HICKORY TECH CORP
Form 10-Q
August 12, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

ý	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	FOR THE QUARTERLY PERIOD ENDED June 30, 2003
	OR
o	**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)

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

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

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ý No o

The total number of shares of the registrant s common stock outstanding as of June 30, 2003: **13,975,561**.

HICKORY TECH CORPORATION

June 30, 2003

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

	For Quarter Ended		For Six Months Ended	
(In Thousands Except Per Share Amounts)	**6/30/2003**	**6/30/2002**	**6/30/2003**	**6/30/2002**
OPERATING REVENUES:				
Telecom Sector	$ 22,648	$ 21,405	$ 44,609	$ 42,122
Information Solutions Sector	809	1,049	1,907	2,083
Enterprise Solutions Sector	3,383	3,037	7,294	6,398
TOTAL OPERATING REVENUES	26,840	25,491	53,810	50,603
COSTS AND EXPENSES:				
Cost of Sales, Enterprise Solutions	2,550	2,033	5,069	4,217
Operating Expenses, excluding Depreciation and Amortization	14,013	14,290	28,449	27,576
Depreciation	4,364	3,931	8,526	7,744
Amortization of Intangibles	199	380	525	741
TOTAL COSTS AND EXPENSES	21,126	20,634	42,569	40,278
OPERATING INCOME	5,714	4,857	11,241	10,325
OTHER INCOME (EXPENSE):				
Equity in Net Income/(Loss) of Investees	(2)	21	(5)	2
Gain on Sale of Assets	2		2	
Interest and Other Income	13	29	23	72
Interest Expense	(1,480)	(1,858)	(3,045)	(3,814)
TOTAL OTHER INCOME (EXPENSE)	(1,467)	(1,808)	(3,025)	(3,740)
INCOME BEFORE INCOME TAXES	4,247	3,049	8,216	6,585
INCOME TAXES	1,737	1,247	3,359	2,693
NET INCOME	$ 2,510	$ 1,802	$ 4,857	$ 3,892
Basic Earnings Per Share	$ 0.18	$ 0.13	$ 0.35	$ 0.28

Dividends Per Share	$	0.11	$	0.11	$	0.22	$	0.22
Weighted Average Common Shares Outstanding		13,951		14,006		13,972		13,984
Diluted Earnings Per Share	$	0.18	$	0.13	$	0.35	$	0.28
Weighted Average Common and Equivalent Shares Outstanding		13,981		14,096		13,986		14,078

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

HICKORY TECH CORPORATION

June 30, 2003

CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(In Thousands Except Share and Per Share Amounts)		**6/30/2003**		**12/31/2002**
ASSETS				
CURRENT ASSETS:				
Cash and Cash Equivalents	**$**	**1,144**	$	1,874
Receivables, Net of Allowance for Doubtful Accounts of $1,382 and $1,358		**11,242**		11,056
Income Taxes Receivable		**13**		3,222
Costs in Excess of Billings on Contracts		**1,874**		2,107
Inventories		**5,262**		5,059
Deferred Income Taxes		**951**		951
Other		**2,310**		2,840
TOTAL CURRENT ASSETS		**22,796**		27,109
INVESTMENTS		**6,741**		10,517
PROPERTY, PLANT AND EQUIPMENT		**251,740**		247,375
Less ACCUMULATED DEPRECIATION		**119,479**		111,101
PROPERTY, PLANT AND EQUIPMENT, NET		**132,261**		136,274
OTHER ASSETS:				
Goodwill		**25,086**		25,086
Intangible Assets, Net		**34,583**		34,669
Financial Derivative Instrument		**985**		
Deferred Costs and Other		**5,281**		6,556
TOTAL OTHER ASSETS		**65,935**		66,311
TOTAL ASSETS	**$**	**227,733**	$	240,211
LIABILITIES & SHAREHOLDERS EQUITY				
CURRENT LIABILITIES:				
Accounts Payable	**$**	**2,640**	$	4,543
Accrued Expenses		**3,301**		3,719
Accrued Interest		**67**		512
Billings in Excess of Costs on Contracts		**159**		80
Advanced Billings and Deposits		**3,855**		3,741
Current Maturities of Long-Term Obligations		**1,426**		1,441
TOTAL CURRENT LIABILITIES		**11,448**		14,036
LONG-TERM OBLIGATIONS, Net of Current Maturities		**144,687**		157,599

DEFERRED INCOME TAXES		**4,781**		4,377
DEFERRED REVENUE AND BENEFITS		**5,664**		5,604
TOTAL LIABILITIES		**166,580**		181,616
COMMITMENTS AND CONTINGENCIES (Note 8)				
SHAREHOLDERS EQUITY:				
Common Stock, no par value, $.10 stated value Shares authorized: 100,000,000 Shares outstanding: 13,975,561 in 2003 and 13,983,929 in 2002		**1,397**		1,398
Additional Paid-In Capital		**8,566**		7,885
Retained Earnings		**50,609**		49,312
Accumulated Other Comprehensive Income		**581**		
TOTAL SHAREHOLDERS EQUITY		**61,153**		58,595
TOTAL LIABILITIES & SHAREHOLDERS EQUITY	**$**	**227,733**	$	240,211

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

HICKORY TECH CORPORATION

June 30, 2003

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	For Six Months Ended	
(Dollars In Thousands)	**6/30/2003**	**6/30/2002**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	**$ 4,857**	$ 3,892
Adjustments to Reconcile Net Income to Net		
Cash Provided by Operating Activities:		
Depreciation and Amortization	**9,051**	8,485
Gain on Sale of Assets	**(2)**	
Stock-Based Compensation	**402**	343
Employee Retirement Benefits and Deferred Compensation	**104**	228
Accrued Patronage Refunds	**(314)**	(446)
Equity in Net (Income) Loss of Investees	**5**	(2)
Provision for Losses on Accounts Receivable	**477**	1,647
Changes in Operating Assets and Liabilities:		
Receivables	**2,546**	2,110
Inventories	**(203)**	(304)
Billings and Costs on Contracts	**312**	1,394
Accounts Payable and Accrued Expenses	**(2,766)**	(1,439)
Advance Billings and Deposits	**114**	(20)
Deferred Revenue and Benefits	**(44)**	(63)
Other	**1,351**	744
Net Cash Provided By Operating Activities	**15,890**	16,569
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to Property, Plant and Equipment	**(4,460)**	(9,325)
Redemption of Investments	**4,100**	100
Proceeds from Sale of Assets	**73**	184
Net Cash Used In Investing Activities	**(287)**	(9,041)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments of Capital Lease Obligations	**(301)**	(219)
Repayments on Credit Facility	**(14,000)**	(8,000)
Borrowings on Credit Facility	**1,250**	1,500
Proceeds from Issuance of Common Stock	**496**	996
Dividends Paid	**(3,074)**	(3,078)
Stock Repurchase	**(704)**	

Net Cash Used In Financing Activities		**(16,333)**		(8,801)
NET DECREASE IN CASH AND CASH EQUIVALENTS		**(730)**		(1,273)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD		**1,874**		2,008
CASH AND CASH EQUIVALENTS AT END OF PERIOD	**$**	**1,144**	$	735
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:				
Cash Paid for Interest	**$**	**3,715**	$	3,969
Cash Paid for Income Taxes, Net of Tax Refunds of $1,600 and $139	**$**	**150**	$	116
NON-CASH INVESTING ACTIVITIES:				
Property, Plant and Equipment Acquired with Capital Leases	**$**	**124**	$	492

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

HICKORY TECH CORPORATION
JUNE 30, 2003
PART 1. FINANCIAL INFORMATION

ITEM 1. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information necessary for a fair presentation of results of operations, financial position, and cash flows in conformity with accounting principles generally accepted in the United States of America. In the opinion of management, the condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation of Hickory Tech Corporation s (HickoryTech) results for the periods presented. Operating results for interim periods are not necessarily indicative of results that may be expected for the fiscal year as a whole. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses, and related disclosures at the date of the financial statements and during the reporting period. Actual results could differ from these estimates. These unaudited interim condensed consolidated financial statements should be read in conjunction with HickoryTech s Annual Report on Form 10-K for the year ended December 31, 2002.

The consolidated financial statements of HickoryTech include Hickory Tech Corporation and its subsidiaries in the following three business segments: (i) Telecom Sector, (ii) Information Solutions Sector and (iii) Enterprise Solutions Sector. An investment in an unconsolidated partnership for the Information Solutions Sector is accounted for using the equity method. The operations of this partnership ended during the second quarter of 2003 with dissolution to follow later in 2003. No material wind down costs are anticipated. All intercompany transactions have been eliminated from the consolidated financial statements.

Certain reclassifications were made to the financial statements as of and for the three months and six months ended June 30, 2002 to conform to the 2003 presentation. These reclassifications had no impact on previously reported operating revenue, net income or shareholders equity.

Operating expenses include all costs related to delivery of HickoryTech s communications services and products. These costs include all selling, general and administrative costs and all costs of performing services and providing related products, except for costs associated with the depreciation and amortization of property, plant and equipment and intangible assets, and cost of sales for the Enterprise Solutions Sector.

NOTE 2. EARNINGS AND CASH DIVIDENDS PER COMMON SHARE

Basic earnings per share is computed by dividing net income by the weighted average number of shares of common stock outstanding during the applicable period. Shares used in the earnings per share assuming dilution calculation are based on the weighted average number of shares of common stock outstanding during the quarter increased by potentially dilutive common shares. Potentially dilutive common shares include stock options and stock subscribed under the employee stock purchase plan (ESPP).

	For Three Months Ended		For Six Months Ended	
	6/30/2003	6/30/2002	6/30/2003	6/30/2002
Weighted Average Shares Outstanding	13,950,824	14,006,421	13,972,141	13,983,691
Stock Options (dilutive only)	13,723	74,775	194	82,222
Weighted Average Stock Subscribed (ESPP)	16,746	14,653	13,980	11,967
Weighted Average Dilutive Shares Outstanding	13,981,293	14,095,849	13,986,315	14,077,880

Options to purchase 493,548 shares for the three and six months ended June 30, 2003 and 76,650 shares for the three and six months ended June 30, 2002 were not included in the computation of earnings per share assuming dilution calculation because their effect on earnings per share would have been antidilutive.

Cash dividends are based on the number of common shares outstanding at the respective record dates. Listed below are the number of shares outstanding as of the record date for the first two quarters of 2003 and 2002.

Shares Outstanding on Record Date	2003	2002
First Quarter (Feb. 15)	14,003,335	13,971,484
Second Quarter (May 15)	13,942,662	14,007,250

Dividends per share is based on the quarterly dividend per share as declared by the HickoryTech Board of Directors.

During the first six months of 2003 and 2002, shareholders have elected to reinvest $134,000 and $121,000, respectively, of dividends into HickoryTech common stock pursuant to the HickoryTech Dividend Reinvestment Plan.

NOTE 3. COMPREHENSIVE INCOME

HickoryTech follows the provisions of SFAS No. 130, Reporting Comprehensive Income. This statement established rules for the reporting of comprehensive income and its components. In addition to net earnings, comprehensive income includes changes in unrealized gains and losses on derivative instruments qualifying and designated as cash flow hedges. Comprehensive income for the three months ended June 30, 2003 and June 30, 2002 was $3,091,000 and $1,802,000, respectively. Comprehensive income for the six months ended June 30, 2003 and June 30, 2002 was $5,438,000 and $3,892,000, respectively.

NOTE 4. INVENTORIES

Inventories, which consist of equipment for resale, materials and supplies, are stated at the lower of average cost or market.

NOTE 5. INTANGIBLE ASSETS

Effective January 1, 2002, HickoryTech adopted SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 142 established new standards related to how acquired goodwill and other intangible assets are to be recorded upon their acquisition as well as how they are to be accounted for after they have been initially recognized in the financial statements.

Effective with the adoption of this standard, HickoryTech is no longer amortizing acquired goodwill. Instead, SFAS No. 142 requires acquired goodwill to be evaluated for impairment using a two-step test based upon a fair value approach. The first step is used to identify potential impairment, while the second step calculates the amount of impairment, if any. Upon adoption of this standard, HickoryTech completed a transitional impairment test for its acquired goodwill, determining the fair value using primarily a discounted cash flow model. The determined fair value was sufficient to pass the first step impairment test, and therefore no impairment was recorded.

Additionally, upon adoption of SFAS No. 142, HickoryTech was required to reassess the useful lives of its other intangible assets. HickoryTech s other intangible assets primarily consist of wireless FCC licenses (FCC licenses). HickoryTech s FCC licenses have terms of ten years, but are renewable. The renewal of FCC licenses is a routine matter involving a nominal fee and HickoryTech has determined that no legal, regulatory, contractual, competitive, economic or other factors currently exist that limit the useful life of its FCC licenses. As such, effective with the adoption of SFAS No. 142, HickoryTech is no longer amortizing FCC licenses as they are deemed to be intangible assets that have indefinite lives. Prospectively, HickoryTech will continue to periodically reevaluate its determination of an indefinite useful life with regards to FCC licenses. SFAS No. 142 requires that indefinite lived intangible assets be tested for impairment by comparing the fair value of the assets to their carrying amount. Upon adoption of this standard, HickoryTech completed a transitional impairment test for FCC licenses, calculating fair value using primarily a discounted cash flow model and corroborating marketplace transactions, and determined that there was no impairment to be recorded. The FCC licenses were tested for impairment on an aggregate basis, which is consistent with HickoryTech s management of the wireless business within the Telecom Sector. HickoryTech also re-assessed the useful life of its other intangible assets and concluded that the existing lives of up to six years should be continued.

On a prospective basis, HickoryTech is required to test both acquired goodwill and FCC licenses for impairment on an annual basis based upon a fair value approach. Additionally, goodwill shall be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of an entity below its carrying value. Other indefinite-lived intangible assets will be tested between annual tests if events or changes in circumstances indicate that the asset might be impaired.

HickoryTech will test for impairment of acquired goodwill and FCC licenses at the end of the fourth quarter of 2003, unless events or occurrences deem it necessary to test for impairment in an interim period.

The carrying value of HickoryTech s goodwill is $25,086,000 as of June 30, 2003 and December 31, 2002.

The components of HickoryTech s other intangible assets are shown in the following table:

	As of June 30, 2003		As of December 31, 2002	
(Dollars in Thousands)	**Gross Carrying Amount**	**Accumulated Amortization**	**Gross Carrying Amount**	**Accumulated Amortization**
Definite-Lived Intangible Assets				
Customers	$ 821	$ 288	$ 821	$ 237
Other Intangibles	150	100	185	100
Total	$ 971	$ 388	$ 1,006	$ 337
Indefinite-Lived Intangible Assets				
FCC Licenses	$ 34,000		$ 34,000	

Amortization expense related to the definite-lived intangible assets for the three months ended June 30, 2003 and 2002 was $25,000 and $123,000, respectively. Amortization expense related to the definite-lived intangible assets for the six months ended June 30, 2003 and 2002 was $51,000 and $227,000, respectively. Total estimated amortization expense for the remaining six months of 2003 and the five years subsequent to 2003 is as follows: 2003 (July 1 through December 31) - $51,000; 2004 - $102,000; 2005 - $102,000; 2006 - $102,000; 2007 - $102,000 and 2008 - $74,000.

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NOTE 6. RECENT ACCOUNTING DEVELOPMENTS

In June 2001, the FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations. SFAS No. 143 requires entities to record the fair value of the liability for legal obligations associated with an asset retirement in the period in which the obligation is incurred. When the liability is initially recorded, the entity capitalizes the cost of the asset retirement obligation by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset.

HickoryTech s incumbent local exchange carrier companies (ILECs) follow the provisions of SFAS No. 71, and therefore conform to the accounting principles as prescribed by the respective state public utilities commissions and other federal agencies and, where applicable, accounting principles generally accepted in the United States of America. On December 20, 2002, the Federal Communications Commission (FCC) notified carriers that they would not adopt SFAS No. 143 for regulatory accounting purposes. At January 1, 2003, HickoryTech determined the amount of asset retirement obligations required to be recorded for its ILEC companies under the provisions of SFAS No. 143 were not significant, and therefore the implementation of SFAS No. 143 on January 1, 2003 did not impact HickoryTech s financial position or results of operations.

HickoryTech s competitive local telephone companies (CLEC), Enterprise Solutions, and Information Solutions also adopted SFAS No. 143 effective January 1, 2003. HickoryTech has determined that its competitive local telephone companies along with Enterprise Solutions and Information Solutions do not have a material legal obligation to remove long-lived assets as described by SFAS No. 143, and accordingly, adoption of SFAS No. 143 did not impact HickoryTech s financial position or results of operations.

HickoryTech also adopted the provisions of SFAS No. 143 for its wireless operations as of January 1, 2003. HickoryTech performed an analysis to identify all potential Asset Retirement Obligations. The legal obligations identified consist of obligations to remediate leased property where cell sites are located. However, based upon HickoryTech s experience and expectations, there is significant uncertainty as to whether third parties that own these leased properties would enforce their remediation rights related to the sites. Therefore, pursuant to the provisions of SFAS No. 143, HickoryTech did not record this potential asset retirement obligation upon adoption and will not record an obligation until such time as the fair value of the obligation can be reasonably estimated.

In April 2002, the FASB issued SFAS No. 145, Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections. SFAS No. 145 rescinds FASB Statement No. 4, Reporting Gains and Losses from Extinguishment of Debt, and an amendment of that Statement, FASB Statement No. 64, Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements. SFAS No. 145 also rescinds FASB Statement No. 44, Accounting for Intangible Assets of Motor Carriers, and amends FASB Statement No. 13, Accounting for Leases. HickoryTech adopted the provisions of SFAS No. 145 on January 1, 2003. Adoption of this standard had no impact on the financial statements presented in this Form 10-Q.

In June 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, which replaces Emerging Issues Task Force (EITF) Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). SFAS No. 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. HickoryTech has engaged in no activities in the three or six months ended June 30, 2003 that are subject to the provisions of SFAS No. 146. Accordingly, the adoption of SFAS No. 146 did not impact HickoryTech s financial position or results of operations.

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In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation Transition Disclosure an amendment of SFAS No. 123 (SFAS No. 148). This Statement amends SFAS No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The provisions of SFAS No. 148 are effective for financial statements for fiscal years ending after December 15, 2002, and disclosure requirements shall be effective for interim periods beginning after December 15, 2002. The Company will continue to account for stock-based compensation to its employees and directors using the intrinsic value method prescribed by APB Opinion No. 25, and related interpretations. The Company adopted the provisions of SFAS No. 148 and has made certain disclosures required by SFAS No. 148 in the consolidated financial statements presented in this report. The adoption of SFAS No. 148 did not impact HickoryTech s financial position or results of operations.

In November 2002, the FASB issued Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. This interpretation elaborates on the disclosures required in financial statements concerning obligations under certain guarantees. It also clarifies the requirements related to the recognition of liabilities by a guarantor at the inception of certain guarantees. The disclosure requirements of this interpretation were effective for HickoryTech on December 31, 2002 but did not require any additional disclosures. The recognition provisions of the interpretation are effective for HickoryTech in 2003 and are applicable only to guarantees issued or modified after December 31, 2002. The adoption of Interpretation No. 45 does not have a material impact on the financial position or results of operations of HickoryTech.

In April 2003, the FASB issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. This statement amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. SFAS No. 149 is effective for certain contracts entered into or modified after June 30, 2003. This standard is not expected to materially impact HickoryTech s consolidated financial position or results of operations.

NOTE 7. QUARTERLY SECTOR FINANCIAL SUMMARY

Business segment information for the first two quarters of 2003 and 2002 is as follows. Certain amounts in 2002 have been reclassified to conform to the 2003 presentation.

(In Thousands)	Telecom	Information Solutions	Enterprise Solutions	Corporate and Eliminations	HickoryTech Consolidated
Three Months Ended 6/30/03					
Operating Revenue from Unaffiliated Customers	$ 22,648	$ 809	$ 3,383	$	$ 26,840
Intersegment Revenues	68	975		(1,043)	
Total	22,716	1,784	3,383	(1,043)	26,840
Depreciation and Amortization	3,908	581	60	14	4,563
Operating Income (Loss)	7,299	(728)	(558)	(299)	5,714
Interest Expense	2	20		1,458	1,480
Income Taxes	2,989	(336)	(232)	(684)	1,737
Net Income (Loss)	4,312	(483)	(334)	(985)	2,510
Identifiable Assets	200,423				