

Hawaiian Telcom Holdco, Inc.  
Form 10-K  
March 13, 2014

Use these links to rapidly review the document

[TABLE OF CONTENTS](#)

[Item 8. Financial Statements and Supplementary Data](#)

[Table of Contents](#)

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

(Mark one)

**ANNUAL REPORT PURSUANT TO SECTIONS 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2013

OR

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

Commission File No. 001-34686

**HAWAIIAN TELCOM HOLDCO, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**16-1710376**

(I.R.S. Employer  
Identification No.)

**1177 Bishop Street**

**Honolulu, Hawaii 96813**

(Address of principal executive offices) (Zip Code)

**808-546-4511**

(Registrant's telephone number, including area code)

Securities to be registered pursuant to Section 12(b) of the Act: **None**

Securities to be registered pursuant to Section 12(g) of the Act:

**Common Stock, par value \$0.01 per share**

(Title of class)

**The NASDAQ Stock Market, LLC**

(Name of each exchange on which registered)

Indicate by check mark if the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act. Yes  No

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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   
(Do not check if a 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 aggregate market value of the registrant's common stock held by non-affiliates as of June 30, 2013 was \$193,551,150.

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes  No

As of March 13, 2014, 10,517,002 shares of the registrant's common stock, \$0.01 par value, were outstanding.

### DOCUMENTS INCORPORATED BY REFERENCE

Portions of registrant's Proxy Statement dated March 14, 2014 (Part III of Form 10-K)

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Table of Contents

**HAWAIIAN TELCOM HOLDCO, INC.  
TABLE OF CONTENTS**

|  | <b>Page</b> |
|--|-------------|
| <b><u>PART I</u></b>   |             |
| <u>Item 1.</u> <u>Business</u>   | <u>1</u>    |
| <u>Item 1A.</u> <u>Risk Factors</u>  | <u>21</u>   |
| <u>Item 1B.</u> <u>Unresolved Staff Comments</u>   | <u>27</u>   |
| <u>Item 2.</u> <u>Properties</u>   | <u>27</u>   |
| <u>Item 3.</u> <u>Legal Proceedings</u>  | <u>28</u>   |
| <u>Item 4.</u> <u>Mine Safety Disclosures</u>  | <u>28</u>   |
| <b><u>PART II</u></b>  |             |
| <u>Item 5.</u> <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | <u>28</u>   |
| <u>Item 6.</u> <u>Selected Financial Data</u>  | <u>31</u>   |
| <u>Item 7.</u> <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                        | <u>32</u>   |
| <u>Item 7A.</u> <u>Quantitative and Qualitative Disclosures About Market Risk</u>  | <u>44</u>   |
| <u>Item 8.</u> <u>Financial Statements and Supplementary Data</u>  | <u>45</u>   |
| <u>Item 9.</u> <u>Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>                         | <u>86</u>   |
| <u>Item 9A.</u> <u>Controls and Procedures</u>   | <u>86</u>   |
| <u>Item 9B.</u> <u>Other Information</u>   | <u>86</u>   |
| <b><u>PART III</u></b>   |             |
| <u>Item 10.</u> <u>Directors, Executive Officers and Corporate Governance</u>  | <u>88</u>   |
| <u>Item 11.</u> <u>Executive Compensation</u>  | <u>89</u>   |
| <u>Item 12.</u> <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>              | <u>90</u>   |
| <u>Item 13.</u> <u>Certain Relationships and Related Transactions, and Director Independence</u>                                   | <u>90</u>   |
| <u>Item 14.</u> <u>Principal Accountant Fees and Services</u>  | <u>90</u>   |
| <b><u>PART IV</u></b>  |             |
| <u>Item 15.</u> <u>Exhibits, Financial Statement Schedules</u>   | <u>91</u>   |

Table of Contents

**Forward-Looking Statements**

This Annual Report on Form 10-K contains certain statements that constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. In particular, any statement, projection or estimate that includes or references the words "believes", "anticipates", "intends", "expects", or any similar expression falls within the safe harbor of forward-looking statements contained in the Reform Act. These forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from our historical experience and our present expectations or projections. Forward-looking statements by us are based on estimates, projections, beliefs, and assumptions of management and are not guarantees of future performance. Such forward-looking statements may be contained in this Form 10-K under "Item 1A Risk Factors" and "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere. In light of these risks, uncertainties and assumptions, you should not place undue reliance on any forward-looking statements. Additional risks that we may currently deem immaterial or that are not currently known to us could also cause the forward-looking events discussed in this Form 10-K not to occur as described. Except as otherwise required by applicable securities laws, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, changed circumstances or any other reason after the date of this Form 10-K.

Table of Contents

**PART I**

**Item 1. Business**

**Business Overview**

Hawaiian Telcom Holdco, Inc. (the "Company") is the largest full-service provider of communications services and products in Hawaii. We operate two primary business segments:

*Telecommunications.* This segment provides local telephone service including voice and data transport, enhanced custom calling features, network access, directory assistance and private lines. In addition, the Telecommunications segment provides high-speed Internet, long distance services, next-generation television service, next-generation Internet protocol (IP)-based network services, customer premises equipment, data solutions, managed services, billing and collection, wireless services, and pay telephone services. Our services are offered on all of Hawaii's major islands, except for our next-generation television service, which currently is available only on the island of Oahu. As of March 1, 2014, our telecommunications operations served approximately 372,100 local access lines, of which 50% served residential customers and 49% served business customers, with the remaining 1% serving other customers; 190,200 long distance lines, of which 61% served residential customers and 39% served business customers; and 111,800 high-speed Internet lines, which served 91,500 retail residential lines, 19,400 retail business lines, and 900 wholesale business and resale lines.

*Data Center Colocation.* This segment consists of data center services including colocation and virtual private cloud.

**History and Organizational Structure**

*General*

The Company was incorporated in Delaware in 2004. Originally incorporated in Hawaii in 1883 as Mutual Telephone Company, our Hawaiian Telcom, Inc. subsidiary has a strong heritage of over 130 years as Hawaii's communications carrier. From 1967 to May 1, 2005, we operated as a division of Verizon Communications Inc. (Verizon) or its predecessors. On May 2, 2005, the Verizon businesses conducted in Hawaii (comprised of Verizon Hawaii Inc. and carved-out components of Verizon Information Services, GTE.NET LLC (dba Verizon Online), Bell Atlantic Communications Inc. (dba Verizon Long Distance) and Verizon Select Services, Inc. (collectively, the "Verizon Hawaii Business")) were transferred to Verizon Holdco LLC, which then was merged (the "2005 Acquisition") with and into Hawaiian Telcom Communications, Inc., a Delaware corporation and wholly-owned subsidiary of the Company. As a result of the 2005 Acquisition, we became a stand-alone provider of communications services, operating as Hawaiian Telcom, Inc. (fka Verizon Hawaii Inc.) and Hawaiian Telcom Services Company, Inc., both wholly-owned subsidiaries of Hawaiian Telcom Communications, Inc.

Hawaiian Telcom, Inc., a Hawaii corporation, operates our regulated local exchange carrier business. Hawaiian Telcom Services Company, Inc., a Delaware corporation, operates other businesses including long distance, Internet, television, advanced communications and network services, managed services, data center services including colocation and virtual private cloud, cloud-based services, and wireless businesses. SystemMetrics Corporation, a Hawaii corporation acquired in September 2013, provides data center services including colocation and virtual private cloud. Wavecom Solutions Corporation, a wholly-owned subsidiary of Hawaiian Telcom, Inc. and a Hawaii corporation, provides voice, data and converged services.

Table of Contents

The following is a chart of our organizational structure.

***Bankruptcy Proceedings***

On December 1, 2008, the Company, Hawaiian Telcom Communications, Inc., Hawaiian Telcom, Inc., Hawaiian Telcom Services Company, Inc. and certain other affiliates (collectively, the "Debtors") filed voluntary petitions for relief under chapter 11 of the U.S. Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware (later transferred to the United States Bankruptcy Court for the District of Hawaii (the "Bankruptcy Court")) in order to facilitate a balance sheet restructuring. In November 2009, the Bankruptcy Court confirmed the Debtors' chapter 11 plan of reorganization (the "Plan of Reorganization") and entered a written confirmation order (the "Confirmation Order") on December 30, 2009. The Plan of Reorganization became effective, and the Company and other Debtors emerged from chapter 11, on October 28, 2010.

**Industry Overview**

The telecommunications industry is comprised of companies involved in the transmission of voice, data and video communications over various media and through various technologies. There are two predominant types of local telephone service providers, or carriers, in the telecommunications industry: incumbent local exchange carriers (ILECs) and competitive local exchange carriers (CLECs). An ILEC refers to the regional Bell operating companies (RBOCs), which were the local telephone companies created from the breakup of AT&T in 1984, as well as small and midsize independent telephone companies, such as Hawaiian Telcom, Inc., Cincinnati Bell Inc. and Consolidated Communications, Inc., which sell local telephone service. These ILECs were the traditional monopoly providers of local telephone service prior to the passage of the Telecommunications Act of 1996. On the other hand, a

Table of Contents

CLEC is a competitor to local telephone companies that has been granted permission by a state regulatory commission to offer local telephone service in an area already served by an ILEC.

In recent years, the U.S. telecommunications industry has undergone significant structural changes. Many of the largest service providers have achieved growth through acquisitions and mergers, while an increasing number of competitive providers have restructured or entered bankruptcy to obtain protection from creditors. Since 2001, capital in the form of public financing has been generally difficult to obtain for new entrants and competitive providers. Capital constraints have caused a number of competitive providers to change their business plans, resulting in consolidation. Despite these changes, the demand for telecommunications services, particularly data services, has not diminished, and telecommunications companies increasingly bundle services and provide integrated offerings for end-user customers.

Hawaii's telecommunications industry remains active, and demand for telecommunications services is strong, due in part to the comparative advantage provided by the State's geographic position. With its location between the mainland United States and Asia, Hawaii has been and will likely continue to be a surfacing location for cables running between the two continents. Hawaii is also connected to the mainland United States and Asia via several satellite networks.

**Our Business Strategy**

Our primary objective is to grow our business with a focus on delivering superior service to our customers, so that we can be recognized as the number one service provider of innovative "Always On<sup>SM</sup>" communications, information and entertainment solutions to the people and businesses of Hawaii. The key elements of our business strategy include the following:

***Further leverage our broadband network.*** Our broadband network is the foundation for our services to our customers, and we continue to expand its footprint and invest in advanced technology platforms that support advanced communications and network services. We completed the build out of our Multiprotocol Label Switching (MPLS) core network statewide and continue to deploy both fiber-to-the-node (FTTN) and fiber-to-the-premise (FTTP) access technologies to enhance and expand the speed and reach of our broadband network. We are deploying high-speed technologies such as VDSL2, Gigabit Passive Optical Network (GPON), and Metro Ethernet to deliver new broadband services such as our next-generation television to consumers, and Voice over Internet Protocol (VoIP), Internet protocol Virtual Private Network (IP-VPN), managed services, data center services including colocation and virtual private cloud, and cloud-based services to businesses. In both customer segments, we continue to enhance our services by adding new service options, features and functionality.

***Drive a customer- and sales-focused organization.*** Our customer operations team allows us to more effectively focus on our customers and strive to ensure the successful delivery of our services. We strive to deliver a consistent and comprehensive customer experience.

***Deliver new and innovative products and solutions to attract and retain customers.*** We have successfully added, and expect to continue to add, new products and services to our customer offerings. We offer a full range of services, including voice, Internet, television, data, customer premises equipment (CPE), wireless, advanced communications and network services, managed services, data center services including colocation and virtual private cloud, and cloud-based services supported by the reach and reliability of our network and Hawaii's only 24x7 state-of-the-art network operations center. Our suite of IP-based services, such as our business VoIP and IP-VPN services, better positions us to compete for new customers and drive winback opportunities while also allowing us to improve retention of existing customers by migrating them from legacy services. Our next-generation television service, *Hawaiian Telcom TV*, is an important growth component for our consumer products portfolio and critical to our strategy to

Table of Contents

win the home and capture a share of the significant television and entertainment market opportunity.

***Improve operating profitability and capital efficiencies.*** We maintain a disciplined approach to managing operating expenses and capital spending. Our focus on driving operational improvements in our business has resulted in cost savings, and we have identified several key initiatives that we believe will further improve our cost structure. In addition, we continue to review and renegotiate contracts with key IT and outsource suppliers, which has led to additional cost savings. We manage our capital expenditures to optimize returns through disciplined planning and targeted investment of capital. Our strategy will be to continue to make strategic investments in our business in order to position us for long-term growth.

In furtherance of our growth strategy, on September 30, 2013, we completed the acquisition of SystemMetrics Corporation (SystemMetrics) for \$16.3 million in cash, net of cash acquired and purchase price adjustments. Of the total purchase price, \$11.9 million was payable at closing with the balance subject to an earn-out over a three year period. SystemMetrics is a leading provider of data center services in the State of Hawaii. The acquisition increased the scale and scope of our existing data center operations by adding a state-of-the art facility in Honolulu with 6,500 square feet of data center capacity and room for expansion. The acquisition complements our existing portfolio of business service offerings and enables us to diversify further our revenue base, and followed our acquisition of Wavecom Solutions Corporation ("Wavecom") on December 31, 2012. Wavecom is an information and communications technology company and facilities-based competitive local exchange carrier headquartered in Honolulu that provides voice, data and converged services to small and medium-sized business and carrier customers through a six-island subsea and terrestrial fiber network. By adding Wavecom's fiber capacity and business capabilities to our network and operations, we enhanced our ability to serve growing customer demand for high-speed Internet bandwidth and next-generation, end-to-end solutions, and improved redundancy and diversity statewide. In addition, we assumed ownership of a new, largely under-utilized 8,000 square foot data center which enhanced our opportunities in managed hosting, colocation, and cloud services.

**Our Competitive Strengths**

We believe the following are among our core competitive strengths and enable us to differentiate ourselves in the marketplace and help us successfully execute our business strategy:

***Strong Local Presence.*** We have been serving Hawaii's communities for over 130 years and employ approximately 1,400 employees statewide. Each year, we donate to various local charities and our employees volunteer thousands of hours of community service. We understand our customers' needs because they are our needs as well. We share Hawaii's history, heritage, and values. We are locally managed, making us more competitive and responsive to Hawaii's consumers and businesses.

***Growth-Oriented Product Portfolio.*** We are the only communications service provider in our market that can provide such a broad array of services to both consumers and business customers that includes voice, Internet, data, CPE, wireless, advanced communications and IP-based network services, managed services, data center services including colocation and virtual private cloud, and cloud-based services. Our expanding service suite, including high-quality enhanced data networking services such as our business VoIP and IP-VPN services, and our managed services, are targeted at the key growth areas in our marketplace. Our next-generation television service, employing Microsoft® Mediaroom , is targeted at capturing a share of the significant video and entertainment market opportunity that we did not address previously.

***Advanced Network Infrastructure.*** We own the State's most extensive and reliable communications network, including the broadest fiber optic cable network consisting of approximately 143,098



Table of Contents

strand miles of fiber optic cable and more than 11,584 route miles of copper wire distribution lines. Our mature and highly-secure statewide MPLS backbone is the largest IP network in the State and allows us to deliver advanced IP-based services to well over 90% of the State's population. Our network is supported by Hawaii's only 24x7 state-of-the-art network operations center. We continue to push fiber deeper into the network and to enhance and expand the speed and reach of our broadband network, which we believe will enable us to offer new products and services that will generate growth in our business and allow us to compete more effectively in the marketplace.

**Strong Management Team.** We have assembled an experienced management team that we believe is well-qualified to lead our Company and execute our strategy. Our management team has significant operational experience in the telecommunications industry combined with extensive knowledge of our local market, which will be a critical driver of our success going forward.

**Our Products and Services**

*Telecommunications*

*Local Exchange Services*

Our local exchange carrier business generates revenue from local network services, network access services and certain other services, each of which is described below.

*Local Network Services*

Our traditional local network service enables customers to originate and receive telephone calls within a defined "exchange" area. We provide basic local services on a retail basis to residential and business customers, generally for a fixed monthly recurring charge. Basic local service also includes non-recurring charges to customers for the installation of new products and services. Basic local exchange services are enhanced with a variety of value-added services such as call waiting, caller ID, voice messaging, three-way calling, call forwarding and speed dialing. Value-added services may be purchased individually or as part of a package offering for a monthly recurring charge. We also offer other local exchange services, such as local private line and inside wire maintenance. The rates that can be charged to customers for basic local and certain other services are regulated by the HPUC. We charge business customers higher rates to recover a portion of the costs of providing local service to residential customers, as is customary in the industry. See " Regulation" for further discussion of regulatory matters.

*Network Access Services*

Our network access services are offered in connection with the origination and termination of long distance, or toll, calls that typically involve more than one company in the provision of end-to-end long distance service. Since toll calls are generally billed to the customer originating the call, a mechanism is required to compensate each company providing services relating to the call. This mechanism is the access charge, which we bill to each interexchange carrier for the use of our facilities to access our customers. In addition, we bill a component of access charges directly to our customers. Our network access services generate intrastate access revenue when an intrastate long distance call that involves us and an interexchange carrier is originated and terminated within Hawaii. This access charge is regulated by the HPUC. Similarly, our network access services generate interstate access revenue when an interstate long distance call is originated from a Hawaii local calling area served by us and is terminated in a local calling area in another state and vice versa. Interstate access charges are regulated by the FCC. We also offer special access voice and data services, which are a key area of growth driven by demand for increasing bandwidth from business and wholesale customers. Special access services include switched and non-switched (or dedicated) services such as point-to-point single channel circuits,

Table of Contents

Synchronous Optical Network (SONET) and Time Division Multiplexing (TDM) transport services, as well as IP-based private networks. See " Regulation" for further discussion of access charges.

*Long Distance Services*

We provide long distance services to transmit international calls, interLATA (Local Access Transport Area) domestic calls, and regional toll calls made to points outside a customer's local calling area but within our local service area (intraLATA toll). In Hawaii, each of the islands is a local calling area, and calls between the islands are intraLATA toll calls. Other long distance services include 800-number services and wide area telecommunication services, or WATS, private line services, and operator services associated with long distance calls. As of March 1, 2014, we served approximately 190,200 long distance lines, of which 61% served residential customers and 39% served business customers.

*Internet Services*

We provide high-speed Internet (HSI) access to our residential and business customers. Our data network enables us to provide extensive high-speed network access. We have HSI available in 79 of our 86 central offices. As of March 1, 2014, we served approximately 91,500 retail residential HSI lines, 19,400 retail business HSI lines, and 900 wholesale business and resale HSI lines.

*Managed and Cloud-Based Services*

We provide managed services as an end-to-end solution that manages, monitors, and supports a business' network, customer premise equipment (CPE), and corporate data security. As business networks become more complex, the amount of time and capital businesses must spend to support their networks increases accordingly. Our managed services enable customers to focus on their core business by leaving the day-to-day management of their networks to us. Our managed services product portfolio consists of managed network and security services, colocation services, IT professional services, and security consulting.

*Advanced Communications and Network Services*

The role of business communication providers is evolving. Consistent with this, we have expanded into application-centric, advanced communications and network services. Our advanced communications and network services include Routed Network Service, a high-performance IP virtual private networking service for business customers; Enhanced Internet Protocol Data Service, a multipoint switched Ethernet service; and Hosted PBX, a business VoIP service that provides businesses with a complete, converged communication solution in a hosted package.

*Next-Generation Television Service*

We introduced our next-generation television service on the island of Oahu in June 2011. During 2013, we continued to invest in our network to provide integrated digital video, high-speed broadband and voice services to new and existing customers. Our *Hawaiian Telcom TV* service is expected to be a critical growth component for our consumer products portfolio and an anticipated anchor of our service bundling strategy. With television, we are now able to market a triple play bundle in certain areas of the island of Oahu. We had strong *Hawaiian Telcom TV* growth, with more than 8,500 subscribers added in 2013, and ended the year with approximately 18,400 subscribers. We also enabled approximately 55,000 households in 2013, which is a record for us, increasing our cumulative total to approximately 120,000 households on Oahu as of the end of 2013. Enabling households means these homes can subscribe to our next generation network services, including our *Hawaiian Telcom TV* service.

Table of Contents

*Wireless Services*

We offer wireless services pursuant to a mobile virtual network operator (MVNO) services agreement with Sprint Spectrum, L.P. (Sprint). That agreement allows us to resell Sprint wireless services, including access to Sprint's nationwide personal communication service (PCS) wireless network to residential and business customers in Hawaii under the *Hawaiian Telcom®* brand name. The services agreement with Sprint was effective as of May 2009 and recently was renewed by us for a one-year term expiring in May 2015.

*Other Telecommunications Services*

We seek to capitalize on our local presence and network infrastructure by offering other services to customers and interexchange carriers. Sales and maintenance of customer premises equipment to the business markets are an important source of local exchange revenues. Customer premises equipment services are also an area of potential growth as attractive contracts with major equipment providers allow us to offer complete voice and data network and management solutions. For the wholesale or carrier market, we offer services including operator services, billing and collection services and space and power rents for colocation services. We also offer public pay telephone services at approximately 4,450 locations throughout the State of Hawaii.

*Data Center Colocation*

We provide colocation and virtual private cloud data center services. Colocation enables our customers to install and remotely operate their IT equipment in our state-of-the art facilities. Virtual private cloud services include the use of shared virtualized computing resources and a variety of customer control features and services, including back-up storage. We also provide related professional services, including planning, design, implementation and support services, to enable our customers to transition seamlessly and easily manage their IT solutions.

**Markets and Customers**

*Telecommunications*

We have been a telecommunications provider in Hawaii for more than 130 years. Our market consists of 86 central offices serving an area of approximately 6,263 square miles on the islands of Oahu, Maui, Hawaii, Kauai, Molokai and Lanai. We are the incumbent provider of local exchange services within this area and own the State's most extensive local telecommunications network, with approximately 372,100 local access lines served as of March 1, 2014, of which 50% served residential customers, 49% served business customers, and the remaining 1% served other customers. Other customers include (1) interexchange carriers that pay for access to long distance calling customers located within our local service area and (2) CLECs that pay for wholesale access to our network to provide competitive local service on either a resale or unbundled network element (UNE) basis as prescribed under the Communications Act of 1934, as amended (the "Communications Act"). We also provide wireless services in the State of Hawaii. It is estimated that there are approximately 1.3 million wireless subscribers in Hawaii and that currently less than 1% of these subscribers utilize us as their wireless provider.

Our market is characterized by high population density, with approximately 70% of the state's population concentrated on Oahu over an area of approximately 598 square miles, or 1,600 persons per square mile. In addition, 39% of the households in Hawaii reside in multi-dwelling units (MDUs) 44% on Oahu compared with 26% in the U.S. overall. This concentration of customers and commerce provides opportunities to leverage our network infrastructure to deliver products and services efficiently and in a cost-effective manner and to market and sell our services more effectively. Given Hawaii's geographic location, its distance from the mainland United States and the diversity of its population

Table of Contents

(approximately 38% being of Asian descent), Hawaii residents and businesses have telecommunications needs that may be different from those on the mainland United States. Furthermore, in 2013, the median household income in Hawaii is estimated to exceed the national average household income by approximately \$15,000. For the foregoing reasons, our strategy is to leverage the distinctive qualities of the Hawaii market to develop customized, local marketing strategies.

Our business marketplace is dominated by several key industries. The federal government accounts for approximately 24% of gross state product. With the U.S. Pacific Command, one of the largest U.S. unified service commands, based in Hawaii, the federal government is one of our largest customers. The hospitality industry and financial institutions also account for a significant portion of our business. The operations of these leading sectors are communications intensive, and we believe that they are dependent on our modern, reliable services. Hawaii's small business market (in the aggregate) is also a key driver of Hawaii's economy approximately 95% of the companies in Hawaii employ fewer than 50 employees, and these businesses make up a market of approximately 36,000 businesses. We believe that these business customers represent an underserved segment that we are targeting aggressively with new product and service offerings.

***Data Center Colocation***

We believe there is a significant growth opportunity to provide data center services, including colocation and virtual private cloud, to businesses across the State of Hawaii. There are two important trends driving the growth in the adoption of data center services the increasing use of cloud-based technologies by business customers to run their most important business functions, and the increasing demand for outsourced solutions. Market research estimates the Hawaii data center services opportunity to be over \$100 million annually. At present, the percentage of businesses in Hawaii that use colocation and virtual private cloud services is small compared to utilization in similarly-sized mainland U.S. markets.

**Competition**

The telecommunications industry is highly competitive. We experience competition from many communications service providers, including the local cable operator Oceanic Time Warner (Oceanic), wireless carriers, long distance providers, competitive local exchange carriers, Internet service providers, Internet information providers, over-the-top hybrid voice providers, and other companies that offer network services and managed enterprise solutions. Many of these companies have a strong market presence, brand recognition, and existing customer relationships, all of which contribute to competition that may affect our future revenue growth. We expect competition to intensify as a result of the entrance of new competitors and the rapid development of new technologies, products and services.

Oceanic, a subsidiary of Time Warner Cable Inc., the second largest cable operator in the United States, is one of our most significant competitors. Approximately 89% of the households in Hawaii (93% of households on Oahu) subscribe to Oceanic's cable television service. Oceanic also has the majority share of the high-speed Internet market in Hawaii, which it uses as a platform to offer voice services utilizing VoIP technology, and markets its cable, high-speed Internet, and voice services through competitive bundled offerings. In addition, Oceanic has targeted communications service offerings to small and medium-sized businesses.

Wireless communications services continue to constitute a significant source of competition, especially as wireless carriers expand and improve their network coverage and continue to lower their prices. As a result, some customers have chosen to completely forego use of traditional wireline phone service and instead rely solely on wireless services. We anticipate the wireless substitution trend will continue, and could pose additional threat to our high-speed Internet product, particularly if wireless service rates continue to decline and the wireless service providers upgrade their networks to

Table of Contents

4G technology and are able to deliver faster data speeds. Over-the-top hybrid providers, such as Skype and Magic Jack, also offer the capability to provide local voice and long distance calls using an Internet-equipped personal computer.

The advanced communications and network services business, as well as the managed services, data center services including colocation and virtual private cloud, and cloud-based services businesses, are highly competitive due to the absence of significant barriers to entry. The emergence of non-traditional, application-centric players in the market is redefining the role of service providers in these fields. We currently compete for business customers with vendors such as tw telecom of hawaii l.p., NetEnterprise Inc., Tri-net Solutions, L.L.C., Dell SecureWorks, Perimeter E-Security, World Wide Technology, Inc., and other traditional and non-traditional carriers.

We are uniquely positioned in the State to bundle data center services with network, managed services, data communications equipment and support services for an end-to-end, statewide solution. Due to the high cost of commercial real estate in the State of Hawaii, there is a limited inventory of colocation data center space available for Hawaii businesses. There are numerous other providers of cloud-based software, including system integrators in Hawaii and web-based service providers, that offer software subscriptions and virtual machines on cloud-based servers housed in data centers on the mainland U.S. and internationally. However, such out-of-state solutions raise concerns regarding response latency, the higher cost of private network connectivity from Hawaii if required for improved responsiveness, and data security.

We employ a number of strategies to combat the competitive pressures. Our strategies are focused on preserving and generating new revenues through customer retention, upgrading and upselling services to existing customers, new customer growth, winbacks of former customers, new product and feature deployment, and by managing our profitability and cash flow through targeted reductions in operating expenses and efficient deployment of capital. Key to success in these strategies is continued enhancement and expansion in the speed and reach of our broadband network, which we believe will enable us to offer new products and services that will generate growth in our business and allow us to compete more effectively in the marketplace. Another key is a focus on enhancing the customer experience, as we believe exceptional customer service will differentiate us from our competition. Customers expect industry leading service from their service providers. As technologies and services evolve, the requirement of the carrier to excel in this area is crucial for customer retention.

**Network Architecture and Technology**

Our strategy is to enhance and expand the most technologically advanced broadband communications network in the state of Hawaii and to position ourselves as a key hub for critical trans-Pacific traffic. Pursuing such a strategy has enabled us, among other things, to continue being the market leader in Hawaii for advanced communications and network services and managed and cloud-based services. In 2013, we invested approximately \$72 million in our network including significant expenditures to expand the reach, capacity, and resiliency of our IP-based packet and broadband network. Significant strides were made in 2013 to add hundreds of miles to our state-leading fiber network and continuing our transformation toward an optical, IP-based broadband network. The acquisition of Wavecom Solutions Corporation in December 2012 alone added over 500 route miles of additional fiber infrastructure into our network.

Table of Contents

*Packet Optical Network*

Our statewide MPLS network is unmatched in reach, capacity, security, resiliency, and reliability in Hawaii. Consisting of 8 core routers and 40 service edge routers meshed throughout the island chain, we offer a wide range of Layer 2 and Layer 3 MPLS services with many advanced features to meet our customers' needs, including advanced traffic engineering support of intelligent QoS, Service OAM capabilities, multiple access technologies, standards based routing protocols, Internet access across a single physical connection, support for IPv6, carrier grade Ethernet, and up to 40Gb/100Gb Ethernet access. Driven by continued high-bandwidth demands from our high-speed Internet service, next-generation television service, wireless backhaul, and other retail and wholesale business requirements, in 2013 we continued to expand our next-generation packet-optical transport network. This next-generation platform combines WDM transport, ROADMs, SONET/SDH ADMs, and centralized carrier Ethernet switching in a single converged device allowing us to meet the growing bandwidth needs at an affordable price while accommodating traditional SONET-based services for transition from our legacy services. Additional new packet-optical nodes were deployed in the State in 2013, resulting in packet-optical nodes deployed throughout the State on all six major islands. Our current backbone infrastructure consists of two border routers with diverse trans-Pacific links to mainland carriers, 19 Frame Relay switches and 12 asynchronous transfer mode (ATM) switches. There are also 1,000 Synchronous Optical Network (SONET) rings in service.

Our telecommunication infrastructure includes more than 15,000 sheath miles of fiber optic cable and copper wire distribution lines. Submarine and deep-sea fiber optic cables connect the islands of Kauai, Oahu, Maui, Molokai, Lanai and Hawaii, while digital microwave radios provides additional inter-island connections. In addition to our owned or leased interisland cables between Oahu, Kauai, Maui, Hawaii, Molokai, and Lanai, we are connected by trans-Pacific fiber optic cables between the Hawaiian islands and to the U.S. Mainland which provide ring diversity to protect our communications between the islands and high-speed broadband links in and out of the State.

*Voice Network*

We continue to add services and features via our VoIP application servers to provide Hawaii businesses the communication tools they need to compete locally and globally. New services such as Hosted PBX were introduced to our business customers in 2012, thereby expanding our Business All-in-One (BAiO) offering to customers with the need for a larger-scale solution.

As of March 1, 2014, we owned 107 local base and remote switches and five tandem switches serving approximately 364,600 total lines on the islands of Hawaii, Kauai, Lanai, Maui, Molokai and Oahu. All of our access lines are served by digital switches provided predominantly by Alcatel-Lucent and Genband. Since 2002, we have updated our infrastructure to meet the technological needs of our customers. Our switches on every island are linked through a combination of extensive aerial, underground and undersea cable, as well as microwave facilities, allowing us to provide our services to customers in a very challenging geographical territory. Our signal transfer points (STPs) are next-generation IP router based, ensuring a smooth migration to IP.

*Access Infrastructure*

We continue our aggressive investment to transform our access network to a high-speed, fiber-based broadband network and added 55,000 households to our next-generation broadband network in 2013. In 2013, we accelerated deployment of fiber-to-the-premise (FTTP) solutions to serve new (greenfield) multi-dwelling unit (MDU) and single-family subdivision developments. By laying fiber and utilizing various passive optical network components from these developments to our central offices, we can further leverage the capabilities of our MPLS backbone, provide higher bandwidth services to our customers, including our television service, and reduce maintenance costs. We also continued to expand

Table of Contents

our fiber network deeper into neighborhoods, shortening over 28,300 customer loops in 2013 to 3,000 feet or less using FTTN technology and expanded our fiber networks to approximately 289 cell sites across the state of Hawaii to provide backhaul services to our wireless carrier customers. These network enhancements allowed the increased penetration and expansion of higher broadband services including our television service.

*Next-Generation Television Service*

The implementation of IP-based television service is driving one of the largest network transformations in the telecommunications industry. We introduced our next-generation television service on the island of Oahu in July 2011, deploying the service to both copper-fed and fiber-fed customers and converting entire MDU complexes to our new service. Utilizing Microsoft® Mediaroom middleware, we provide a wide range of content and multimedia services over our IP-based network and provide our customers with new viewing experiences and applications. We continue to see strong demand for our television service as we expand our footprint to additional areas on the island of Oahu.

*Network Surveillance and Operations*

Our statewide network infrastructure is monitored and managed by our world-class Network Operations Center (NOC) located in Honolulu. The NOC provides surveillance 24x7, 365 days a year, for our statewide network consisting of 86 central offices, associated interoffice facilities, and microwave radio towers. Our network infrastructure for voice, data, and video is monitored proactively with state-of-the-art performance and fault management systems. Customer networks are also monitored proactively in the NOC upon request. We have a customer service center which also operates on a 24x7, 365 days a year basis to handle customer inquiries and repairs, and provide call completion services. All customer installations and repairs requiring a field technician are offered during extended hours and coordinated by our Dispatch Center. All construction activity, for both outside and inside plant, is coordinated by our engineering operations team located at our main office on Oahu.

In addition to our network infrastructure, we operate a wide range of equipment from large boom trucks to small passenger vehicles, mobile generators, and other miscellaneous trailers, tools and test equipment. We own or lease most of our administrative and maintenance facilities, central offices, remote switching platforms, and transport and distribution network facilities. Our assets are located primarily in the state of Hawaii.

**Information Technology and Support Systems**

A number of IT-related initiatives, beginning in 2010 and continuing to the present, are aimed at delivering advanced technologies to our customers as well as delivering a superior customer service experience. Our systems have evolved and we continue to focus our strategy towards customer-centric architectures. This approach focuses on delivering end-to-end system solutions based on customer improvement initiatives integrated into product development. The service delivery mechanisms are comprised of a mixture of commercial off-the-shelf systems, internally-designed and developed systems purpose built for functions such as inventory and network activation, and select niche applications that offer optimal capabilities and flexibility at the network layer.

As part of our ongoing commitment to customer service, we implemented improvements in 2013 to our website that include new online billing features and a redesigned residential web portal, and enhanced customer interaction by introducing a web chat feature for communicating with our customer contact center. We are planning improvements to our customer contact center systems to further improve the customer experience. In addition, we improved our service qualification systems in 2013

Table of Contents

and intend to provide our sales force with new system capabilities in 2014 in support of our next-generation network.

We continue to focus efforts on flow-through automation from order entry through billing, and in 2013 we implemented improvements which reduced manual processing of complex orders, increased productivity, and enhanced overall data quality. We plan to make further improvements in 2014 through consolidation of order entry process and systems. We improved our field dispatch systems in 2013 to increase dispatch efficiency, and we plan to make further improvements in 2014 in our fiber-based systems to support our next-generation network.

To improve the cost and efficiency of our internal IT services, we are continuing the process of consolidating our two data centers and implementing a state-of-the-art virtualization platform to support our growing computing needs. This effort has lowered the operating costs and energy consumption at our data centers and improved the efficiency, scalability, and reliability of our operations. We expect to complete the data center consolidation process in 2014.

We have aggressively pursued initiatives to reduce our cyber security-related risks. In 2013, we continued to expand the scope of our most advanced security controls and deployed additional controls into key areas of our network. We continue to make technology and resource investments to improve further our security posture in critical areas. These and other changes reflect our on-going commitment to securing our information assets and protecting sensitive data held and carried by our information systems.

As is the case with other telecommunications companies, we are an on-going target for cyber criminals. However, there were no noteworthy cyber security incidents during 2013. Our information security team continues to work closely with law enforcement at the federal, state and local levels, and we adjust our protection schemes as necessary. We remain committed to invest appropriately in initiatives that reduce our cyber security risk.

In addition to our cyber security efforts in the Company and in the State of Hawaii, we have participated in the national effort to secure cyberspace. Our security personnel have attended working sessions facilitated by the National Institute of Standards and Technology (NIST) to develop the cyber security framework that is mandated in President Obama's Executive Order 13636. We also are an active member of US Telecom Association's cyber security working group and participate in the activities of the FCC's Communications Security, Reliability and Interoperability Council (CSRIC). The mission of CSRIC is to provide recommendations to the FCC to ensure, among other things, optimal security and reliability of communications systems, including telecommunications, media, and public safety.

**Employees**

As of March 1, 2014, we employed approximately 1,400 full-time employees in Hawaii. Of the total employees, 55% were represented by the International Brotherhood of Electrical Workers (IBEW) Local 1357. In January 1, 2013, a new five-year collective bargaining agreement with IBEW Local 1357 went into effect. We believe that management currently has a constructive relationship with the represented and non-represented employee group.

**Insurance**

We have insurance to cover risks incurred in the ordinary course of business, including errors and omissions, general liability, property coverage (which includes business interruption), director and officers and employment practices liability, auto, crime, fiduciary and worker's compensation insurance in amounts typical of similar operators in our industry and with reputable insurance providers. Central office equipment, buildings, furniture and fixtures and certain operating and other equipment are



Table of Contents

insured under a blanket property insurance program. This program provides substantial coverage against "all risks" of loss including fire, windstorm, flood, earthquake, and other perils not specifically excluded by the terms of the policies. As is typical in the telecommunications industry, we are self-insured for damage or loss to certain of our transmission facilities, including our buried, undersea and above-ground transmission lines. We believe that our insurance coverage is adequate; however, if we become subject to substantial uninsured liabilities due to damage or loss to such facilities, our financial results may be adversely affected.

**Regulation**

*Federal and State Regulation of Telecommunications Services*

Our telephone operations generally are subject to the jurisdiction of the FCC with respect to interstate services and the HPUC with respect to intrastate services. The following summary does not purport to describe all current and proposed applicable federal and state regulation.

*Competition*

We face increasing competition in all areas of our business. Regulatory changes brought on by the 1996 amendments to the Communications Act, regulatory and judicial actions, and the development of new technologies, products and services have created opportunities for alternative telecommunication service providers, many of which are subject to fewer regulatory constraints than our ILEC. We are unable to predict definitively the impact that the ongoing changes in the telecommunications industry will ultimately have on our business, results of operations or financial condition. The financial impact will depend on several factors, including the timing, extent and success of competition in our markets, the timing and outcome of various regulatory proceedings and any appeals, the timing, extent and success of our pursuit of new opportunities resulting from the amendments to the Communications Act and technological advances, and any changes in the state or federal laws or regulations governing communications.

*Universal Service*

As a provider of interstate telecommunications, we are required to contribute to federal universal service programs. The FCC adjusts the contribution amount quarterly and may increase or decrease this amount depending on demand for support and the total base of contributors. Pending proposals to change the contribution methodology could increase or reduce our total obligation to this funding. We also draw Interstate Access Support from this funding, which is frozen and subject to phase out, as further described below.

On December 31, 2007, we filed a petition with the FCC requesting a waiver to determine our eligibility to receive federal high-cost loop support according to our average line costs per wire center instead of our statewide average line costs. In Order and Further Notice of Proposed Rulemaking WC Docket No. 10-90, FCC 11-161, which was released on November 18, 2011, the FCC denied our petition on the grounds that the reforms adopted in the Order could provide the relief we had sought in our waiver petition, and to the extent they did not, we could seek additional targeted support through a request for waiver of the new rules.

In November 2011, the FCC released its "Connect America Fund" Order which adopted a number of proposals relating to reforming existing universal service support mechanisms. Among other things, the Order transforms the FCC's universal service and intercarrier compensation systems into a new Connect America Fund ("CAF"), which will fund broadband deployment in areas unserved by an unsubsidized wireline competitor and eventually will replace all existing high-cost support for voice services. For price cap carriers such as our subsidiary Hawaiian Telcom, Inc., CAF support first will be distributed pursuant to a forward-looking cost model to carriers that make a state-wide commitment to

Table of Contents

meet minimum broadband deployment obligations established by the FCC. If the price cap carrier declines to make that commitment, CAF support will be distributed in accordance with competitive bidding open to all eligible carriers. In the interim, until the CAF is fully operational, a price cap carrier's Interstate Access Support will be frozen at current levels, but continued receipt of such funds is conditioned on the carrier meeting FCC broadband deployment obligations including speed and other technical parameters of service. In addition, the FCC will make an additional \$300 million in CAF funding available to price cap carriers willing to commit to meeting these broadband public interest requirements. A number of details, such as the makeup and results of the cost model used to determine support levels, are still to be developed. In addition, a number of petitions for reconsideration of the FCC's Order, as well as multiple appeals, have been filed. The FCC awarded Hawaiian Telcom, Inc. approximately \$402,000 in CAF Phase I Round 1 support and approximately \$1 million in CAF Phase I Round 2 support. We do not know when the CAF proceeding will be concluded, how the FCC will implement the programs, or how accurate the CAF Phase II cost model will be, and therefore do not know how this proceeding ultimately will impact our universal service support level or the outcome or timing of the petitions or appeals.

***Government Regulation of Retail Rates***

The FCC and the HPUC are the two agencies that regulate our telecommunications services. In general, the FCC regulates interstate service, and the HPUC regulates intrastate service. The HPUC has, slowly over time, reduced its rate regulation of some of our services. The HPUC classifies all regulated telecommunications services as fully competitive, partially competitive, or non-competitive.

In 2009, the Hawaii State Legislature passed Act 180, which it clarified with an amendment in 2010 (Act 8). As amended, Act 180 requires that the HPUC treat all intrastate retail telecommunications services, including intrastate toll (i.e., inter-island), central exchange (Centrex), most residential and business local exchange services, integrated service digital network (ISDN) private lines and special assemblies, and directory assistance, as "fully competitive" under the HPUC's rules with certain qualifications. In addition, HPUC approval and cost support filings are no longer required to establish or reduce rates or to bundle service offerings; however, all service offerings must be priced above the service's long-run incremental cost, and the HPUC can require us to provide such cost support demonstrating compliance with its costing rules at any time. If the HPUC is not satisfied, it retains the ability to investigate the offering and to suspend the offering pending the outcome of its investigation. In addition, HPUC approval is required in order to increase the rate for a service to a level that is greater than the rate for the retail service in the tariff at the time of implementation of either Act 180 or Act 8, whichever is applicable. In 2012, the Hawaii State Legislature passed Act 74, which further leveled the regulatory playing field in intrastate retail telecommunications services by providing us with pricing flexibility to increase rates higher than the above-mentioned appropriate tariffed rate for any retail telecommunications service except basic exchange service without approval from the HPUC. HPUC approval still is required to increase rates for basic exchange service (i.e., single-line residential and single-line business services). Competitive forces, however, may cause us to be unable to raise our local rates in the future.

The classification of retail local exchange intrastate services as fully competitive and the ability to bundle the services with other fully or partially competitive services or other services that are not within the HPUC's jurisdiction enable us to charge a discounted rate for bundled service offerings and have helped us to be more competitive. Pricing flexibility has allowed us to increase the monthly charge for non-published numbers.

***State and Federal Regulation of Long Distance Services***

We are subject to certain conditions imposed by the HPUC and the FCC on the manner in which we conduct our long distance operations. For example, we are prohibited from joint ownership of local

Table of Contents

and long-distance telephone transmission or switching facilities. The HPUC is responsible for ensuring that our ILEC does not discriminate against other long distance providers.

***Federal Requirements***

As an ILEC, we are subject to a number of access and interconnection requirements under federal law. Among other things, an ILEC must negotiate in good faith with other carriers requesting interconnection and access to UNEs and must offer its competitors access to UNEs, such as local loops and inter-office transport, at regulated rates. However, we are no longer required to provide our competitors with access to switching UNEs, or the combination of loop, transport and switching UNEs known as the UNE Platform (UNE-P). The FCC also has limited our obligation to unbundle fiber facilities to multiple dwelling units, such as apartment buildings, and to homes and offices deployed in fiber-to-the-curb and fiber-to-the-premises arrangements. In addition, federal law regulates competitors' requests to colocate facilities within our central offices and to have access to our subscriber list information in order to produce competing directories, and other matters, including the manner in which we must protect our customers' information. The FCC currently is examining its pricing standard for UNEs and may modify other aspects of its UNE rules as market conditions change. The FCC also has imposed specific rules regarding the manner and time within which a customer's telephone number must be ported to a competing carrier's service.

***Interstate and Intrastate Access Charges***

The rates that we can charge for interstate access are regulated by the FCC. The FCC has made various reforms to the existing rate structure for access charges, which, combined with the development of competition, have generally caused the aggregate amount of access charges paid by long-distance carriers to decrease over time. For example, the FCC has instituted caps on the per-minute rate we can charge for our switched access services as well as on our monthly subscriber line charges (SLCs). The FCC has adopted rules for special access services that provide for pricing flexibility and ultimately the removal of services from price regulation when prescribed competitive thresholds are met. We currently have pricing flexibility for certain special access services offered throughout our territory. On May 18, 2008, the FCC granted our request for pricing flexibility for certain special access services offered on the neighbor islands. We also have pricing flexibility for certain special access services offered on Oahu. On December 18, 2012, the FCC released an order establishing mandatory data collection for price cap carriers such as Hawaiian Telcom, Inc. If approved by the Office of Management and Budget, the data collection will seek detailed information concerning carrier services provided to enterprise and wholesale customers, including special access services. The FCC also will seek comment on a proposal for using the data collected to evaluate competition in the market for special access services. This review is being conducted to help the FCC decide whether to modify the special access pricing rules for price cap carriers, including whether the pricing flexibility rules should be modified or eliminated. We do not know when this proceeding will be concluded or what impact it will have on price cap carriers.

Our intrastate access rates are set forth in an interim tariff approved by the HPUC in 1995 and are based on our embedded costs. Although it has been the HPUC's intention to initiate a proceeding to adopt permanent access rates based on a forward-looking cost methodology, the HPUC has not yet initiated a proceeding to do so.

Our interstate and intrastate access charge levels will be fundamentally affected by the FCC's reform of intercarrier compensation, described below.

***Federal Framework for Intercarrier Compensation***

In its "Connect America Fund" Order (see " *Universal Service*" above) that reformed universal service, the FCC also fundamentally restructured the regulatory regime for intercarrier compensation.

Table of Contents

Intercarrier compensation consists of state and interstate access charges and local reciprocal compensation. Among other things, this comprehensive reform unifies state and interstate intercarrier charges in certain circumstances, provides a mechanism to replace intercarrier revenues lost through rate unification, and resolves prospectively a number of outstanding disputes among carriers regarding interconnection and compensation obligations. In particular, the FCC required that most intercarrier compensation be eliminated, and that a system of "bill & keep" replace it whereby the carrier would have to seek recovery of its costs entirely from its own end users. In the interim, the FCC capped most existing intercarrier compensation rates and established a phase-down of those rates over a six-year period for price cap companies such as Hawaiian Telcom, Inc. To partially offset the resulting decrease in revenues, the Commission authorized carriers (1) to assess its end user customers a limited recovery charge that would increase over time as intercarrier compensation rates decline, and (2) to receive CAF support in limited amounts subject to specific requirements, to be phased out over a three-year period beginning in 2017. Hawaiian Telcom, Inc. does not receive any such intercarrier compensation CAF support. Finally, the FCC decided that interstate access charges should apply to VoIP or other Internet protocol-based service providers on a prospective basis, subject to the same interim phase-down requirements described above. The FCC found that carriers should have the opportunity to make up for any loss of revenues either through the established recovery mechanisms or through the sale of additional services, such as broadband and television services. A number of petitions for reconsideration of the FCC's order, as well as multiple court appeals, have been filed. In July 2012, Hawaiian Telcom, Inc. implemented the first phase of the intercarrier compensation reform, including reducing by fifty percent the amount by which intrastate terminating switched access rates exceed interstate rates, and offsetting most of the resulting revenue loss by implementing a monthly recurring access recovery charge for certain classes of customers. In July 2013, Hawaiian Telcom, Inc. implemented the second phase of the intercarrier compensation reform, including reducing intrastate terminating switched access rates to interstate rates, and offsetting a portion of the resulting revenue loss by implementing a monthly recurring access recovery charge for certain classes of customers. The intercarrier compensation portion of the FCC's order is also subject to a number of petitions for reconsideration and court appeals. We do not know the timing or outcome of such petitions or appeals.

The FCC has found that Internet-bound traffic is not subject to reciprocal compensation under Section 251(b)(5) of the Communications Act. Instead, the FCC established a federal rate cap for this traffic, which is and will remain \$0.0007 per minute until the FCC decides otherwise.

***Federal Regulatory Classification of Broadband and Internet Services***

The FCC has been considering whether, and under what circumstances, services that employ Internet protocol are "telecommunications services" subject to regulations that apply to other telecommunications services, but it has not definitively ruled on the issue and instead has made a series of decisions addressing specific services and regulations. For example, some VoIP providers must comply with the federal wiretap law and with FCC requirements to provide enhanced 911 emergency calling capabilities, ensure disability access and provide local number portability. Certain VoIP providers are exempt from state telecommunications market entry regulation. As a result, our VoIP competitors are less regulated than we are.

In September 2005, the FCC ruled that ILECs like ours may offer dedicated broadband Internet access service as an information service. As a result, we are no longer required to offer the underlying broadband transmission capacity used to provide our HSI service on a tariffed, common carrier basis to competing Internet Service Providers (ISPs). This decision gives us greater flexibility in how we offer and price such transmission capacity. It also puts us on more even footing with our cable competitors in the broadband market since the FCC had previously held that high-speed Internet access service delivered using cable television facilities constitutes an information service not subject to common carrier regulations, a determination that was upheld by the United States Supreme Court.

Table of Contents

In March 2006, a request of Verizon that sought forbearance from Title II regulation for certain specified advanced broadband special access services was deemed granted by operation of law. This forbearance grant was applicable to us since Hawaiian Telcom Communications, Inc. was part of Verizon when the original Verizon petition for forbearance was filed. This action permits us to deregulate covered advanced broadband special access services, giving us greater flexibility in our pricing and terms and conditions of offering. In October 2011, tw telecom of hawaii l.p. and others filed a petition requesting the FCC to reverse in part the forbearance deemed granted to Verizon by operation of law. We filed comments in opposition to the petition. In November 2012, the Ad Hoc Telecommunications Users Committee and others filed a petition requesting the FCC to reverse in part the forbearance for Verizon and other grants of forbearance by the FCC related to advanced broadband special access services. There is no definite timeframe for an FCC decision on these petitions.

In February 2009, Congress enacted a law that required the FCC to establish a national broadband plan to promote broadband service availability to all Americans. This plan was released by the FCC in March 2010 and contained recommendations on how to promote the provision of broadband in unserved and underserved areas of the country, including an increase in the speed at which current customers can obtain broadband services. It also addressed how to increase the adoption of broadband services by those consumers who currently do not have access to those services. The FCC announced that there will be additional rulemakings to implement the recommendations of the plan. The comprehensive reforms to universal service and intercarrier compensation detailed earlier in this section were a partial response to that plan. It is not known how the broadband plan will impact our business operations given that not all of the proposed actions have been taken.

In December 2010, the FCC adopted "net neutrality" rules, termed "open Internet" rules, that would bar Internet service providers from blocking or slowing Web content sent to homes and businesses. The rules continue to treat broadband Internet access services under the FCC's Title I authority, but adopted as rules the existing guidelines applicable to Internet service providers. The FCC also adopted three additional rules concerning blocking, non-discrimination, and transparency. The no-blocking rule prohibits a fixed broadband Internet access service provider from blocking lawful content, applications, services, or devices, subject to reasonable network management. The anti-discrimination rule prohibits a fixed broadband Internet access service provider from unreasonably discriminating in the transmission of lawful network traffic over a consumer's broadband Internet access services, subject to reasonable network management. Wireless broadband providers are not subject to these two rules, but only to a scaled-back version of the no-blocking rule applicable to fixed providers. The transparency rule requires all Internet access service providers to disclose publicly accurate information regarding their network management practices, performance, and commercial terms of service so that consumers are able to make informed choices and device providers are able to develop, market, and maintain Internet offerings. The anti-discrimination and no-blocking rules were recently vacated by a federal court of appeals, but the public disclosure requirement remains in place. We do not know how the FCC will respond to this court decision.

***Video Services Regulation***

Through our Hawaiian Telcom Services Company, Inc. subsidiary, we began to provide television service on the island of Oahu in July 2011. We are regulated as a cable TV operator under federal and state law. As the non-dominant video service provider in the state of Hawaii, we face the risk that we will be unable to obtain access to programming that we need in order to compete with Oceanic Time Warner (Oceanic), the dominant cable TV provider on the island. Some of this programming is owned by the parent company of Oceanic, which may or may not be required to provide access to us under the FCC's program access rules.

Table of Contents

In December 2011, Oceanic filed a petition with the FCC seeking to be declared free from rate regulation for its basic cable TV services on Oahu. The state of Hawaii opposed Oceanic's petition. If the petition is granted, Oceanic would have more flexibility to raise or lower prices for its services and become more competitively nimble. We do not know when the FCC will act on the petition or whether the petition will be granted.

In October 2012, the FCC issued an order lifting the program access rule ban on exclusive contracts between any cable operator and any cable-affiliated programming vendor. It also issued a separate notice seeking comment on whether (1) to establish a rebuttable presumption that an exclusive contract for a cable-affiliated Regional Sports Network (RSN) is an unfair act; (2) it should establish a standstill provision during an RSN-related complaint; and (3) the presumptions for RSNs should be extended to a cable-affiliated national sports network. The FCC found a preemptive prohibition on exclusive contracts is no longer necessary and that a case-by-case process will remain in place to assess the impact of individual exclusive contracts. The FCC order provides a 45-day answer period for all complaints and a six-month deadline for it to act on a complaint alleging a denial of programming. The order also incorporates safeguards regarding RSNs, by establishing a rebuttable presumption that an exclusive contract involving a cable-affiliated RSN has the "purpose or effect" of "significantly hindering or preventing" the complainant from providing television services, placing the burden of proof on the distributor.

In December 2012, the FCC granted a complaint filed by the Mauna Kea Broadcasting Company with the FCC seeking to place its over-the-air broadcasting station KLEI-TV on both Oceanic's and our television systems. The order required us to place KLEI-TV on channel 6, which is already occupied by another programming station. Both Oceanic and Hawaiian Telcom Services Company, Inc. have filed a petition for reconsideration of this decision, which effectively stays the mandate of the order until all appeals are resolved. We cannot predict when or how the FCC will resolve this petition.

***Other Federal and State Regulatory Proceedings***

The FCC has been exploring whether to modify its rules requiring utilities to provide telecommunications carriers and cable television companies with access to their poles, ducts, and rights of way. In April 2010, the FCC adopted new pole attachment rules that, among other things, require access to poles and conduit within a shorter period of time, and further limit make ready costs. In addition, these new rules change the rates for pole attachments by mandating that broadband attachers pay pole attachment rates that are closer to existing cable TV rates, than higher rates applicable to telecommunications carriers. These rules also for the first time allow telephone companies to demand reasonable rates from utility pole owners. These rules tend to increase the burdens and costs of pole and conduit owners such as us. The rules were upheld on appeal in February 2013.

In May 2011, the HPUC closed a proceeding it had opened in October 2006 to examine our service quality and performance levels and standards in relation to our wholesale and retail customers. In closing the proceeding, the HPUC adopted stipulations entered into by the parties to the proceeding in which (i) the parties agreed there were no outstanding issues that needed to be addressed by the HPUC and that the proceeding could be closed without further HPUC action, and (ii) we and tw telecom of hawaii l.p. agreed to work collaboratively to address or resolve informally certain identified service-related and reporting issues between the two companies. In addition, pursuant to the HPUC order closing the proceeding, all periodic service quality reports required in connection with the proceeding were discontinued by July 2012.

In October 2012, the FCC approved a deal between Verizon Wireless and the cable company owners of SpectrumCo, which allows joint marketing agreements between Verizon Wireless and these cable companies to cross-sell each other's services. In Hawaii, Verizon Wireless and Oceanic Time Warner began their joint marketing efforts in October 2012.

Table of Contents

In December 2012, the FCC and the HPUC approved the transfer of licenses and facilities from Wavecom Solutions Corporation (Wavecom) to Hawaiian Telcom, Inc. in connection with Hawaiian Telcom, Inc.'s acquisition of Wavecom. In connection with these approvals, Hawaiian Telcom, Inc. agreed to freeze for seven years certain enterprise customer prices in twelve specific buildings in Hawaii where both Hawaiian Telcom, Inc. and Wavecom owned telecommunications facilities, but subject to exemptions including an exemption for a building if two other fiber-based facilities carriers provided facilities to that building. In addition, Hawaiian Telcom, Inc. agreed that, until Wavecom's transport facilities are transferred to other subsidiaries of the Company, if Hawaiian Telcom, Inc. uses the Wavecom transport facilities to provide its own retail services, it will make available such facilities to competitors if capacity is not available in existing facilities or in other specified circumstances. These conditions potentially could impact our revenues, but the impact is not expected to affect financial performance materially.

***Environmental, Health and Safety Regulations***

We are subject to various environmental, health and safety laws and regulations that govern our operations and may adversely affect our costs. Some of our properties use, or may have used in the past, on-site facilities or underground storage tanks for the storage of hazardous materials that could create the potential for the release of hazardous substances or contamination of the environment. We cannot predict with any certainty our future capital expenditure requirements for environmental regulatory compliance, although we have not currently identified any of our facilities as requiring major expenditures for environmental remediation or to achieve compliance with environmental regulations.

**Business Transactions**

***Agreement Relating to IT Support Services***

We executed an Amended and Restated Master Application Services Agreement with Accenture effective as of March 2009 for long-term IT support services. Pursuant to this agreement, Accenture provides us with certain application maintenance services that provide 24x7 support for critical applications such as for order capture, workflow, network inventory and billing. The agreement also provides queue and data management services that deal with resolution of order fallout issues, telephone number management issues, and manual billing needs, as well as major enhancement services allow us to request major enhancements to our applications through specific statements of work. The services provided by Accenture pursuant to the agreement assist us in our continuing efforts to enhance our back-office systems and IT infrastructure with the objective of continuing to improve and expand our customer services and streamline our operations. The term of the agreement has been extended to April 2017.

***Intellectual Property Agreements***

Although the merger agreement for the 2005 Acquisition contains several provisions relating to the disposition of intellectual property assets related to our business, such as an obligation of GTE to use commercially reasonable efforts from signing of the merger agreement through May 2, 2006 to obtain for us the right to use all third-party network element software that is installed on our network elements in Hawaii, our ownership, rights and licenses of intellectual property are generally established under an Intellectual Property Agreement and Verizon Proprietary Software License Agreement entered into with GTE on May 2, 2005.

Pursuant to the Intellectual Property Agreement, we acquired certain trademarks and trade names that relate to our business, although the majority of the marks and names that were used in the business before the 2005 Acquisition were retained by Verizon and GTE, which required us to undertake a re-branding process. We also acquired (a) the copyrights to 41 specified phone books and compilation copyrights to all of the white page, yellow page and other telephone print directory

Table of Contents

products published by Verizon's Hawaii Business for use by its customers (subject to a license back to GTE in such copyrights), (b) all customer proprietary network information (other than subscriber list information) that relates solely to customers of Verizon's Hawaii Business and (c) a joint ownership interest (with GTE) in the other non-technical proprietary business information relating to Verizon's Hawaii Business. In addition, under the Intellectual Property Agreement we are licensing from GTE all other intellectual property used in the business (other than trademarks, third-party intellectual property and Verizon proprietary software).

Pursuant to the Verizon Proprietary Software License Agreement with GTE, we have nonexclusive, perpetual, internal-use only licenses to use certain Verizon proprietary software (including object and source code) that was used by Verizon in connection with Verizon's Hawaii Business. The software licensed to us consists of numerous back-office systems that were used in various operations of Verizon's Hawaii Business. The software includes, among other things, the assignment, activation and inventory system (AAIS); an automated workforce administration system (AWAS); an FTTP and HSI loop qualification system (LQP); and data exchange utility and connection engine systems (DEU/DEUCE). In addition, Verizon's AIN Service Logic programs are licensed to us perpetually pursuant to the Verizon Proprietary AIN Software License Agreement, entered into in May 2005.

***Agreements Relating to Directories Publishing***

In November 2007, we completed the sale of our directories publishing business to HYP Media Holdings LLC ("HYP Holdings"), a wholly-owned subsidiary of CBD Investor, Inc. ("CBD"). The sale was made pursuant to the Purchase Agreement dated as of April 29, 2007 among Hawaiian Telcom Communications, Inc., Hawaiian Telcom Services Company, Inc. and HYP Holdings as assignee of CBD, for a cash purchase price of \$435.0 million plus certain adjustments related to working capital. In connection with the sale, we transferred the copyrights to our phone books (including those acquired from GTE) to HYP Media LLC, a wholly-owned subsidiary of HYP Holdings, and licensed to HYP Media LLC the right to use several of our trademarks in connection with certain of its directory products. We also entered into continuing commercial arrangements with HYP Media LLC relating to the directory publishing business, including but not limited to a 50-year publishing agreement pursuant to which HYP Media LLC will serve as the exclusive official publisher of telephone directories on behalf of Hawaiian Telcom, Inc. Under this agreement, HYP Media LLC will publish both white and yellow pages print directories under the *Hawaiian Telcom*® brand. Also as part of this transaction, HYP Media LLC assumed our rights and obligations under our directory services agreement with L.M. Berry and Company, a subsidiary of AT&T. In April 2008, The Berry Company LLC, an affiliate of HYP Media LLC, acquired substantially all the assets of L.M. Berry and Company's Independent Line of Business, including the directory services agreement. In July 2008, HYP Media LLC assigned all its rights under the directory services agreement to HYP Media Finance LLC, an indirect, wholly owned subsidiary of HYP Media LLC. Under the directory services agreement, The Berry Company LLC (as assignee of L.M. Berry and Company), on behalf of HYP Media Finance LLC, is responsible for selling advertising in the Hawaiian Telcom, Inc. print directories as well as for the publication, printing and distribution of the print directories.

***Agreement Relating to Procurement and Logistics***

We entered into a Supply Chain Services Agreement with KGP Logistics, Inc. ("KGP") dated December 7, 2009, pursuant to which KGP provides us with a variety of telecommunications products and handles the logistics with respect to such products, including procurement, shipping, warranty returns and related services such as testing. We have the ability to purchase a significant portion of our telecommunications equipment from KGP under the agreement. The agreement is non-exclusive and has no minimum purchase requirements. The agreement also contains benchmarking and most-favored-customer provisions that enable us to receive pricing that is roughly equivalent to prices generally available to similarly situated customers in the telecommunications industry. The initial term of the



Table of Contents

agreement was until December 7, 2011, with the option to extend the agreement for up to three renewal terms of one year each. We may terminate the agreement for convenience at any time upon 180 days' notice to KGP.

***Agreements Relating to our Wireless Business***

*Sprint Wireless Agreement*

We entered into a Private Label PCS Services Agreement with Sprint, dated as of May 8, 2009, by which we purchase wireless telephone and data services from Sprint and resell those services to our own end users under the *Hawaiian Telcom*® brand name. This agreement allows us to buy airtime from Sprint at wholesale rates that decline with volume. We recently renewed the agreement for a one-year term expiring in May 2015.

*Other Agreements*

We have contracts with other parties that provide the equipment and other services that are necessary to our wireless business. In August 2007, we entered into a Non-Exclusive License and Servicing Agreement with Qualution Systems Inc. to utilize its Catalyst customer relations management software application suite, for which we pay a flat monthly fee. The agreement is renewable for additional one-year terms. We purchase our wireless handsets and related equipment through agreements with WSA Distributing Inc. and Aerovoice that have no specific terms or minimum purchase requirements.

**Available Information**

We make available, through the Investor Relations link on our website at [www.hawaiiantel.com](http://www.hawaiiantel.com), under "SEC Filings," our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports, free of charge as soon as reasonably practicable after we electronically file or furnish them to the U.S. Securities and Exchange Commission. The charters for the committees of our Board of Directors (Audit, Compensation, Executive, and Nominating and Governance Committees), as well as our Code of Business Conduct and any amendments and waivers thereto, also can be found on the Investor Relations site, under "Corporate Governance." The contents of our website are not incorporated into this Annual Report on Form 10-K.

**Item 1A. Risk Factors**

*You should carefully consider the risks described below as well as the other information contained in this Registration Statement. The risks described below are not the only risks facing us. Any of the following risks could materially adversely affect our business, financial condition or results of operations.*

**Risks Relating to our Business**

Our business faces a variety of financial, operating and market risks, including the following:

***Failures in our critical back-office systems and IT infrastructure or a breach of our cyber security systems could have a material adverse effect on our business and operations.***

We operate our own back-office and IT infrastructure, including business processes, software applications (such as billing systems, corporate finance systems, human resources and payroll systems and customer relationship management systems), and hardware that are vital to our operations. If we experience problems with our back-office and IT infrastructure, our business and financial results could be adversely impacted.

In addition, we are subject to cyber security risks primarily related to breaches of security pertaining to sensitive customer, employee, and vendor information maintained by us in the normal

Table of Contents

course of business, as well as breaches in the technology that supports our communications network and other business processes. This risk may be heightened as we expand our managed services, data center services, and cloud-based services. While we have technology and information security processes and disaster recovery plans in place to mitigate these risks, there is no assurance these measures will be adequate to ensure that our operations will not be disrupted. A loss of confidential or proprietary data or security breaches of other technology business tools could adversely affect our reputation, diminish customer confidence, disrupt operations, and subject us to possible financial liability, any of which could have a material adverse effect on the Company's financial condition and results of operations and our ability to expand our managed services, data center services, and cloud-based services.

***We have made and expect to continue to make a significant amount of capital expenditures in connection with improvements to our network and other facilities.***

We have made and expect to continue to make a significant amount of capital expenditures to, among other things, enhance the capabilities of our network, enhance the functionality of our existing IT systems, and support the deployment of new products and services. We intend to fund these capital expenditures and expenses with operating cash flows and funds available to us under our credit facilities. If the amount of capital expenditures and expenses required to upgrade our network and other facilities exceeds those contemplated by our current business plan, our cash flows and available financing may be insufficient to fund such capital expenditures and expenses and to provide us with the liquidity that we otherwise would require.

***We rely on several material agreements to operate our business. The loss of certain of these agreements, or the failure of any third party to perform under certain of these agreements, could have a material adverse effect on our business.***

Several critical services necessary to operate our business are provided by third-party service providers. For example, we have entered into agreements with Accenture and other third parties for the provision of, among other things, critical printing, billing, and IT services.

The expiration or termination of certain of our material agreements by third-party service providers could have a material adverse effect on our business. Upon expiration or termination of these agreements, we may not be able to replace the services provided to us in a timely manner or on terms and conditions, including service levels and cost, favorable to us. The failure of these third-party service providers to satisfy their obligations under their agreements with us could have a material adverse effect on our business. Additionally, if these third-party service providers were to seek U.S. bankruptcy law protection, our agreements with such service providers, and such service providers' ability to provide the services under those agreements, could be adversely impacted, and although we may have a claim for damages against the bankruptcy estate, the claim may or may not be paid in the bankruptcy proceeding.

***Our business is subject to extensive governmental regulation. Applicable legislation and regulations and changes to them could adversely affect our business.***

We operate in a heavily regulated industry, and most of our revenues come from the provision of services regulated by the FCC and the HPUC. Laws and regulations applicable to us and our competitors may be, and have been, challenged in the courts and could be changed by federal or state legislative initiative, judicial review or regulatory agencies at any time. We cannot predict the impact of future developments or changes to the regulatory environment or the impact such developments or changes would have on us.

The "Connect America Fund" Order adopted by the FCC in November 2011 comprehensively reformed both the universal service program and intercarrier compensation and could have a significant impact on us. See " *Universal Service*" above for a discussion of the impact of the Order on the

Table of Contents

universal service program, and " *Federal Framework for Intercarrier Compensation*" above for a discussion on the impact of the Order on intercarrier compensation. Until the rulemaking proceedings by the FCC are completed and the numerous court appeals and petitions for reconsideration of the FCC's Order are resolved, we cannot know the actual impact of the Order on us. Changes in other FCC policies under review also could have a significant impact on us by increasing our obligations and/or reducing our revenue.

State government regulation also is a source of business uncertainty. The HPUC has deferred several matters from earlier telecommunications proceedings which could be initiated in the future. We cannot predict whether state proceedings will be initiated or the possible outcome of such proceedings at this time.

***A reduction by the HPUC or the FCC of the rates we charge our customers would reduce our revenues and could reduce our earnings.***

The rates we charge our local telephone customers are based, in part, on a rate-of-return authorized by the HPUC on capital invested in our network. These authorized rates, as well as allowable investment and expenses, are subject to review and change by the HPUC at any time. If the HPUC orders us to reduce our rates, our revenues would be reduced and our earnings also could be reduced absent corresponding reductions in costs or growth in services. We cannot assure you that our rates will remain at their current levels. In connection with the HPUC Order approving the Plan of Reorganization, we agreed with the Division of Consumer Advocacy that we would not submit a rate case with a test year earlier than 2013, unless the HPUC determines that it would be in the public interest to waive this requirement. In addition, the HPUC order received in connection with the 2007 sale of our directories publishing business imposed a condition requiring the imputation of revenues. Specifically, a directory publishing revenue credit in the annual amount of \$42.6 million per year must be added as regulated revenues into the calculation of Hawaiian Telcom, Inc.'s earnings from 2008 to 2022 in all future rate cases, alternative form of regulation proceedings, or other proceedings before the HPUC investigating Hawaiian Telcom, Inc.'s earnings or financial performance. Such conditions may adversely affect our ability to obtain rate increases in the future.

Also, our local exchange service competitors may gain a competitive advantage based on rules which favor competitors. For example, competitors have the ability to purchase our services at discounted rates set by the HPUC and to resell them at rates that are not subject to the level of regulatory scrutiny generally faced by us. Additionally, as a result of the state regulators permitting our competitors to intervene in rate-setting proceedings, there is a potential that such competitors could obtain business sensitive information about us during such proceedings.

The FCC approves tariffs for interstate access and subscriber line charges, both of which are components of our network access revenue. The FCC currently is considering whether to restrain special access pricing by carriers like us subject to price caps on interstate rates. The "Connect America Fund" Order that the FCC adopted in November 2011 will reduce switched interstate access charges for carriers like us over a period of six years but allow us to recover some of the foregone revenue from our end users. It is possible we may be required to recover more revenue through subscriber line charges or forego this revenue altogether. This could reduce our revenue or impair our competitive position.

***The telecommunications industry is increasingly competitive, and we may have difficulty competing effectively.***

All sectors of the telecommunications industry are competitive. Competition in the markets in which we operate could:

reduce our customer base;

require us to lower prices charged customers in order to compete; or

Table of Contents

require us to increase marketing expenditures and the use of discounting and promotional campaigns.

Any of these factors could adversely affect our business.

*Wireline Services.* As the ILEC, we face competition from resellers, local providers who lease UNEs from us, from facilities-based providers of local telephone services, and from providers of VoIP services.

We have historically faced access line losses as a result of competition and substitution of traditional wireline services with wireless services. Access line losses have been faced by the industry as a whole, and we cannot assure you that access line losses will not continue in the future. In particular, the increasing penetration of high-speed Internet and VoIP could lead to further primary and secondary access line losses.

Interconnection duties are governed, in part, by telecommunications rules and regulations related to the UNEs that must be provided. These rules and regulations remain subject to ongoing modifications. Our business is subject to extensive governmental regulation, and applicable legislation and regulations and changes to them could adversely affect our business. However, we received some regulatory relief in 2009 when the Hawaii State Legislature passed Act 180, which classified retail local exchange intrastate services as fully competitive. While HPUC approval and cost support filings are no longer required to establish or modify rates or to bundle service offerings, HPUC approval is required to raise the rate that existed for the retail service in the tariff at the time of implementation of Act 180. In addition, while cellular wireless services initially complemented traditional local exchange and long distance services, existing and emerging wireless and IP technologies are increasingly competitive with local exchange and, particularly, long distance services in some or all of our service areas.

*Internet Services.* We expect that the Internet access services business will continue to be highly competitive due to the absence of significant barriers to entry. We currently compete with a number of established online services companies, inter-exchange carriers and cable companies. Competition is particularly intense for broadband services.

*Managed Services.* We face numerous competitors that vary based on the type of managed services being offered. Other network service providers provide some form of managed network service monitoring capability. Numerous voice and data equipment vendors provide management of the installed equipment either at an individual location or across multiple networked locations. Competitive managed IP and network security services are offered by various firms that specialize in this area.

*Data Center and Cloud-Based Services.* There currently is a limited inventory of colocation data center space available in Hawaii. However, there are numerous other providers of cloud-based software, including system integrators in Hawaii and web-based service providers, that offer software subscriptions and virtual machines on cloud-based servers housed in data centers on the U.S. mainland and internationally.

*Advanced Communications and Network Services.* These advanced services businesses are highly competitive. Many non-traditional players have emerged in the business communications market, attracted by the absence of significant barriers to entry. Many of these non-traditional players are capable of focusing on highly specialized areas of the market.

*Next-Generation Television Service.* We launched our television service on the island of Oahu in July 2011. The market for television services in Hawaii is dominated by Oceanic. On the island of Oahu, approximately 93% of households on Oahu currently are customers of Oceanic's cable service. There is no assurance we will be able to compete successfully against Oceanic. In particular, the costs to acquire programming is a significant and increasing cost, and there is no assurance our content

Table of Contents

acquisition costs will be in line with Oceanic's such that we can remain competitive. Direct broadcast satellite companies currently are not significant competitors, but this could change in the future.

*Wireless Services.* We provide wireless telecommunications services by use of a MVNO model in which we resell another carrier's facilities-based wireless services under the *Hawaiian Telcom®* brand name. The market in Hawaii for wireless telecommunications services is subject to intense competition. In addition, our wireless business may be less profitable than the wireless businesses of other telecommunications companies due to our use of a MVNO model.

***If we do not adapt to technological changes in the telecommunications industry, we could lose customers or market share.***

The telecommunications industry is subject to rapid and significant changes in technology, frequent new service introductions and evolving industry standards. We cannot predict the effect of these changes on our competitive position, profitability or industry. Technological developments may reduce the competitiveness of our network and require unbudgeted upgrades or the procurement of additional products that could be expensive and time consuming to implement. In addition, new products and services arising out of technological developments may reduce the attractiveness of our services. If we fail to adapt successfully to technological changes or fail to obtain access to important new technologies, we could lose customers and be limited in our ability to attract new customers and sell new services to our existing customers. An element of our business strategy is to deliver enhanced and ancillary services to customers. The successful delivery of new services is uncertain and dependent on many factors, and we may not generate anticipated revenues from such services.

***The successful operation and growth of our businesses are dependent on economic conditions in Hawaii.***

Substantially all of our customers and operations are located in Hawaii. Because of our geographical position, the successful operation and growth of our businesses is dependent on economic conditions in Hawaii. The Hawaii economy, in turn, is dependent upon many factors, including:

the level of government and military spending;

the development of the local financial services industry;

the strength of the Hawaii tourism industry;

the continued growth in services industries; and

the absence of hurricanes or other natural disasters and terrorism incidents.

The customer base for telecommunications services in Hawaii is small and geographically concentrated. The population of Hawaii is approximately 1.4 million, approximately 70% of whom live on the island of Oahu. Any adverse development affecting Oahu, or Hawaii generally, could substantially impact our ability to do business. Labor shortages or increased labor costs in Hawaii could have a material adverse effect on our operations. We cannot assure you that we will be able to continue to hire and retain a sufficient labor force of qualified persons, or that future collective bargaining agreement negotiations will not result in significant increases in the cost of labor.

***If the limitation on lump sum distributions under our union pension plan is lifted, retirements of our experienced union employees may increase, which could have an adverse impact on our operations if we cannot timely hire and train replacements.***

Our union pension plan allows for lump sum distributions to employees who retire under certain circumstances. Since 2008, lump sum distributions have been limited to no more than 50% of the accrued amount, because of the funded status of the pension plan. If the funded status exceeds 80% in the future, then the restrictions on lump sum distributions will be lifted and a significant number of

Table of Contents

experienced union employees would be eligible to receive larger lump sum distributions and elect to retire. If a significant number of employees retire before we can hire and train their replacements, our operations could be negatively impacted. We are taking steps to address this possibility, but there is no assurance we will be successful.

***If we experience an ownership change, it could have adverse tax consequences.***

We currently have a material amount of net operating loss ("NOL") carryforwards and so-called "built-in losses," all of which we intend to use in the future to reduce our federal and state taxable income. In the event that an "ownership change" were to occur with respect to our stock, it is possible that our ability to use our NOLs and built-in losses would become subject to an annual limitation. An ownership change could occur with respect to our stock merely as a result of one or more "5-percent shareholders" buying or selling our shares, even if no one person were to acquire a controlling percentage of our stock. Although we will monitor transfers of our stock in order to take additional action, if feasible, to avoid an ownership change, there can be no assurance that we will not suffer an ownership change with substantial adverse tax consequences.

***Our indebtedness could adversely affect our financial condition.***

We have a significant amount of indebtedness in relation to our equity. We maintain a Term Loan in the amount of \$300 million and a revolving credit facility in the amount of \$30 million ("Revolving Credit Facility"), each with a first priority lien on all assets.

The debt service requirements of our indebtedness could:

make it more difficult for us to satisfy the service requirements of our other obligations, including pension funding obligations, investments required to maintain and upgrade our network and service fleet, investments required to introduce and deploy new products and services, as well as the operating costs of our businesses;

increase our vulnerability to general adverse economic and industry conditions;

require us to dedicate a higher than desired portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures, research and development efforts and other general corporate purposes;

limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;

make it difficult to secure credit terms with our vendors;

place us at a competitive disadvantage compared to our competitors that have less debt; and

limit our ability to borrow additional funds.

In addition, the terms of our Term Loan and Revolving Credit Facility contain financial and other restrictive covenants that limit our ability to engage in activities that may be in our long-term best interests. Our failure to comply with those covenants could result in an event of default which, if not cured or waived, could result in the acceleration of all of our debts.

The Term Loan matures in 2019. We generally do not expect to generate the necessary cash flow to repay our Term Loan in its entirety by the maturity date and such repayment in full is dependent upon the ability to refinance the Term Loan on reasonable terms. The ability to refinance the indebtedness on reasonable terms before the maturity date cannot be assured.

Table of Contents

*To service our indebtedness, we will require a significant amount of cash. Our ability to generate cash depends on many factors beyond our control.*

Our ability to make payments on and to refinance our current indebtedness and to fund planned capital expenditures will depend on our ability to generate cash in the future. This, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control.

We cannot assure you that our business will generate sufficient cash flow from operations or that future borrowings will be available to us in an amount sufficient to enable us to pay our indebtedness or to fund our other liquidity needs. We will likely need to refinance all or a portion of our indebtedness on or before maturity. We cannot assure you that we will be able to refinance any of our indebtedness on commercially reasonable terms or at all.

*Restrictive covenants in the agreements governing our indebtedness restrict our ability to pursue our business strategies, and a breach of such covenants may result in the acceleration of our long-term debt maturities.*

The restrictive covenants in the Term Loan and Revolving Credit Facility limit our ability, among other things, to:

incur additional indebtedness;

pay dividends or make distributions in respect of our capital stock or to make certain other restricted payments or investments;

sell assets, including capital stock of subsidiaries;

consolidate, merge, sell or otherwise dispose of all or substantially all of our assets;

enter into transactions with our affiliates;

invest in new products and services or make capital expenditures; and

incur liens.

In addition, the restrictive covenants may prohibit us from prepaying our other indebtedness and require us to maintain compliance with specified financial ratios. Our ability to comply with these ratios may be affected by events beyond our control.

**Item 1B. Unresolved Staff Comments.**

None

**Item 2. Properties.**

We own our corporate headquarters, which is located in 1177 Bishop Street, Honolulu, Hawaii 96813 and consists of over 465,000 square feet of office space. We also have other properties consisting primarily of approximately 118 owned (including part-owned) and approximately 73 leased real estate properties, including our administrative facilities and facilities for call centers, customer service sites for the television business, switching equipment, fiber optic networks, microwave radio and cable and wire facilities, cable head-end equipment, coaxial distribution networks, routers and servers used in our telecommunications business, as well as a state-of-the-art data center facility with up to 6,500 square feet of data center capacity and room for expansion. See Item 1, "Business Network Architecture and Technology." For purposes of Hawaii state law, we are classified as a public utility and, accordingly, do not pay any property taxes. Substantially all of our assets (including those of our subsidiaries) are pledged for the Term Loan.





Table of Contents**Item 3. Legal Proceedings**

We are involved in various claims, legal actions and regulatory proceedings arising from time to time in the ordinary course of business. Other than the matter set forth below, in the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on our combined financial position, results of operations or cash flows.

**Item 4. Mine Safety Disclosures**

Not applicable.

**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.****Market Information**

Our Common Stock trades on The NASDAQ Stock Market under the symbol "HCOM". The holders of our Common Stock are entitled to one vote per share on any matter to be voted upon by stockholders. The following table sets forth the high and low sales prices of our New Common Stock for the period from January 1, 2012 through December 31, 2013:

|                | Market Price |          |
|----------------|--------------|----------|
|                | High         | Low      |
| <b>2013</b>    |              |          |
| First Quarter  | \$ 23.24     | \$ 19.18 |
| Second Quarter | \$ 26.51     | \$ 22.85 |
| Third Quarter  | \$ 27.89     | \$ 24.81 |
| Fourth Quarter | \$ 30.33     | \$ 26.46 |
| <b>2012</b>    |              |          |
| First Quarter  | \$ 17.24     | \$ 13.40 |
| Second Quarter | \$ 20.81     | \$ 17.49 |
| Third Quarter  | \$ 19.76     | \$ 17.16 |
| Fourth Quarter | \$ 19.96     | \$ 16.49 |

 **Holders**

As of March 1, 2014, there were 26 holders of record of our Common Stock and approximately 1,300 beneficial owners.

**Dividends**

We have not declared or paid any dividends on our Common Stock. Our Term Loan and Revolving Credit Facility limit our ability to declare or pay dividends.

Table of Contents

**Securities Authorized for Issuance Under Equity Compensation Plans.**

Securities authorized for issuance under equity compensation plans as of December 31, 2013 included:

| Plan Category   | Number of securities<br>to be issued upon<br>exercise of<br>outstanding options,<br>warrants and rights(2) | Weighted-average<br>exercise price of<br>outstanding<br>options,<br>warrants and rights | Number of securities<br>remaining available for<br>future issuance under<br>equity compensation<br>plans (excluding<br>securities reflected in<br>column (a)) |
|---|--|---|---|
|   | (a)  | (b)   | (c)   |
| Equity Compensation Plans Approved by Security Holders        |  |   |   |
| Equity Compensation Plans not Approved by Security Holders(1) | 345,792  |   | 807,538   |
| <b>Total</b>  | <b>345,792</b>   |   | <b>807,538</b>  |

- 
- (1) The 2010 Equity Incentive Plan was authorized by the Plan of Reorganization. Under the 2010 Equity Incentive Plan, the securities remaining available for future issuance may be issued either as restricted stock, restricted stock units, stock appreciation rights, stock options, or other stock or stock-based awards.
- (2) For performance-based restricted stock units granted in 2013, amounts reflected in this table assume payout in shares at 156.25% of target. The actual number of shares issued can range from 0% to 156.25% of target depending upon achievement of applicable performance goals.

**Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

None.

Table of Contents

**Stockholder Return Performance Graph**

The graph below compares the cumulative total stockholder return on our Common Stock with the cumulative total return on the Standards & Poor's ("S&P") 500 Stock Index, and the NASDAQ Telecommunications Index for the period beginning December 21, 2010 (the date our Common Stock began trading) and ending December 31, 2013, assuming an initial investment of \$100 with reinvestment of dividends.

|                                 | 12/21/10 | 12/31/10 | 06/30/11 | 12/31/11 | 06/30/12 | 12/31/12 | 06/30/13 | 12/30/13 |
|---------------------------------|----------|----------|----------|----------|----------|----------|----------|----------|
| Hawaiian Telcom<br>Holdco, Inc. | 100.00   | 153.42   | 141.10   | 84.38    | 106.90   | 106.85   | 137.86   | 160.93   |
| S&P 500                         | 100.00   | 100.29   | 106.33   | 102.40   | 112.12   | 118.79   | 135.22   | 157.27   |
| NASDAQ Telecom                  | 100.00   | 100.70   | 95.56    | 89.45    | 84.88    | 94.35    | 109.02   | 120.09   |

*The foregoing performance graph and related information shall not be deemed "soliciting material" or to be "filed" with the SEC, nor shall such information be incorporated by reference into any future filings under the Securities Act of 1933 or the Securities Exchange Act of 1934, each as amended, except to the extent we specifically incorporate it by reference into such filing.*

# Edgar Filing: Hawaiian Telcom Holdco, Inc. - Form 10-K

## Table of Contents

### Item 6. Selected Financial Data

The following data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes thereto included elsewhere in this annual report.

#### Selected Financial Data (dollars in thousands, except per share amounts)

|   | Successor(1)            |            |            | Period from<br>November 1<br>to<br>December 31,<br>2010 | Predecessor(1)                                     |                                    |
|---|-------------------------|------------|------------|---|--|------------------------------------|
|   | Year Ended December 31, |            |            |   | Period from<br>January 1 to<br>October 31,<br>2010 | Year Ended<br>December 31,<br>2009 |
|   | 2013                    | 2012       | 2011       |   |  |                                    |
| <b>Statements of income data:</b>                                   |                         |            |            |   |  |                                    |
| Operating revenues  | \$ 391,150              | \$ 385,498 | \$ 395,156 | \$ 66,759   | \$ 334,686   | \$ 408,595                         |
| Depreciation and amortization                                       | 77,301                  | 70,908     | 63,806     | 9,723   | 136,661  | 164,376                            |
| Operating income (loss)   | 41,771                  | 45,856     | 51,138     | 7,981   | (42,902)   | (56,794)                           |
| Interest expense  | 18,875                  | 22,183     | 25,339     | 4,329   | 23,398   | 30,089                             |
| Income tax provision (benefit)(3)                                   | 8,782                   | (91,382)   | (1,341)    |   | (346)  | (2,985)                            |
| Net income (loss)(2)  | 10,488                  | 109,982    | 26,155     | 3,129   | 185,794  | (130,734)                          |
| <b>Earnings (loss) per common share</b>                             |                         |            |            |   |  |                                    |
| Basic   | \$ 1.01                 | \$ 10.74   | \$ 2.58    | \$ 0.31   | \$ 434.10  | \$ (305.45)                        |
| Diluted   | \$ 0.95                 | \$ 10.32   | \$ 2.41    | \$ 0.30   | \$ 434.10  | \$ (305.45)                        |
| <b>Statements of cash flow data net cash provided by (used in):</b> |                         |            |            |   |  |                                    |
| Operating activities  | \$ 76,961               | \$ 86,460  | \$ 79,219  | \$ 12,921   | \$ 48,909  | \$ 95,112                          |
| Investing activities  | (85,030)                | (85,310)   | (77,992)   | (21,235)  | (57,659)   | (87,537)                           |
| Financing activities  | (9,373)                 | (16,220)   | (811)      |   | 2,161  |                                    |
| <b>Balance Sheets data (as of end of period):</b>                   |                         |            |            |   |  |                                    |
| Cash and cash equivalents   | \$ 49,551               | \$ 66,993  | \$ 82,063  | \$ 81,647   | \$ 94,138  | \$ 96,550                          |
| Property, plant and equipment, net                                  | 524,375                 | 507,197    | 482,371    | 459,781   | 670,714  | 711,265                            |
| Total assets  | 778,015                 | 785,092    | 661,772    | 646,036   | 1,103,969  | 1,183,677                          |
| Long-term debt(4)   | 294,679                 | 295,410    | 300,000    | 300,000   | 1,097,369  | 1,085,797                          |
| Stockholders' equity (deficiency)                                   | 313,012                 | 276,860    | 136,196    | 178,792   | (262,796)  | (180,264)                          |

(1) Although the Company emerged from bankruptcy on October 28, 2010, the Predecessor adopted "fresh-start" accounting as of October 31, 2010. Under the provisions of fresh-start accounting, a new entity is deemed created for financial reporting purposes. References to "Successor" refer to the Company after October 31, 2010 after giving effect to provisions of the Plan of Reorganization and application of fresh-start accounting. References to "Predecessor" refer to the Company on and prior to October 31, 2010.

(2)

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The net income (loss) for the year ended December 31, 2009, for the period from January 1 to October 31, 2010, for the period November 1 to December 31, 2010 and for the year ended

Table of Contents

December 31, 2011 includes gain (charges) for reorganization items amounting to (\$43.0) million, \$251.7 million, (\$0.5) million and (\$1.1) million, respectively.

- (3) As of December 31, 2012, the Company released its valuation allowance resulting in an income tax benefit of \$91.4 million for the year ended December 31, 2012. Refer to Note 10 to the consolidated financial statements for further information.
- (4) Long-term debt of the Predecessor included debt classified as liabilities subject to compromise.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**Background**

In the following discussion and analysis of financial condition and results of operations, unless the context otherwise requires, "we," "us" or the "Company" refers, collectively, to Hawaiian Telcom Holdco, Inc. and its subsidiaries.

The statements in the discussion and analysis regarding industry outlook, our expectations regarding the future performance of our business and the other non-historical statements in the discussion and analysis are forward-looking statements. These forward-looking statements are subject to numerous risks and uncertainties, including, but not limited to, the risks and uncertainties described in Item 1A, "Risk Factors." Our actual results may differ materially from those contained in any forward-looking statements. You should read the following discussion together with Item 6, "Selected Financial Data" and our consolidated financial statements and related notes thereto included elsewhere in this annual report.

**Segments and Sources of Revenue**

We operate in two reportable segments (telecommunication and data center colocation) based on how resources are allocated and performance is assessed by our chief operating decision maker. Our chief operating decision maker is our Chief Executive Officer.

In the fourth quarter of 2013, we reevaluated our reportable segments. This was prompted by the acquisition of SystemMetrics and our current strategic focus. Previously, we presented a wireline and other segment (which was primarily wireless services). With the diminishing significance of the wireless segment, we no longer provide separate wireless information to our chief operating decision maker. Both these segments are now combined into the telecommunications segment. Prior to the acquisition of SystemMetrics on September 30, 2013, we did not have data center colocation operations. Hence, we were in a single segment prior to September 30, 2013 under the revised reportable segment structure.

***Telecommunications***

The telecommunication segment derives revenue from the following sources:

**Local Telephone Services** We receive revenue from providing local exchange telephone services. These revenues include monthly charges for basic service, local private line services and enhanced calling features such as voice mail, caller ID and 3-way calling.

**Network Access Services** We receive revenue for access to our network for wholesale carrier data, business customer data including Dedicated Internet Access, switched carrier access and subscriber line charges imposed on end users. Switched carrier access revenue compensates us for origination, transport and termination of calls for long distance and other interexchange carriers.

**Long Distance Services** We receive revenue from providing long distance services to our customers.

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### Table of Contents

High-Speed Internet ("HSI") Services We provide HSI to our residential and business customers.

Video Services Our video services marketed as Hawaiian Telcom TV is an advanced entertainment service offered to customers in select areas.

Equipment and Managed Services We provide installation and maintenance of customer premise equipment as well as managed service for customer telephone and IT networks.

We receive revenue from wireless services, including the sale of wireless handsets and other wireless accessories.

### **Data Center Colocation**

The data center colocation segment provides physical colocation, virtual colocation and various related telephony services.

### **Results of Operations for the Years Ended December 31, 2013, 2012 and 2011**

#### **Operating Revenues**

The following tables summarize our volume information (lines or subscribers) as of December 31, 2013, 2012 and 2011, and our operating revenues for the years ended December 31, 2013, 2012 and 2011.

#### **Volume Information**

|                           | December 31, |         |         | 2013 vs. 2012<br>Change |            | 2012 vs. 2011<br>Change |            |
|---------------------------|--------------|---------|---------|-------------------------|------------|-------------------------|------------|
|                           | 2013         | 2012    | 2011    | Number                  | Percentage | Number                  | Percentage |
| <b>Voice access lines</b> |              |         |         |                         |            |                         |            |
| Residential               | 186,415      | 203,330 | 223,009 | (16,915)                | (8.3)%     | (19,679)                | (8.8)%     |
| Business(1)               | 193,027      | 185,142 | 189,035 | 7,885                   | 4.3%       | (3,893)                 | (2.1)%     |
| Public                    | 4,155        | 4,405   | 4,623   | (250)                   | (5.7)%     | (218)                   | (4.7)%     |
|                           | 383,597      | 392,877 | 416,667 | (9,280)                 | (2.4)%     | (23,790)                | (5.7)%     |

#### High-Speed Internet lines

|             |         |         |         |       |        |       |         |
|-------------|---------|---------|---------|-------|--------|-------|---------|
| Residential | 91,437  | 88,016  | 84,634  | 3,421 | 3.9%   | 3,382 | 4.0%    |
| Business    | 19,320  | 18,575  | 17,442  | 745   | 4.0%   | 1,133 | 6.5%    |
| Wholesale   | 963     | 1,020   | 1,156   | (57)  | (5.6)% | (136) | (11.8)% |
|             | 111,720 | 107,611 | 103,232 | 4,109 | 3.8%   | 4,379 | 4.2%    |

#### Long distance lines

|             |         |         |         |         |        |          |        |
|-------------|---------|---------|---------|---------|--------|----------|--------|
| Residential | 117,282 | 126,551 | 136,921 | (9,269) | (7.3)% | (10,370) | (7.6)% |
| Business(1) | 79,496  | 74,781  | 76,160  | 4,715   | 6.3%   | (1,379)  | (1.8)% |

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196,778    201,332    213,081    (4,554)    (2.3)%    (11,749)    (5.5)%

|             |        |       |       |       |       |       |        |
|-------------|--------|-------|-------|-------|-------|-------|--------|
| Video       |        |       |       |       |       |       |        |
| Subscribers | 18,393 | 9,829 | 1,620 | 8,564 | 87.1% | 8,209 | 506.7% |

|               |         |        |        |        |       |        |        |
|---------------|---------|--------|--------|--------|-------|--------|--------|
| Homes Enabled |         |        |        |        |       |        |        |
|               | 120,000 | 65,000 | 27,400 | 55,000 | 84.6% | 37,600 | 137.2% |

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(1) Business voice access lines and business long distance lines included approximately 9,400 and 5,500 lines, respectively, as of December 31, 2013 related to the acquisition of Wavecom. These



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### Table of Contents

lines were not included in the volume information as of December 31, 2012 as they were not deemed meaningful to analyzing 2012 results.

### **2013 compared to 2012**

#### **Operating Revenues (dollars in thousands)**

|                                | <b>For the Year Ended<br/>December 31,</b> |             | <b>Change</b> |                   |
|--------------------------------|--|-------------|---------------|-------------------|
|                                | <b>2013</b>                                | <b>2012</b> | <b>Amount</b> | <b>Percentage</b> |
| <b>Telecommunications</b>      |  |             |               |                   |
| Local voice services           | \$ 137,166                                 | \$ 141,352  | \$ (4,186)    | (3.0)%            |
| <b>Network access services</b> |  |             |               |                   |
| Business data                  | 25,392                                     | 18,946      | 6,446         | 34.0%             |
| Wholesale carrier data         | 59,529                                     | 63,192      | (3,663)       | (5.8)%            |
| Subscriber line access charge  | 37,739                                     | 38,885      | (1,146)       | (2.9)%            |
| Switched carrier access        | 7,698                                      | 8,883       | (1,185)       | (13.3)%           |
|                                | 130,358                                    | 129,906     | 452           | 0.3%              |
| <b>Long distance services</b>  |  |             |               |                   |
| Long distance services         | 24,733                                     | 27,959      | (3,226)       | (11.5)%           |
| High-Speed Internet            | 39,800                                     | 36,323      | 3,477         | 9.6%              |
| Video                          | 13,012                                     | 4,883       | 8,129         | 166.5%            |
| Equipment and managed services | 26,994                                     | 31,418      | (4,424)       | (14.1)%           |
| Wireless                       | 2,713                                      | 3,336       | (623)         | (18.7)%           |
| Other                          | 14,186                                     | 10,321      | 3,865         | 37.4%             |
|                                | 388,962                                    | 385,498     | 3,464         | 0.9%              |
| Data center colocation         | 2,188                                      |             | 2,188         | NA                |
|                                | \$ 391,150                                 | \$ 385,498  | \$ 5,652      | 1.5%              |
| <b>Channel</b>                 |  |             |               |                   |
| Business                       | \$ 170,544                                 | \$ 163,923  | \$ 6,621      | 4.0%              |
| Consumer                       | 141,234                                    | 137,765     | 3,469         | 2.5%              |
| Wholesale                      | 66,206                                     | 71,673      | (5,467)       | (7.6)%            |
| Other                          | 13,166                                     | 12,137      | 1,029         | 8.5%              |
|                                | \$ 391,150                                 | \$ 385,498  | \$ 5,652      | 1.5%              |

The decrease in local voice services revenues was caused primarily by the decline of \$7.9 million of voice access lines. This was offset by \$3.7 million of revenue from Wavecom customers acquired in December 2012. Continued competition in the telecommunications industry has increasingly resulted in customers using technologies other than traditional phone lines for voice and

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data. Residential customers are increasingly using wireless services in place of traditional wireline phone service as well as moving local voice service to VoIP technology offered by competitors. Generally, VoIP technology offered by cable providers is less expensive than traditional wireline phone service, requiring us to respond with more competitive pricing. Additionally, Competitive Local Exchange Carriers (CLECs) and our cable competitor continue to focus on business customers and selling services to our customer base.

In an effort to slow the rate of line loss, we are continuing retention and acquisition programs, and are increasingly focusing efforts on bundling of services. We have instituted various "saves" campaigns designed to focus on specific circumstances where we believe customer churn is controllable. These campaigns include targeted offers to "at risk" customers as well as other promotional tools designed to enhance customer retention. We also emphasize win-back and employee referral programs.

Table of Contents

Additionally, we are intensifying our efforts relative to developing tools and training to enhance our customer service capability to improve customer retention and growth.

Business data revenue for the year ended December 31, 2013 increased when compared to the prior year primarily because of \$5.1 million of revenue from Wavecom customers acquired in December 2012 as well as growth from customer win-backs and increasing bandwidth needs from our customers. Wholesale carrier revenue decreased because of revenues received from Wavecom in 2012 which we no longer recognize as Wavecom is a wholly-owned subsidiary. In addition, the impact of the decline in voice access lines is reflected in subscriber line access charges and switched carrier access charges.

The decrease in long distance revenue was primarily because of the decline in long distance lines and customers moving to wireless and VoIP based technologies for long distance calling.

HSI revenues increased when compared to the prior year primarily because an approximate 3.8% growth in our HSI subscribers as well as improved revenue per subscriber with increased bandwidth offerings.

On July 1, 2011, we commercially launched our video service on the island of Oahu. We are rolling out Hawaiian Telcom TV gradually to selected areas to ensure delivery of superior service and an ongoing excellent customer experience. Our volume is ramping up as more homes become enabled for video service. We expect to expand both the availability and the capabilities of our Hawaiian Telcom TV service over the next several years through additional capital investment and innovation.

Equipment and managed services sales have decreased because of a decline in the sales and installations of customer premise equipment for certain large government customers during 2013 compared to 2012. Revenue from equipment sales varies from period to period based on the volume of large installation projects. The volume of such projects in future periods is uncertain.

Wireless revenues declined as there has been a reduction in marketing effort as we focus on other products.

The increase in other services revenue for the year ended December 31, 2013 compared to the prior year is because of revenue from Wavecom of \$1.7 million. In addition, business VoIP equipment usage fees amounted to \$2.0 million in 2013 and were negligible in 2012.

Data center colocation revenues were recognized in the fourth quarter of 2013 with the acquisition of SystemMetrics on September 30, 2013.

Table of Contents**2012 compared to 2011****Operating Revenues (dollars in thousands)**

|                                | For the Year Ended<br>December 31, |            | Change     |            |
|--------------------------------|------------------------------------|------------|------------|------------|
|                                | 2012                               | 2011       | Amount     | Percentage |
| Telecommunications             |                                    |            |            |            |
| Local voice services           | \$ 141,352                         | \$ 146,921 | \$ (5,569) | (3.8)%     |
| Network access services        |                                    |            |            |            |
| Business data                  | 18,946                             | 18,133     | 813        | 4.5%       |
| Wholesale carrier data         | 63,192                             | 64,589     | (1,397)    | (2.2)%     |
| Subscriber line access charge  | 38,885                             | 39,857     | (972)      | (2.4)%     |
| Switched carrier access        | 8,883                              | 9,833      | (950)      | (9.7)%     |
|                                | 129,906                            | 132,412    | (2,506)    | (1.9)%     |
| Long distance services         | 27,959                             | 31,945     | (3,986)    | (12.5)%    |
| High-Speed Internet            | 36,323                             | 35,426     | 897        | 2.5%       |
| Video                          | 4,883                              | 269        | 4,614      | NA         |
| Equipment and managed services | 31,418                             | 33,274     | (1,856)    | (5.6)%     |
| Wireless                       | 3,336                              | 4,271      | (935)      | (21.9)%    |
| Other                          | 10,321                             | 10,638     | (317)      | (3.0)%     |
|                                | \$ 385,498                         | \$ 395,156 | \$ (9,658) | (2.4)%     |

| Channel   |            |            |            |         |
|-----------|------------|------------|------------|---------|
| Business  | \$ 163,923 | \$ 168,262 | \$ (4,339) | (2.6)%  |
| Consumer  | 137,765    | 137,563    | 202        | 0.1%    |
| Wholesale | 71,673     | 74,422     | (2,749)    | (3.7)%  |
| Other     | 12,137     | 14,909     | (2,772)    | (18.6)% |
|           | \$ 385,498 | \$ 395,156 | \$ (9,658) | (2.4)%  |

The decrease in local voice services revenues was caused primarily by the decline in voice access lines of 5.7% (\$8.4 million of the decline in revenue). The decline in voice access lines from 2011 to 2012 was caused by the same factors discussed previously for the decline from 2012 to 2013.

Network access services revenue decreased as compared to the prior year because certain wireless carriers disconnected lower bandwidth circuits replaced with new more efficient higher bandwidth circuits resulting in a reduction in wholesale carrier data revenue for the year. In addition, the impact of the decline in voice access lines is reflected in subscriber line access charges and switched carrier access charges. These reductions were partially offset by growth in business data revenue.

The decrease in long distance revenue was primarily because of the decline in long distance lines.

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The increase in video is attributed to the same factors discussed for the increase from 2012 to 2013 related the ramp up of Hawaiian Telcom TV services.

HSI revenues increased when compared to the prior year primarily because an approximate 4.2% growth in our HSI subscribers (\$1.5 million of the increase in revenue).

Equipment and managed services sales decreased as compared to the prior year because of less sales and installations of customer premise equipment for certain large government customers in 2012.

Wireless revenues decreased as we attempted to focus our marketing efforts on other segments of our business.

Table of Contents**Operating Costs and Expenses****2013 compared to 2012**

The following table summarizes our costs and expenses for 2013 compared to the costs and expenses for 2012 (dollars in thousands):

|   | For the Year Ended<br>December 31, |            | Change   |            |
|---|------------------------------------|------------|----------|------------|
|   | 2013                               | 2012       | Amount   | Percentage |
| Cost of revenues (exclusive of depreciation and amortization) | \$ 163,749                         | \$ 160,226 | \$ 3,523 | 2.2%       |
| Selling, general and administrative expenses                  | 114,875                            | 108,508    | 6,367    | 5.9%       |
| Gain on sale of property                                      | (6,546)                            |            | (6,546)  | NA         |
| Depreciation and amortization                                 | 77,301                             | 70,908     | 6,393    | 9.0%       |
|   | \$ 349,379                         | \$ 339,642 | \$ 9,737 | 2.9%       |

Operations, including costs and expenses, for the data center colocation segment were not significant as it was newly acquired on September 30, 2013. Hence, a separate discussion for the telecommunications and data center colocation segment is not provided for the current period.

The Company's total headcount as of December 31, 2013 was 1,388 compared to 1,392 as of December 31, 2012. Employee related costs are included in both cost of revenues and selling, general and administrative expenses. As the change in headcount was less than one percent, it did not significantly impact results for 2013 as compared to 2012.

Cost of revenues consists of costs we incur to provide our products and services including those for operating and maintaining our networks, installing and maintaining customer premise equipment, and cost of goods sold directly associated with various products. The costs of revenue for the year ended December 31, 2013 increased because of an increase of \$5.8 million in TV content and other costs. This was partially offset by reduced customer premise equipment costs of \$3.7 million on lower revenue.

Selling, general and administrative expenses include costs related to sales and marketing, information systems and other administrative functions. The increase was because of increased gross receipt taxes of \$1.9 million as there were beneficial settlements related to such taxes in 2012 as we were able to settle certain gross receipts taxes with taxing authorities for amounts less than originally anticipated. In addition, rent expense increased \$1.2 million related to Wavecom and SystemMetrics operations. There was also a \$2.7 million increase in bad debt expense as the prior year included a one-time benefit from the settlement of our preexisting relationship with Wavecom. See Note 3 to the consolidated financial statements for further discussion of this matter.

In 2013, we sold a parcel of land and warehouse not actively used in our operations for a purchase price, as amended, of \$13.9 million. A gain on the sale of \$6.5 million was recognized in the second quarter of 2013. The Hawaii Public Utilities Commission ("HPUC") approval of the sale requires we spend \$0.3 million on training employees on broadband telecommunication deployment and operation. In addition, the HPUC approval provides for the balance of the sales price to be used for improvement to our broadband network.

Depreciation and amortization increased because of new property additions placed into service.

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### Table of Contents

#### **2012 compared to 2011**

The following table summarizes our costs and expense for the year ended December 31, 2012 compared to the year ended December 31, 2011 (dollars in thousands).

|   | For the Year Ended<br>December 31, |            | Change     |            |
|---|------------------------------------|------------|------------|------------|
|   | 2012                               | 2011       | Amount     | Percentage |
| Cost of revenues (exclusive of depreciation and amortization) | \$ 160,226                         | \$ 159,822 | \$ 404     | 0.3%       |
| Selling, general and administrative expenses                  | 108,508                            | 120,390    | (11,882)   | -9.9%      |
| Depreciation and amortization                                 | 70,908                             | 63,806     | 7,102      | 11.1%      |
|   | \$ 339,642                         | \$ 344,018 | \$ (4,376) | -1.3%      |

The Company's total headcount as of December 31, 2012 was 1,392 compared to 1,309 as of December 31, 2011.

The costs of revenues for the year ended December 31, 2012 increased when compared to the prior year even though revenues declined for the same period. Cost of video content increased with the ramp up of Hawaiian Telcom TV. This increased cost was not fully offset by other declines in revenue related cost components.

Selling, general and administrative expenses decreased primarily because of reduced labor costs of \$8.9 million on lower average headcount and reduced pension costs. Average headcount for 2012 was lower than 2011 even though headcount as of December 31, 2012 increased when compared to December 31, 2011. This was primarily because of Wavecom employees obtained through the December 31, 2012 acquisition. There was also a decline in bad debt expense of \$2.2 million primarily because of the settlement of balances due from Wavecom as described in Note 3 to the consolidated financial statements.

Depreciation and amortization increased because of new property additions placed into service.

#### **Other Income and (Expense)**

#### **2013 compared to 2012**

The following table summarizes other income (expense) for the years ended December 31, 2013 and 2012 (dollars in thousands).

|                                      | For the Year Ended<br>December 31, |             | Change   |            |
|--------------------------------------|------------------------------------|-------------|----------|------------|
|                                      | 2013                               | 2012        | Amount   | Percentage |
| Interest expense, net                | \$ (18,875)                        | \$ (22,183) | \$ 3,308 | -14.9%     |
| Loss on early extinguishment of debt | (3,660)                            | (5,112)     | 1,452    | -28.4%     |
| Interest income and other            | 34                                 | 59          | (25)     | -42.4%     |
|                                      | \$ (22,501)                        | \$ (27,236) | \$ 4,735 | -17.4%     |

Interest expense decreased primarily because of the lower interest rates on the refinanced debt.

In connection with the refinancing of debt in the second quarter of 2013 and in the first quarter of 2012, we incurred charges of \$3.7 million and \$5.1 million, respectively, which consisted of the loss on the repayment of the old debt and certain refinancing costs.





Table of Contents**2012 compared to 2011**

The following table summarizes other income (expense) for the years ended December 31, 2012 and 2011 (dollars in thousands).

|                                      | For the Year Ended<br>December 31, |             | Change     |            |
|--------------------------------------|------------------------------------|-------------|------------|------------|
|                                      | 2012                               | 2011        | Amount     | Percentage |
| Interest expense, net                | \$ (22,183)                        | \$ (25,339) | \$ 3,156   | -12.5%     |
| Loss on early extinguishment of debt | (5,112)                            |             | (5,112)    | NA         |
| Interest income and other            | 59                                 | 65          | (6)        | -9.2%      |
|                                      | \$ (27,236)                        | \$ (25,274) | \$ (1,962) | 7.8%       |

Interest expense decreased primarily because of the lower interest rates on the refinanced debt.

In connection with the refinancing of debt in the first quarter of 2012, we incurred a \$5.1 million charge to income which consisted of the premium on the repayment of the old debt and certain refinancing costs.

***Reorganization Items***

Reorganization items represent amounts incurred as a direct result of the Company's Chapter 11 filing and are presented separately in our consolidated statements of income. Such expense items consisted of \$1.1 million in professional fees for the year ended December 31, 2011.

The Company emerged from Chapter 11 in October 2010 but continued to incur reorganization related expenses until December 2011 as the Chapter 11 cases were not closed until January 2012.

***Income Tax***

As of December 31, 2011, we had maintained a full valuation allowance over our net deferred income tax assets. This situation resulted from our having a short history as a new entity (post Chapter 11). From emergence in 2010 through 2012, we had generated earnings in all periods. As a result of our continued positive annual earnings, as well as positive forecasted earnings in the future, management concluded that it was more likely than not that we would realize our deferred income tax assets, and therefore, we released our valuation allowance as of December 31, 2012. If there is a decline in the level of actual future or forecasted earnings, the conclusion regarding the need for a valuation allowance may change in future periods resulting in the establishment of a valuation allowance for some or all of our deferred income tax assets.

***Liquidity and Capital Resources***

As of December 31, 2013, we had cash of \$49.6 million. From an ongoing operating perspective, our cash requirements going into 2014 consist of supporting the development and introduction of new products, capital expenditure projects, pension funding obligations and other changes in working capital. A combination of cash-on-hand and cash generated from operating activities will be used to fund our cash requirements.

Table of Contents

We have continued to take actions to conserve cash and improve liquidity. Efforts have also been taken to generate further operating efficiencies and focus on expense management. We have focused on improving operating results, including efforts to simplify product offerings, improve our customer service experience and increase our revenue enhancement activities. There can be no assurance that these additional actions will result in improved overall cash flow. We continue to have sizable retirement obligations for our existing employee base. Any sustained declines in the value of pension trust assets or relatively high levels of pension lump sum benefit payments will increase the magnitude of future plan contributions.

Agreements with the HPUC and the debt agreements of Hawaiian Telcom Communications, Inc. limit the ability of our subsidiaries to pay dividends to the parent company and restrict the net assets of all of our subsidiaries. This can limit our ability to pay dividends to our shareholders. As the parent company has no operations, debt or other obligations, this restriction has no other immediate impact on our operations.

***Cash Flows***

Our primary source of funds continues to be cash generated from operations. We use the net cash generated from operations to fund network expansion and modernization to facilitate enhanced services. We expect that our capital spending requirements will continue to be financed through internally generated funds. We also expect to use cash generated in future periods for debt service. Additional debt or equity financing may be needed to fund additional development activities or to maintain our capital structure to ensure financial flexibility.

Net cash provided by operations amounted to \$77.0 million for 2013. Net cash provided by operations amounted to \$86.5 million for 2012. Our cash flows from operations are impacted by our results of operations, changes in working capital and payments on certain long-term pension liabilities. Our results of operations were discussed above. The decrease in cash provided by operations was because of working capital demands. Pension plan contributions amounted to \$11.9 million and \$14.2 million for the years ended December 31, 2013 and 2012, respectively.

Cash used in investing activities was comprised of \$85.0 million and \$85.3 million for the year ended December 31, 2013 and 2012, respectively. The level of capital expenditures for 2014 is expected to be comparable to 2013 as we invest in systems to support new product introductions and transform our network to enable next-generation technologies such as Hawaiian Telcom TV.

Cash used in financing activities for the years ended December 31, 2013 and 2012 includes the impact of the 2013 and 2012 refinancing of our debt.

***Outstanding Debt and Financing Arrangements***

As of December 31, 2013, we had outstanding \$299.1 million in aggregate long-term debt and an undrawn \$30.0 million revolving line of credit.

Our bank credit facilities contain various negative and affirmative covenants that restrict, among other things, incurrence of additional indebtedness, payment of dividends, redemptions of stock, other distributions to shareholders and sales of assets. In addition, there are financial covenants which have the following metrics as of December 31, 2013: interest coverage with maximum allowed ratio of 4.50:1 of earnings before interest, taxes, depreciation and amortization to interest expense; leverage with maximum allowed ratio of 3.00:1 of indebtedness to earnings before interest, taxes, depreciation and amortization, as defined; and a maximum level of annual capital expenditures of \$105.0 million. We were in compliance with these covenants as of December 31, 2013.

On June 6, 2013, we refinanced the existing term debt with a new six year term loan. With our new debt structure, we do not expect to generate the necessary cash flow from operations to repay the





Table of Contents

excess. Fair value is an estimate based on either an approach using market capitalization or on the present value of an expected range of future cash flows.

The expected range of future cash flows is based on internal forecasts developed utilizing management's knowledge of the business and the anticipated effects of market forces. The use of different assumptions or estimates of future cash flows could produce different impairment amounts (or none at all) for goodwill and indefinite-lived intangible assets.

Significant assumptions which are reasonably possible of changing in future periods relate to control premiums used for the market capitalization approach, and to projection of future cash flows for determination of the reporting unit value for goodwill impairment evaluation and the company wide cash flows for purposes of the brand name impairment evaluation. For the brand name intangible assets, future cash flows were estimated using a relief of royalty method using an assumed royalty rate of one percent applied to projected revenues. In addition, the discount rates used are based on the estimated weighted average cost of capital which is subject to change based on various economic factors.

***Impairment of Long-Lived Assets and Definite-Lived Intangibles***

We assess the recoverability of long-lived assets, including property, plant and equipment and definite-lived intangible assets, whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In such cases, if the sum of the expected cash flows, undiscounted and without interest, resulting from use of the asset is less than the carrying amount, an impairment loss is recognized based on the difference between the carrying amount and the fair value of the assets. When determining future cash flow estimates, we consider historical operating results, as adjusted to reflect current and anticipated operating conditions. Estimating future cash flows requires significant judgment by us in such areas as future economic conditions, industry specific conditions and necessary capital expenditures. The use of different assumptions or estimates for future cash flows could produce different impairment amounts (or none at all) for long-lived assets, including identifiable intangible assets subject to amortization. Significant assumptions which are reasonably possible of changing in future periods relate to projection of future cash flows generated by the long-lived assets which are dependent on projections of company-wide profitability and capital expenditures for maintaining our network in future periods. In addition, estimates of the cash generating useful lives are also critical to such evaluations.

***Revenue Recognition***

We recognize revenue when evidence of an arrangement exists, the earnings process is complete and collectability is reasonably assured. We recognize service revenues based upon usage of our local exchange network and facilities and contract fees. In general, fixed fees for local telephone, Internet access, television, data center colocation and certain other services are billed one month in advance and recognized the following month when earned. Revenue from other products that are not fixed fee or that exceed contracted amounts is recognized when such services are provided.

Amounts billed to customers for activating wireline service are deferred and recognized over the average customer relationship. The costs associated with activating such services are deferred and recognized as an operating expense over the same period. Costs in excess of revenues are recognized as expense in the period in which activation occurs.

Universal Service revenues are government-sponsored support received in association with providing service in mostly rural, high-cost areas. These revenues are typically based on information provided by us and are calculated by the government agency responsible for administering the support program. These revenues are recognized in the period the service is provided.

Table of Contents

Telecommunication systems and structured cabling project revenues are recognized on a percentage completion basis, generally based on the relative portion of costs incurred to total estimated costs of a project, except for short duration projects which are recognized upon completion of the project. Maintenance services are recorded when the service is provided.

***Allowance for Doubtful Accounts***

Our allowance for doubtful accounts reflects reserves for customer receivables to reduce receivables to amounts expected to be collected. In estimating uncollectible amounts, management considers factors such as current overall economic conditions, industry-specific economic conditions, historical customer performance and anticipated customer performance. While we believe our process effectively addresses our exposure for doubtful accounts, changes in economic, industry or specific customer conditions may require adjustment to the allowance for doubtful accounts recognized by us.

***Income Taxes***

Management calculates the income tax provision, current and deferred income taxes along with the valuation allowance based upon various complex estimates and interpretations of income tax laws and regulations. Valuation allowances are recognized to reduce deferred tax assets to the amount that will more likely than not be realized. The most significant assumption in this process are projections of future income which are reasonably possible of changing in future periods.

***Employee-Related Benefits***

We incur certain employee-related costs associated with pensions and post-retirement health care benefits. In order to measure the expense associated with these employee-related benefits, management must make a variety of estimates, including discount rates used to measure the present value of certain liabilities, assumed rates of return on assets set aside to fund these expenses, employee turnover rates, anticipated mortality rates and anticipated healthcare costs. The estimates used by management are based on our historical experience, as well as current facts and circumstances. We use third-party specialists to assist management in appropriately measuring the expenses associated with these employee-related benefits. Different estimates could result in our recognizing different amounts of expense over different time periods.

The discount rate used for determining the year-end benefit plan obligation was generally calculated using a weighting of expected benefit payments and rates associated with high-quality U.S. corporate bonds for each year of expected payment to derive a single estimated rate at which the benefits could be effectively settled.

The estimated return on plan assets was based on historical trends combined with long-term expectations. In selecting the rate of return on plan assets for purposes of determining net periodic benefit cost, we considered economic forecasts for the types of investments held by the plans (primarily equity and fixed income investments), and the plans' asset allocations. While primary emphasis was on the economic forecasts of long-term returns, consideration was given to the past performance of the plans' assets. The assumption is based on consideration of all inputs, with a focus on long-term trends to avoid short-term market influences. Assumptions are not changed unless structural trends in the underlying economy are identified, our asset strategy changes, or there are significant changes in other inputs. The method for selecting the expected return on plan assets did not change from prior periods.

Table of Contents

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

As of December 31, 2013, our floating rate obligations consisted of \$299.1 million of debt outstanding under our term loan facility. Accordingly, our earnings and cash flow are affected by changes in interest rates. Based on our borrowings at December 31, 2013 and assuming a 1.0 percentage point increase or decrease in the average interest rate under these borrowings, we estimate that our annual interest expense would increase or decrease by approximately \$3.0 million.

Table of Contents

**Item 8. Financial Statements and Supplementary Data**

**Index to Financial Statements**

**Hawaiian Telcom Holdco, Inc. Consolidated Financial Statements**

|  |           |
|--|-----------|
| <u>Management's Annual Report on Internal Control over Financial Reporting</u>   | <u>46</u> |
| <u>Report of Independent Registered Public Accounting Firm Consolidated Financial Statements</u>                       | <u>47</u> |
| <u>Report of Independent Registered Public Accounting Firm Internal Control over Financial Reporting</u>               | <u>48</u> |
| <u>Consolidated Statements of Income for the Years Ended December 31, 2013, 2012 and 2011</u>                          | <u>50</u> |
| <u>Consolidated Statements of Comprehensive Income (Loss) for the Years Ended December 31, 2013, 2012 and 2011</u>     | <u>51</u> |
| <u>Consolidated Balance Sheets as of December 31, 2013 and 2012</u>  | <u>52</u> |
| <u>Consolidated Statements of Cash Flows for the Years Ended December 31, 2013, 2012 and 2011</u>                      | <u>53</u> |
| <u>Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 31, 2013, 2012 and 2011</u> | <u>54</u> |
| <u>Notes to Consolidated Financial Statements</u>  | <u>55</u> |



Table of Contents

**Management's Annual Report on Internal Control over Financial Reporting**

Management of Hawaiian Telcom Holdco, Inc. (the "Company"), including the Chief Executive Officer and the Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) of the Securities Exchange Act of 1934, as amended. The Company's internal controls were designed to provide assurance as to the reliability of its financial reporting and the preparation and presentation of the consolidated financial statements for external purposes in accordance with accounting principles generally accepted in the United States and includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

The Company conducted an evaluation of the effectiveness of its internal control over financial reporting based on the criteria in *Internal Control Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. This evaluation included review of the documentation of controls, evaluation of the design effectiveness of controls, testing of the operating effectiveness of controls and a conclusion on this evaluation. There are inherent limitations in the effectiveness of any system of internal control over financial reporting; however, based on the evaluation, management has concluded the Company's internal control over financial reporting was effective as of December 31, 2013.

The Company's independent registered public accounting firm has audited the accompanying consolidated financial statements and the Company's internal control over financial reporting. The reports of the independent registered public accounting firm are included in this Annual Report on Form 10-K on the following pages.

/s/ ERIC K. YEAMAN

/s/ ROBERT F. REICH

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Eric K. Yeaman  
*Chief Executive Officer*  
March 13, 2014

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Robert F. Reich  
*Senior Vice President and Chief Financial Officer*  
March 13, 2014  
46

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Table of Contents

**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders of  
Hawaiian Telcom Holdco, Inc.  
Honolulu, Hawaii

We have audited the accompanying consolidated balance sheets of Hawaiian Telcom Holdco, Inc. and subsidiaries (the "Company") as of December 31, 2013 and 2012, and the related consolidated statements of income, comprehensive income (loss), changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Hawaiian Telcom Holdco, Inc. and subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2013, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2013, based on the criteria established in *Internal Control Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 13, 2014 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP

Honolulu, Hawaii  
March 13, 2014

Table of Contents

**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders of  
Hawaiian Telcom Holdco, Inc.  
Honolulu, Hawaii

We have audited the internal control over financial reporting of Hawaiian Telcom Holdco, Inc. and subsidiaries (the "Company") as of December 31, 2013, based on criteria established in *Internal Control - Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the criteria established in *Internal Control - Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

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### Table of Contents

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2013 of the Company and our report dated March 13, 2014 expressed an unqualified opinion on those financial statements.

/s/ DELOITTE & TOUCHE LLP

Honolulu, Hawaii  
March 13, 2014

Table of Contents**Hawaiian Telcom Holdco, Inc.****Consolidated Statements of Income****(Dollars in thousands, except per share amounts)**

|   | <b>For the Year Ended December 31,</b> |             |             |
|---|--|-------------|-------------|
|   | <b>2013</b>                            | <b>2012</b> | <b>2011</b> |
| Operating revenues  | \$ 391,150                             | \$ 385,498  | \$ 395,156  |
| Operating expenses:   |  |             |             |
| Cost of revenues (exclusive of depreciation and amortization)         | 163,749                                | 160,226     | 159,822     |
| Selling, general and administrative                                   | 114,875                                | 108,508     | 120,390     |
| Gain on sale of property  | (6,546)                                |             |             |
| Depreciation and amortization   | 77,301                                 | 70,908      | 63,806      |
| Total operating expenses  | 349,379                                | 339,642     | 344,018     |
| Operating income  | 41,771                                 | 45,856      | 51,138      |
| Other income (expense):   |  |             |             |
| Interest expense, net   | (18,875)                               | (22,183)    | (25,339)    |
| Loss on early extinguishment of debt                                  | (3,660)                                | (5,112)     |             |
| Interest income and other   | 34                                     | 59          | 65          |
| Total other expense   | (22,501)                               | (27,236)    | (25,274)    |
| Income before reorganization items and income tax provision (benefit) | 19,270                                 | 18,620      | 25,864      |
| Reorganization items expense  |  |             | 1,050       |
| Income before income tax provision (benefit)                          | 19,270                                 | 18,620      | 24,814      |
| Income tax provision (benefit)  | 8,782                                  | (91,362)    | (1,341)     |
| Net income  | \$ 10,488                              | \$ 109,982  | \$ 26,155   |
| Net income per common share   |  |             |             |
| Basic   | \$ 1.01                                | \$ 10.74    | \$ 2.58     |

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|         |    |      |    |       |    |      |
|---------|----|------|----|-------|----|------|
| Diluted | \$ | 0.95 | \$ | 10.32 | \$ | 2.41 |
|---------|----|------|----|-------|----|------|

Weighted average shares used to compute net income per common share

|       |            |            |            |
|-------|------------|------------|------------|
| Basic | 10,337,339 | 10,242,573 | 10,147,561 |
|-------|------------|------------|------------|

|         |            |            |            |
|---------|------------|------------|------------|
| Diluted | 11,093,931 | 10,660,647 | 10,843,542 |
|---------|------------|------------|------------|

See accompanying notes to consolidated financial statements.

Table of Contents**Hawaiian Telcom Holdco, Inc.****Consolidated Statements of Comprehensive Income (Loss)****(Dollars in thousands)**

|  | <b>For the Year Ended December 31,</b> |             |             |
|--|--|-------------|-------------|
|  | <b>2013</b>                            | <b>2012</b> | <b>2011</b> |
| Net income   | \$ 10,488                              | \$ 109,982  | \$ 26,155   |
| Other comprehensive income (loss), net of tax        |  |             |             |
| Unrealized holding losses arising during period      | (24)                                   | (3)         | (17)        |
| Retirement plan gain (loss)                          | 38,459                                 | 11,490      | (70,894)    |
| Net tax benefit (cost) on other comprehensive income | (14,701)                               | 17,581      |             |
| Other comprehensive income (loss), net of tax        | 23,734                                 | 29,068      | (70,911)    |
| Comprehensive income (loss)                          | \$ 34,222                              | \$ 139,050  | \$ (44,756) |

See accompanying notes to consolidated financial statements.

Table of Contents**Hawaiian Telcom Holdco, Inc.****Consolidated Balance Sheets****(Dollars in thousands, except per share information)**

|  | <b>December 31,</b> |                   |
|--|---------------------|-------------------|
|  | <b>2013</b>         | <b>2012</b>       |
| <b>Assets</b>  |                     |                   |
| Current assets   |                     |                   |
| Cash and cash equivalents  | \$ 49,551           | \$ 66,993         |
| Receivables, net   | 34,521              | 34,082            |
| Material and supplies  | 15,939              | 11,352            |
| Prepaid expenses   | 3,724               | 5,161             |
| Deferred income taxes  | 8,146               | 5,727             |
| Other current assets   | 2,851               | 2,181             |
| <b>Total current assets</b>  | <b>114,732</b>      | <b>125,496</b>    |
| Property, plant and equipment, net   | 524,375             | 507,197           |
| Intangible assets, net   | 40,225              | 39,075            |
| Goodwill   | 12,104              | 1,569             |
| Deferred income taxes  | 75,274              | 102,680           |
| Other assets   | 11,305              | 9,075             |
| <b>Total assets</b>  | <b>\$ 778,015</b>   | <b>\$ 785,092</b> |
| <b>Liabilities and Stockholders' Equity</b>  |                     |                   |
| Current liabilities  |                     |                   |
| Current portion of long-term debt  | \$ 3,000            | \$ 3,000          |
| Accounts payable   | 40,228              | 36,351            |
| Accrued expenses   | 18,787              | 20,537            |
| Advance billings and customer deposits   | 16,122              | 15,185            |
| Other current liabilities  | 6,412               | 3,961             |
| <b>Total current liabilities</b>   | <b>84,549</b>       | <b>79,034</b>     |
| Long-term debt   | 291,679             | 292,410           |
| Employee benefit obligations   | 80,321              | 132,004           |
| Other liabilities  | 8,454               | 4,784             |
| <b>Total liabilities</b>   | <b>465,003</b>      | <b>508,232</b>    |
| Commitments and contingencies (Note 15)  |                     |                   |
| Stockholders' equity   |                     |                   |
| Common stock, par value of \$0.01 per share, 245,000,000 shares authorized and 10,495,856 and 10,291,897 shares issued and outstanding at December 31, 2013 and 2012, respectively | 105                 | 103               |



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|  |            |            |
|--|------------|------------|
| Additional paid-in capital                 | 167,869    | 165,941    |
| Accumulated other comprehensive loss       | (4,716)    | (28,450)   |
| Retained earnings                          | 149,754    | 139,266    |
| Total stockholders' equity                 | 313,012    | 276,860    |
| Total liabilities and stockholders' equity | \$ 778,015 | \$ 785,092 |

See accompanying notes to consolidated financial statements.

Table of Contents**Hawaiian Telcom Holdco, Inc.****Consolidated Statements of Cash Flows****(Dollars in thousands)**

|  | <b>For the Year Ended December 31,</b> |             |             |
|--|--|-------------|-------------|
|  | <b>2013</b>                            | <b>2012</b> | <b>2011</b> |
| <b>Cash flows from operating activities:</b>                                     |  |             |             |
| Net income   | \$ 10,488                              | \$ 109,982  | \$ 26,155   |
| Adjustments to reconcile net income to net cash provided by operating activities |  |             |             |
| Depreciation and amortization  | 77,301                                 | 70,908      | 63,806      |
| Loss on early extinguishment of debt   | 3,660                                  | 5,112       |             |
| Gain on sale of property   | (6,546)                                |             |             |
| Employee retirement benefits   | (13,224)                               | (11,933)    | (9,920)     |
| Provision for uncollectibles   | 3,455                                  | 716         | 2,940       |
| Stock based compensation   | 2,736                                  | 1,872       | 2,135       |
| Deferred income taxes  | 9,617                                  | (90,827)    |             |
| Reorganization items   |  |             | 1,050       |
| Changes in operating assets and liabilities:                                     |  |             |             |
| Receivables  | (3,409)                                | (724)       | (2,930)     |
| Material and supplies  | (4,587)                                | (3,161)     | 240         |
| Prepaid expenses and other current assets  | 456                                    | (1,109)     | 4,039       |
| Accounts payable and accrued expenses  | (6,518)                                | 3,255       | (6,058)     |
| Advance billings and customer deposits   | 138                                    | 424         | (276)       |
| Other current liabilities  | 812                                    | 269         | 1,421       |
| Other, net   | 2,582                                  | 1,676       | (990)       |
| Net cash provided by operating activities before reorganization items            | 76,961                                 | 86,460      | 81,612      |
| Operating cash flows used by reorganization items                                |  |             | (2,393)     |
| Net cash provided by operating activities  | 76,961                                 | 86,460      | 79,219      |
| <b>Cash flows from investing activities:</b>                                     |  |             |             |
| Capital expenditures   | (86,290)                               | (77,713)    | (77,992)    |
| Acquisitions, net of cash acquired   | (11,858)                               | (8,343)     |             |
| Proceeds on sale of property   | 13,118                                 |             |             |
| Proceeds on sale of investments  |  | 746         |             |
| Net cash used in investing activities  | (85,030)                               | (85,310)    | (77,992)    |
| <b>Cash flows from financing activities:</b>                                     |  |             |             |
| Repayment of debt including premium  | (303,083)                              | (306,750)   |             |
| Proceeds from borrowing  | 298,500                                | 295,500     |             |
| Loan refinancing costs   | (3,442)                                | (4,130)     |             |
| Proceeds from stock issuance   |  |             | 49          |
| Repayments of capital lease  | (542)                                  | (582)       | (582)       |
| Revolving loan refinancing costs   |  |             | (253)       |
| Taxes paid related to net share settlement on equity awards                      | (806)                                  | (258)       | (25)        |

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|  |           |           |           |
|--|-----------|-----------|-----------|
| Net cash used in financing activities        | (9,373)   | (16,220)  | (811)     |
| Net change in cash and cash equivalents      | (17,442)  | (15,070)  | 416       |
| Cash and cash equivalents, beginning of year | 66,993    | 82,063    | 81,647    |
| Cash and cash equivalents, end of year       | \$ 49,551 | \$ 66,993 | \$ 82,063 |

See accompanying notes to consolidated financial statements.

Table of Contents**Hawaiian Telcom Holdco, Inc.****Consolidated Statements of Changes in Stockholders' Equity****(Dollars in thousands, except share information)**

|  | Common Stock |        | Additional<br>Paid-In<br>Capital | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Retained<br>Earnings | Total<br>Stockholders'<br>Equity |
|--|--------------|--------|----------------------------------|--|----------------------|----------------------------------|
|  | Shares       | Amount |                                  |  |                      |                                  |
| Balance, January 1, 2011   | 10,135,063   | \$ 101 | \$ 162,169                       | \$ 13,393  | \$ 3,129             | \$ 178,792                       |
| Stock based compensation   |              |        | 2,135                            |  |                      | 2,135                            |
| Issuance of stock under warrant agreements   | 4,021        |        | 49                               |  |                      | 49                               |
| Common stock issued for stock compensation plans, net of shares withheld and withholding paid for employee taxes | 51,442       | 1      | (25)                             |  |                      | (24)                             |
| For the year ended December 31, 2011:  |              |        |                                  |  |                      |                                  |
| Net income   |              |        |                                  |  | 26,155               | 26,155                           |
| Other comprehensive loss, net of tax   |              |        |                                  | (70,911)   |                      | (70,911)                         |
| Balance, December 31, 2011   | 10,190,526   | 102    | 164,328                          | (57,518)   | 29,284               | 136,196                          |
| Stock based compensation   |              |        | 1,872                            |  |                      | 1,872                            |
| Issuance of stock under warrant agreements   | 17           |        |                                  |  |                      |                                  |
| Common stock issued for stock compensation plans, net of shares withheld and withholding paid for employee taxes | 101,354      | 1      | (259)                            |  |                      | (258)                            |
| For the year ended December 31, 2012:  |              |        |                                  |  |                      |                                  |
| Net income   |              |        |                                  |  | 109,982              | 109,982                          |
| Other comprehensive income, net of tax   |              |        |                                  | 29,068   |                      | 29,068                           |
| Balance, December 31, 2012   | 10,291,897   | 103    | 165,941                          | (28,450)   | 139,266              | 276,860                          |
| Stock based compensation   |              |        | 2,736                            |  |                      | 2,736                            |
| Issuance of stock under warrant agreements   | 117,784      | 1      | (1)                              |  |                      |                                  |
| Common stock issued for stock compensation plans, net of shares withheld and withholding paid for employee taxes | 86,175       | 1      | (807)                            |  |                      | (806)                            |
| For the year ended December 31, 2013:  |              |        |                                  |  |                      |                                  |
| Net income   |              |        |                                  |  | 10,488               | 10,488                           |
| Other comprehensive income, net of tax   |              |        |                                  | 23,734   |                      | 23,734                           |
| Balance, December 31, 2013   | 10,495,856   | \$ 105 | \$ 167,869                       | \$ (4,716)   | \$ 149,754           | \$ 313,012                       |

See accompanying notes to consolidated financial statements.

Table of Contents

**Hawaiian Telcom Holdco, Inc.**

**Notes to Consolidated Financial Statements**

**1. Description of Business**

*Business Description*

Hawaiian Telcom Holdco, Inc. and subsidiaries (the "Company") is the incumbent local exchange carrier for the State of Hawaii with an integrated telecommunications network. The Company offers a variety of telecommunication services to residential and business customers in Hawaii including local telephone, network access and data transport, long distance, Internet, television and wireless phone service. The Company also provides communications equipment sales and maintenance, data center colocation and network managed services.

The communication services the Company provides are subject to regulation by the Public Utilities Commission of the State of Hawaii (HPUC) with respect to intrastate rates and services and other matters, and the State of Hawaii Department of Commerce and Consumer Affairs with respect to television. Certain agreements with the HPUC limit the amount of dividends and other distributions the Company may pay as well as place restrictions on certain transactions affecting the operations and capital structure of the Company. The Federal Communication Commission (FCC) regulates rates that the Company charges long-distance carriers and other end-user subscribers for interstate access services and interstate traffic.

*Organization*

The Company has one direct wholly-owned subsidiary, Hawaiian Telcom Communications, Inc. which has two direct wholly-owned subsidiaries Hawaiian Telcom, Inc. and Hawaiian Telcom Services Company, Inc. Hawaiian Telcom, Inc. operates the regulated incumbent local exchange carrier and Hawaiian Telcom Services Company, Inc. operates all other businesses.

**2. Summary of Significant Accounting Policies**

The accompanying consolidated financial statements of the Company have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America and pursuant to the rules and regulations of the U.S. Securities and Exchange Commission ("SEC") and, in the opinion of management, includes all adjustments necessary for a fair presentation of the results of operations, comprehensive income (loss), financial position and cash flows for each period presented.

*Use of Estimates*

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 and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates.

*Principles of Consolidation*

The consolidated financial statements of the Company include the results of operations, financial position, and cash flows of Hawaiian Telcom Holdco, Inc. and its wholly owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

Table of Contents

**Hawaiian Telcom Holdco, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**2. Summary of Significant Accounting Policies (Continued)**

***Revenue Recognition***

Revenue is recognized when evidence of an arrangement exists, the earnings process is complete and collectibility is reasonably assured. The prices for most services are filed in tariffs with the regulatory body that exercises jurisdiction over the services.

Basic local service, enhanced calling features such as caller ID, special access circuits, long-distance flat rate calling plans, most data services, HSI, television, data center colocation and wireless services are billed one month in advance. Revenue for these services is recognized in the month services are rendered. The portion of advance-billed services associated with services that will be delivered in a subsequent period is deferred and recorded as a liability in advance billings and customer deposits.

Amounts billed to customers for activating wireline service are deferred and recognized over the average customer relationship. The costs associated with activating such services are deferred and recognized as an operating expense over the same period. Costs in excess of revenues are recognized as expense in the period in which activation occurs.

Revenues for providing usage based services, such as per-minute long-distance service, access charges billed to long-distance companies for originating and terminating long-distance calls on the Company's network and video on demand, are billed in arrears. Revenues for these services are based on actual rated usage and, where necessary, historical usage patterns, and are recognized in the month services are rendered.

Universal Service revenues are government-sponsored support received in association with providing service in mostly rural, high-cost areas. These revenues are typically based on information provided by the Company and are calculated by the government agency responsible for administering the support program. These revenues are recognized in the period the service is provided.

Telecommunication systems and structured cabling project revenues are recognized on a percentage completion basis, generally based on the relative portion of costs incurred to total estimated costs of a project, except for short duration projects which are recognized upon completion of the project. Maintenance services are recorded when the service is provided.

With respect to arrangements with multiple deliverables, the Company determines whether more than one unit of accounting exists in an arrangement. To the extent that the deliverables are separable into multiple units of accounting, total consideration is allocated to the individual units of accounting based on their relative fair value, determined by the price of each deliverable when it is regularly sold on a stand-alone basis. Revenue is recognized for each unit of accounting as delivered or as service is performed depending on the nature of the deliverable comprising the unit of accounting.

***Taxes Collected from Customers***

The Company presents taxes collected from customers and remitted to governmental authorities on a gross basis, including such amounts in the Company's reported operating revenues and selling, general and administrative expenses. Such amounts represent primarily Hawaii state general excise taxes and HPUC fees. Such taxes and fees amounted to \$7.4 million, \$7.2 million and \$6.8 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Table of Contents

**Hawaiian Telcom Holdco, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**2. Summary of Significant Accounting Policies (Continued)**

***Cash and Cash Equivalents***

Cash and cash equivalents include cash and money market accounts with maturities at acquisition of three months or less. The majority of cash balances at December 31, 2013 are held in one bank in demand deposit accounts.

***Supplemental Non-Cash Investing and Financing Activities***

Accounts payable included \$14.2 million and \$7.4 million at December 31, 2013 and 2012, respectively, for additions to property, plant and equipment.

***Receivables***

The Company recognizes accounts receivable net of an allowance for doubtful accounts. The Company makes estimates of the uncollectibility of its accounts receivable by specifically analyzing accounts receivable and historic bad debts, customer concentrations, customer creditworthiness, current economic trends and changes in its customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. After multiple attempts at collection of delinquent accounts, the balance due is deemed uncollectible and charged against the allowance.

***Material and Supplies***

Material and supplies which consist mainly of cable, supplies and replacement parts, are stated at the lower of cost, determined principally by the average cost method, or net realizable value.

***Property and Depreciation***

Property, plant and equipment are carried at cost. Depreciation has been calculated using the composite remaining life methodology and straight-line depreciation rates. The composite method depreciates the remaining net investment in telephone plant over remaining economic asset lives by asset category. This method requires periodic review and revision of depreciation rates. The average economic lives utilized for assets recognized in conjunction with the Company's fresh-start accounting in October 2010 are as follows: buildings 18 years; cable and wire 11 years; switching and circuit equipment 3 years; and other property 2 to 4 years. The average economic lives for all other assets (i.e., primarily new additions) are as follows: building 34 years; cable and wire 11 to 37 years; switching and circuit equipment 6 to 15 years; and other property 5 to 17 years.

***Software***

The Company capitalizes the costs associated with externally acquired software for internal use. Project costs associated with internally developed software are segregated into three project stages: preliminary project stage, application development stage and post-implementation stage. Costs associated with both the preliminary project stage and post-implementation stage are expensed as incurred. Costs associated with the application development stage are capitalized. Software maintenance and training costs are expensed as incurred. Capitalized software is generally amortized on a straight-line method basis over its useful life, not to exceed five years.

Table of Contents

**Hawaiian Telcom Holdco, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**2. Summary of Significant Accounting Policies (Continued)**

***Goodwill and Other Intangible Assets***

Goodwill and other indefinite-lived intangible assets are not amortized. Such assets are reviewed annually, or more frequently under various conditions, for impairment. The goodwill impairment test involves a two-step process. The first step, identifying a potential impairment, compares the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying value of the reporting unit exceeds its fair value, the second step will need to be conducted. The second step, measuring the impairment loss, compares the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. Any excess of the reporting unit goodwill carrying value over the respective implied fair value is recognized as an impairment loss. The Company performs its annual impairment test during the fourth quarter, primarily using a market valuation and discounted cash flows methodology.

Intangible assets with definite lives, including the value assigned to the customer base, are being amortized over the remaining estimated lives. For customer relationship intangibles, amortization is calculated using a declining balance method in relation to estimated retention lives of acquired customers.

***Impairment of Long-Lived Assets***

The Company assesses the recoverability of long-lived assets, including property, plant and equipment and definite-lived intangible assets, whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In such cases, if the sum of the expected cash flows, undiscounted and without interest, resulting from use of the asset are less than the carrying amount, an impairment loss is recognized based on the difference between the carrying amount and the fair value of the assets.

***Debt Issuance***

Deferred financing costs, included in other assets on the consolidated balance sheet and original issue discount are amortized over the term of the related debt issuance using the effective interest method.

***Income Taxes***

Deferred tax assets and liabilities are determined based on the differences between the financial reporting and tax bases of assets and liabilities at each balance sheet date using enacted tax rates expected to be in effect in the year the differences are expected to reverse. Valuation allowances are recognized to reduce deferred tax assets to the amount that will more likely than not be realized.

The Company recognizes interest and penalties related to unrecognized tax benefits within income tax expense in the accompanying consolidated statements of income.

***Employee Benefit Plans***

Pension and postretirement health and life insurance benefits earned during the year as well as interest on projected benefit obligations are accrued currently. Actuarial gains and losses are amortized over the average remaining expected life of participants deemed inactive.



Table of Contents**Hawaiian Telcom Holdco, Inc.****Notes to Consolidated Financial Statements (Continued)****2. Summary of Significant Accounting Policies (Continued)*****Maintenance and Repairs***

The cost of maintenance and repairs, including the cost of replacing minor items not constituting substantial betterments, is charged to expense as these costs are incurred.

***Advertising***

Advertising costs are expensed as incurred. Advertising expense amounted to \$4.0 million, \$4.2 million and \$4.4 million for the years ended December 31, 2013, 2012 and 2011, respectively.

***Stock Based Compensation***

The Company measures and recognizes the compensation expense for all share-based awards made to employees and directors based on estimated fair values. The fair value of restricted stock units is generally based on share trading price on the date of grant. The fair value of market-based stock awards is estimated using a statistical pricing model as of the date of grant. Because share-based compensation expense is based on awards ultimately expected to vest, it has been reduced for forfeitures.

***Earnings per Share***

Basic earnings per share is based on the weighted effect of all common shares issued and outstanding, and is calculated by dividing earnings by the weighted average shares outstanding during the period. Diluted earnings per share is calculated by dividing earnings, adjusted for the effect, if any, from assumed conversion of all potentially dilutive common shares outstanding, by the weighted average number of common shares used in the basic earnings per share calculation plus the number of common shares that would be issued assuming conversion of all potentially dilutive common shares outstanding. The denominator used to compute basic and diluted earnings per share is as follows:

|  | <b>For the Year Ended December 31,</b> |             |             |
|--|--|-------------|-------------|
|  | <b>2013</b>                            | <b>2012</b> | <b>2011</b> |
| Basic earnings per share weighted average shares   | 10,337,339                             | 10,242,573  | 10,147,561  |
| Effect of dilutive securities:                     |  |             |             |
| Employee and director restricted stock units       | 163,101                                | 112,510     | 145,429     |
| Warrants   | 593,491                                | 305,564     | 550,552     |
| Diluted earnings per share weighted average shares | 11,093,931                             | 10,660,647  | 10,843,542  |

The computation of weighted average dilutive shares outstanding excluded restricted stock units to acquire 7,511 shares of common stock for the year ended December 31, 2012. The unrecognized compensation on a per unit basis for these restricted stock units was greater than the average market price of the Company's common stock for the period presented. Therefore, the effect would be anti-dilutive. For the years ended December 31, 2013 and 2011, the restricted stock units excluded were not significant.

Table of Contents**Hawaiian Telcom Holdco, Inc.****Notes to Consolidated Financial Statements (Continued)****3. Acquisitions*****SystemMetrics Corporation***

On September 30, 2013, the Company completed its acquisition for all the voting stock of SystemMetrics Corporation ("SystemMetrics") for \$16.3 million in cash, net of cash acquired and purchase price adjustments. Of the total purchase price, \$11.9 million was paid at closing of the purchase with the balance subject to an earn-out over a three year period. Payment of the earn-out is contingent on SystemMetrics meeting certain performance metrics and continued employment of the SystemMetrics' key executive. For financial reporting purposes, the earn-out will be accounted for as compensation expense as earned.

SystemMetrics provides virtual and physical data center colocation services in the State of Hawaii along with other telecommunication services that are complementary to the Company's operations. Transaction costs amounted to \$0.9 million, were primarily professional fees and were recognized as general and administrative expenses as incurred.

The Company followed the acquisition method of accounting and allocated the purchase price to the tangible and intangible assets acquired and liabilities assumed based on their provisional fair values, which estimates and assumptions are subject to change within the measurement period, which shall not be more than one year from the acquisition date. The measurement period remains open as of December 31, 2013 as the Company continues to obtain additional information related to the amount recognized for certain assets and estimated liabilities. The excess of the purchase price over the fair values was recorded as goodwill.

Subsequent to the measurement date and within the measurement period, the Company obtained new information related to tax basis that allowed for refinements to provisional amounts. The measurement period adjustments did not have a significant impact on the Company's consolidated statements of income for the year ended December 31, 2013. The adjustments are as follows (dollars in thousands):

|                         | <b>Recognized<br/>as of<br/>Acquisition</b> | <b>Measurement<br/>Period<br/>Adjustments</b> | <b>Recognized<br/>as of<br/>Acquisition<br/>As Revised</b> |
|-------------------------|---|---|--|
| <b>Assets</b>           |   |   |  |
| Property and equipment  | \$ 3,781                                    | \$  | \$ 3,781   |
| Intangible assets       | 4,380                                       |   | 4,380  |
| Goodwill                | 10,368                                      | 159   | 10,527   |
| Other assets            | 643   |   | 643  |
|                         | 19,172                                      | 159   | 19,331   |
| <b>Liabilities</b>      |   |   |  |
| Current liabilities     | 3,684                                       | (5)   | 3,679  |
| Non-current liabilities | 2,304                                       | 332   | 2,636  |
| Deferred income taxes   | 1,326                                       | (168)   | 1,158  |
|                         | 7,314                                       | 159   | 7,473  |
| Net acquisition price   | \$ 11,858                                   | \$  | \$ 11,858  |



Table of Contents**Hawaiian Telcom Holdco, Inc.****Notes to Consolidated Financial Statements (Continued)****3. Acquisitions (Continued)**

The fair value of property, plant and equipment was based on the highest and best use of the specific properties. To determine fair value, the Company considered and applied primarily the cost approach. This approach considers the amount required to construct or purchase a new asset of equal utility at current prices with adjustments to the value for physical deterioration, functional obsolescence and economic obsolescence. The fair value of intangible assets including the trade name and customer relationship intangibles were based on discounted cash flows from projections of results of operations for SystemMetrics. The fair value of liabilities assumed, including future payments related to tenant improvements of \$3.0 million, was based on the present value of the expected future cash flows.

The goodwill recognized is attributed to the anticipated growth opportunities for colocation services and from combining the operations of the Company and SystemMetrics. This includes the ability of the Company to offer a complete data solution to its business customers with more robust virtual and physical colocation. In addition, as a significant component of colocation services is data transmission, the Company can offer SystemMetrics customers multiple transmission options. The goodwill is not deductible for income tax reporting purposes and is attributed to the newly formed data center colocation segment.

The following unaudited pro forma results of operations are provided for the years ended December 31, 2013 and 2012 as if the acquisition of SystemMetrics occurred on January 1, 2012. The pro forma combined results of operations have been prepared by adjusting the historical results of the Company to include the historical results of SystemMetrics. Adjustments were made to the historical results for the purchase price allocation which primarily impacts depreciation and amortization, to eliminate the interest on certain debt financing which was not assumed in the purchase, to eliminate certain intercompany revenue between the entities and to reallocate the transaction related expenses from the 2013 to the 2012 periods.

These supplemental pro forma results of operations are provided for illustrative purposes only and do not purport to be indicative of the actual results that would have been achieved by the combined company for the periods presented or that may be achieved by the combined company in the future. The pro forma results of operations do not include any costs savings or synergies that resulted, or will result, from the acquisition or any estimated costs that will be incurred to integrate SystemMetrics. Future results may vary significantly from the results reflected in this pro forma financial information because of future events and transactions as well as other factors.

The pro forma results are as follows (dollars in thousands):

|            | <b>For the Year Ended</b> |             |
|------------|---------------------------|-------------|
|            | <b>December 31,</b>       |             |
|            | <b>2013</b>               | <b>2012</b> |
| Revenues   | \$ 396,950                | \$ 393,280  |
| Net income | 10,940                    | 109,438     |

For the year ended December 31, 2013, revenues and net loss for SystemMetrics since acquisition amounted to \$2.2 million and \$0.2 million, respectively.

***Wavecom Solutions Corporation***

On December 31, 2012, the Company completed its acquisition for all the voting stock of Wavecom Solutions Corporation ("Wavecom") for \$8.7 million in cash, net of cash acquired and final

Table of Contents**Hawaiian Telcom Holdco, Inc.****Notes to Consolidated Financial Statements (Continued)****3. Acquisitions (Continued)**

purchase adjustments. Wavecom provides telecommunication services in the State of Hawaii which are complementary to the Company's operations. Transaction costs amounted to \$0.8 million, were primarily professional fees and were recognized as general and administrative expenses as incurred.

The Company followed the acquisition method of accounting and allocated the purchase price to the tangible and intangible assets acquired and liabilities assumed based on their provisional fair values. The excess of the purchase price over those fair values was recorded as goodwill. During the measurement period, the Company recognized adjustments to the preliminary purchase price allocation based on new information as to the existence and value of certain assets and liabilities. The measurement period adjustments did not have a significant impact on the Company's consolidated statements of income for the year ended December 31, 2013. In addition, these adjustments did not have a significant impact on the Company's consolidated balance sheets as of December 31, 2012. Therefore, the Company has not retrospectively adjusted the comparative 2012 financial information presented herein. The following table summarizes the assets acquired and the liabilities assumed (dollars in thousands):

|                                     | Recognized<br>as of<br>Acquisition | Measurement<br>Period<br>Adjustments | Recognized<br>as of<br>Acquisition<br>As Revised |
|-------------------------------------|------------------------------------|--------------------------------------|--|
| <b>Assets</b>                       |                                    |                                      |  |
| Property and equipment              | \$ 11,898                          | \$ 876                               | \$ 12,774  |
| Intangible assets                   | 1,060                              | (410)                                | 650  |
| Goodwill                            | 1,569                              | 8                                    | 1,577  |
| Deferred income taxes               |                                    | 488                                  | 488  |
| Other assets                        | 1,663                              |                                      | 1,663  |
|                                     | 16,190                             | 962                                  | 17,152   |
| <b>Liabilities</b>                  |                                    |                                      |  |
| Current liabilities                 | 2,360                              |                                      | 2,360  |
| Payable from Wavecom to the Company | 4,037                              |                                      | 4,037  |
| Non-current liabilities             | 1,450                              | 650                                  | 2,100  |
|                                     | 7,847                              | 650                                  | 8,497  |
| Net acquisition price               | \$ 8,343                           | \$ 312                               | \$ 8,655   |

The Company had a receivable from Wavecom equal to the amount of the payable from Wavecom to the Company. These intercompany balances are now eliminated in the consolidated financial statements of the Company. The Company had previously recognized an allowance reducing the carrying value of the receivable to zero because of concerns regarding collectability. With the acquisition of Wavecom and effective settlement of the balance due, the Company recognized a gross settlement gain of \$4.0 million for its pre-existing relationship with Wavecom. The Company estimates the net impact the settlement gain offset by bad debt expense on Wavecom balances resulted in a net credit of \$2.5 million to selling, general and administrative expenses in the consolidated financial statements for the year ended December 31, 2012.

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The fair value of property, plant and equipment was based on the highest and best use of the specific properties. To determine fair value the Company considered and applied primarily the cost

Table of Contents**Hawaiian Telcom Holdco, Inc.****Notes to Consolidated Financial Statements (Continued)****3. Acquisitions (Continued)**

approach. This approach considers the amount required to construct or purchase a new asset of equal utility at current prices with adjustments to the value for physical deterioration, functional obsolescence and economic obsolescence. The fair value of intangible assets including the brand name and customer relationship intangibles were based on discounted cash flows from projections of results for Wavecom's operations.

The goodwill recognized is attributed to the anticipated synergies to be achieved by combining the operations of the Company and Wavecom. This includes the ability to provide the Company and Wavecom customers a similar set of telecommunication offerings using a joint network composed of the best components of both organizations. All of the goodwill is deductible for income tax reporting purposes and is attributed to the telecommunications segment.

The following unaudited pro forma results of operations are provided for the years ended December 31, 2012 and 2011 as if the acquisition of Wavecom occurred on January 1, 2011. The pro forma combined results of operations have been prepared by adjusting the historical results of the Company to include the historical results of Wavecom. Adjustments were made to the historical results for the purchase price allocation which primarily impacts depreciation and amortization, to eliminate the interest on certain debt financing which was not assumed in the purchase, to eliminate certain intercompany revenue between the entities and to reallocate the transaction related expenses from the year ended December 31, 2012 to the year ended December 31, 2011.

These supplemental pro forma results of operations are provided for illustrative purposes only and do not purport to be indicative of the actual results that would have been achieved by the combined company for the periods presented or that may be achieved by the combined company in the future. The pro forma results of operations do not include any costs savings or synergies that resulted, or will result, from the acquisition or any estimated costs that will be incurred to integrate Wavecom. Future results may vary significantly from the results reflected in this pro forma financial information because of future events and transactions as well as other factors.

The pro forma results are as follows (dollars in thousands):

|            | <b>For the Year Ended<br/>December 31,</b> |             |
|------------|--|-------------|
|            | <b>2012</b>                                | <b>2011</b> |
| Revenues   | \$ 394,159                                 | \$ 408,714  |
| Net income | 106,124                                    | 23,944      |

**4. Receivables**

Receivables consisted of the following (dollars in thousands):

|                                 | <b>December 31,</b> |                  |
|---------------------------------|---------------------|------------------|
|                                 | <b>2013</b>         | <b>2012</b>      |
| Customers and other             | \$ 38,463           | \$ 36,713        |
| Allowance for doubtful accounts | (3,942)             | (2,631)          |
|                                 | <b>\$ 34,521</b>    | <b>\$ 34,082</b> |

Table of Contents**Hawaiian Telcom Holdco, Inc.****Notes to Consolidated Financial Statements (Continued)****4. Receivables (Continued)**

The Company grants credit to customers in the normal course of business. At December 31, 2013 and 2012, the Company did not have customer balances representing more than 10% of total receivables. During the years ended December 31, 2013, 2012 and 2011, the Company had no customers that represented more than 10% of total revenues.

The following is a summary of activity for the allowance for doubtful accounts (dollars in thousands):

|                                | Beginning<br>Balance | Additional<br>Charges to<br>Costs and<br>Expenses | Recoveries to<br>(Deductions<br>from)<br>Allowance | Ending<br>Balance |
|--------------------------------|----------------------|---|--|-------------------|
| January 1 to December 31, 2013 | \$ 2,631             | \$ 3,455  | \$ (2,144)   | \$ 3,942          |
| January 1 to December 31, 2012 | 2,924                | 716   | (1,009)  | 2,631             |
| January 1 to December 31, 2011 | 802                  | 2,940   | (818)  | 2,924             |

In the summary above, the additional charges to costs and expenses for the year ended December 31, 2012 is net of a \$4.0 million settlement gain relating to the preexisting relationship with Wavecom. In 2011, the Company recovered \$2.5 million on two large receivable balances previously assumed to be uncollectible.

**5. Property, Plant and Equipment**

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

|  | December 31, |            |
|--|--------------|------------|
|  | 2013         | 2012       |
| Land   | \$ 67,278    | \$ 73,227  |
| Buildings                                      | 107,273      | 103,104    |
| Central office equipment                       | 149,940      | 124,482    |
| Outside communications plant                   | 290,201      | 244,770    |
| Furniture, vehicles and other work equipment   | 42,613       | 33,663     |
| Construction in progress                       | 24,557       | 20,683     |
| Software                                       | 42,645       | 34,597     |
| Other  | 4,857        | 4,817      |
|  | 729,364      | 639,343    |
| Less accumulated depreciation and amortization | 204,989      | 132,146    |
| Total property, plant and equipment, net       | \$ 524,375   | \$ 507,197 |

Depreciation expense amounted to \$74.5 million, \$68.2 million and \$61.2 million for the years ended December 31, 2013, 2012 and 2011, respectively.

In February 2013, the Company entered into an agreement to sell a parcel of land and warehouse not actively used in the Company's operations for a purchase price, as amended, of \$13.9 million. The sale was subject to due diligence by the buyer and approval of the HPUC. The HPUC approval was received in May 2013 and the sale was consummated in June 2013. The net proceeds, net of commissions and other costs paid through escrow of \$0.8 million, amounted to \$13.1 million. A gain on





Table of Contents**Hawaiian Telcom Holdco, Inc.****Notes to Consolidated Financial Statements (Continued)****5. Property, Plant and Equipment (Continued)**

the sale of \$6.5 million was recognized in 2013 as management concluded the land sold was not grouped with the assets subject to the composite depreciation method. The HPUC approval requires the Company to spend \$0.3 million on training employees on broadband telecommunication deployment and operation. In addition, the HPUC approval provides for the Company to make improvements to its broadband network in an amount equal to the net proceeds less the training cost commitment. The planned training expenses and network capital spending will be recognized as the costs are incurred.

**6. Goodwill and Other Intangible Assets**

The gross carrying amount and accumulated amortization of the identifiable intangible assets are as follows (dollars in thousands):

|                              | December 31, 2013    |                          |                    | December 31, 2012    |                          |                    |
|------------------------------|----------------------|--------------------------|--------------------|----------------------|--------------------------|--------------------|
|                              | Gross Carrying Value | Accumulated Amortization | Net Carrying Value | Gross Carrying Value | Accumulated Amortization | Net Carrying Value |
| Subject to amortization:     |                      |                          |                    |                      |                          |                    |
| Customer relationships       | \$ 21,709            | \$ 8,983                 | \$ 12,726          | \$ 17,850            | \$ 6,285                 | \$ 11,565          |
| Trade name and other         | 320                  | 121                      | 199                | 210                  |                          | 210                |
|                              | 22,029               | 9,104                    | 12,925             | 18,060               | 6,285                    | 11,775             |
| Not subject to amortization: |                      |                          |                    |                      |                          |                    |
| Brand name                   | 27,300               |                          | 27,300             | 27,300               |                          | 27,300             |
|                              | 27,300               |                          | 27,300             | 27,300               |                          | 27,300             |
|                              | \$ 49,329            | \$ 9,104                 | \$ 40,225          | \$ 45,360            | \$ 6,285                 | \$ 39,075          |

During the year ended December 31, 2013, the Company recognized customer relationship intangibles amounting to \$4.3 million and other intangibles amounting to \$0.1 million related to the acquisition of SystemMetrics. The estimated useful life of the customer relationship intangible assets acquired was 13 years. The determination of useful lives for customer relationships was made based on historical and expected customer attrition rates. The Company uses an accelerated amortization method reflecting the rate of expected customer attrition.

During the year ended December 31, 2012, the Company recognized customer relationship intangibles amounting to \$0.9 million and other intangibles amounting to \$0.2 million related to the acquisition of Wavecom. The estimated useful life of the customer relationship intangible assets acquired was 6 years. The determination of useful lives for customer relationships was made based on historical and expected customer attrition rates. The Company uses an accelerated amortization method reflecting the rate of expected customer attrition.

Table of Contents**Hawaiian Telcom Holdco, Inc.****Notes to Consolidated Financial Statements (Continued)****6. Goodwill and Other Intangible Assets (Continued)**

Amortization expense amounted to \$2.8 million, \$2.7 million and \$2.6 million for the years ended December 31 2013, 2012 and 2011, respectively. Estimated amortization expense for the next five years and thereafter is as follows (dollars in thousands):

|            |    |       |
|------------|----|-------|
| 2014       | \$ | 2,896 |
| 2015       |    | 2,498 |
| 2016       |    | 2,101 |
| 2017       |    | 1,703 |
| 2018       |    | 1,308 |
| Thereafter |    | 2,419 |

|  |    |        |
|--|----|--------|
|  | \$ | 12,925 |
|--|----|--------|

In conjunction with the acquisition of SystemMetrics, the Company recognized goodwill of \$10.5 million which will be attributed to the data center colocation segment. In conjunction with the acquisition of Wavecom, the Company adjusted the carrying value of goodwill in 2013 as further discussed in Note 3. The revised goodwill amounted to \$1.6 million and is included in the telecommunications segment.

**7. Accrued Expenses**

Accrued expenses consisted of the following (dollars in thousands):

|                       | December 31, |           |
|-----------------------|--------------|-----------|
|                       | 2013         | 2012      |
| Salaries and benefits | \$ 15,160    | \$ 15,642 |
| Interest              | 2,576        | 3,607     |
| Other taxes           | 1,051        | 1,288     |
|                       | \$ 18,787    | \$ 20,537 |

**8. Long-Term Debt**

Long-Term debt consists of the following (dollars in thousands):

|                         | Interest Rate<br>at December 31,<br>2013 | Final<br>Maturity | December 31, |            |
|-------------------------|--|-------------------|--------------|------------|
|                         |  |                   | 2013         | 2012       |
| Term loan               | 5.00%                                    | June 6, 2019      | \$ 299,138   | \$ 299,250 |
| Original issue discount |  |                   | (4,459)      | (3,840)    |

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|            |            |            |
|------------|------------|------------|
|            | 294,679    | 295,410    |
| Current    | 3,000      | 3,000      |
| Noncurrent | \$ 291,679 | \$ 292,410 |

The term loan outstanding at December 31, 2013 provides for interest at the Alternate Base Rate, a rate which is indexed to the prime rate with certain adjustments as defined, plus a margin of 3.00% or a Eurocurrency rate on deposits of one, two, three or six months but no less than 1.00% per annum

Table of Contents

**Hawaiian Telcom Holdco, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**8. Long-Term Debt (Continued)**

plus a margin of 4.00%. The Company has selected the Eurocurrency rate as of December 31, 2013 resulting in an interest rate currently at 5.00%.

The term loan provides for interest payments no less than quarterly. In addition, quarterly principal payments of \$0.8 million are required. The balance of the loan is due at maturity on June 6, 2019. The Company must prepay, generally within three months after year end, 50% or 25% of excess cash flow, as defined. The percent of excess cash flow required is dependent on the Company's leverage ratio. The excess cash flow payment for the year ended December 31, 2012 amounted to \$2.1 million and was paid in March of 2013. No excess cash flow payment is due for the year ended December 31, 2013. The Company must also make prepayments on loans in the case of certain events such as large asset sales.

The Company also has a revolving credit facility which matures on October 3, 2015. The facility has an available balance of \$30.0 million with no amounts drawn as of or for the periods ended December 31, 2013 and 2012. A commitment fee is payable quarterly to the lender under the facility. Interest on amounts outstanding is based on, at the Company's option, the bank prime rate plus a margin of 3.0% to 6.0% or the Eurocurrency rate for one, two, three or six month periods plus a margin of 4.0% to 5.5%. The margin is dependent on the Company's leverage, as defined in the agreement, at the time of the borrowing.

The obligations under the bank facilities are guaranteed by the Company and each subsidiary with certain exceptions. In addition, the bank credit facilities are collateralized by substantially all of the Company's assets.

The bank credit facilities contain various negative and affirmative covenants that restrict, among other things, incurrence of additional indebtedness, payment of dividends, redemptions of stock, other distributions to shareholders and sales of assets. In addition, there are financial covenants consisting of an interest coverage ratio, leverage ratio and a maximum level of capital expenditures.

***Refinancing 2013***

In June 2013, the Company refinanced its term loan debt. The Company paid a premium on the repayment of the old term loan of \$3.0 million. In addition, the Company paid \$3.4 million in underwriting fees and legal costs. The premium on repayment of debt, existing original issue discount, existing deferred financing costs, underwriting fees and legal costs were accounted for in accordance with accounting standards for modification of debt instruments with different terms. The Company compared each syndicated lenders' loan under the old term loan with the syndicated lenders' loan under the new term loans. For loans under the new term loan that were substantially different, the Company recognized the exchange of debt instruments as a debt extinguishment. For loans under the new term loan that were not substantially different, the Company accounted for the exchange of debt instruments as a modification. As a result of the refinancing, the Company deferred \$2.7 million of financing related costs and recognized a loss on early extinguishment of debt of \$3.7 million.

***Refinancing 2012***

In connection with the February 2012 refinancing of the term loan debt, the Company paid a premium on the repayment of the old term loan of \$6.0 million. In addition, the Company paid \$4.1 million in underwriting fees and legal costs. The premium on repayment of debt, and underwriting

Table of Contents**Hawaiian Telcom Holdco, Inc.****Notes to Consolidated Financial Statements (Continued)****8. Long-Term Debt (Continued)**

fees and legal costs were accounted for in accordance with accounting standards for modification of debt instruments with different terms. The Company compared each syndicated lenders' loan under the old term loan with the syndicated lenders' loan under the new term loan. For loans under the new term loan that were substantially different, the Company recognized the exchange of debt instruments as a debt extinguishment. For loans under the new term loan that were not substantially different, the Company accounted for the exchange of debt instruments as a modification. As a result of the refinancing, the Company capitalized \$5.0 million of the premium on the repayment of debt and refinancing fees and expensed the remainder resulting in a loss on early extinguishment of debt of \$5.1 million.

***Capitalized Interest***

Interest capitalized by the Company amounted to \$1.2 million, \$2.0 million and \$2.3 million for the years ended December 31, 2013, 2012 and 2011, respectively.

***Maturities***

The annual requirements for principal payments on long-term debt, assuming no defaults, as of December 31, 2013 are as follows (dollars in thousands):

|                         |            |
|-------------------------|------------|
| Year Ended December 31, |            |
| 2014                    | \$ 3,000   |
| 2015                    | 3,000      |
| 2016                    | 3,000      |
| 2017                    | 3,000      |
| 2018                    | 3,000      |
| Thereafter              | 284,138    |
|                         | \$ 299,138 |

**9. Employee Benefit Plans*****Pension and Other Postretirement Benefits***

The Company sponsors a defined benefit pension plan, with benefits frozen as of March 1, 2012, and postretirement health and life insurance benefits for union employees. The Company also sponsors a cash balance pension plan for nonunion employees, with benefits frozen as of April 1, 2007, and certain management employees receive postretirement health and life insurance under grandfathered provisions of a terminated plan.

The Company amended its union pension plan on January 24, 2012 for the freeze of benefits effective March 1, 2012. This resulted in a reduction of the projected benefit obligation by \$30.2 million which is the difference between the accumulated benefit obligation and projected benefit obligation at that date. The liability as of January 24, 2012 was measured using a discount rate of 4.54%. The union pension trust assets were also measured as of this date. The reduction in the net recorded liability of \$33.4 million was used to offset actuarial losses previously recognized in the accumulated other comprehensive loss. In addition, the periodic benefit cost was reduced to reflect that there is no future service cost for the union pension plan beginning March 1, 2012.



Table of Contents**Hawaiian Telcom Holdco, Inc.****Notes to Consolidated Financial Statements (Continued)****9. Employee Benefit Plans (Continued)**

The change in projected benefit obligation, change in plan assets, funded status and weighted average actuarial assumptions were as follows (dollars in thousands):

|  | Pension Benefits |             | Other Postretirement Benefits |             |
|--|------------------|-------------|-------------------------------|-------------|
|  | December 31,     |             | December 31,                  |             |
|  | 2013             | 2012        | 2013                          | 2012        |
| <b>Change in projected benefit obligation:</b>   |                  |             |                               |             |
| Obligation at beginning of period  | \$ 245,211       | \$ 249,851  | \$ 53,630                     | \$ 49,731   |
| Service cost   |                  | 1,488       | 1,047                         | 965         |
| Interest cost  | 8,344            | 10,008      | 2,089                         | 2,362       |
| Actuarial (gain) loss  | (16,236)         | 25,014      | (4,044)                       | 2,289       |
| Curtailement   |                  | (30,150)    |                               |             |
| Benefits paid  | (16,989)         | (11,000)    | (1,734)                       | (1,717)     |
| Obligation at end of period  | 220,330          | 245,211     | 50,988                        | 53,630      |
| <b>Change in plan assets:</b>  |                  |             |                               |             |
| Fair value of plan assets at beginning of period   | 164,426          | 141,685     |                               |             |
| Actual return on plan assets   | 29,056           | 19,588      |                               |             |
| Employer contributions   | 11,893           | 14,153      | 1,734                         | 1,717       |
| Benefits paid  | (16,989)         | (11,000)    | (1,734)                       | (1,717)     |
| Fair value of plan assets at end of period   | 188,386          | 164,426     |                               |             |
| <b>Funded status:</b>  |                  |             |                               |             |
| Plan assets less than projected benefit obligation                                       | \$ (31,944)      | \$ (80,785) | \$ (50,988)                   | \$ (53,630) |
| <b>Amounts recognized on balance sheet:</b>  |                  |             |                               |             |
| Other current liabilities  | \$               | \$          | \$ (2,611)                    | \$ (2,411)  |
| Employee benefit obligation, noncurrent  | (31,944)         | (80,785)    | (48,377)                      | (51,219)    |
| Net amount recognized  | \$ (31,944)      | \$ (80,785) | \$ (50,988)                   | \$ (53,630) |
| <b>Actuarial gain (loss) recognized in accumulated other comprehensive income (loss)</b> |                  |             |                               |             |
|  | \$ (3,783)       | \$ (37,844) | \$ (3,752)                    | \$ (8,151)  |



Actuarial assumptions:

| Measurement date                                   | 12/31/2013     | 12/31/2012     | 12/31/2013     | 12/31/2012     |
|--|----------------|----------------|----------------|----------------|
| Discount rate                                      | 4.40% to 4.62% | 3.55% to 3.80% | 4.75% to 5.01% | 3.85% to 4.10% |
| Assumed health care cost trend rate, current       | NA             | NA             | 7.00%          | 7.50%          |
| Assumed health care cost trend rate, ultimate      | NA             | NA             | 5.00%          | 5.00%          |
| Assumed health care cost trend rate, ultimate year | NA             | NA             | 2022           | 2018           |

The estimated amount of the actuarial loss to be amortized from accumulated other comprehensive income (loss) during 2014 is \$0.1 million for pension benefits and \$0.1 million for other postretirement benefits.

Table of Contents**Hawaiian Telcom Holdco, Inc.****Notes to Consolidated Financial Statements (Continued)****9. Employee Benefit Plans (Continued)**

The Company accrues the costs of pension and postretirement benefits over the period from the date of hire until the date the employee becomes fully eligible for benefits. The following provides the components of benefit costs and weighted average actuarial assumptions for the years ended December 31, 2013, 2012 and 2011 (dollars in thousands):

**Pension Benefits**

|                                    | For the Year Ended December 31, |               |                 |
|------------------------------------|---------------------------------|---------------|-----------------|
|                                    | 2013                            | 2012          | 2011            |
| Service cost                       | \$ 1,488                        | \$ 10,008     | \$ 7,621        |
| Interest cost                      | 8,344                           | 10,008        | 10,400          |
| Expected asset return              | (11,860)                        | (11,491)      | (11,567)        |
| Amortization of net (gain) loss    | 628                             | 429           | 19              |
| <b>Total benefit cost (income)</b> | <b>\$ (2,888)</b>               | <b>\$ 434</b> | <b>\$ 6,473</b> |

## Actuarial assumptions:

|   |                |                |                |
|---|----------------|----------------|----------------|
| Discount rate                           | 3.55% to 3.80% | 4.44% to 4.59% | 5.47% to 5.64% |
| Expected return on plan assets          | 7.50%          | 7.75%          | 8.00%          |
| Long-term rate of compensation increase | NA             | 3.50% to 5.00% | 3.50% to 5.00% |

**Other Postretirement Benefits**

|                                 | For the Year Ended December 31, |                 |                 |
|---------------------------------|---------------------------------|-----------------|-----------------|
|                                 | 2013                            | 2012            | 2011            |
| Service cost                    | \$ 1,047                        | \$ 965          | \$ 947          |
| Interest cost                   | 2,089                           | 2,362           | 2,053           |
| Amortization of net (gain) loss | 356                             | 118             | (367)           |
| <b>Total benefit cost</b>       | <b>\$ 3,492</b>                 | <b>\$ 3,445</b> | <b>\$ 2,633</b> |

## Actuarial assumptions:

|  |                |                |                |
|--|----------------|----------------|----------------|
| Discount rate                                      | 3.85% to 4.10% | 4.85% to 5.09% | 5.65% to 5.96% |
| Assumed health care cost trend rate, current       | 7.50%          | 7.50%          | 8.00%          |
| Assumed health care cost trend rate, ultimate      | 5.00%          | 5.00%          | 5.00%          |
| Assumed health care cost trend rate, ultimate year | 2018           | 2018           | 2018           |

The measurement date for all plans was December 31, 2013, 2012 and 2011. At December 31, 2013 and 2012, the accumulated benefit obligation was the same as the projected benefit obligation.

The Company based its selection of an assumed discount rate for 2014 net periodic benefit cost and December 31, 2013 disclosure on a cash flow matching analysis that utilized bond information provided from a published bond index for all non-callable, high quality bonds (i.e., rated AA- or better) as of December 31, 2013. The matching of bond income to anticipated benefit cash flows and the basic methods of

selecting the assumed discount rate and expected return on plan assets at December 31, 2013 did not change from December 31 2012.

Table of Contents

**Hawaiian Telcom Holdco, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**9. Employee Benefit Plans (Continued)**

In selecting the expected rate of return on plan assets of 7.25% for 2014 net periodic benefit cost, the Company considered economic forecasts for the types of investments held by the plans (primarily equity and fixed income investments), the plans' asset allocations and the past performance of the plans' assets. The expected rate of return on plan assets was based on various factors including historical experience and long-term inflation assumptions. The Company's expected long-term rate of return on plan assets is determined using the target allocation of assets which is based on the goal of earning the highest rate of return while maintaining risk at acceptable levels. The plan strives to have assets sufficiently diversified so that adverse or unexpected results from a security class will not have a significant adverse impact on the entire portfolio.

The Company's overall investment strategy is to primarily invest for long-term growth with sufficient investments available to fund near-term benefit payments. The Company aims for diversification of asset types, fund strategies and fund managers. The target allocations for plan assets are 60 percent equity securities and 40 percent fixed income securities. Equity securities primarily include investments in equity funds and common stock of individual companies. Together these investments are diversified in both large and small cap companies located in the United States and internationally. Fixed income securities are in funds that invest in bonds of companies from diversified industries, mortgage-backed securities and U.S. Treasuries.

Accounting standards establish a fair value hierarchy when measuring the fair value of pension plan assets. The three levels of inputs within the hierarchy are defined as follows. Level 1 is quoted prices for identical assets or liabilities in active markets. Level 2 is significant other observable inputs other than level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data. Level 3 is significant unobservable inputs that reflect the Company's own assumptions as to how market participants would price an asset.

Table of Contents**Hawaiian Telcom Holdco, Inc.****Notes to Consolidated Financial Statements (Continued)****9. Employee Benefit Plans (Continued)**

The fair values of the Company's pension plan assets at December 31, 2013 and 2012, based on trading values or fund net asset value, by asset category and basis of valuation are as follows (dollars in thousands):

|                                     | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total      |
|-------------------------------------|---|---|--|------------|
| <b>2013</b>                         |   |   |  |            |
| Common stocks domestic large cap    | \$ 18,658   | \$  | \$   | \$ 18,658  |
| Equity funds large cap index        |   | 100,478   |  | 100,478    |
| Fixed income funds diversified bond |   | 68,242  |  | 68,242     |
| Short term investment funds         |   | 1,008   |  | 1,008      |
|                                     | \$ 18,658   | \$ 169,728  | \$   | \$ 188,386 |
| <b>2012</b>                         |   |   |  |            |
| Common stocks domestic large cap    | \$ 16,419   | \$  | \$   | \$ 16,419  |
| Equity funds large cap index        |   | 84,507  |  | 84,507     |
| Fixed income funds diversified bond |   | 63,050  |  | 63,050     |
| Short term investment funds         |   | 450   |  | 450        |
|                                     | \$ 16,419   | \$ 148,007  | \$   | \$ 164,426 |

The fair values of the financial instruments shown in the table above represent the Company's best estimates of the amounts that would be received upon sale of those assets or that would be paid to transfer those liabilities in an orderly transaction between market participants at that date. Those fair value measurements maximize the use of observable inputs. However, in situations where there is little, if any, market activity for the asset or liability at the measurement date, the fair value measurement reflects the Company's judgments about the assumptions that market participants would use in pricing the asset or liability. Those judgments are developed by the Company based on the best information available in the circumstances.

The Company used the following valuation methodologies for assets measured at fair value. There have been no changes in the methodologies used at December 31, 2013 and 2012.

Equity securities (Level 1) were valued at the closing price reported on the active market on which the individual securities are traded.

Fixed income securities, equity funds, and mutual funds (Level 2) were valued as follows. Fixed income securities are valued based on yields currently available on comparable securities of issuers with similar credit ratings. Equity funds and mutual funds include commingled equity funds that are not open to public investment and are valued at the net asset value per share.

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All contributions made were as required by law. The Company expects to contribute \$13.1 million to its defined benefit pension plans in 2014.

Table of Contents**Hawaiian Telcom Holdco, Inc.****Notes to Consolidated Financial Statements (Continued)****9. Employee Benefit Plans (Continued)**

The Company projects that it will make the following benefit payments for the years ended December 31 (dollars in thousands):

|                   | <b>Pension Plans<br/>Benefits Paid</b> | <b>Other<br/>Postretirement<br/>Benefits Paid</b> |
|-------------------|--|---|
| 2014              | \$ 40,235                              | \$ 2,673  |
| 2015              | 22,133                                 | 2,941   |
| 2016              | 19,930                                 | 3,015   |
| 2017              | 16,099                                 | 3,162   |
| 2018              | 16,480                                 | 3,384   |
| 2019 through 2023 | 64,422                                 | 17,957  |
|                   | <b>\$ 179,299</b>                      | <b>\$ 33,132</b>                                  |

Assumed health care costs trend rates have a significant impact on the amounts reported for other postretirement benefits. A one-percentage point change in the assumed health care cost trend rates would have the following annual effects (dollars in thousands):

|  | <b>1-Percentage<br/>Point Increase</b> | <b>1-Percentage<br/>Point Decrease</b> |
|--|--|--|
| Effect on total of service and interest costs components | \$ 220                                 | \$ (185)                               |
| Effect on postretirement benefit obligation              | 2,660                                  | (2,238)                                |

**401(k) Plan**

The Company participates in two 401(k) employee savings plans that allow for voluntary contributions into designated investment funds by eligible employees with the Company matching employee contributions, up to a maximum of 10% of compensation for union employees after February 29, 2012 and 6% of compensation for non-union employees. Prior to March 1, 2012, union employee matching was 5% of compensation for union employees hired before September 13, 2008 and 6% for union employees hired on or after September 13, 2008. Company contributions were \$4.9 million, \$4.7 million and \$3.9 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Table of Contents**Hawaiian Telcom Holdco, Inc.****Notes to Consolidated Financial Statements (Continued)****10. Income Taxes**

The components of the income tax expense (benefit) are as follows (dollars in thousands):

|   | <b>For the Year Ended<br/>December 31,</b> |                    |                   |
|---|--|--------------------|-------------------|
|   | <b>2013</b>                                | <b>2012</b>        | <b>2011</b>       |
| <b>Current</b>                            |  |                    |                   |
| Federal                                   | \$   | \$                 | \$                |
| State and local                           | (835)                                      | (535)              | (1,341)           |
|   | (835)                                      | (535)              | (1,341)           |
| <b>Deferred</b>                           |  |                    |                   |
| Federal                                   | 8,346                                      | (78,978)           |                   |
| State and local                           | 1,271                                      | (11,849)           |                   |
|   | 9,617                                      | (90,827)           |                   |
| <b>Total income tax expense (benefit)</b> | <b>\$ 8,782</b>                            | <b>\$ (91,362)</b> | <b>\$ (1,341)</b> |

The income tax expense (benefit) differs from the amounts determined by applying the statutory federal income tax rate of 34% to the income or loss before income taxes for the following reasons (dollars in thousands):

|   | <b>For the Year Ended<br/>December 31,</b> |                    |                   |
|---|--|--------------------|-------------------|
|   | <b>2013</b>                                | <b>2012</b>        | <b>2011</b>       |
| Income tax (benefit) at federal rate          | \$ 6,552                                   | \$ 6,331           | \$ 8,437          |
| Increase (decrease) resulting from:           |  |                    |                   |
| State income taxes, net of federal income tax | 814  | 774                | 1,105             |
| Permanent differences                         | 1,826                                      | 501                | 2,517             |
| Capital goods excise tax credit               | (836)                                      | (535)              | (1,341)           |
| Other, net                                    | 6  |                    | 136               |
| Change in valuation allowance                 | 420  | (98,433)           | (12,195)          |
| <b>Total income tax expense (benefit)</b>     | <b>\$ 8,782</b>                            | <b>\$ (91,362)</b> | <b>\$ (1,341)</b> |



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During the years ended December 31, 2013, 2012 and 2011, the permanent difference was attributed primarily to the Company recognizing adjustments to certain tax attributes for income tax purposes.

Table of Contents**Hawaiian Telcom Holdco, Inc.****Notes to Consolidated Financial Statements (Continued)****10. Income Taxes (Continued)**

Deferred income taxes consisted of the following (dollars in thousands):

|   | December 31, |            |
|---|--------------|------------|
|   | 2013         | 2012       |
| Deferred tax liabilities:                   |              |            |
| Property and equipment                      | \$ 37,319    | \$ 36,940  |
| Other basis differences                     | 582          | 568        |
|   | 37,901       | 37,508     |
| Deferred tax assets:                        |              |            |
| Net operating loss and credit carryforwards | 25,730       | 19,126     |
| Intangible assets                           | 62,626       | 76,646     |
| Expenses deferred for tax                   | 7,278        | 7,508      |
| Employee benefits                           | 21,654       | 41,621     |
| Other basis differences                     | 4,453        | 1,014      |
|   | 121,741      | 145,915    |
| Valuation allowance                         | (420)        |            |
|   | 121,321      | 145,915    |
| Deferred tax asset, net                     | \$ 83,420    | \$ 108,407 |

As of December 31, 2013, net operating losses available for carry forward through 2033 amounted to \$60.0 million for federal purposes and \$66.3 million for state purposes. Availability of net operating losses in future periods may be subject to additional limitations if there is a deemed change in control for income tax reporting purposes. Such change in control will be determined for income tax reporting purposes based on future changes in stock ownership.

As of December 31, 2011, the Company maintained a full valuation allowance over its net deferred income tax assets. This situation resulted from the Company having a short history as a new entity (post Chapter 11). From emergence in 2010 through 2012, the Company had generated earnings in all periods. As a result of its continued positive earnings for the year, as well as positive forecasted earnings in the future, management concluded that it was more likely than not that the Company would realize its deferred income tax assets, and therefore, the Company released its valuation allowance as of December 31, 2012. For the year ended December 31, 2013, the Company recognized a valuation allowance for \$0.4 million for charitable loss carry forwards subject to deduction limitations. If there is a decline in the level of actual future or forecasted earnings, the conclusion regarding the need for a valuation allowance may change in future periods resulting in the establishment of a valuation allowance for some or all of the deferred income tax assets. The following is a summary of activity for the valuation allowance (dollars in thousands):

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|                                | Beginning<br>Balance | Charge (Credit)<br>to Income Tax<br>Expense or<br>Equity | Ending<br>Balance |
|--------------------------------|----------------------|--|-------------------|
| January 1 to December 31, 2013 | \$                   | \$ 420   | \$ 420            |
| January 1 to December 31, 2012 | 120,336              | (120,336)  |                   |
| January 1 to December 31, 2011 | 108,312              | 12,024   | 120,336           |

75

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Table of Contents

**Hawaiian Telcom Holdco, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**10. Income Taxes (Continued)**

The Company evaluates its tax positions for liability recognition. As of December 31, 2013, the Company had no unrecognized tax benefit. No interest or penalties related to tax assessments were recognized in the Company's consolidated statements of income for the years ended December 31, 2013, 2012 or 2011. All tax years from 2010 remain open for both federal and Hawaii state purposes.

**11. Stockholder's Equity**

*Warrants*

In 2010, the Company issued warrants to purchase 1,481,055 shares of common stock for \$14.00 per share. The warrants to purchase shares may be exercised anytime from January 26, 2011 to the maturity on October 28, 2015. As of December 31, 2013, 1,245,040 warrants were outstanding.

*Equity Incentive Plan*

The Compensation Committee of the Company's Board of Directors may grant awards under the Company's equity incentive plan in the form of incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock, restricted stock units and other stock-based awards. The maximum number of shares issuable under the new equity incentive plan is 1,400,000 shares. All grants under the equity incentive plan will be issued to acquire shares at the fair value on date of grant.

As of December 31, 2013, all awards were restricted stock units.

*Restricted Stock Units*

Restricted stock units are generally subject to forfeiture if employment terminates prior to release of the restrictions. The Company expenses the cost of restricted stock units, which is determined to be the fair market value of the shares at the date of grant, ratably over the period during which the restrictions lapse.

Restricted stock units have service, performance and market conditions for vesting. Those with service conditions vest in equal installments on each of the first through fourth anniversaries of the date of grant except for those granted to directors which vest over three years. Those with performance and market conditions vest in installments over four years based on the achievement of goals to be established by the Compensation Committee of the Company's Board of Directors.

Table of Contents**Hawaiian Telcom Holdco, Inc.****Notes to Consolidated Financial Statements (Continued)****11. Stockholder's Equity (Continued)**

Activity with respect to outstanding restricted stock units for the years ended December 31, 2013, 2012 and 2011 was as follows:

|                                | Shares    | Weighted-<br>Average<br>Grant-Date<br>Fair Value |
|--------------------------------|-----------|--|
| Nonvested at January 1, 2011   | 246,778   | \$ 12  |
| Granted                        | 111,193   | 24   |
| Vested                         | (53,096)  | 12   |
| Forfeited                      | (55,924)  | 15   |
| Nonvested at January 1, 2012   | 248,951   | 17   |
| Granted                        | 124,636   | 16   |
| Vested                         | (116,711) | 20   |
| Forfeited                      | (33,652)  | 18   |
| Nonvested at January 1, 2013   | 223,224   | 15   |
| Granted                        | 181,330   | 20   |
| Vested                         | (120,902) | 15   |
| Forfeited                      | (22,918)  | 17   |
| Nonvested at December 31, 2013 | 260,734   | \$ 18  |

As of December 31, 2013, there was \$2.0 million of unrecognized share-based compensation expense related to nonvested restricted stock unit awards expected to vest. The cost is expected to be recognized over a weighted-average period of 3 years.

The Company recognized compensation expense of \$2.7 million, \$1.9 million and \$2.1 million for the years ended December 31, 2013, 2012 and 2011, respectively.

The fair value as of the vesting date for the restricted stock units that vested during the years ended December 31, 2013, 2012 and 2011 was \$2.5 million, \$1.8 million and \$0.7 million, respectively. Upon vesting, unit holders have the option to net share-settle to cover the required withholding tax and the remaining amount is converted into an equivalent number of shares of common stock. The total shares withheld were 34,730, 15,360 and 1,654 for the years ended December 31, 2013, 2012 and 2011, respectively, and were based on the value of the restricted stock units as determined by the Company's closing stock price. Total payments for the employees' tax obligations to the tax authorities was \$0.8 million, \$0.3 million and less than \$0.1 million for the years ended December 31, 2013, 2012 and 2011, respectively. Other than reimbursements for tax withholdings, there was no cash received under all share-based arrangements.

Table of Contents**Hawaiian Telcom Holdco, Inc.****Notes to Consolidated Financial Statements (Continued)****12. Restructuring and Reorganization**

In 2011, the Company recorded a restructuring expense of \$1.8 million included in selling, general and administrative expenses in conjunction with a cost reduction plan in the telecommunications segment. The plan was primarily to align the Company's operations to its strategic plan and resulted in the termination of approximately six percent of the Company's workforce. The related severance cost amounted to \$1.4 million. The restructuring included closure of the Company's remaining retail stores, outsourcing of toll operators and downsizing of various other legacy functions. In conjunction with closure of the retail stores, the Company recognized a liability of \$0.4 million for the termination of three retail space leases. All liabilities recognized have been settled with cash payments.

Reorganization items represent expense or income amounts that were recognized as a direct result of the Chapter 11 filing (the Company emerged in 2010) and are presented separately in the consolidated statements of income. Such expense items consisted of \$1.1 million in professional fees for the year ended December 31, 2011. Professional fees relate to legal, financial advisory and other professional costs directly associated with the reorganization process. The Company emerged from Chapter 11 in October 2010 but continued to incur reorganization related expenses until December 2011 as the Chapter 11 cases were not closed until January 2012.

Net cash paid for reorganization items, consisting of professional and other fees, amounted to \$2.4 million for the year ended December 31, 2011.

**13. Leases**

The Company leases certain facilities and equipment for use in the Company's operations under several operating agreements. Certain of the leases provide for escalation or renegotiation of rental rates, and for extension of lease terms. Total rent expense for the Company amounted to \$3.9 million, \$2.7 million and \$2.9 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Information on the aggregate minimum rental commitments under non-cancelable operating leases is as follows (dollars in thousands):

|                           |           |
|---------------------------|-----------|
| Years ended, December 31: |           |
| 2014                      | \$ 2,824  |
| 2015                      | 2,508     |
| 2016                      | 2,232     |
| 2017                      | 2,086     |
| 2018                      | 1,868     |
| Thereafter                | 12,525    |
|                           | \$ 24,043 |

Table of Contents**Hawaiian Telcom Holdco, Inc.****Notes to Consolidated Financial Statements (Continued)****14. Accumulated Other Comprehensive Income (Loss)**

The components of accumulated other comprehensive income (loss) are as follows (dollars in thousands):

|  | Unrealized<br>Gain (Loss) on<br>Investments | Defined Benefit<br>Postretirement<br>Plans | Total      |
|--|---|--|------------|
| January 1, 2011  | \$ (16)                                     | \$ 13,409                                  | \$ 13,393  |
| Other comprehensive income (loss) for 2011             | (17)  | (70,894)                                   | (70,911)   |
| December 31, 2011                                      | (33)  | (57,485)                                   | (57,518)   |
| Other comprehensive income (loss) for 2012, net of tax | (3)   | 29,071                                     | 29,068     |
| December 31, 2012                                      | (36)  | (28,414)                                   | (28,450)   |
| Other comprehensive income (loss) for 2013, net of tax | (24)  | 23,758                                     | 23,734     |
| December 31, 2013                                      | \$ (60)                                     | \$ (4,656)                                 | \$ (4,716) |

Reclassifications out of accumulated other comprehensive income (loss) for the years ended December 31, 2013, 2012 and 2011 were as follows (dollars in thousands):

|   | Year Ended<br>December 31, |        |          |
|---|----------------------------|--------|----------|
|   | 2013                       | 2012   | 2011     |
| Retirement plans                                |                            |        |          |
| Amortization of (gain) loss                     | \$ 984                     | \$ 547 | \$ (348) |
| Income tax charge on other comprehensive income | 374                        |        |          |
| Net of tax                                      | \$ 610                     | \$ 547 | \$ (348) |

The amortization of gain or loss was recognized primarily in selling, general and administrative expense for all three periods presented.

**15. Commitments and Contingencies*****Long-Term Fixed Supplier Commitments***

The Company has entered into agreements with various entities under long-term fixed contractual commitments primarily for technology related services. Annual fixed fee commitments for agreements in effect at December 31, 2013, amounted to the following (dollars in thousands):

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|                           |          |
|---------------------------|----------|
| Years ended, December 31: |          |
| 2014                      | \$ 5,085 |
| 2015                      | 1,765    |
|                           | \$ 6,850 |

Under the long-term agreements, the Company incurred fees amounting to \$12.8 million, \$12.8 million and \$14.7 million for the years ended December 31, 2013, 2012 and 2011, respectively.



Table of Contents**Hawaiian Telcom Holdco, Inc.****Notes to Consolidated Financial Statements (Continued)****15. Commitments and Contingencies (Continued)*****Collective Bargaining Agreement***

The Company has a collective bargaining agreement with the International Brotherhood of Electrical Workers Local 1357 ("IBEW") with an effective date of January 1, 2013 for a term of five years. The agreement covers approximately half of the Company's workforce.

***Third Party Claims***

In the normal course of conducting its business, the Company is involved in various disputes with third parties, including vendors and customers. The outcome of such disputes is generally uncertain and subject to commercial negotiations. The Company periodically assesses its liabilities in connection with these matters and records reserves for those matters where it is probable that a loss has been incurred and the loss can be reasonably estimated. Based on management's most recent assessment, the Company believes that the risk of loss in excess of liabilities recorded is not material for all outstanding claims and disputes and the ultimate outcome of such matters will not have a material adverse effect on the Company's results of operations, cash flows or financial position.

***Litigation***

The Company is involved in litigation arising in the normal course of business. The outcome of litigation is not expected to have a material adverse impact on the Company's consolidated financial statements.

**16. Fair Value of Financial Instruments**

The following method and assumptions were used to estimate the fair value of each class of financial instruments for which it is practical to estimate the fair value.

Cash and cash equivalents, accounts receivable and accounts payable The carrying amount approximates fair value. The valuation is based on settlements of similar financial instruments all of which are short-term in nature and generally settled at or near cost. Cash is measured at Level 1.

Investment securities The fair value of investment securities is based on quoted market prices. Investment securities are included in other assets on the consolidated balance sheets.

Debt The fair value of debt is based on the value at which debt is trading among holders.

The estimated fair value of financial instruments is as follows (dollars in thousands):

|  | Carrying<br>Value | Fair<br>Value |
|--|-------------------|---------------|
| December 31, 2013                              |                   |               |
| Assets investment in U.S. Treasury obligations | \$ 807            | \$ 807        |
| Liabilities long-term debt (carried at cost)   | 294,679           | 299,886       |
| December 31, 2012                              |                   |               |
| Assets investment in U.S. Treasury obligations | \$ 905            | \$ 905        |
| Liabilities long-term debt (carried at cost)   | 295,410           | 302,000       |

80

Table of Contents**Hawaiian Telcom Holdco, Inc.****Notes to Consolidated Financial Statements (Continued)****16. Fair Value of Financial Instruments (Continued)*****Fair Value Measurements***

Fair value for accounting purposes is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price).

Accounting standards establish a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). Assets measured at fair value on a recurring basis represent investment securities included in other assets. Liabilities carried at cost with fair value disclosure on a recurring basis represent long-term debt. A summary is as follows (dollars in thousands):

|  | December 31,<br>2013 | December 31,<br>2012 |
|--|----------------------|----------------------|
| Asset value measurements using:                                |                      |                      |
| Quoted prices in active markets for identical assets (Level 1) | \$ 807               | \$ 905               |
| Significant other observable inputs (Level 2)                  |                      |                      |
| Significant unobservable inputs (Level 3)                      |                      |                      |
|  | \$ 807               | \$ 905               |
|  |                      |                      |
| Liability value measurements using:                            |                      |                      |
| Quoted prices in active markets for identical assets (Level 1) | \$                   | \$                   |
| Significant other observable inputs (Level 2)                  | 299,886              | 302,000              |
| Significant unobservable inputs (Level 3)                      |                      |                      |
|  | \$ 299,886           | \$ 302,000           |

Assets and liabilities measured at fair value on a non-recurring basis for the year ended December 31, 2013 and 2012 represent those recognized in conjunction with the acquisition of SystemMetrics and Wavecom, respectively. A summary of the valued assets and liabilities is included in Note 3 including a discussion of the valuation methodology. The majority of assets and liabilities were valued using level 3 unobservable inputs.

**17. Cash Flow Information**

Supplemental cash flow information is as follows:

|                            | For the Year Ended<br>December 31, |      |      |
|----------------------------|------------------------------------|------|------|
|                            | 2013                               | 2012 | 2011 |
| Cash paid during the year: |                                    |      |      |

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|  |        |        |        |
|--|--------|--------|--------|
| Income taxes paid, net of refunds  | \$     | \$     | \$     |
| Interest paid, net of amounts capitalized  | 18,094 | 21,966 | 25,323 |
| Non-cash investing activities receipt of equipment for settlement of receivable or for capital lease |        |        | 2,250  |
|  | 81     |        |        |

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Table of Contents**Hawaiian Telcom Holdco, Inc.****Notes to Consolidated Financial Statements (Continued)****18. Segment Information**

The Company operates in the two reportable segments of telecommunications and data center colocation. This conclusion is based on how resources are allocated and performance is assessed by the Chief Executive Officer, the Company's chief operating decision maker. The telecommunications segment provides local voice services, long distance voice services, high-speed internet and video. In addition, the segment provides network access which includes data transport. Various related telephony services are provided including equipment and managed services. The data center colocation segment provides physical colocation, virtual colocation and various related telephony services.

In 2013, the Company reevaluated its reportable segments. This was prompted by the acquisition of SystemMetrics and the Company's current strategic focus. Previously, the Company presented a wireline and other segment (which was primarily wireless services). With the diminishing significance of the wireless segment, the Company no longer provides separate wireless information to the Company's chief operating decision maker. Both these segments are now combined into the telecommunications segment. Prior to the acquisition of SystemMetrics on September 30, 2013, the Company did not have data center colocation operations. Hence, the Company was in a single segment prior to 2013 under the revised reportable segment structure.

The following table provides operating financial information for the Company's reportable segments for the year ended and as of December 31, 2013 (dollars in thousands):

|                               | Tele-<br>communications | Data Center<br>Colocation | Intersegment<br>Elimination | Total      |
|-------------------------------|-------------------------|---------------------------|-----------------------------|------------|
| Operating revenues            | \$ 389,168              | \$ 2,188                  | \$ (206)                    | \$ 391,150 |
| Depreciation and amortization | 76,935                  | 366                       |                             | 77,301     |
| Operating income (loss)       | 41,907                  | (136)                     |                             | 41,771     |
| Capital expenditures          | 92,742                  | 299                       |                             | 93,041     |
| Assets                        | 758,993                 | 19,022                    |                             | 778,015    |

Intersegment revenue represents network access services provided by the telecommunications segment for data center colocation. For the year ended December 31, 2013, total operating income above reconciles to the consolidated statement of income as follows:

|   |               |
|---|---------------|
| Operating income                          | \$ 41,771     |
| Corporate other expense                   | 22,501        |
| <b>Income before income tax provision</b> | <b>19,270</b> |

The operating income of the telecommunications segment included the gain from the sale of property for \$6.5 million for the year ended December 31, 2013.

Table of Contents**Hawaiian Telcom Holdco, Inc.****Notes to Consolidated Financial Statements (Continued)****18. Segment Information (Continued)**

The following table provides information on the Company's revenue, net of intersegment eliminations, by product group (dollars in thousands):

|                                       | Year Ended December 31, |            |            |
|---------------------------------------|-------------------------|------------|------------|
|                                       | 2013                    | 2012       | 2011       |
| Local voice and other retail services | \$ 258,604              | \$ 255,592 | \$ 262,744 |
| Network access services               | 130,358                 | 129,906    | 132,412    |
| Data center colocation                | 2,188                   |            |            |
|                                       | \$ 391,150              | \$ 385,498 | \$ 395,156 |

**19. Quarterly Financial Information (Unaudited)**

The Company's quarterly operating results are presented in the following table (dollars in thousands, except per share amounts):

|                               | Operating<br>Revenues | Operating<br>Income | Net<br>Income | Earnings<br>per share -<br>basic | Earnings<br>per share -<br>diluted |
|-------------------------------|-----------------------|---------------------|---------------|----------------------------------|------------------------------------|
| Year Ended December 31, 2013: |                       |                     |               |                                  |                                    |
| First Quarter                 | \$ 95,965             | \$ 8,585            | \$ 1,848      | \$ 0.18                          | \$ 0.17                            |
| Second Quarter                | 96,997                | 15,226              | 3,951         | 0.38                             | 0.36                               |
| Third Quarter                 | 97,682                | 7,914               | 2,061         | 0.20                             | 0.18                               |
| Fourth Quarter                | 100,506               | 10,046              | 2,628         | 0.25                             | 0.23                               |
| Total                         | \$ 391,150            | \$ 41,771           | \$ 10,488     | \$ 1.01                          | \$ 0.95                            |
| Year Ended December 31, 2012: |                       |                     |               |                                  |                                    |
| First Quarter                 | \$ 97,574             | \$ 11,161           | \$ 207        | \$ 0.02                          | \$ 0.02                            |
| Second Quarter                | 94,689                | 10,909              | 5,521         | 0.54                             | 0.51                               |
| Third Quarter                 | 96,647                | 10,901              | 5,615         | 0.55                             | 0.52                               |
| Fourth Quarter                | 96,588                | 12,885              | 98,639        | 9.60                             | 9.21                               |
| Total                         | \$ 385,498            | \$ 45,856           | \$ 109,982    | \$ 10.74                         | \$ 10.32                           |

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As of December 31, 2012, management of the Company concluded that it was more likely than not that the Company would realize its deferred income tax assets and therefore, the Company released its valuation allowance as of that date. That resulted in a total income tax benefit of \$91.0 million in 2012.

### **20. Restricted Net Assets and Parent Company Condensed Financial Information**

Agreements with the HPUC and the debt agreements of Hawaiian Telcom Communications, Inc. limit the ability of the Company's subsidiaries to pay dividends to the parent company and restrict the net assets of all of the Company's subsidiaries.

The following condensed financial information for Hawaiian Telcom Holdco, Inc. reflects parent company financial information only. Such financial information should be read in conjunction with the consolidated financial statements of the Company.

Table of Contents**Hawaiian Telcom Holdco, Inc.****Notes to Consolidated Financial Statements (Continued)****20. Restricted Net Assets and Parent Company Condensed Financial Information (Continued)**

The parent company has accounted for its investment in its consolidated subsidiary on the equity method of accounting. No dividends were paid by the subsidiaries to the parent company at any time during the existence of the parent company.

**Hawaiian Telcom Holdco, Inc.**  
**(Parent Company Only)**  
**Condensed Statements of Income and Comprehensive Income (Loss)**  
**(Dollars in Thousands)**

|  | For the Year Ended December 31, |            |             |
|--|---------------------------------|------------|-------------|
|  | 2013                            | 2012       | 2011        |
| Equity in earnings of Hawaiian Telcom Communications, Inc. | \$ 10,488                       | \$ 109,982 | \$ 26,155   |
| Income tax expense   |                                 |            |             |
| Net income   | 10,488                          | 109,982    | 26,155      |
| Other comprehensive income (loss), net of tax              | 23,734                          | 29,068     | (70,911)    |
| Comprehensive income (loss)                                | \$ 34,222                       | \$ 139,050 | \$ (44,756) |

**Hawaiian Telcom Holdco, Inc.**  
**(Parent Company Only)**  
**Condensed Balance Sheets**  
**(Dollars in Thousands)**

|  | December 31,<br>2013 | December 31,<br>2012 |
|--|----------------------|----------------------|
| <b>Assets</b>                                      |                      |                      |
| Investment in Hawaiian Telcom Communications, Inc. | \$ 313,012           | \$ 276,860           |
| Total assets                                       | \$ 313,012           | \$ 276,860           |

**Stockholders' Equity**

|   |         |          |
|---|---------|----------|
| Common stock, par value \$0.01 per share, 245,000,000 shares authorized and 10,495,856 and 10,291,897 shares issued and outstanding | \$ 105  | \$ 103   |
| Additional paid-in capital  | 167,869 | 165,941  |
| Accumulated other comprehensive loss  | (4,716) | (28,450) |
| Retained earnings   | 149,754 | 139,266  |

|                            |    |         |    |         |
|----------------------------|----|---------|----|---------|
| Total stockholders' equity | \$ | 313,012 | \$ | 276,860 |
|----------------------------|----|---------|----|---------|



Table of Contents

**Hawaiian Telcom Holdco, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**20. Restricted Net Assets and Parent Company Condensed Financial Information (Continued)**

**Hawaiian Telcom Holdco, Inc.  
(Parent Company Only)  
Condensed Statements of Cash Flows  
(Dollars in Thousands)**

|  | <b>For the Year Ended December 31,</b> |             |             |
|--|--|-------------|-------------|
|  | <b>2013</b>                            | <b>2012</b> | <b>2011</b> |
| Net income   | \$ 10,488                              | \$ 109,982  | \$ 26,155   |
| Undistributed earnings of Hawaiian Telcom Communications, Inc.                           | (10,488)                               | (109,982)   | (26,155)    |
| Net cash provided by operating activities, net change in cash and ending balance of cash | \$                                     | \$          | \$          |

Table of Contents

**Item 9. Change In and Disagreements with Accountants on Accounting and Financial Disclosure**

None

**Item 9A. Controls and Procedures**

**Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures**

Eric K. Yeaman, Chief Executive Officer, and Robert F. Reich, Chief Financial Officer, have evaluated the disclosure controls and procedures of Hawaiian Telcom Holdco, Inc. (the "Company") as of December 31, 2013. Based on their evaluations, as of December 31, 2013, they have concluded that the disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective in ensuring that information required to be disclosed by the Company in reports the Company files or submits under the Securities Exchange Act of 1934:

- (1) is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and
- (2) is accumulated and communicated to the Company's management, including the Company's principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

**Changes in Internal Control over Financial Reporting**

There have been no changes in internal control over financial reporting during the quarter ended December 31, 2013 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Annual Report on Internal Control over Financial Reporting**

Management of Hawaiian Telcom Holdco, Inc. (the "Company") has prepared an annual report on internal control over financial reporting. The Company's independent registered public accounting firm has rendered an opinion on the Company's internal control over financial reporting. Management's report, together with the opinion of the independent registered public accounting firm, is set forth in Part II, Item 8 of this report.

**Item 9B. Other Information**

On March 11, 2014, the Company entered into a new employment agreement ("New Agreement"), dated March 11, 2014, with Eric K. Yeaman, the Company's President and Chief Executive Officer (CEO). The New Agreement will be effective October 29, 2014. Mr. Yeaman's Amended and Restated Employment Agreement dated as of April 5, 2010, as amended ("Prior Agreement"), will continue to be in effect until October 28, 2014. The New Agreement will provide for an annual base salary of \$725,000, the opportunity to receive an annual performance payment under the Company's Performance Compensation Plan targeted at 100% of annual base salary, and the opportunity to receive equity awards from time to time under the Company's 2010 Equity Incentive Plan. The New Agreement also provides that he will be eligible to receive severance benefits under the Company's Executive Severance Plan, which was amended and restated effective March 11, 2014 to provide that, (i) upon termination of employment either by the Company without cause or by Mr. Yeaman for good reason, he would be entitled to (a) a lump-sum cash payment in an amount equal to two times the sum of his base salary and his target-level award under the Company's Performance Compensation Plan for the year of termination, and (b) a lump-sum cash payment in an amount equal to an award, if any, under the Company's Performance Compensation Plan that has been earned but not yet paid for a completed calendar year, and (ii) upon termination of Mr. Yeaman's employment due to death or

Table of Contents

disability, he or his estate will be entitled to receive a lump-sum cash payment in an amount equal to an award, if any, under the Company's Performance Compensation Plan that has been earned but not yet paid for a completed calendar year.

Also on March 11, 2014, the Company's Board of Directors amended and restated the Executive Severance Plan in order to incorporate the severance benefits for Mr. Yeaman described above. The purpose of amending the Executive Severance Plan was to incorporate severance benefits that already were being provided under the Prior Agreement.

On March 10, 2014, the Compensation Committee approved amendments to the performance-based restricted stock units ("PBRsUs") granted to employees prior to 2013 to align the structure of the performance goals applicable to these PBRsUs with the PBRsUs granted in 2013 and 2014. Following the amendments, the PBRsUs granted prior to 2013 will vest based on the achievement of the following categories of performance goals for each of the performance years applicable to the pre-amended PBRsUs: (i) the Company's financial performance for revenue and adjusted EBITDA for the applicable performance year and (ii) the Company's total shareholder return (TSR) for a two-year period ending on December 31 of the applicable performance year as compared to the NASDAQ Telecommunications Index. The amendments also provide that participants may receive additional shares upon settlement of the PBRsUs if the financial performance goals and/or the relative TSR performance goal exceed the target goals. After giving effect to the amendments, the Compensation Committee determined the level of performance against the goals set for the 2013 performance period for the PBRsUs granted prior to 2013 and determined that 108.25% of the target PBRsUs for the 2013 performance year vested.

Table of Contents**PART III****Item 10. Directors, Executive Officers and Corporate Governance.****A. Directors**

For information about the Directors and corporate governance of the Company, see the section captioned "Election of Directors" in the Company's Proxy Statement for its 2014 Annual Meeting of Stockholders (the "2014 Proxy Statement"), which section is incorporated herein by reference.

**B. Executive Officers and Key Employees**

The following table provides information regarding our executive officers and other key employees as of March 1, 2014:

| <b>Name</b>     | <b>Age</b> | <b>Position(s)</b>                                  |
|-----------------|------------|---|
| <i>Officers</i> |            |   |
| Eric K. Yeaman  | 46         | President, Chief Executive Officer and Director     |
| Scott K. Barber | 53         | Chief Operating Officer                             |
| Robert F. Reich | 54         | Senior Vice President and Chief Financial Officer   |
| John T. Komeiji | 60         | Senior Vice President and General Counsel           |
| Kevin T. Paul   | 58         | Senior Vice President Technology                    |
| Amy S. Aapala   | 41         | Vice President Customer Service                     |
| Jason K. Fujita | 39         | Vice President Consumer Sales and Product Marketing |
| Paul G. Krueger | 49         | Vice President Business Sales and Product Marketing |

*Eric K. Yeaman* became our President, Chief Executive Officer and a Director in June 2008, and led the Company through its filing for bankruptcy protection under chapter 11 of the United States Bankruptcy Code in December 2008 and its emergence from chapter 11 on October 28, 2010. Prior to joining us, Mr. Yeaman served as Senior Executive Vice President and Chief Operating Officer of Hawaiian Electric Company, Inc. (HECO) from January 2008 to June 2008, where he was responsible for its Oahu operations, energy solutions, public affairs and the financial and administrative process areas. From January 2003 to January 2008, Mr. Yeaman served as Financial Vice President, Treasurer and Chief Financial Officer of Hawaiian Electric Industries, Inc. (HEI), HECO's parent company. At HEI, he oversaw the controller, treasury, investor relations, corporate tax, information technology and enterprise risk management functions. Mr. Yeaman began his career at Arthur Andersen LLP in September 1989. Mr. Yeaman has been a director of Alexander & Baldwin, Inc. since June 2012 and a director of Alaska Air Group, Inc. since November 2012. He also is a director of the United States Telecom Association.

*Scott K. Barber* became our Chief Operating Officer in January 2013. Mr. Barber is responsible for overseeing day-to-day operations of the Company's technology, sales, marketing, customer service, customer care, business operations, and business development teams, and is tasked with integrating them to drive the implementation of our strategic plan. Prior to joining us, Mr. Barber was Vice President of Operations of Consolidated Communications, an Illinois-based telecommunications company, since July 2012, during which time he led field and network operations teams across six states. Prior to joining Consolidated Communications, Mr. Barber held various executive positions at SureWest Communications beginning 1994, most recently as Chief Operating Officer from 2011 to 2012.

*Robert F. Reich* became our Senior Vice President and Chief Financial Officer in May 2008. He previously served as our Senior Vice President and interim Chief Financial Officer from March 2008 and Vice President, Finance and Controller from April 2007 to March 2008. Mr. Reich oversees our financial operations, including financial analysis and reporting, corporate and regulatory accounting, tax,

Table of Contents

risk management, treasury and investor relations. Prior to joining us, Mr. Reich was with McLeodUSA Incorporated from 2002 to 2007, a facilities-based competitive local exchange carrier servicing small and mid-sized businesses in the Western and Midwestern United States, serving most recently as Vice President, Controller and Treasurer. Mr. Reich is a Certified Public Accountant.

*John T. Komeiji* became our Senior Vice President and General Counsel in June 2008 and is responsible for our legal, government affairs, support services, external affairs, and as of November 2010, human resources and labor relations. Prior to joining us, Mr. Komeiji was senior partner at Watanabe Ing & Komeiji LLP from 1998 to June 2008, where his practice focused on litigation of complex commercial, personal injury and professional liability matters. He is the past president of the Hawaii State Bar Association and has served on the American Bar Association's Standing Committee on Lawyer Competence.

*Kevin T. Paul* became our Senior Vice President Technology in August 2011 and is responsible for the architecture, engineering, development, test and support of our network and systems. Mr. Paul has held leadership technology roles for over 25 years. Prior to joining us, he served in various capacities at Level 3 Communications since 2000, including as Vice President of Content Engineering & Development from January 2009 to July 2011, where he had responsibility for the architecture, engineering, development, test and tier IV support of Level 3's CDN and VYVX services, and Vice President of Network Integration from November 2005 to December 2008, where he had responsibility for network due diligence, integration, planning and execution.

*Amy S. Aapala* became our Vice President Customer Service in March 2013, and is responsible for our order management systems, network operations, and construction services. She joined us in 2005, having most recently served as our Executive Director-Field Operations from December 2011 and Executive Director-OMS Operations from January 2011 to December 2011. Ms. Aapala has more than 18 years of experience in the telecommunications industry. Prior to joining us, Ms. Aapala worked as a consultant for The Carlyle Group and in senior management positions in billing and customer service with various telecommunications companies.

*Jason K. Fujita* became our Vice President Consumer Sales and Product Marketing in November 2013. He previously served as our Vice President Consumer Sales from August 2012. Mr. Fujita is in charge of our customer contact centers as well as our public communications, wireless, *Hawaiian Telcom TV* and multiple dwelling unit sales, and consumer product marketing. He began his career with us in 1997, having most recently served as Executive Director Consumer and Business Sales from April 2012 to August 2012 and Director Contact Centers from May 2009 to April 2012.

*Paul G. Krueger* became our Vice President Business Sales and Product Marketing in November 2013. He previously served as our Vice President Business and Wholesale Sales from October 2012. Mr. Krueger is in charge of our business sales, business sales operations, sales engineering, sales planning and performance analysis, wholesale markets, and business product marketing. With more than 20 years in the telecommunications industry, he previously served in various capacities at SureWest Communications beginning 1995, most recently as Executive Director of business sales from 2008 to September 2012.

**Item 11. Executive Compensation**

For information about executive compensation, see the section captioned "Compensation of the Named Executive Officers and Directors" in the Company's 2014 Proxy Statement, which section is incorporated herein by reference.

Table of Contents

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

See the section captioned "Security Ownership of Certain Stockholders, Directors and Executive Officers" in the Company's 2014 Proxy Statement, which section is incorporated herein by reference.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

See the sections captioned "Certain Relationships and Related Transactions" and "Director Independence" in the Company's 2014 Proxy Statement, which sections are incorporated herein by reference.

**Item 14. Principal Accounting Fees and Services.**

See the section captioned "Ratification of the Appointment of Deloitte & Touche LLP as the Company's Independent Registered Public Accounting Firm for 2014" in the Company's 2014 Proxy Statement, which section is incorporated herein by reference.

Table of Contents

**PART IV**

**Item 15. Exhibits, Financial Statement Schedules.**

(a)

The following documents are being filed as part of this report.

1. Consolidated Financial Statements. Financial statements and supplementary data required by this Item 15 are set forth at the pages indicated in Item 8 above.
2. Financial Statement Schedules. All schedules for which provision is made in the applicable accounting regulations of the SEC are not required under the related instructions, are inapplicable or not material, or the information called for thereby is otherwise included in the financial statements and therefore has been omitted.
3. Exhibits required by Item 601 of Regulation S-K.

| <b>Exhibit No.</b> | <b>Description of Exhibit</b>   |
|--------------------|---|
| 2.1                | Plan of Reorganization, dated December 30, 2009, confirmed by the Bankruptcy Court (incorporated by reference to Exhibit 2.1 of the Registrant's Form 10-12B, File No. 1-34686, filed with the SEC on April 7, 2010).   |
| 3.1                | Amended and Restated Certificate of Incorporation of Hawaiian Telcom Holdco, Inc., filed October 28, 2010 with The State of Delaware (incorporated by reference to Exhibit 3.1 of the Registrant's Form 10-12G, File No. 0-54196, filed with the SEC on November 16, 2010).   |
| 3.2                | Bylaws of Hawaiian Telcom Holdco, Inc., amended and restated effective November 9, 2010 (incorporated by reference to Exhibit 3.2 of the Registrant's Form 10-12G, File No. 0-54196, filed with the SEC on November 16, 2010).  |
| 4.1                | Form of Common Stock Certificate (incorporated by reference to Exhibit 4.6 of the Registrant's Form 10-12G, File No. 0-54196, filed with the SEC on November 16, 2010).   |
| 4.2                | Warrant Agreement and form of Warrant Certificate dated October 28, 2010, between Hawaiian Telcom Holdco, Inc. and U.S. Bank National Association (incorporated by reference to Exhibit 4.7 of the Registrant's Form 10-12G, File No. 0-54196, filed with the SEC on November 16, 2010).  |
| 10.1               | Supply Chain Services Agreement by and between Hawaiian Telcom Communications, Inc. and KGP Logistics, Inc. (KGP) dated December 7, 2009 (incorporated by reference to Exhibit 10.3 of the Registrant's Form 10-12B, File No. 1-34686, filed with the SEC on April 7, 2010).  |
| 10.2               | Intellectual Property Agreement between GTE Corporation, Hawaiian Telcom Holdco, Inc., Verizon HoldCo LLC and Hawaiian Telcom Communications, Inc., dated May 2, 2005 (incorporated by reference to Exhibit 10.11 of Hawaiian Telcom Communications, Inc.'s Form S-4, File No. 333-131152, filed with the SEC on January 19, 2006). |
| 10.3               | Verizon Proprietary Software License Agreement between GTE Corporation and Hawaiian Telcom Communications, Inc., effective as of May 2, 2005 (incorporated by reference to Exhibit 10.12 of Hawaiian Telcom Communications, Inc.'s Form S-4, File No. 333-131152, filed with the SEC on January 19, 2006).                          |

## Edgar Filing: Hawaiian Telcom Holdco, Inc. - Form 10-K

### Table of Contents

| <b>Exhibit No.</b> | <b>Description of Exhibit</b>   |
|--------------------|---|
| 10.4               | Amendment No. 1, dated March 5, 2007, to the Verizon Proprietary Software License Agreement between GTE Corporation and Hawaiian Telcom Communications, Inc., effective as of May 2, 2005 (incorporated by reference to Exhibit 10.17 of Hawaiian Telcom Communications, Inc.'s Form 10-K, File No. 333-131152, filed with the SEC on April 2, 2007). |
| 10.5               | Production Agreement between Dataprose, Inc. and Hawaiian Telcom Communications, Inc., dated as of October 15, 2005 (incorporated by reference to Exhibit 10.24 of Hawaiian Telcom Communications, Inc.'s Form S-4, File No. 333-131152, filed with the SEC on January 19, 2006).   |
| 10.6               | Amendment No. 1 to the Production Agreement between Dataprose, Inc. and Hawaiian Telcom Communications, Inc., dated February 1, 2006 (incorporated by reference to Exhibit 10.29 of Hawaiian Telcom Communications, Inc.'s Amendment No. 1 to Form S-4, File No. 333-131152, filed with the SEC on March 31, 2006).                                   |
| 10.7               | Amended and Restated Master Application Services Agreement effective as of March 13, 2009, by and between Hawaiian Telcom Communications, Inc. and Accenture LLP (incorporated by reference to Exhibit 10.14 of the Registrant's Form 10-12B, File No. 1-34686, filed with the SEC on April 7, 2010).   |
| 10.8*              | Amended and Restated Employment Agreement dated as of April 5, 2010, by and between Eric K. Yeaman and Hawaiian Telcom Holdco, Inc. (incorporated by reference to Exhibit 10.15 of the Registrant's Form 10-12B, File No. 1-34686, filed with the SEC on April 7, 2010).  |
| 10.9*              | Amendment dated May 12, 2011 to Amended and Restated Employment Agreement, dated as of April 5, 2010, by and between Eric K. Yeaman and Hawaiian Telcom Holdco, Inc. (incorporated by reference to Exhibit 10.2 of the Registrant's Form 10-Q, File No. 0-54196, filed with the SEC on May 16, 2011).   |
| 10.10*             | Employment Offer Letter, dated March 11, 2014 and effective as of October 29, 2014, by and between Eric K. Yeaman and Hawaiian Telcom Holdco, Inc.  |
| 10.11*             | Employment Offer Letter, effective as of December 12, 2012, by and between Scott K. Barber and Hawaiian Telcom Communications, Inc. (incorporated by reference to Exhibit 10.10 on the Registrant's Form 10-K, File No. 1-34686, filed with the SEC on March 13, 2013).   |
| 10.12*             | Employment Offer Letter, effective as of December 17, 2012, by and between Robert F. Reich and Hawaiian Telcom Communications, Inc. (incorporated by reference to Exhibit 10.14 on the Registrant's Form 10-K, File No. 1-34686, filed with the SEC on March 13, 2013).   |
| 10.13*             | Employment Agreement, effective as of July 28, 2008, by and between John T. Komeiji and Hawaiian Telcom Communications, Inc. (incorporated by reference to Exhibit 10.21 of the Registrant's Form 10-12B, File No. 1-34686, filed with the SEC on April 7, 2010).   |
| 10.14*             | Amendment dated December 21, 2009 to Employment Agreement, effective as of July 28, 2008, by and between John T. Komeiji and Hawaiian Telcom Communications, Inc. (incorporated by reference to Exhibit 10.22 of the Registrant's Form 10-12B, File No. 1-34686, filed with the SEC on April 7, 2010).  |



## Edgar Filing: Hawaiian Telcom Holdco, Inc. - Form 10-K

### Table of Contents

| <b>Exhibit No.</b> | <b>Description of Exhibit</b>   |
|--------------------|---|
| 10.15*             | General Waiver and Release of Claims dated October 5, 2012, by and between Kurt Hoffman and Hawaiian Telcom Communications, Inc. (incorporated by reference to Exhibit 10.19 on the Registrant's Form 10-K, File No. 1-34686, filed with the SEC on March 13, 2013).  |
| 10.16              | Credit Agreement, dated as of February 29, 2012, among Hawaiian Telcom Communications, Inc., as borrower, Hawaiian Telcom Holdco, Inc., the lenders party thereto, and Credit Suisse AG, Cayman Islands Branch, as administrative agent and collateral agent (incorporated by reference to Exhibit 10.1 of the Registrant's Form 10-Q, File No. 1-34686, filed with the SEC on May 10, 2012).   |
| 10.17              | Amendment No. 1 dated June 6, 2013 to the Credit Agreement, dated as of February 29, 2012, among Hawaiian Telcom Communications, Inc., as borrower, Hawaiian Telcom Holdco, Inc., the lenders party thereto, and Credit Suisse AG, Cayman Islands Branch, as administrative agent and collateral agent (incorporated by reference to Exhibit 10.1 of the Registrant's Form 10-Q, File No. 1-34686, filed with the SEC on August 5, 2013). |
| 10.18              | Guarantee and Collateral Agreement, dated as of February 29, 2012, among Hawaiian Telcom Holdco, Inc., Hawaiian Telcom Communications, Inc., the subsidiaries of Hawaiian Telcom Communications, Inc. identified therein, and Credit Suisse AG, Cayman Islands Branch, as collateral agent (incorporated by reference to Exhibit 10.2 of the Registrant's Form 10-Q, File No. 1-34686, filed with the SEC on May 10, 2012).               |
| 10.19              | Amended and Restated Revolving Line of Credit Agreement, dated as of October 3, 2011, by and among Hawaiian Telcom Communications, Inc., First Hawaiian Bank, as agent, and each of the lenders from time to time party thereto (incorporated by reference to Exhibit 10.1 of the Registrant's Form 8-K, File No. 1-34686, filed with the SEC on October 6, 2011).  |
| 10.20              | Amended and Restated Guaranty, dated as of October 3, 2011, by and among Hawaiian Telcom Holdco, Inc., Hawaiian Telcom, Inc., Hawaiian Telcom Services Company, Inc., and First Hawaiian Bank (incorporated by reference to Exhibit 10.2 of the Registrant's Form 8-K, File No. 1-34686, filed with the SEC on October 6, 2011).  |
| 10.21*             | Hawaiian Telcom 2010 Equity Incentive Plan, dated as of October 29, 2010 (incorporated by reference to Exhibit 10.31 of the Registrant's Form 10-12G, File No. 0-54196, filed with the SEC on November 16, 2010).   |
| 10.22*             | Form of Restricted Stock Unit Agreement for Executives pursuant to the Hawaiian Telcom 2010 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 of the Registrant's Form 10-Q, File No. 1-34686, filed with the SEC on May 6, 2013).   |
| 10.23*             | Form of Restricted Stock Unit Agreement for the CEO pursuant to the Hawaiian Telcom 2010 Equity Incentive Plan (incorporated by reference to Exhibit 10.33 of the Registrant's Form 10-12G, File No. 0-54196, filed with the SEC on November 16, 2010).   |
| 10.24*             | Form of Restricted Stock Unit Agreement for Non-Employee Directors pursuant to the Hawaiian Telcom 2010 Equity Incentive Plan (incorporated by reference to Exhibit 10.2 of the Registrant's Form 10-Q, File No. 1-34686, filed with the SEC on May 6, 2013).   |
| 10.25*             | Form of Amendment effective as of March 10, 2014 to Restricted Stock Unit Agreements.   |
| 10.26*             | Hawaiian Telcom Performance Compensation Plan, dated as of March 21, 2011 (incorporated by reference to Exhibit 10.36 on the Registrant's Form 10-K, File No. 0-54196, filed with the SEC on March 28, 2011).   |

## Edgar Filing: Hawaiian Telcom Holdco, Inc. - Form 10-K

### Table of Contents

| <b>Exhibit No.</b> | <b>Description of Exhibit</b>   |
|--------------------|---|
| 10.27*             | Hawaiian Telcom Holdco, Inc. Amended and Restated Executive Severance Plan, effective March 11, 2014. |
| 21.1               | List of Subsidiaries.   |
| 23.1               | Consent of Deloitte & Touche LLP dated March 13, 2014.  |
| 31.1               | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 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 Section 906 of the Sarbanes-Oxley Act of 2002.   |
| 32.2               | Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.   |
| 99.1               | Earnings Release dated March 13, 2014.  |
| 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  |

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Identifies each management contract or compensatory plan or arrangement.

