

SHENANDOAH TELECOMMUNICATIONS CO/VA/
Form 10-Q
October 31, 2014

UNITED STATES OF AMERICA
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

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

For the transition period from _____ to _____

Commission File No.: 000-09881

SHENANDOAH TELECOMMUNICATIONS COMPANY
(Exact name of registrant as specified in its charter)

VIRGINIA 54-1162807
(State or other jurisdiction of (I.R.S. Employer Identification No.)
incorporation or organization)

500 Shentel Way, Edinburg, Virginia 22824
(Address of principal executive offices) (Zip Code)

(540) 984-4141
(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 definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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 Exchange Act). Yes No

The number of shares of the registrant's common stock outstanding on October 23, 2014 was 24,113,184.

SHENANDOAH TELECOMMUNICATIONS COMPANY
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SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES

UNAUDITED CONSOLIDATED BALANCE SHEETS

(in thousands)

	September 30, 2014	December 31, 2013
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 78,643	\$ 38,316
Accounts receivable, net	27,747	25,824
Income taxes receivable	2,141	16,576
Materials and supplies	7,605	10,715
Prepaid expenses and other	4,980	5,580
Deferred income taxes	866	963
Total current assets	121,982	97,974
Investments, including \$2,628 and \$2,528 carried at fair value	9,999	9,332
Property, plant and equipment, net	405,843	408,963
Other Assets		
Intangible assets, net	68,680	70,816
Deferred charges and other assets, net	8,108	9,921
Net other assets	76,788	80,737
Total assets	\$ 614,612	\$ 597,006

See accompanying notes to unaudited consolidated financial statements.

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SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES

UNAUDITED CONSOLIDATED BALANCE SHEETS

(in thousands)

	September	December
LIABILITIES AND SHAREHOLDERS' EQUITY	30, 2014	31, 2013
Current Liabilities		
Current maturities of long-term debt	\$ 23,000	\$ 5,750
Accounts payable	8,522	12,604
Advanced billings and customer deposits	12,336	11,661
Accrued compensation	4,850	4,192
Accrued liabilities and other	8,438	9,787
Total current liabilities	57,146	43,994
Long-term debt, less current maturities	207,000	224,250
Other Long-Term Liabilities		
Deferred income taxes	66,637	74,547
Deferred lease payable	6,916	6,156
Asset retirement obligations	6,856	6,485
Other liabilities	9,384	7,259
Total other long-term liabilities	89,793	94,447
Commitments and Contingencies		
Shareholders' Equity		
Common stock	28,667	26,759
Accumulated other comprehensive income	1,810	2,594
Retained earnings	230,196	204,962
Total shareholders' equity	260,673	234,315
Total liabilities and shareholders' equity	\$ 614,612	\$ 597,006

See accompanying notes to unaudited consolidated financial statements.

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UNAUDITED CONSOLIDATED STATEMENTS OF INCOME AND
COMPREHENSIVE INCOME (LOSS)

(in thousands, except per share amounts)

	Three Months		Nine Months Ended	
	Ended September 30, 2014	2013	2014	2013
Operating revenues	\$82,268	\$77,513	\$244,136	\$230,976
Operating expenses:				
Cost of goods and services, exclusive of depreciation and amortization shown separately below	33,330	31,778	97,970	93,006
Selling, general and administrative, exclusive of depreciation and amortization shown separately below	18,063	17,481	51,836	49,966
Depreciation and amortization	16,731	14,992	48,714	45,034
Total operating expenses	68,124	64,251	198,520	188,006
Operating income	14,144	13,262	45,616	42,970
Other income (expense):				
Interest expense	(2,007)	(2,050)	(6,119)	(6,270)
Gain on investments, net	239	348	335	526
Non-operating income, net	409	377	1,496	1,356
Income before taxes	12,785	11,937	41,328	38,582
Income tax expense	4,782	5,220	16,094	15,672
Net income	\$8,003	\$6,717	\$25,234	\$22,910
Other comprehensive income (loss):				
Unrealized gain (loss) on interest rate hedge, net of tax	476	(398)	(784)	2,909
Comprehensive Income	\$8,479	\$6,319	\$24,450	\$25,819
Earnings per share:				
Basic	\$0.33	\$0.28	\$1.05	\$0.95
Diluted	\$0.33	\$0.28	\$1.04	\$0.95
Weighted average shares outstanding, basic	24,113	24,010	24,091	23,993
Weighted average shares outstanding, diluted	24,393	24,125	24,334	24,078

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UNAUDITED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(in thousands, except per share amounts)

	Shares	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2012	23,962	\$ 24,688	\$ 184,023	\$ (863)	\$ 207,848
Net income	-	-	29,586	-	29,586
Other comprehensive income, net of tax	-	-	-	3,457	3,457
Dividends declared (\$0.36 per share)	-	-	(8,647)	-	(8,647)
Dividends reinvested in common stock	20	475	-	-	475
Stock based compensation	-	1,938	-	-	1,938
Common stock issued through exercise of incentive stock options	66	1,186	-	-	1,186
Common stock issued for share awards	68	-	-	-	-
Common stock issued	1	10	-	-	10
Common stock repurchased	(77)	(1,600)	-	-	(1,600)
Net excess tax benefit from stock options exercised	-	62	-	-	62
Balance, December 31, 2013	24,040	\$ 26,759	\$ 204,962	\$ 2,594	\$ 234,315
Net income	-	-	25,234	-	25,234
Other comprehensive loss, net of tax	-	-	-	(784)	(784)
Stock based compensation	-	2,152	-	-	2,152
Stock options exercised	51	1,139	-	-	1,139
Common stock issued for share awards	81	-	-	-	-
Common stock issued	1	7	-	-	7
Common stock repurchased	(60)	(1,785)	-	-	(1,785)
Net excess tax benefit from stock options exercised	-	395	-	-	395
Balance, September 30, 2014	24,113	\$ 28,667	\$ 230,196	\$ 1,810	\$ 260,673

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SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Nine Months Ended September 30, 2014	2013
Cash Flows From Operating Activities		
Net income	\$ 25,234	\$ 22,910
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	46,569	41,749
Amortization	2,145	3,285
Provision for bad debt	1,155	1,504
Stock based compensation expense	2,152	1,540
Excess tax benefits on stock awards	(395)	(69)
Deferred income taxes	(6,261)	4,950
Net loss on disposal of equipment	1,739	234
Realized gain on disposal of investments	-	1
Unrealized gains on investments	(40)	(233)
Net gains from patronage and equity investments	(667)	(627)
Other	1,446	1,976
Changes in assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	(3,078)	(510)
Materials and supplies	3,111	982
Income taxes receivable	14,434	(5,609)
Increase (decrease) in:		
Accounts payable	2,411	885
	760	981

Deferred lease payable				
Other prepaids, deferrals and accruals		623		(431)
Net cash provided by operating activities	\$	91,338	\$	73,518

Cash Flows From Investing Activities				
Purchase and construction of property, plant and equipment	\$	(51,197)	\$	(80,784)
Proceeds from sale of assets		-		271
Proceeds from sale of equipment		390		25
(Purchase) sale of investment securities		-		(13)
Proceeds from sale of investment securities		40		110
Net cash used in investing activities	\$	(50,767)	\$	(80,391)

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UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Nine Months Ended September 30, 2014 2013	
Cash Flows From Financing Activities		
Principal payments on long-term debt	\$-	\$(1,977)
Excess tax benefits on stock awards	395	69
Repurchases of stock	(1,785)	(1,297)
Proceeds from issuances of stock	1,146	947
Net cash used in financing activities	\$(244)	\$(2,258)
Net increase (decrease) in cash and cash equivalents	\$40,327	\$(9,131)
Cash and cash equivalents:		
Beginning	38,316	71,086
Ending	\$78,643	\$61,955
Supplemental Disclosures of Cash Flow Information		
Cash payments for:		
Interest	\$5,927	\$6,476
Income taxes paid	\$8,825	\$16,330

During the first nine months of 2013, the Company traded in certain PCS equipment and received credits of \$14.2 million against the purchase price of new equipment.

At December 31, 2013, accounts payable included approximately \$7.6 million associated with the capital expenditures related to the Network Vision project. These payables were disbursed during 2014.

See accompanying notes to unaudited consolidated financial statements.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The interim consolidated financial statements of Shenandoah Telecommunications Company and Subsidiaries (collectively, the “Company”) are unaudited. In the opinion of management, all adjustments necessary for a fair presentation of the interim results have been reflected therein. All such adjustments were of a normal and recurring nature. These statements should be read in conjunction with the consolidated financial statements and related notes in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013. The balance sheet information at December 31, 2013 was derived from the audited December 31, 2013 consolidated balance sheet. Operating revenues and income from operations for any interim period are not necessarily indicative of results that may be expected for the entire year.

2. Property, Plant and Equipment

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

	September 30, 2014	December 31, 2013
Plant in service	\$ 668,718	\$ 633,480
Plant under construction	18,493	23,181
	687,211	656,661
Less accumulated amortization and depreciation	281,368	247,698
Net property, plant and equipment	\$ 405,843	\$ 408,963

3. Earnings per share

Basic net income per share was computed on the weighted average number of shares outstanding. Diluted net income per share was computed under the treasury stock method, assuming the conversion as of the beginning of the period, for all dilutive stock options. Of 698 thousand and 764 thousand shares and options outstanding at September 30, 2014 and 2013, respectively, zero and 293 thousand were anti-dilutive, respectively. These options have been excluded from the computations of diluted earnings per share for their respective period. There were no adjustments to net income for either period.

4. Investments Carried at Fair Value

Investments include \$2.6 million and \$2.5 million of investments carried at fair value as of September 30, 2014 and December 31, 2013, respectively, consisting of equity, bond and money market mutual funds. These investments were acquired under a rabbi trust arrangement related to a non-qualified supplemental retirement plan maintained by the Company. During the nine months ended September 30, 2014, the Company recognized \$111 thousand in dividend and interest income from investments, and recorded net unrealized gains of \$40 thousand on these investments. Fair values for these investments held under the rabbi trust were determined by Level 1 quoted market prices for the underlying mutual funds.

5. Financial Instruments

Financial instruments on the consolidated balance sheets that approximate fair value include: cash and cash equivalents, receivables, investments carried at fair value, payables, accrued liabilities, interest rate swaps and variable rate long-term debt.

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6. Derivative Instruments, Hedging Activities and Accumulated Other Comprehensive Income

The Company's objectives in using interest rate derivatives are to add stability to cash flows and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps (both those designated as cash flow hedges as well as those not designated as cash flow hedges) involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount.

The Company entered into a pay-fixed, receive-variable interest rate swap of \$63.3 million of notional principal in August 2010. This interest rate swap was not designated as a cash flow hedge. Changes in the fair value of interest rate swaps not designated as cash flow hedges are recorded in interest expense each reporting period. The changes in fair value recorded in interest expense for the three and nine months ended September 30, 2013 were decreases of \$33 thousand and \$239 thousand, respectively. This swap expired in July 2013.

The Company entered into a pay-fixed, receive-variable interest rate swap of \$174.6 million of notional principal in September 2012. This interest rate swap was designated as a cash flow hedge. The total outstanding notional amount of the cash flow hedge was \$174.6 million as of September 30, 2014.

The effective portion of changes in the fair value of interest rate swaps designated and that qualify as cash flow hedges is recorded in accumulated other comprehensive income and is subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. The Company uses its derivatives to hedge the variable cash flows associated with existing variable-rate debt. The ineffective portion of the change in fair value of the derivative is recognized directly in earnings through interest expense. No hedge ineffectiveness was recognized during any of the periods presented.

Amounts reported in accumulated other comprehensive income related to the interest rate swap designated and that qualifies as a cash flow hedge are reclassified to interest expense as interest payments are made on the Company's variable-rate debt. As of September 30, 2014, the Company estimates that \$1.5 million will be reclassified as an increase to interest expense during the next twelve months due to the interest rate swap since the hedge interest rate exceeds the variable interest rate on the debt.

The table below presents the fair value of the Company's derivative financial instrument as well as its classification on the consolidated balance sheet as of September 30, 2014 and December 31, 2013 (in thousands):

Derivatives	Fair Value as of	
Balance Sheet Location	September 30, 2014	December 31, 2013
Derivatives designated as hedging instruments:		
Interest rate swap		
Accrued liabilities and other	\$ (1,459)	\$ (1,590)
Deferred charges and other assets, net	4,482	5,926
Total derivatives designated as hedging instruments	\$ 3,023	\$ 4,336

The fair value of interest rate swaps is determined using a pricing model with inputs that are observable in the market (level 2 fair value inputs).

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The table below presents change in accumulated other comprehensive income by component for the nine months ended September 30, 2014 (in thousands):

	Gains and (Losses) on Cash Flow Hedges	Income Tax (Expense) Benefit	Accumulated Other Comprehensive Income (Loss)
Balance as of December 31, 2013	\$4,336	\$ (1,742)	\$ 2,594
Other comprehensive income before reclassifications	(2,603)	1,043	(1,560)
Amounts reclassified from accumulated other comprehensive income (to interest expense)	1,290	(514)	776
Net current period other comprehensive income (loss)	(1,313)	529	(784)
Balance as of September 30, 2014	\$3,023	\$ (1,213)	\$ 1,810

7. Segment Information

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision makers. The Company has three reportable segments, which the Company operates and manages as strategic business units organized by lines of business: (1) Wireless, (2) Cable, and (3) Wireline. A fourth segment, Other, primarily includes Shenandoah Telecommunications Company, the parent holding company.

The Wireless segment provides digital wireless service to a portion of a four-state area covering the region from Harrisburg, York and Altoona, Pennsylvania, to Harrisonburg, Virginia, as a Sprint PCS Affiliate. This segment also owns cell site towers built on leased land, and leases space on these towers to both affiliates and non-affiliated service providers.

The Cable segment provides video, internet and voice services in Virginia, West Virginia and Maryland, and leases fiber optic facilities throughout southern Virginia and West Virginia. It does not include video, internet and voice services provided to customers in Shenandoah County, Virginia.

The Wireline segment provides regulated and unregulated voice services, DSL internet access, and long distance access services throughout Shenandoah County and portions of Rockingham, Frederick, Warren and Augusta counties, Virginia. The segment also provides video services in portions of Shenandoah County, and leases fiber optic facilities throughout the northern Shenandoah Valley of Virginia, northern Virginia and adjacent areas along the Interstate 81 corridor through West Virginia, Maryland and portions of Pennsylvania.

Three months ended September 30, 2014

(in thousands)	Wireless	Cable	Wireline	Other	Eliminations	Consolidated Totals
External revenues						
Service revenues	\$48,013	\$17,602	\$5,102	\$ -	\$ -	\$ 70,717
Other	3,083	3,370	5,098	-		