loss)	2,301	1,040	2,061	(1,455 )	3,947
Total assets	112,582	24,964	116,313	11,531	265,390
Property, plant and equipment, net	93,964	2,202	84,340	99	180,605
Additions to property, plant and equipment	5,913	961	5,379	52	12,305

17

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Table of Contents

(Dollars in thousands)	Fiber and			Corporate and	
Six Months Ended June 30, 2012	Data	Equipment	Telecom	Eliminations	Consolidated
Revenue from unaffiliated customers	\$28,396	\$ 30,285	\$32,120	\$ -	\$ 90,801
Intersegment revenue	386	-	854	(1,240 )	-
Total operating revenue	28,782	30,285	32,974	(1,240 )	90,801
Depreciation and amortization	4,517	142	8,218	49	12,926
Operating income (loss)	4,629	1,219	4,180	(289 )	9,739
Interest expense	-	-	22	2,988	3,010
Income tax provision (benefit)	1,875	494	1,692	(1,330 )	2,731
Net income (loss)	2,754	725	2,485	(1,932 )	4,032
Total assets	103,611	14,753	121,064	25,158	264,586
Property, plant and equipment, net	84,216	1,433	88,424	77	174,150
Additions to property, plant and equipment	5,568	190	3,799	-	9,557

## Note 16. Commitments and Contingencies

We are involved in certain contractual disputes in the ordinary course of business, but do not believe the resolution of any of these existing matters will have a material adverse effect on our financial position, results of operations or cash flows.

In August 2010, we were awarded a National Telecommunications Information Administration ("NTIA") Broadband Technology Opportunities Program ("BTOP") grant to extend our middle mile fiber-optic network across greater Minnesota with the potential to connect health care facilities, schools, libraries, higher education institutions and public offices with an advanced high-capacity broadband network. The original project plan projected total costs of \$24,000,000 of capital expenditures of which \$16,800,000 is to be funded by the NTIA grant. Our investment in the project was anticipated to be approximately \$7,200,000 or 30% of the estimated total project cost. Total project costs incurred through June 30, 2013 are \$20,368,000. Due to scope revisions and effective cost management, we anticipate completing the project at a total cost of approximately \$22,000,000 to \$23,000,000 reducing our investment to approximately \$6,600,000 to \$6,900,000. We began capitalizing costs associated with this project in 2010 and began receiving grant funds in June 2011.

The following table provides an overview of the capital expenditures incurred on or received from the program.

(Dollars in thousands)	Project Activity YTD June 30,			Project Total
	2013	2012	2011	
Capital expenditures incurred	\$623	\$7,081	\$12,664	\$20,368
NTIA reimbursements received	\$831	\$5,745	\$6,945	\$13,521
Capital expenditures pending reimbursement	\$725	\$1,100	\$1,920	

The project grant period ended July 31, 2013. All construction was completed and all capital expenditures were incurred as required by that date. The grant closeout period extends until October 31, 2013, during which a final accounting of total project costs will be performed and final reimbursement requests made under the grant agreement.





## Table of Contents

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

#### Forward Looking Statements

The Private Securities Litigation Reform Act of 1995 contains certain safe harbor provisions regarding forward-looking statements. This Quarterly Report on Form 10-Q may include forward-looking statements. These statements may include, without limitation, statements with respect to anticipated future operating and financial performance, growth opportunities and growth rates, acquisition and divestiture opportunities, business strategies, business and competitive outlook, and other similar forecasts and statements of expectation. Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," "targets," "projects," "will," "may," "continues," and "should," and variations of these words and similar expressions, are intended to identify these forward-looking statements. Such forward-looking statements are subject to risks and uncertainties that could cause our actual results to differ materially from such statements. Factors that might cause such a difference include, but are not limited to, those contained in Item 1A of Part II, "Risk Factors" of this Quarterly Report on Form 10-Q and Item 1A of Part I, "Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2012, which is incorporated herein by reference.

Because of these risks, uncertainties, and assumptions and the fact that any forward-looking statements made by us and our management are based on estimates, projections, beliefs, and assumptions of management, they are not guarantees of future performance and you should not place undue reliance on them. In addition, forward-looking statements speak only as of the date they are made. With the exception of the requirements set forth in the federal securities laws or the rules and regulations of the Securities and Exchange Commission, we do not undertake any obligations to update any forward-looking information, whether as a result of new information, future events or otherwise.

#### Critical Accounting Policies

The preparation of our financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and the related disclosure of contingent assets and liabilities. A description of the accounting policies that we consider particularly important for the portrayal of our results of operations and financial position, and which may require a higher level of judgment by our management, is contained under the caption, "Critical Accounting Policies," in the Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2012.

#### Overview

We are an integrated communications solution provider serving the upper Midwest engaged in providing an array of services to customers ranging from residential, business and enterprise to service providers and carriers over our multi-state fiber network spanning 4,100 route miles. We offer advanced business and IP networking services, data services, voice and VoIP, managed hosted services, high-capacity transport services, MPLS, equipment solutions, high-speed Internet, digital TV, local and long distance services.

#### Results of Operations

We conduct our operations in three business segments: (i) Fiber and Data, (ii) Equipment and (iii) Telecom. An overall description of our business segments can be found in Note 15 "Quarterly Segment Financial Summary."

#### Executive Summary

Second quarter 2013 revenue of \$47.1 million represents an increase of 7% compared to 2012. Year-over-year, revenue has grown 6%. Growth in the Fargo market subsequent to our IdeaOne Telecom acquisition and success in selling integrated voice and data services including VoIP, Ethernet and MPLS resulted in double digit revenue growth in our Fiber and Data Segment of 11% in the second quarter and 17% year-to-date. Our Equipment Segment posted revenue growth of 18% in the second quarter and 7% year-to-date driven by increased equipment sales which incorporate emerging technology to enable our customers to integrate their communications and information technology networks. The Telecom Segment experienced a modest decline of 4% in the second quarter and 6% year-to-date as the expected loss in traditional local service and network access revenue was mitigated by increased revenue from broadband services.

19

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Table of Contents

Approximately 79% of our total revenue for the second quarter of 2013 and year-to-date period was from business and broadband services. This revenue is derived from the Fiber and Data Segment, Equipment Segment and broadband services revenue from our Telecom Segment. These revenue streams are a strategic focus and remain our growth opportunity as consumers migrate from traditional legacy voice services to advanced communication services. We will leverage our regional network and long-haul routes to provide wireless transport or backhaul services. We continue to invest in our network and our fiber-to-the-tower capital initiative to accommodate the increased network capacity requirements for wireless carriers as the demand for data usage increases. We will continue to expand and refine our product portfolio to meet the demands of our business customers with integrated voice and data services to offer them flexibility in meeting their communication needs.

Total costs and expenses increased 7% in the second quarter of 2013 and the year-to-date period compared to 2012 as we continue to support and stimulate the growth in our Fiber and Data Segment and experience higher sales volume in our Equipment Segment. Depreciation and amortization expense increased 8% in the second quarter and 10% year-to-date driven by the acquired IdeaOne assets and capital expenditures related to investments to expand and enhance our network. Interest expense declined 29% in the second quarter and 25% year-to-date primarily driven by a decline of our outstanding debt balance and by our adoption of hedge accounting on January 1, 2013 for our interest rate swap agreements.

Second quarter net income of \$2.3 million, or \$0.17 per diluted share, is up 34% or \$0.04 per diluted share and year-to-date net income of \$3.9 million, or \$0.29 per diluted share, is down 2% or \$0.01 per diluted share.

20

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Table of Contents

## Fiber and Data Segment

The following table provides a breakdown of the Fiber and Data Segment operating results.

## Fiber and Data

(Dollars in thousands)	Three Months Ended			Six Months Ended			
	June 30 2013	2012	% Change	June 30 2013	2012	% Change	
Operating revenue before intersegment eliminations:							
Services	\$16,779	\$15,177	11	% \$33,250	\$28,396	17	%
Intersegment	213	193	10	% 426	386	10	%
Total operating revenue	\$16,992	\$15,370	11	% \$33,676	\$28,782	17	%
Cost of services							
(excluding depreciation and amortization)	\$8,583	\$7,489	15	% \$16,840	\$14,084	20	%
Selling, general and administrative expenses	3,233	3,046	6	% 6,593	5,552	19	%
Asset impairment	5	-		638	-		
Depreciation and amortization	2,922	2,551	15	% 5,718	4,517	27	%
Total costs and expenses	14,743	13,086	13	% 29,789	24,153	23	%
Operating income	\$2,249	\$2,284	-2	% \$3,887	\$4,629	-16	%
Net income	\$1,340	\$1,359	-1	% \$2,301	\$2,754	-16	%
Capital expenditures	\$2,970	\$3,603	-18	% \$5,913	\$5,568	6	%

The financial results of this segment reflect IdeaOne Telecom's operations beginning on March 1, 2012.

## Revenue

Fiber and Data. We serve wholesale, enterprise and commercial business customers. We provide fiber-based transport and access services to regional and national service providers, wireless carriers and other service providers by delivering custom network solutions. We also provide advanced data services (such as Ethernet, private line, MPLS and data center services), Internet, voice and VoIP services, through our extensive regional fiber network and community access rings supported by a 24x7x365 network operations center. Our services can be extended beyond our regional network through our agreements and interconnections with other carriers for end-to-end national connectivity. This revenue stream is generally based on multi-year contracts with retail businesses, regional and national service providers and wireless carriers building a solid monthly recurring revenue base.

Fiber and Data revenue grew \$1,622,000 or 11% in the second quarter of 2013 and \$4,894,000 or 17% year-to-date compared to 2012. We continue to experience success in both of our customer segment groups: wholesale and business. Although industry consolidation, technology changes, customer network optimization and price compression continue to negatively impact our wholesale customer segment, we achieved overall growth due to the demand for increased bandwidth supporting our fiber-based services. The number of fiber-served cell sites we serve has nearly doubled in the past year from 31 to 60 sites. We currently have contracts to build fiber to additional cell sites during the second half of 2013 increasing our total to approximately 125 sites at year-end and expect to continue to grow revenue in this area both by building to additional sites and by offering additional bandwidth on existing towers. We also remain focused on our business customer segment customizing solutions to fit their needs and continue to

enhance and refine our capabilities in integrated voice and data services. Growth in our business customer segment is driven by purchases of our data services including MPLS, dynamic, Ethernet and VoIP.

Cost of Services (excluding Depreciation and Amortization)

Cost of services increased \$1,094,000 or 15% in the second quarter and \$2,756,000 or 20% year-to-date compared to 2012. The higher costs of services can be attributed to (1) an increase of \$184,000 during the quarter and \$676,000 year-to-date in circuit-related costs to support the increased demand for our transport products and services, (2) an increase of \$324,000 during the quarter and \$775,000 year-to-date in wages and benefits driven by increased staffing levels to support the growth in this segment, (3) an increase of \$121,000 during the quarter and \$148,000 year-to-date in contract labor due to a higher rate of contractor services to augment staffing, and (4) an increase of \$95,000 during the quarter and \$216,000 year-to-date in maintenance contracts related to the deployment of new infrastructure and customer premise equipment.

21

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Table of Contents

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased \$187,000 or 6% during the quarter and \$1,041,000 or 19% year-to-date compared to 2012. The main contributors include an increase of \$219,000 during the quarter and \$439,000 year-to-date in corporate expense as a result of growth in this segment and an increase of \$118,000 during the quarter and \$240,000 year-to-date in commission expense which correlates to the increase in revenue. The quarterly expense increases were partially offset by a decline of \$137,000 in wages and benefits due to a lower number of sales staff compared to the second quarter of 2012. On a year-to-date basis lower wages and benefits from a reduced sales force was offset by one-time payments resulting in an increase of \$197,000.

Asset Impairment

We recognized an asset impairment of \$633,000 in the first quarter of 2013 related to assets supporting a service we elected to discontinue. Minor adjustments to fully recognize the impairment on all related assets resulted in adding \$5,000 in the second quarter to bring the final year-to-date impairment recognition to \$638,000.

Depreciation and Amortization

Fiber and Data Segment depreciation and amortization increased \$371,000 or 15% in the second quarter and \$1,201,000 or 27% year-to-date as compared to the same periods in 2012. Increased depreciation is a result of the IdeaOne acquisition, continued capital expenditures supporting growth initiatives within our strategic services and enhancements of our network reliability and capacity.

Table of Contents

## Equipment Segment

The following table provides a breakdown of the Equipment Segment operating results.

## Equipment

(Dollars in thousands)	Three Months Ended			Six Months Ended			
	June 30		%	June 30		%	
	2013	2012	Change	2013	2012	Change	
Operating revenue before intersegment eliminations:							
Equipment	\$12,910	\$10,740	20	% \$28,274	\$26,039	9	%
Services	2,206	2,124	4	% 4,079	4,246	-4	%
Total operating revenue	\$15,116	\$12,864	18	% \$32,353	\$30,285	7	%
Cost of sales							
(excluding depreciation and amortization)	\$10,860	\$9,292	17	% \$24,082	\$22,758	6	%
Cost of services							
(excluding depreciation and amortization)	1,808	1,627	11	% 3,503	3,339	5	%
Selling, general and administrative expenses	1,390	1,475	-6	% 2,804	2,827	-1	%
Depreciation and amortization	124	71	75	% 209	142	47	%
Total costs and expenses	14,182	12,465	14	% 30,598	29,066	5	%
Operating income	\$934	\$399	134	% \$1,755	\$1,219	44	%
Net income	\$555	\$239	132	% \$1,040	\$725	43	%
Capital expenditures	\$403	\$117	244	% \$961	\$190	406	%

## Revenue

Equipment. We are a Master Unified Communications and Gold Certified Cisco partner providing Cisco equipment solutions and support for a broad spectrum of business customers ranging in size from medium to large enterprise. Our equipment business solutions team plans, designs and implements networks utilizing emerging technological advancements including TelePresence Video, Unified Communications and Data Center solutions. We also utilize relationships with other industry-leading vendors to provide integrated communication solutions for our clients to meet their emerging networking needs. Equipment sales are non-recurring in nature making this revenue dependent upon attracting new sales from existing and new customers, as well as leveraging relationships with our current customer base by adding more value through enhanced product and service offerings.

Equipment revenue increased \$2,170,000 or 20% in the second quarter and \$2,235,000 or 9% year-to-date compared to 2012. The higher revenue is related to the increased size and volume of orders in 2013 versus 2012. Customers continue to invest in technology solutions such as unified communication products, data center products and cloud computing solutions.

Equipment Services. We provide a comprehensive set of services to support equipment solutions, including: advisory, planning and design, implementation, development and support. Maintenance contracts ("Smartnet" contracts) are offered in collaboration with Cisco systems. Our Total Care support team provides a proactive approach to monitoring and supporting customer networks, unified communications environments and data centers as well as a single-point-of-contact for the support of applications, systems and infrastructure.



Equipment services revenue increased \$82,000 or 4% in the second quarter and decreased \$167,000 or 4% year-to-date compared to 2012. Maintenance revenue is a large contributor to equipment services revenue and is cyclical as it is tied to equipment installations. Maintenance contracts typically range in term from three to five years and are renewable upon expiration. We experienced a decline of \$113,000 during the quarter and \$361,000 year-to-date in maintenance revenue driven by receipt of Cisco rebates in 2012 which did not re-occur in 2013. These rebates are an incentive for us to sell and renew maintenance contracts. We continue to have success with renewals but did not achieve the thresholds required to receive the rebates in 2013. In both periods we experienced an increase in contract services revenue of \$196,000 in the second quarter and \$259,000 year-to-date. Our strategy is to focus on selling professional and support services with our equipment solutions in order to grow recurring revenue in the Equipment Segment.

23

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Table of Contents

Cost of Sales

Cost of sales is composed of equipment material costs associated with equipment sales. Higher equipment sales drove a cost of sales increase of 17% in the second quarter and 6% year-to-date compared to 2012. Labor associated with installation of the equipment is included in cost of services (excluding depreciation and amortization) described below.

Cost of Services (excluding Depreciation and Amortization)

Cost of services increased \$181,000 or 11% in the second quarter and \$164,000 or 5% year-to-date compared to 2012. The increase is primarily from wages and benefits which were \$111,000 and \$134,000 higher in the quarter and year-to-date periods.

Selling, General and Administrative Expenses

Selling, general and administrative expenses declined \$85,000 or 6% in the second quarter and \$23,000 or 1% year-to-date compared to 2012. A quarterly decrease of \$74,000 and \$149,000 year-to-date in corporate expense was offset by an increase in wages and benefits of \$45,000 during the quarter and \$75,000 year-to-date. We also experienced an increase of \$95,000 in year-to-date commissions driven by the increased revenue in this segment.

Depreciation and Amortization

Depreciation expense increased \$53,000 or 75% in the second quarter and \$67,000 or 47% year-to-date compared to 2012, driven by expansion of office space.

Table of Contents

## Telecom Segment

The following table provides a breakdown of the Telecom Segment operating results.

## Telecom

(Dollars in thousands)	Three Months Ended			Six Months Ended			
	June 30, 2013	2012	% Change	June 30, 2013	2012	% Change	
Operating revenue before intersegment eliminations:							
Local service	\$2,885	\$3,348	-14 %	\$5,848	\$6,777	-14 %	
Network access	4,482	4,749	-6 %	9,183	9,652	-5 %	
Broadband	5,241	4,977	5 %	10,246	9,979	3 %	
Directory	730	770	-5 %	1,460	1,552	-6 %	
Long distance	584	636	-8 %	1,156	1,284	-10 %	
Bill processing	1,040	1,035	0 %	1,853	2,240	-17 %	
Intersegment	571	444	29 %	1,144	854	34 %	
Other	284	301	-6 %	561	636	-12 %	
Total Telecom operating revenue	\$15,817	\$16,260	-3 %	\$31,451	\$32,974	-5 %	
Total Telecom revenue before intersegment eliminations							
Unaffiliated customers	\$15,246	\$15,816		\$30,307	\$32,120		
Intersegment	571	444		1,144	854		
	15,817	16,260		31,451	32,974		
Cost of services (excluding depreciation and amortization)	7,305	7,365	-1 %	14,680	14,926	-2 %	
Selling, general and administrative expenses	2,438	2,817	-13 %	4,971	5,650	-12 %	
Depreciation and amortization	4,198	4,085	3 %	8,319	8,218	1 %	
Total Telecom costs and expenses	13,941	14,267	-2 %	27,970	28,794	-3 %	
Operating income	\$1,876	\$1,993	-6 %	\$3,481	\$4,180	-17 %	
Net income	\$1,118	\$1,186	-6 %	\$2,061	\$2,485	-17 %	
Capital expenditures	\$3,131	\$2,203	42 %	\$5,379	\$3,799	42 %	
Key metrics							
Business access lines	19,628	20,764	-5 %				
Residential access lines	21,496	23,209	-7 %				
Total access lines	41,124	43,973	-6 %				
Long distance customers	29,535	30,872	-4 %				
Digital subscriber line customers	20,538	19,364	6 %				
Digital TV customers	11,001	10,110	9 %				

## Revenue

Local Service. We receive recurring revenue for local residential and business voice services, enhanced calling features and miscellaneous local services. We also receive reciprocal compensation revenue based on interconnection agreements with wireless carriers who use our network to terminate calls.

Local service revenue declined 14% in both the second quarter and year-to-date periods of 2013 compared to the same periods in 2012. Revenue declines can be attributed to (1) the 6% local access line loss we experienced, (2) lower feature revenue as it is included in the bundle packages and (3) price compression due to competition and alternative communication options. Network access reform driven by provisions of FCC Order 11-161, issued November 2011, has also adversely affected local service revenue. The Order mandated elimination of reciprocal compensation from wireless carriers. We expect to continue to experience modest access line erosion as consumers replace traditional voice services with VoIP and wireless service options. To mitigate the trend of local service line loss, we offer competitive two and three-service bundle packages and promotions along with term discounts. We believe the associated package savings provide our customers the best value for their communication and entertainment needs. We also offer our own VoIP services through our Fiber and Data Segment as an alternative to our competitors' products, allowing us to maintain the customer; this revenue is recorded within the Fiber and Data Segment.

Network Access. We provide access services to other communications carriers to terminate or originate long distance calls on our network. We also bill subscriber line charges to our customers for access to the public switched network. Network access revenue is derived from several federally administered pooling arrangements designed to provide support and distribute funding to ILECs.

### Table of Contents

Network access revenue declined 6% in the second quarter of 2013 and 5% year-to-date compared to the same periods in 2012. The decline is attributable to the erosion of our access lines and lower minutes of use due to competition and network grooming/optimization by the carriers. This revenue stream also was and will continue to be impacted by regulatory decisions; particularly FCC Order 11-161 which comprehensively reforms Universal Service Fund and intercarrier compensation. Provisions in FCC Order 11-161 call for the elimination of interstate and intrastate access charges over time. However, the introduction of the Connect America Fund (CAF) and increased charges to end-user subscribers has mitigated the decline in this revenue stream. In both periods, we experienced a decline in minutes-of-use, end-user and special access revenue which was partially offset by receipt of CAF support.

**Broadband.** We provide residential and business broadband services for monthly recurring revenue. Broadband services include: DSL/high-speed Internet access, digital TV services, and business Ethernet and data services.

Broadband revenue increased \$264,000 or 5% in the current quarter and \$267,000 or 3% year-to-date compared to 2012. Compared to last year, our digital TV and DSL customer bases have grown 9% and 6%, respectively. Although we continue to experience lower revenue per subscriber as a result of competitive pricing strategies related to market conditions, the revenue growth is driven by our increased customer base and restructuring of our DSL services.

In an effort to remain competitive, we continue to invest in our broadband network for the delivery of reliable and higher speed services and market our multi-service bundles which provide competitive and flexible options to our customers. The bundles provide discounts when bundling one, two or three services including digital TV, Internet and/or voice services with their choice of free options such as multi-room DVR or high-definition programming. Additional savings are offered when customers opt into a six-month or one- or two-year agreement. Since the launch of our new service bundles one year ago, over 9,000 customers have taken advantage of the bundle savings with approximately 92% opting into a two-year agreement.

**Directory.** We receive monthly recurring revenue from subscribers for yellow page advertising in our telephone directories.

Directory revenue declined \$40,000 or 5% in the second quarter and \$92,000 or 6% year-to-date compared to 2012. This revenue stream is expected to continue to decline as businesses migrate from the traditional printed directory to online media platforms.

**Long Distance.** We charge our end-user customers for toll or long distance service on either a per-call or flat-rate basis. Services include the provision of directory assistance, operator service and long distance private lines. We offer a variety of long distance calling plans including regional, nationwide and unlimited long distance plans.

Long distance revenue declined \$52,000 or 8% in the current quarter and \$128,000 or 10% year-to-date compared to the same periods in 2012. The decrease is driven by the 4% decrease in our customer base, customers opting for unlimited long distance plans, lower per-minute rates in order to remain competitive and wireless substitution.

**Bill Processing.** We provide data processing and billing services to other communication service providers. We collect a combination of monthly recurring revenue, software license fees, and contract and integration services revenue. Our SuiteSolution® product offers communication providers a billing and customer management software system using the latest in database and screen presentation technology.

Bill processing revenue was similar in the second quarter and down \$387,000 or 17% year-to-date compared to 2012. The year-over-year decline is due to timing of customer installations of our SuiteSolution® product. We expect increased customer installations in the second half of 2013.

Other Revenue. Other revenue consists primarily of sales of wholesale contract services, late fees applied to subscriber billings, and add, move, and change revenue on customer premise equipment.

Other revenue declined \$17,000 or 6% in the second quarter and \$75,000 or 12% year-to-date compare to 2012. The decline is attributed to lower customer premise equipment revenue and revenue associated with our wholesale contract services.

26

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## Table of Contents

### Cost of Services (excluding Depreciation and Amortization)

Cost of services (excluding depreciation and amortization) decreased \$60,000 or 1% in the second quarter and \$246,000 or 2% year-to-date compared to 2012. The primary contributors to the decrease include: (1) a decrease of \$142,000 during the quarter and \$260,000 year-to-date in access expenses which correlates to the lower long distance revenue and decline in the customer base, (2) a decrease of \$46,000 during the quarter and \$155,000 year-to-date in wages and benefits due to a reduction in headcount and savings in post-retirement benefits as a result of a plan amendment and (3) a decrease of \$54,000 during the quarter and \$107,000 year-to-date in reciprocal compensation expense related to FCC Order 11-161 noted above. A combination of other expense savings also contributed to the overall decline. The expense decreases were partially offset by an increase in programming costs of \$169,000 during the quarter and \$290,000 year-to-date due to growth in our digital TV subscriber base and higher costs per program channel and an increase in circuit-related expenses of \$96,000 during the quarter and \$256,000 year-to-date due to an increase in off-net costs associated with expanding services provided to our customers beyond the reach of our network.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$379,000 or 13% lower in the second quarter and \$679,000 or 12% lower year-to-date, compared to 2012. The decline can be attributed to (1) a decrease of \$191,000 during the quarter and \$337,000 year-to-date in wages and benefits due to reduced staff and a savings in post-retirement benefits as a result of a plan amendment, (2) a decrease of \$71,000 during the quarter and \$141,000 year-to-date in corporate expense and (3) a decrease of \$112,000 during the quarter and \$139,000 year-to-date in regulatory fees.

### Depreciation and Amortization

Depreciation and amortization expense increased \$113,000 or 3% in the second quarter and \$101,000 or 1% year-to-date compared to 2012.

### Consolidated Results

#### Interest Expense

Consolidated interest expense was \$468,000 or 29% lower in the second quarter of 2013 and \$740,000 or 25% lower year-to-date compared to the same period in 2012 primarily driven by a reduction in our outstanding debt balance. The outstanding balance of our debt obligations (long-term and current portion) declined \$5,509,000 from \$141,488,000 at June 30, 2012 to \$135,979,000 as of June 30, 2013. The June 30, 2013 debt balance has decreased \$802,000 since December 31, 2012. Interest expense comparisons were also affected by the accounting for our interest rate swap agreements. During 2013, the changes in fair value in the swap agreements are primarily recorded as a component of equity due to designating the derivatives as cash flow hedges as of January 1, 2013. During 2012, the changes in the fair value of the swap agreements were recorded as an adjustment to interest expense.

#### Income Taxes

Our effective income tax rate for the second quarter of 2013 and 2012 was 40.3% and 40.1%, respectively. The effective tax rate from operations differs from the federal statutory rate primarily due to state income taxes.

### Liquidity and Capital Resources

#### Working Capital

Working capital (i.e. current assets minus current liabilities) was \$14,241,000 as of June 30, 2013 compared to working capital of \$11,364,000 as of December 31, 2012. The ratio of current assets to current liabilities was 1.5 as of June 30, 2013 and 1.3 as of December 31, 2012.



Table of Contents

Capital Structure

The total capital structure (long-term and current maturities of long-term debt obligations plus shareholders' equity) was \$184,514,000 at June 30, 2013, reflecting 26% equity and 74% debt. This compares to a total capital structure of \$185,629,000 at December 31, 2012, reflecting 26% equity and 74% debt. In the communications industry, the capacity for debt financing is most often based on multiples of operating cash flows. Specifically, our current use of the senior credit facility is in a ratio of approximately 2.88 times debt to Earnings before Interest, Tax, Depreciation and Amortization, ("EBITDA") as defined in our credit agreement; well within the acceptable limit for our agreement of 3.25 times debt to EBITDA and well within the levels experienced in our industry.

We employ an extended term payable financing arrangement for the equipment provisioning portion of our Equipment Segment and view this arrangement as a structured accounts payable that is paid within 60 days with no separate interest charge. As such, the extended term payable financing amount of \$10,867,000 and \$8,115,000 as of June 30, 2013 and December 31, 2012, respectively, is not considered to be part of our capital structure and has been excluded from the references above regarding debt and total capital. See Note 9 "Extended Term Payable."

Internal operations of our business continue to be our primary source of liquidity. We have invested in capital expenditures, paid interest, taxes, dividends and debt obligations. We have not changed our equity capitalization and new equity was not a source of liquidity during this period. Our cash and cash equivalents balance decreased \$3,108,000 from \$8,305,000 at December 31, 2012 to \$5,197,000 as of June 30, 2013 primarily due to the timing of our capital expenditures and the working capital needs of our Equipment Segment. We have also repurchased \$1,275,000 of our common stock in 2013.

Cash Flows

Management expects our cash flows from operations, cash and cash equivalents, and borrowings available under our credit facility will be sufficient to meet our current and long-term liquidity and capital requirements. For temporary increases in cash demand, we utilize our cash inflow and for more significant fluctuations in liquidity driven by growth initiatives, we rely on our senior credit facility. These sources coupled with our access to a \$30,000,000 revolving credit facility (presently unused) provide further assurance against interruption in our business plans due to financing. Our expected primary cash outflows include: funding ongoing working capital requirements, capital expenditures, scheduled principal and interest payments on our credit facility, temporary financing of trade accounts receivable and the payment of dividends as they are declared.

While it is difficult for us to predict the impact general economic conditions may have on our business, we believe that we will be able to meet our current and long-term cash requirements through our operating cash flows. We are in full compliance with our debt covenants and anticipate that we will be able to plan for and match future liquidity needs with future internal and available external resources. Our senior debt agreement will be the sole external source of financing for the foreseeable future.

We feel we can adjust the timing or the number of strategic and growth initiatives accordingly to correspond to any limitation we may face or be imposed by our capital structure or sources of financing. We do not anticipate our capital structure will limit future growth initiatives over the next 12 months.

Net cash provided by operations was \$11,889,000, a decrease of \$9,627,000 compared to the first six months of 2012. Changes in operating assets and liabilities are the primary driver for this change, specifically receivables, inventory and accounts payable. The changes in our receivables and inventory balances are reflective of the timing and the volume of equipment orders associated with our Equipment Segment. Accounts payable and accrued expenses made up \$1,007,000 of the decrease due to timing of accrued payroll and incentive compensation.

Cash used for investing activities was \$12,172,000, a decrease of \$25,291,000 compared to 2012. This change is primarily due to the acquisition of IdeaOne Telecom during 2012. Excluding the IdeaOne acquisition, cash used in investing activities increased \$1,046,000 compared to the period ended June 30, 2012. Capital expenditures increased \$2,743,000 or 29% when comparing 2013 to 2012 after netting out receipt of the National Telecommunications Information Administration ("NTIA") Broadband Technology Opportunities Program ("BTOP") grant. The increase is primarily due to timing of projects within the year, and does not necessarily represent an expected level throughout the entire year.

Table of Contents

Capital spending continues to be our primary recurring investing activity allowing us to expand and enhance our network, remain competitive and enhance and expand our service offerings. We continue to focus our spending on strategic investments in success-based and network expansion projects, such as last mile builds to customer premises, fiber connections to cellular towers and expansion in key strategic locations, along with required network maintenance spending. Investment in our network and business services will continue to support growth and customer demand in wireless backhaul transport services optimizing long-term revenue opportunities. We expect our 2013 capital spending to range between \$24,000,000 and \$28,000,000.

Our Greater Minnesota Broadband Collaborative project which is being funded in part by the NTIA BTOP grant extended our fiber-optic network across greater Minnesota to provide governmental, educational and health care organizations the opportunity to connect to a high-capacity broadband network. As of June 30, 2013, \$20,368,000 had been expended and \$14,246,000 had been reimbursed or is pending reimbursement by the NTIA BTOP grant. The original project plan projected total costs of \$24,000,000 of which \$16,800,000 would be funded by the NTIA grant. Due to scope revisions and effective cost management, we anticipate completing the project at a total cost of approximately \$22,000,000 to \$23,000,000. The grant period ended July 31, 2013. All construction was completed and all capital expenditures were incurred as required by that date. The grant closeout period extends until October 31, 2013, during which a final accounting of total project costs will be performed and final reimbursement requests made under the grant agreement.

Financing activities primarily consist of borrowings and payments on our credit facility, payment of dividends to our shareholders and the repurchase of our common stock. Cash used in financing activities was \$2,825,000 in 2013 compared to cash provided by financing activities of \$17,321,000 in 2012. The significant change is due to an Incremental Term credit facility of \$22,000,000 we obtained to purchase IdeaOne Telecom, as an extension of our senior credit facility. In the first six months of 2013 and 2012, we used \$3,936,000 and \$3,769,000 in cash to make dividend payments to our shareholders, respectively. In July 2013, our Board of Directors declared a dividend of \$0.145 per share. We expect to pay similar dividends in the future; however, this will be dependent upon many factors, such as: operating results, capital requirements, debt compliance and other factors. In 2011, the Board of Directors authorized a stock repurchase plan to repurchase up to \$3,000,000 of our common stock of which approximately \$2,676,000 was still available at the beginning of 2013. During the six months ended June 30, 2013, we repurchased 124,285 shares for a total cost of \$1,275,000.

Our long-term obligations, including current maturities of debt and capital leases as of June 30, 2013 and December 31, 2012 were \$135,979,000 and \$136,781,000, respectively. Our credit facility requires us to comply with specified financial ratios and tests. The financial ratios required by our credit facility are not calculated in accordance with accounting principles generally accepted in the United States ("non-GAAP financial measures"). The non-GAAP financial measures are presented below for the purpose of demonstrating compliance with our debt covenants:

(Dollars in thousands)

	June 30, 2013
Leverage Ratio:	
(A) Total debt (including outstanding letters of credit)	\$ 135,999
(B) Adjusted EBITDA as defined by our credit agreement	
Three months ended 6-30-13	12,276
Three months ended 3-31-13	11,501
Three months ended 12-31-12	12,048
Three months ended 9-30-12	11,429
Total adjusted EBITDA as defined by our credit agreement	\$47,254
Total leverage ratio (A)/(B)	2.88

Maximum leverage ratio allowed  
29

3.25

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Table of Contents

(Dollars in thousands)

Debt Service Coverage

Ratio:

June 30, 2013

(A) Adjusted EBITDA as

defined by our credit

agreement, minus

\$ 47,254

Income taxes

(5,313 )

\$ 41,941

(B) the sum of (i) all

scheduled principal

payments to be made on debt

and (ii) interest expense

6,648

Debt service coverage ratio

(A)/(B)

6.3

Minimum debt service ratio

allowed

2.5

## New Accounting Pronouncements

The financial statement impact relating to new accounting standards that have not yet been adopted by us can be found in Item 1, "Financial Statements" under Note 1 "Basis of Presentation and Consolidation."

## Reconciliation of Non-GAAP Financial Measures

In addition to the results reported in accordance with accounting principles generally accepted in the United States of America ("GAAP"), we also use certain non-GAAP measures including EBITDA (as defined in our credit agreement) to evaluate operating performance and to facilitate the comparison of our historical results and trends. These non-GAAP measures are also used to manage and evaluate the operating performance of our reportable segments. These financial measures should not be considered in isolation or as a substitute for net income (loss) as a measure of performance and net cash flow provided by operating activities as a measure of liquidity. EBITDA is included as a supplemental disclosure because management believes that it provides (1) additional information with respect to our ability to service debt, fund capital expenditures and meet working capital requirements, (2) helpful measure for comparing our operating performance with the performance of other companies with different capital structures or tax rates and (3) comparison of our business segments performance to other public companies. Reconciliations to the most directly comparable GAAP measure are provided below.

(Dollars in thousands)	Three Months		Six Months Ended	
	Ended June 30	2012	June 30	2012
Net income	2013	2012	2013	2012
	\$2,321	\$1,738	\$3,947	\$4,032
Add:				
Depreciation and amortization	7,252	6,732	14,261	12,926
Interest expense	1,131	1,599	2,270	3,010
Income taxes	1,567	1,164	2,661	2,731
EBITDA	\$12,271	\$11,233	\$23,139	\$22,699

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Asset impairment	5	-	638	-
Adjusted EBITDA as defined by our credit agreement	\$12,276	\$11,233	\$23,777	\$22,699

(Dollars in thousands)	Three Months Ended			
	Jun-13	Mar-13	Dec-12	Sep-12
Reconciliation of net income to EBITDA:				
Net income	\$2,321	\$1,626	\$2,525	\$1,741
Add:				
Depreciation and amortization	7,252	7,009	6,951	6,869
Interest expense	1,131	1,139	1,114	1,625
Income taxes	1,567	1,094	1,458	1,194
EBITDA	\$12,271	\$10,868	\$12,048	\$11,429
Adjustments allowed under our credit agreement:				
Asset impairment	5	633	-	-
Adjusted EBITDA as defined in our credit agreement	\$12,276	\$11,501	\$12,048	\$11,429

Debt to EBITDA ratio	
Total outstanding debt as of June 30, 2013	\$135,979
Adjusted EBITDA for the last (4) consecutive fiscal quarters as presented above	47,254
Debt to EBITDA ratio as of June 30, 2013	2.88

Table of Contents

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We do not have operations subject to risks of foreign currency fluctuations. We do, however, use financial derivative instruments to manage exposure to interest rate fluctuations. Our objective for holding derivatives is to minimize interest rate risks using the most effective methods to eliminate or reduce the impact of these exposures. Variable rate debt instruments are subject to interest rate risk. For any portion of our debt not covered with interest rate swap agreements, our earnings are affected by changes in interest rates as a portion of its long-term debt has variable interest rates based on LIBOR. If interest rates for the portion of our long-term debt based on variable rates had averaged 10% more for the quarter ended June 30, 2013, our interest expense would have increased \$57,000.

Item 4. Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q (the Evaluation Date), we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, regarding the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities and Exchange Act of 1934, as amended). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded, as of the end of the period covered by this Quarterly Report, that our disclosure controls and procedures were not effective as a result of the previously identified material weaknesses in internal control over financial reporting, the nature of which is summarized below.

Previously Reported Material Weaknesses in Internal Control over Financial Reporting

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis. In connection with management's assessment of our internal control over financial reporting, we had identified material weaknesses in our internal control over financial reporting as of December 31, 2012 as described below.

The Company did not have effective controls to provide reasonable assurance as to the selection and application of generally accepted accounting principles ("GAAP") to account for interest rate swap financial derivative instruments. This material weakness resulted in adjustments to interest expense, income taxes, and other comprehensive income. The restatement of certain periods of the Company's financial statements is included in our Form 10-K/A for the year ended December 31, 2011.

The Company did not have effective controls to provide reasonable assurance as to the selection and application of GAAP around complex and/or non-routine transactions, including accounting for its share-based compensation arrangements. The Company lacked adequate technical expertise to apply proper accounting methods within the provisions of FASB ASC 718, "Compensation – Stock Compensation," for our share-based compensation plans.

As a result of the material weaknesses described above, management concluded that the Company's internal control over financial reporting was not effective as of December 31, 2012 based on the criteria established in the 1992 Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

For additional information regarding the material weaknesses identified by management, see "Item 9A. Controls and Procedures" in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 filed on March 7, 2013 with the Securities and Exchange Commission.

Remediation Efforts in 2013

Promptly following the identification of the material weaknesses as described above, management, with the oversight of the Audit Committee, began taking steps to remediate the material weaknesses. We have taken the following actions thus far in 2013:

Engaged a third party specialist for advice and consultation with consideration of the latest interpretation of the FASB rules for all current and future hedge accounting. Services include assisting management with preparation of hedge designation documentation, consultation and support for all hedge accounting transactions, and assisting management with their periodic testing of hedge effectiveness.

Provided training and education regarding hedge accounting requirements with GAAP for all relevant personnel involved in derivatives transactions.

Determined the Company will hire additional personnel knowledgeable regarding GAAP.

Engaged third party advisors that are knowledgeable regarding GAAP and internal controls to review the Company's financial reporting controls in areas which involve significant judgments and estimates, which involve application of complex accounting methods under GAAP, or which could have a material impact on the accuracy of our financial statements, in order to provide input to management regarding ways to strengthen the Company's control procedures in these areas.



### Table of Contents

In addition to the above steps, management intends to continue its remediation efforts by:

Providing training and education relating to accounting for share-based payments for all relevant personnel involved in computing and recording share-based compensation cost.

Providing ongoing training and education relating to GAAP around complex and non-routine transactions specifically identified through regular review of emerging issues and Company business activities.

Completing our review with the assistance of a third party advisor of the Company's financial reporting controls and implementing recommended control procedures to strengthen the Company's control procedures in areas which involve significant judgments and estimates, which involve application of complex accounting methods under GAAP, or which could have a material impact on the accuracy of our financial statements.

Management intends to complete these remediation steps in 2013.

### Changes in Internal Control Over Financial Reporting

There has been no change in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting, except for the remediation steps to address the material weaknesses in its internal control over financial reporting described above.

Under the direction of the Audit Committee, management will continue to review and make any changes it deems necessary to the overall design of the Company's internal control over financial reporting, including implementing improvements in policies and procedures.

We are committed to a strong internal control environment, and believe that, when fully implemented, the remediation actions described above will represent significant improvements in the Company's accounting function. The Company anticipates that it will complete its testing of the additional internal control processes designed to remediate these material weaknesses during the balance of 2013. We will continue to assess the effectiveness of our remediation efforts in connection with management's future evaluations of internal control over financial reporting.

## Part II Other Information

### Item 1. Legal Proceedings

Brandywine Communications Technologies, LLC filed an action for patent infringement against HickoryTech Corporation on December 26, 2012, in United States District Court for the District of Minnesota. The Company filed responsive pleadings denying the charge. In May 2013, Brandywine then sought transfer of the Minnesota action, together with approximately forty other defendants into a Multi-District Litigation ("MDL") in Florida. That transfer motion is pending. The litigation is at a very preliminary stage, and all further proceedings in the Minnesota action have been stayed until the MDL transfer motion is decided. Although we continue to deny any wrongdoing, at this time the Company cannot predict the outcome of the matter.

Other than routine litigation incidental to our business and those previously disclosed in the December 31, 2012 Form 10-K, there are no pending material legal proceedings to which we are a party or to which any of our property is subject.

### Item 1A. Risk Factors

There have not been any material changes to the risk factors previously disclosed in Item 1A, "Risk Factors," of our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On August 18, 2011, we announced that our Board of Directors approved a stock repurchase plan to repurchase up to \$3,000,000 of our common stock with no specified expiration date. During the three months ended June 30, 2013, we acquired and retired 71,638 common shares for \$746,376 in block transactions handled through market makers. During the three months ended March 31, 2013, we repurchased 52,647 common shares for \$528,493 and in 2011 we repurchased 36,248 common shares for \$324,180 of our common stock.

32

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Table of Contents

Details of the second quarter of 2013 transactions are below.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan	Maximum Dollar Value that May Yet be Purchased Under Plan
April 1 - April 30, 2013	24,844	\$ 10.15	24,844	\$ 1,894,081
May 1 - May 31, 2013	46,794	10.49	46,794	\$ 1,400,951
June 1 - June 30, 2013	-	-	-	\$ 1,400,951
Total	71,638	\$ 10.37	71,638	\$ 1,400,951

## Item 3. Defaults Upon Senior Securities

None.

## Item 4. Mine Safety Disclosures

None.

## Item 5. Other Information

None.

## Item 6. Exhibit Listing

Exhibit Number	Description
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 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
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

33

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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.

Dated: August 6, 2013 HICKORY TECH  
CORPORATION

By: /s/ John W. Finke  
John W. Finke, President  
and Chief Executive Officer

By: /s/ David A. Christensen  
David A. Christensen,  
Senior Vice President and  
Chief Financial Officer