

SHENANDOAH TELECOMMUNICATIONS CO/VA/
Form 10-Q
November 08, 2011

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, 2011

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
(State or other jurisdiction of incorporation or organization)

54-1162807
(I.R.S. Employer Identification No.)

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 21, 2011 was 23,786,193.

SHENANDOAH TELECOMMUNICATIONS COMPANY
INDEX

| | | Page Numbers |
|--------------------------------------|---|-----------------|
| PART I. FINANCIAL INFORMATION | | |
| Item 1. | Financial Statements | |
| | <u>Unaudited Condensed Consolidated Balance Sheets September 30, 2011 and December 31, 2010</u> | 3-4 |
| | <u>Unaudited Condensed Consolidated Statements of Income for the Three and Nine Months Ended September 30, 2011 and 2010</u> | 5 |
| | <u>Unaudited Condensed Consolidated Statements of Shareholders' Equity and Comprehensive Income for the Nine Months Ended September 30, 2011 and the Year Ended December 31, 2010</u> | 6 |
| | <u>Unaudited Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2011 and 2010</u> | 7-8 |
| | <u>Notes to Unaudited Condensed Consolidated Financial Statements</u> | 9-14 |
| Item 2 . | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 15-32 |
| Item 3. | <u>Quantitative and Qualitative Disclosures about Market Risk</u> | 32 |
| Item 4. | <u>Controls and Procedures</u> | 33 |
| PART II. OTHER INFORMATION | | |
| Item 1A. | <u>Risk Factors</u> | 34 |
| Item 2. | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 34 |
| Item 6. | <u>Exhibits</u> | 35 |
| | <u>Signatures</u> | 36 |
| | <u>Exhibit Index</u> | 37 |

Index

SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES
 UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
 (in thousands)

| ASSETS | September 30, 2011 | December 31, 2010 |
|--|--------------------------|----------------------|
| Current Assets | | |
| Cash and cash equivalents | \$21,862 | \$27,453 |
| Accounts receivable, net | 20,915 | 20,634 |
| Income taxes receivable | 6,470 | 2,576 |
| Materials and supplies | 5,310 | 6,360 |
| Prepaid expenses and other | 3,932 | 3,770 |
| Assets held for sale | 6,967 | 9,305 |
| Deferred income taxes | 620 | 702 |
| Total current assets | 66,076 | 70,800 |
| Investments, including \$2,041 and \$2,287 carried at fair value | 8,453 | 9,090 |
| Property, plant and equipment, net | 300,110 | 280,051 |
| Other Assets | | |
| Intangible assets, net | 83,201 | 90,389 |
| Cost in excess of net assets of businesses acquired | 10,962 | 10,962 |
| Deferred charges and other assets, net | 4,339 | 5,145 |
| Net other assets | 98,502 | 106,496 |
| Total assets | \$473,141 | \$466,437 |

See accompanying notes to unaudited condensed consolidated financial statements.

(Continued)

Index

SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES
 UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
 (in thousands)

| LIABILITIES AND SHAREHOLDERS' EQUITY | September 30, 2011 | December 31, 2010 |
|--|-----------------------|----------------------|
| Current Liabilities | | |
| Current maturities of long-term debt | \$ 21,911 | \$14,823 |
| Accounts payable | 7,790 | 12,237 |
| Advanced billings and customer deposits | 10,022 | 8,067 |
| Accrued compensation | 2,627 | 3,278 |
| Liabilities held for sale | 1,017 | 910 |
| Accrued liabilities and other | 7,590 | 5,583 |
| Total current liabilities | 50,957 | 44,898 |
| Long-term debt, less current maturities | 164,087 | 180,289 |
| Other Long-Term Liabilities | | |
| Deferred income taxes | 41,901 | 35,902 |
| Deferred lease payable | 4,056 | 3,734 |
| Asset retirement obligations | 6,905 | 6,542 |
| Other liabilities | 4,656 | 4,767 |
| Total other liabilities | 57,518 | 50,945 |
| Commitments and Contingencies | | |
| Shareholders' Equity | | |
| Common stock | 21,086 | 19,833 |
| Retained earnings | 179,493 | 170,472 |
| Total shareholders' equity | 200,579 | 190,305 |
| Total liabilities and shareholders' equity | \$ 473,141 | \$466,437 |

See accompanying notes to unaudited condensed consolidated financial statements.

Index

SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES
 UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME
 (in thousands, except per share amounts)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|-----------|------------------------------------|------------|
| | 2011 | 2010 | 2011 | 2010 |
| Operating revenues | 62,657 | \$ 53,233 | \$ 184,640 | \$ 137,192 |
| Operating expenses: | | | | |
| Cost of goods and services, exclusive of depreciation and amortization shown separately below | 25,514 | 21,265 | 76,792 | 50,601 |
| Selling, general and administrative, exclusive of depreciation and amortization shown separately below | 14,199 | 14,180 | 41,438 | 32,770 |
| Depreciation and amortization | 13,774 | 12,202 | 42,155 | 28,927 |
| Total operating expenses | 53,487 | 47,647 | 160,385 | 112,298 |
| Gain on sale of directory | - | 4,000 | - | 4,000 |
| Operating income | 9,170 | 9,586 | 24,255 | 28,894 |
| Other income (expense): | | | | |
| Interest expense | (2,003) | (2,416) | (6,668) | (2,992) |
| Gain (loss) on investments, net | (250) | (11) | (499) | (153) |
| Non-operating income, net | 195 | 275 | 703 | 543 |
| Income from continuing operations before income taxes | 7,112 | 7,434 | 17,791 | 26,292 |
| Income tax expense | 3,497 | 3,229 | 8,070 | 10,994 |
| Net income from continuing operations | 3,615 | 4,205 | 9,721 | 15,298 |
| Earnings (loss) from discontinued operations, net of tax (expense) benefit of \$392, \$109, \$436 and \$(41), respectively | (613) | (171) | (700) | 62 |
| Net income | \$ 3,002 | \$ 4,034 | \$ 9,021 | \$ 15,360 |
| Basic and diluted income (loss) per share: | | | | |
| Net income from continuing operations | \$0.15 | \$ 0.17 | \$0.41 | \$ 0.65 |
| Net earnings (loss) from discontinued operations | (0.02) | - | (0.03) | - |
| Net income | \$0.13 | \$ 0.17 | \$0.38 | \$ 0.65 |
| Weighted average shares outstanding, basic | 23,781 | 23,738 | 23,773 | 23,724 |
| Weighted average shares, diluted | 23,823 | 23,883 | 23,823 | 23,799 |

See accompanying notes to unaudited condensed consolidated financial statements.

Index

SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES
 UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
 AND COMPREHENSIVE INCOME

(in thousands, except per share amounts)

| | Shares | Common Stock | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total |
|---|--------|-----------------|----------------------|--|-----------|
| Balance, December 31, 2009 | 23,681 | \$17,890 | \$160,230 | \$ (2,448) | \$175,672 |
| Comprehensive income: | | | | | |
| Net income | - | - | 18,075 | - | 18,075 |
| Reclassification adjustment for unrealized loss from pension plans included in net income, net of tax | - | - | - | 2,596 | 2,596 |
| Net unrealized gain from pension plans, net of tax | - | - | - | (148) | (148) |
| Total comprehensive income | | | | | 20,523 |
| Dividends declared (\$0.33 per share) | - | - | (7,833) | - | (7,833) |
| Dividends reinvested in common stock | 29 | 520 | - | - | 520 |
| Stock-based compensation | - | 792 | - | - | 792 |
| Common stock issued through exercise of incentive stock options | 57 | 561 | - | - | 561 |
| Net excess tax benefit from stock options exercised | - | 70 | - | - | 70 |
| Balance, December 31, 2010 | 23,767 | \$19,833 | \$170,472 | \$ - | \$190,305 |
| Comprehensive income: | | | | | |
| Net income | - | - | 9,021 | - | 9,021 |
| Total comprehensive income | | | | | 9,021 |
| Stock-based compensation | - | 1,335 | - | - | 1,335 |
| Common stock issued for share awards | 19 | - | - | - | - |
| Common stock repurchased | (5) | (92) | - | - | (92) |
| Common stock issued | - | 10 | - | - | 10 |
| Balance, September 30, 2011 | 23,781 | \$21,086 | \$179,493 | \$ - | \$200,579 |

See accompanying notes to unaudited condensed consolidated financial statements.

Index

SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES
 UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (in thousands)

| | Nine Months Ended September 30, | |
|---|------------------------------------|--------------|
| | 2011 | 2010 |
| Cash Flows From Operating Activities | | |
| Net income | \$9,021 | \$15,360 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Non-cash impairment charge | 645 | - |
| Depreciation | 33,732 | 26,040 |
| Amortization | 8,423 | 2,887 |
| Provision for bad debt | 2,559 | 844 |
| Stock based compensation expense | 1,335 | 539 |
| Pension settlement and curtailment expenses | - | 3,964 |
| Excess tax benefits on stock option exercises | - | (70) |
| Deferred income taxes | 6,081 | 152 |
| Net (gain) loss on disposal of equipment | (1,035) | 316 |
| Realized (gain) on sale of directory | - | (4,000) |
| Realized loss on disposal of investments | 27 | 147 |
| Unrealized (gains) losses on investments | 236 | (229) |
| Net (gain) loss from patronage and equity investments | 13 | 67 |
| Other | 51 | 576 |
| Changes in assets and liabilities: | | |
| (Increase) decrease in: | | |
| Accounts receivable | (2,876) | (4,031) |
| Materials and supplies | 1,050 | 707 |
| Income taxes receivable | (3,894) | 5,531 |
| Increase (decrease) in: | | |
| Accounts payable | (4,449) | (841) |
| Deferred lease payable | 319 | 237 |
| Income taxes payable | - | 512 |
| Other prepaids, deferrals and accruals | 3,283 | 4,989 |
| Net cash provided by operating activities | \$54,521 | \$53,697 |
| Cash Flows From Investing Activities | | |
| Purchase and construction of property, plant and equipment | \$(52,505) | \$(33,940) |
| Cash paid for acquisition of business | - | (147,613) |
| Cash received on sale of directory | - | 4,000 |
| Cash paid to acquire prepaid subscriber rights | - | (6,884) |
| Proceeds from sale of assets | 1,170 | - |
| Proceeds from sale of equipment | 60 | 503 |
| Purchase of investment securities | (84) | (114) |
| Proceeds from sale of investment securities | 444 | 54 |
| Net cash used in investing activities | \$(50,915) | \$(183,994) |

(Continued)

7

Index

SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES
 UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (in thousands)

| | Nine Months Ended September 30, | |
|--|------------------------------------|-------------|
| | 2011 | 2010 |
| Cash Flows From Financing Activities | | |
| Principal payments on long-term debt | \$(9,115) | \$(25,595) |
| Amounts borrowed under debt agreements | - | 189,800 |
| Cash paid for debt issuance costs | - | (3,445) |
| Excess tax benefits on stock option exercises | - | 70 |
| Repurchases of stock | (92) | - |
| Proceeds from exercise of incentive stock options | 10 | 557 |
| Net cash provided by (used in) financing activities | \$(9,197) | \$161,387 |
| Net increase (decrease) in cash and cash equivalents | \$(5,591) | \$31,090 |
| Cash and cash equivalents: | | |
| Beginning | 27,453 | 12,054 |
| Ending | \$21,862 | \$43,144 |
| Supplemental Disclosures of Cash Flow Information | | |
| Cash payments for: | | |
| Interest | \$5,600 | \$2,392 |
| Income taxes | \$5,447 | \$5,225 |

During the third quarter of 2011, the Company traded in certain PCS equipment for equipment with additional capacity and received credits of \$2.2 million against the purchase price of the new equipment.

See accompanying notes to unaudited condensed consolidated financial statements.

Index

SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The interim condensed 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, 2010. The balance sheet information at December 31, 2010 was derived from the audited December 31, 2010 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. Discontinued Operations

In September 2008, the Company announced its intention to sell its Converged Services operation, and the related assets and liabilities were reclassified as held for sale in the consolidated balance sheet and the historical operating results were reclassified as discontinued operations. Depreciation and amortization on long-lived assets was also discontinued.

During 2009 and 2010, the Company determined that the fair value of Converged Services had declined. Accordingly, the Company recorded an impairment loss of \$17.5 million (\$10.7 million, net of taxes) as of March 31, 2009, and recorded an additional impairment loss of \$1.9 million (\$1.1 million, net of taxes) as of December 31, 2010, to reduce the carrying value of these assets to their estimated fair value less cost to sell. Enhancements to the physical assets since the impairment recorded at December 31, 2010, have been capitalized and immediately expensed during 2011, in the amount of \$0.2 million and \$0.4 million in the three months and nine months ended September 30, 2011, respectively.

During the first quarter of 2011, the Company made the decision to transfer service contracts and related equipment for five Converged Services’ properties that were within the Shentel Cable franchised cable footprint and could be serviced by the Company’s nearby cable headends. These properties, with an aggregate net book value of approximately \$0.4 million, were transferred to Shentel Cable and have been reclassified from discontinued operations for all prior periods. The Company recorded an adjustment to depreciation expense of \$0.1 million to reduce the carrying value of the assets transferred to the lower of their carrying value net of the impairment charge or the carrying value as if depreciation had been recorded on these assets at all times.

During the second quarter of 2011, the Company sold service contracts and related equipment for seven Converged Services’ properties to a third-party purchaser, receiving cash proceeds of \$0.9 million (with an additional \$0.1 million in proceeds placed in escrow for twelve months). The total proceeds approximated the carrying value of the assets sold.

During the third quarter of 2011, the Company sold service contracts and related equipment for two Converged Services’ properties to third party purchasers, receiving cash proceeds of \$0.3 million. The total proceeds approximated the carrying value of the assets sold.

At September 30, 2011, negotiations with potential purchasers continue. Based upon indications of interest made by potential buyers in recent months, the Company has determined that the fair value of Converged Services has declined. Accordingly, the Company recorded an impairment loss of \$0.6 million (\$0.4 million, net of taxes) as of

September 30, 2011, to reduce the carrying value of these assets to their estimated fair value less cost to sell.

Index

Assets and liabilities held for sale consisted of the following:

| | September 30, 2011 | December 31, 2010 |
|------------------------------------|-----------------------|----------------------|
| Assets held for sale: | | |
| Property, plant and equipment, net | \$ 4,966 | \$ 6,614 |
| Intangible assets, net | 640 | 706 |
| Deferred charges | 670 | 1,310 |
| Other assets | 691 | 675 |
| | \$ 6,967 | \$ 9,305 |
| Liabilities: | | |
| Other liabilities | \$ 1,017 | \$ 910 |

Discontinued operations included the following amounts of operating revenue and income (loss) before income taxes:

| | Three Months Ended September 30, | |
|-------------------------------------|-------------------------------------|-----------|
| | 2011 | 2010 |
| Operating revenues | \$2,531 | \$ 2,816 |
| Earnings (loss) before income taxes | \$(1,005) | \$ (280) |
| | Nine Months Ended September 30, | |
| | 2011 | 2010 |
| Operating revenues | \$8,868 | \$ 9,358 |
| Earnings (loss) before income taxes | \$(1,136) | \$ 103 |

3. Property, Plant and Equipment

Property, plant and equipment consisted of the following:

| | September 30, 2011 | December 31, 2010 |
|--|-----------------------|----------------------|
| Plant in service | \$ 516,853 | \$ 466,658 |
| Plant under construction | 18,775 | 25,515 |
| | 535,628 | 492,173 |
| Less accumulated amortization and depreciation | 235,518 | 212,122 |
| Net property, plant and equipment | \$ 300,110 | \$ 280,051 |

During the third quarter of 2011, the Company traded in certain PCS equipment for equipment with additional capacity and received credits of \$2.2 million against the purchase price of the new equipment. The Company recognized a gain of \$1.4 million on the trade-in.

4. Earnings per share

Basic net income (loss) per share was computed on the weighted average number of shares outstanding. Diluted net income (loss) 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 511 thousand and 383 thousand shares and options outstanding at September 30, 2011 and 2010, respectively, 363 thousand and 213 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.

Index

5. Investments Carried at Fair Value

Investments include \$2.0 million and \$2.3 million of investments carried at fair value as of September 30, 2011 and December 31, 2010, 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, 2011, the Company recognized \$27 thousand in net losses on dispositions of investments, recognized \$17 thousand in dividend and interest income from investments, and recognized net unrealized losses of \$236 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.

6. 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, and long-term debt. Due to the relatively short time frame to maturity of the Company's fixed rate debt, fair value approximates its carrying value.

The Company measures its interest rate swap at fair value based on information provided by the counterparty and recognizes it as a liability on the Company's condensed consolidated balance sheet. Changes in the fair value of the swap are recognized in interest expense, as the Company did not designate the swap agreement as a cash flow hedge for accounting purposes.

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) Wireline, and (3) Cable TV. A fourth segment, Other, primarily includes Shenandoah Telecommunications Company, the parent holding company as well as certain general and administrative costs historically charged to Converged Services that cannot be allocated to discontinued operations.

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 of Sprint Nextel. 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 Wireline segment provides regulated and unregulated voice services, dial-up and DSL internet access, and long distance access services throughout Shenandoah County and portions of northwestern Augusta County, Virginia, and leases fiber optic facilities throughout the northern Shenandoah Valley of Virginia, northern Virginia and adjacent areas along the Interstate 81 corridor, including portions of West Virginia and Maryland.

The Cable TV segment provides video, internet and voice services in Virginia, West Virginia and Maryland. It includes the operations acquired from JetBroadBand, LLC, since July 30, 2010, and the operations acquired from Suddenlink since November 30, 2010.

The financial information below includes revenues and related expenses billed by one segment of the Company to another segment within the Company. These internal revenues and related expenses are eliminated in order to arrive at the consolidated total revenues and expenses as shown below. All individual segment financial results include these internal revenues and expenses, which are only eliminated at the consolidated level.

Index

Selected financial data for each segment is as follows:

Three months ended September
30, 2011

| (In thousands) | Wireless | Wireline | Cable TV | Other | Eliminations | Consolidated Totals |
|---|----------|----------|----------|--------|--------------|------------------------|
| External revenues | | | | | | |
| Service revenues | \$34,403 | \$3,604 | \$14,532 | \$- | \$ - | \$ 52,539 |
| Other | 3,286 | 4,829 | 2,003 | - | - | 10,118 |
| Total external revenues | 37,689 | 8,433 | 16,535 | - | - | 62,657 |
| Internal revenues | 800 | 3,994 | 83 | - | (4,877) | - |
| Total operating revenues | 38,489 | 12,427 | 16,618 | - | (4,877) | 62,657 |
| Operating expenses | | | | | | |
| Costs of goods and services, exclusive of depreciation and amortization shown separately below | 12,667 | 4,887 | 12,082 | 36 | (4,158) | 25,514 |
| Selling, general and administrative, exclusive of depreciation and amortization shown separately below | 7,028 | 1,891 | 5,271 | 728 | (719) | 14,199 |
| Depreciation and amortization | 5,868 | 2,156 | 5,692 | 58 | - | 13,774 |
| Total operating expenses | 25,563 | 8,934 | 23,045 | 822 | (4,877) | 53,487 |
| Operating income (loss) | 12,926 | 3,493 | (6,427) | (822) | - | 9,170 |

Three months ended September
30, 2010

| (In thousands) | Wireless | Wireline | Cable TV | Other | Eliminations | Consolidated Totals |
|-------------------|----------|----------|----------|-------|--------------|------------------------|
| External revenues | | | | | | |
| Service revenues | \$28,624 | \$3,596 | \$10,663 | \$- | \$ - | \$ 42,883 |