

Hawaiian Telcom Holdco, Inc.

Form 10-Q

November 14, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended September 30, 2011

OR

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

For the transition period from to

Commission File Number: 001-34686

Hawaiian Telcom Holdco, Inc.

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(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

84-1659868

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

1177 Bishop Street

Honolulu, Hawaii 96813

(Address of principal executive offices)

808-546-4511

(Registrant's telephone number, including area code)

Not Applicable

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer ☐

Accelerated Filer ☐

Non-Accelerated Filer ☒
(Do not check if smaller reporting company)

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 ☒

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As of November 14, 2011, 10,190,526 shares of the registrant's common stock were outstanding.

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[Table of Contents](#)**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****Hawaiian Telcom Holdco, Inc.****Condensed Consolidated Statements of Operations****(Unaudited, dollars in thousands, except per share amounts)**

	Successor		Predecessor	
	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2010
Operating revenues	\$ 97,040	\$ 296,290	\$ 101,455	\$ 301,329
Operating expenses:				
Cost of revenues (exclusive of depreciation and amortization)	39,055	121,585	41,943	121,557
Selling, general and administrative	28,066	88,584	31,145	94,656
Depreciation and amortization	17,086	47,603	41,604	126,275
Total operating expenses	84,207	257,772	114,692	342,488
Operating income (loss)	12,833	38,518	(13,237)	(41,159)
Other income (expense):				
Interest expense (contractual interest was \$19,017 and \$56,612 for the three and nine months ended September 30, 2010, respectively)	(6,364)	(18,858)	(7,142)	(21,047)
Interest income and other	21	51	29	59
Total other expense	(6,343)	(18,807)	(7,113)	(20,988)
Income (loss) before reorganization items and income tax benefit	6,490	19,711	(20,350)	(62,147)
Reorganization items	(70)	880	3,474	7,301
Income (loss) before income tax benefit	6,560	18,831	(23,824)	(69,448)
Income tax benefit	(813)	(813)	(346)	(346)
Net income (loss)	\$ 7,373	\$ 19,644	\$ (23,478)	\$ (69,102)
Net income (loss) per common share -				
Basic	\$ 0.73	\$ 1.94	\$ (54.86)	\$ (161.45)
Diluted	\$ 0.68	\$ 1.80	\$ (54.86)	\$ (161.45)

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Weighted average shares used to
compute net income (loss) per common
share -

Basic	10,138,795	10,138,358	428,000	428,000
Diluted	10,775,318	10,921,717	428,000	428,000

See accompanying notes to condensed consolidated financial statements.

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Hawaiian Telcom Holdco, Inc.
Condensed Consolidated Balance Sheets
(Unaudited, dollars in thousands, except per share amounts)

	September 30, 2011	December 31, 2010
Assets		
Current assets		
Cash and cash equivalents	\$ 82,383	\$ 81,647
Receivables, net	34,330	39,222
Material and supplies	8,534	8,431
Prepaid expenses	5,261	5,707
Other current assets	1,522	4,566
Total current assets	132,030	139,573
Property, plant and equipment, net	471,716	459,781
Intangible assets, net	41,505	43,315
Other assets	4,017	3,367
Total assets	\$ 649,268	\$ 646,036
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	\$ 20,113	\$ 24,162
Accrued expenses	22,319	28,752
Advance billings and customer deposits	14,091	14,948
Other current liabilities	3,202	2,810
Total current liabilities	59,725	70,672
Long-term debt	300,000	300,000
Employee benefit obligations	86,607	94,453
Other liabilities	2,968	2,119
Total liabilities	449,300	467,244
Commitments and contingencies (Note 15)		
Stockholders' equity		
Common stock, par value of \$0.01 per share, 245,000,000 shares authorized and 10,139,084 and 10,135,063 shares issued and outstanding at September 30, 2011 and December 31, 2010, respectively	101	101
Additional paid-in capital	163,708	162,169
Accumulated other comprehensive income	13,386	13,393
Retained earnings	22,773	3,129
Total stockholders' equity	199,968	178,792
Total liabilities and stockholders' equity	\$ 649,268	\$ 646,036

See accompanying notes to condensed consolidated financial statements.

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Hawaiian Telcom Holdco, Inc.
Condensed Consolidated Statements of Cash Flows
(Unaudited, dollars in thousands)

	Successor Nine Months Ended September 30, 2011	Predecessor Nine Months Ended September 30, 2010
Cash flows from operating activities:		
Net income (loss)	\$ 19,644	\$ (69,102)
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Depreciation and amortization	47,603	126,275
Employee retirement benefits	(7,846)	(11,446)
Provision for uncollectibles	1,507	4,501
Stock based compensation	1,489	59
Interest cost added to loan principal		10,474
Reorganization items	880	7,301
Changes in operating assets and liabilities:		
Receivables	1,884	(2,390)
Material and supplies	(103)	(2,633)
Prepaid expenses and other current assets	3,491	(5,712)
Accounts payable and accrued expenses	(8,960)	6,657
Advance billings and customer deposits	(858)	900
Other current liabilities	974	283
Other	(1,059)	359
Net cash provided by operating activities before reorganization items	58,646	65,526
Operating cash flows used by reorganization items	(2,222)	(13,924)
Net cash provided by operating activities	56,424	51,602
Cash flows used in investing activities:		
Capital expenditures	(55,156)	(50,611)
Net cash used in investing activities	(55,156)	(50,611)
Cash used in financing activities:		
Proceeds from sale of common stock	50	
Repayments of capital lease	(582)	
Net cash used in financing activities	(532)	
Net change in cash and cash equivalents	736	991
Cash and cash equivalents, beginning of period	81,647	96,550
Cash and cash equivalents, end of period	\$ 82,383	\$ 97,541
Supplemental disclosure of cash flow information:		
Interest paid, net of amounts capitalized	\$ 18,858	\$ 9,892
Non-cash investing activities - receipt of equipment for settlement of receivable or for capital lease	2,250	

See accompanying notes to condensed consolidated financial statements.

Table of Contents**Hawaiian Telcom Holdco, Inc.****Condensed Consolidated Statement of Changes in Stockholders' Equity (Deficiency)**

(Unaudited, dollars in thousands)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Total Stockholders' Equity (Deficiency)
Successor						
Balance, January 1, 2011	10,135,063	\$ 101	\$ 162,169	\$ 13,393	\$ 3,129	\$ 178,792
Stock based compensation			1,489			1,489
Sale of common stock under warrant agreement	4,021		50			50
Net income					19,644	19,644
Other comprehensive income unrealized loss on investments				(7)		(7)
Balance, September 30, 2011	10,139,084	\$ 101	\$ 163,708	\$ 13,386	\$ 22,773	\$ 199,968
Predecessor						
Balance, January 1, 2010	428,000	\$ 4	\$ 428,993	\$ (33,191)	\$ (576,070)	\$ (180,264)
Stock based compensation			59			59
Net loss					(69,102)	(69,102)
Other comprehensive income Reclassification adjustment for recognition of loss on interest rate swap				416		416
Unrealized gain on investments				16		16
Balance, September 30, 2010	428,000	\$ 4	\$ 429,052	\$ (32,759)	\$ (645,172)	\$ (248,875)

See accompanying notes to condensed consolidated financial statements.

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Hawaiian Telcom Holdco, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

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 servicing approximately 422,000 voice access lines as of September 30, 2011. The Company also served approximately 216,000 long distance lines and 102,000 High-Speed Internet (HSI) connections as of that date.

As a result of the adoption of fresh-start reporting, the financial statements before and on October 31, 2010 are not comparable to the financial statements for the period after October 31, 2010. References to Successor refer to the Company after October 31, 2010 after giving effect to the adoption of fresh-start reporting. References to Predecessor refer to the Company prior to and on October 31, 2010. See Note 2 for further details.

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 local exchange carrier and Hawaiian Telcom Services Company, Inc. operates all other businesses.

2. Chapter 11

On December 1, 2008, Hawaiian Telcom Holdco, Inc. and its subsidiaries, with the exception of Hawaiian Telcom Insurance Company, Incorporated (the Non-Debtor), filed voluntary petitions for reorganization under Chapter 11 of Title 11 of the United States Code (the Bankruptcy Code) in the United States Bankruptcy Court for the District of Delaware. The cases were transferred to the District of Hawaii on December 22, 2008 (the Bankruptcy Court). The Debtors continued to operate as debtors-in-possession under the jurisdiction of the Bankruptcy Court and orders of the Bankruptcy Court. In general, as debtors-in-possession, the Debtors were authorized under Chapter 11 to continue to operate as an ongoing business but could not engage in transactions outside the ordinary course of business without the prior approval of the Bankruptcy Court.

On June 3, 2009, the Debtors filed a plan of reorganization with the Bankruptcy Court together with the disclosure statement. On August 28, 2009, the Bankruptcy Court approved distribution of the disclosure statement for vote by the prepetition creditors. On November 13, 2009, the judge of the Bankruptcy Court ruled that the plan as presented was approved. The final confirmation order was issued by the Court on

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December 30, 2009. The plan of reorganization, including the proposed debt and equity structure, was subject to approval of the Hawaii Public Utilities Commission (HPUC) and Federal Communications Commission. Approvals were obtained in September 2010 and relevant appeal periods expired in October 2010. After satisfying all conditions precedent to emergence under the Plan, the Company emerged from Chapter 11 effective as of October 28, 2010 (Emergence Date).

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3. Basis of Presentation

The accompanying unaudited condensed 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. Certain information and disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted and condensed. In the opinion of the Company's management, all adjustments (consisting of only normal and recurring accruals) have been made to present fairly the financial position, the results of operations and cash flows for the periods presented. The results of operations for the periods presented are not necessarily indicative of the results to be expected for the full year. Although the Company believes that the disclosures are adequate to make the information presented not misleading, these financial statements should be read in conjunction with the Company's audited consolidated financial statements as of and for the year ended December 31, 2010.

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 September 30, 2011 are held in one bank in demand deposit accounts.

Supplemental Non-Cash Investing and Financing Activities

Accounts payable included \$0.7 million and \$8.5 million at September 30, 2011 and 2010, respectively, for additions to property, plant and equipment.

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. Such amounts represent primarily Hawaii state general excise taxes and HPUC fees. Such taxes and fees amounted to \$1.6 million and \$5.0 million for the three and nine months ended September 30, 2011 and \$1.5 million and \$4.6 million for the three and nine months ended September 30, 2010, respectively.

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 computation of diluted earnings per share excludes the impact of outstanding stock options for Predecessor periods as they were antidilutive to earnings per share. The denominator used to compute basic and diluted earnings per share by the Successor for the three and nine months ended September 30, 2011 is as follows:

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	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
Basic earnings per share - weighted average shares	10,138,795	10,138,358
Effect of dilutive securities:		
Employee and director restricted stock units	133,122	145,556
Warrants	503,401	637,803
Diluted earnings per share - weighted average shares	10,775,318	10,921,717

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Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board (FASB) issued guidance on the presentation of comprehensive income. The new guidance is effective for fiscal years and interim periods beginning after December 15, 2011. The adoption of this new guidance is not expected to have a material effect on the Company's condensed consolidated financial statements.

In May 2011, the FASB issued amendments to achieve common fair value measurement and disclosure requirements in U.S. generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRSs). The amendments explain how to measure fair value and improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRSs. The guidance is effective during interim and annual periods beginning after December 15, 2011. The Company is currently evaluating the potential impact of the accounting guidance on the condensed consolidated financial statements.

4. Reorganization Items

The accompanying condensed consolidated financial statements have been prepared in accordance with accounting standards for financial reporting by entities in reorganization under the Bankruptcy Code. The Predecessor's condensed consolidated statement of operations for the three and nine months ended September 30, 2010 present the results of operations during the Chapter 11 proceedings. As such, any revenues, expenses, and gains and losses realized or incurred that are directly related to the bankruptcy case were reported separately as reorganization items due to the bankruptcy. The operations of the Non-Debtor, included in the condensed consolidated statement of operations and cash flow statement were not significant.

Reorganization items represent expense or income amounts that were recognized as a direct result of the Chapter 11 filing and are presented separately in the condensed consolidated statements of operations. Such items consist of the following (dollars in thousands):

	Successor		Predecessor	
	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2010
Professional fees (reimbursements)	\$ (70)	\$ 880	\$ 3,476	\$ 7,308
Other			(2)	(7)
	\$ (70)	\$ 880	\$ 3,474	\$ 7,301

Professional fees relate to legal, financial advisory and other professional costs directly associated with the reorganization process.

Net cash paid for reorganization items, consisting of professional and other fees, amounted to \$2.2 million and \$13.9 million for the nine months ended September 30, 2011 and 2010, respectively.

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5. Receivables

Receivables consisted of the following (dollars in thousands):

	September 30, 2011	December 31, 2010
Customers and other	\$ 36,151	\$ 40,024
Allowance for doubtful accounts	(1,821)	(802)
	\$ 34,330	\$ 39,222

In the second quarter of 2011, the Company recovered \$2.5 million on two large receivable balances previously assumed to be uncollectible.

6. Long-Lived Assets

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

	September 30, 2011	December 31, 2010
Property, plant and equipment	\$ 524,573	\$ 468,315
Less accumulated depreciation	(52,857)	(8,534)
	\$ 471,716	\$ 459,781

Depreciation expense amounted to \$16.3 million and \$45.8 million for the three and nine months ended September 30, 2011. Depreciation expense amounted to \$31.5 million and \$96.0 million for the three and nine months ended September 30, 2010.

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

	September 30, 2011			December 31, 2010		
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Subject to amortization customer relationships	\$ 17,000	\$ 2,795	\$ 14,205	\$ 17,000	\$ 985	\$ 16,015

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Not subject to amortization
brand name

27,300

27,300

27,300

27,300

\$	44,300	\$	2,795	\$	41,505	\$	44,300	\$	985	\$	43,315
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Amortization expense amounted to \$0.8 million and \$1.8 million for the three and nine months ended September 30, 2011. Amortization expense amounted to \$10.1 million and \$30.3 million for the three and nine months ended September 30, 2010. Estimated amortization expense for the next five years and thereafter is as follows (dollars in thousands):

2011 (remaining months)	\$	760
2012		2,730
2013		2,421
2014		2,112
2015		1,803
Thereafter		4,379
	\$	14,205

7. Accrued Expenses

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

	September 30, 2011	December 31, 2010
Salaries and benefits	\$ 14,999	\$ 21,382
Interest	4,875	4,875
Other taxes	2,445	2,495
	\$ 22,319	\$ 28,752

8. Long-Term Debt

Long-term debt consists of a term loan which has an original principal amount of \$300.0 million and will mature on October 28, 2015. For each fiscal year that the Company has a cash balance greater than \$67.5 million, the Company shall prepay, no later than 105 days after the fiscal year end, loans in an aggregate amount equal to the lesser of: (a) 75% of excess cash flow, as defined, for such fiscal year; and (b) the amount by which the cash balance exceeds \$67.5 million. In addition, the Company must make prepayment on loans in the case of certain prepayment events such as large assets sales. No term loan prepayment is anticipated for 2011.

The loans on the term loan bear interest at a Eurocurrency rate on deposits for one, two, three or six month periods but no less than 3% plus a margin of 6%. The interest rate on the debt at September 30, 2011 was 9%. The Company may request interest at the rate of 1.5% be paid-in-kind for 2011 and added to the principal balance of the loan.

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The term loan includes a provision whereby members of the lender group may request that the Company make an offer to exchange term loan debt for equity at the then fair value of common equity shares. The Company, in its sole discretion, can make the offer or not. The Company, in its sole discretion, can also initiate an offer to exchange term loan debt for equity at the then fair value of common equity shares. Members of the lender group are not required to accept such offers.

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On October 3, 2011, the Company extended its revolving credit facility to mature on October 3, 2015. The facility has an available balance of \$30.0 million with no amounts drawn during the nine months ended and as of September 30, 2011. 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 a leverage ratio, minimum liquidity and a maximum level of capital expenditures.

Contractual Interest Expense

The Predecessor recorded postpetition interest on prepetition obligations only to the extent it believed the interest would be paid during the bankruptcy proceedings or that it was probable that the interest would be an allowed claim. Had the Predecessor recorded interest expense based on all of the prepetition contractual obligations, interest expense would have increased by \$11.9 million and \$35.6 million for the three and nine months ended September 30, 2010.

9. Derivative Instruments and Hedging Activities

The Company utilized a combination of fixed-rate and variable-rate debt to finance its operations. The variable-rate debt exposed the Company to variability in interest payments due to changes in interest rates. Management believed that it was prudent to mitigate the interest rate risk on a portion of its variable-rate borrowings. To meet this objective, management maintained interest rate swap agreements to manage fluctuations in cash flows resulting from adverse changes in interest rates on its term loans and notes.

Changes in the fair value of interest rate swaps designated as hedging instruments that effectively offset the variability of cash flows associated with the Company's variable-rate debt obligations were reported in accumulated other comprehensive loss. These amounts were subsequently reclassified into interest expense as a yield adjustment of the hedged interest payment in the same period in which the related interest payments affect earnings.

The impact of interest rate swaps, classified as cash flow hedges, was for the three and nine months ended September 30, 2010 a reclassification from accumulated other comprehensive loss into income (effective portion recognized as interest expense) in the amount of \$0.1 million and \$0.4 million, respectively. Amounts included in accumulated other comprehensive loss for the cash flow hedges were reclassified into earnings as cash interest was paid on the underlying debt that was hedged. There are no ongoing interest rate hedging activities.

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10. Employee Benefit Plans

The Company sponsors a defined benefit pension plan and postretirement medical and life insurance benefits for union employees. The Company also sponsors a cash balance pension plan for nonunion employees and certain management employees receive postretirement health and life insurance under grandfathered provisions of a terminated plan.

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 for the three and nine months ended September 30, 2011 and 2010 (dollars in thousands):

Pension

	Successor		Predecessor	
	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2010
Service cost	\$ 1,821	\$ 5,463	\$ 1,756	\$ 5,268
Interest cost	2,708	8,124	2,537	7,611
Expected asset return	(2,943)	(8,829)	(2,103)	(6,309)
Amortization of loss			381	1,143
Net periodic benefit cost	1,586	4,758	2,571	7,713

Other Postretirement Benefits

	Successor		Predecessor	
	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2010
Service cost	\$ 229	\$ 687	\$ 285	\$ 855
Interest cost	514	1,542	566	1,698
Amortization of gain	(99)	(297)		
Net periodic benefit cost	\$ 644	\$ 1,932	\$ 851	\$ 2,553

The Company previously disclosed in its consolidated financial statements for the year ended December 31, 2010 that it expected to contribute \$17.0 million to its pension plan in 2011. As of September 30, 2011, the Company has contributed \$13.3 million. The Company presently anticipates contributing the full amount during the remainder of 2011.

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

	Successor		Predecessor	
	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2010
Income tax provision (benefit)	\$ 2,230	\$ 6,403	\$ (8,100)	\$ (23,613)
Increase (decrease) resulting from:				
Permanent difference	(8,351)	(8,351)		
State income taxes, net of federal income tax	262	753	(953)	(2,778)
Valuation allowance	5,046	382	8,707	26,045
Income tax benefit	\$ (813)	\$ (813)	\$ (346)	\$ (346)

The permanent difference is attributed to a reduction in certain gains recognized only for income tax return purposes related to emergence from Chapter 11.

A valuation allowance has been provided at September 30, 2011 and December 31, 2010 for the deferred tax assets because of the uncertainty of future realization of such amounts. The Company assesses the recoverability of deferred income tax assets and the related valuation allowance on a quarterly basis. To the extent that the Company consistently generates income in future periods and it determines that such valuation allowance is no longer required, the tax benefit of all or a portion of the remaining deferred tax assets will be recognized at that time.

The Company evaluates its tax positions for liability recognition. As of September 30, 2011, the Company had no unrecognized tax benefits. No interest or penalties related to tax assessments were recognized in the Company's condensed consolidated statements of operations for the three or nine months ended September 30, 2011 or 2010. All tax years from 2007 remain open for both federal and Hawaii state purposes.

12. Stock Compensation**Successor**

On October 28, 2010, the new equity incentive plan became effective pursuant to the plan of reorganization. The Compensation Committee of the Company's Board of Directors may grant awards under the 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

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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.

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As of September 30, 2011, all awards were restricted stock units. Activity with respect to outstanding restricted stock units for the nine months ended September 30, 2011 was as follows:

	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2011	246,778	\$ 12
Granted	88,222	26
Vested		
Forfeited	(49,723)	15
Nonvested at September 30, 2011	285,277	\$ 16

The Successor recognized compensation expense of \$0.5 million and \$1.5 million for the three and nine months ended September 30, 2011. There was no cash received under all share-based payment arrangements during the same period. The Company did not receive any tax benefits for the tax deductions from share-based payment arrangements during the period.

Predecessor

The Predecessor recognized share-based compensation expense of less than \$0.1 million for the three and nine months ended September 30, 2010 related to option grants.

13. Restructuring

In the second quarter of 2011, the Company recorded a restructuring expense of \$1.9 million included in selling, general and administrative expenses in conjunction with a cost reduction plan in the wireline segment. The plan is primarily to align the Company's operations to its current strategic plan and resulted in the termination of approximately six percent of the Company's workforce. 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 for the termination of three retail space leases.

The following is a summary of the major components of the restructuring charges and the remaining accrual balance relating to the restructuring plan (dollars in thousands):

	Severance	Lease Termination	Total
Restructuring expense	\$ 1,477	\$ 470	\$ 1,947

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Cash payments		(1,266)			(1,266)
Balance at September 30, 2011	\$	211	\$	470	\$ 681

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14. Comprehensive Income (Loss)

A summary of components of comprehensive income (loss) is as follows (dollars in thousands):

	Successor		Predecessor	
	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2010
Net income (loss)	\$ 7,373	\$ 19,644	\$ (23,478)	\$ (69,102)
Other comprehensive income (loss) -				
Reclassification adjustment for recognition of loss on interest rate swap			140	416
Unrealized gain (loss) on investments	7	(7)	25	16
Other comprehensive income (loss)	7	(7)	165	432
Comprehensive income (loss)	\$ 7,380	\$ 19,637	\$ (23,313)	\$ (68,670)

15. Commitments and Contingencies

Collective Bargaining Agreement

On October 24, 2011, after several extensions beyond the original September 12, 2011 expiration date, the Company's collective bargaining agreement with the International Brotherhood of Electrical Workers Local 1357 (IBEW) expired. The agreement covers approximately half of the Company's work force. On October 31, 2011, the IBEW announced that a majority of union-represented employees rejected the Company's last, best, and final offer and authorized union leadership to call a strike. On November 10, 2011, the IBEW declared a work stoppage. The Company cannot predict the ultimate outcome of the work stoppage including whether management will be able to negotiate a new collective bargaining agreement on terms believed necessary to be competitive.

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

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

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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 because of the short maturities of these instruments.

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

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

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

	Carrying Value	Fair Value
September 30, 2011		
Assets - investment in U.S. Treasury obligations (Level 1)	\$ 1,754	\$ 1,754
Liabilities - long-term debt (carried at cost)	300,000	296,000
December 31, 2010		
Assets - investment in U.S. Treasury obligations (Level 1)	\$ 1,805	\$ 1,805
Liabilities - long-term debt (carried at cost)	300,000	300,000

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.

17. Segment Information

The Company operates in two reportable segments (Wireline Services and Other) based on how resources are allocated and performance is assessed by the Company's Chief Executive Officer, the Company's chief operating decision maker. The Wireline Services segment provides local telephone service including voice and data transport, enhanced custom calling features, network access, directory assistance and private lines. In addition, the Wireline Services segment provides Internet, long distance services, television, managed services, customer premise equipment, data solutions, billing and collection, and pay telephone services. The Other segment consists primarily of wireless services.

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The following table provides operating financial information for the Company's two reportable segments (dollars in thousands):

	Wireline Services	Other	Intersegment Elimination	Total
Successor				
For the three months ended September 30, 2011				
Operating revenues				
Local voice and other retail services	\$ 63,134	\$ 1,394	\$ (324)	\$ 64,204
Network access services	32,836			32,836
	\$ 95,970	\$ 1,394	\$ (324)	\$ 97,040
Depreciation and amortization	\$ 17,086	\$	\$	\$ 17,086
Net income (loss)	8,170	(797)		7,373
For the nine months ended September 30, 2011				
Operating revenues				
Local voice and other retail services	\$ 192,577	\$ 4,263	\$ (987)	\$ 195,853
Network access services	100,437			100,437
	\$ 293,014	\$ 4,263	\$ (987)	\$ 296,290
Depreciation and amortization	\$ 47,603	\$	\$	\$ 47,603
Net income (loss)	22,501	(2,857)		19,644
Capital expenditures	54,977			54,977
Assets as of December 31, 2010	\$ 645,425	\$ 611	\$	\$ 646,036
Predecessor				
For the three months ended September 30, 2010				
Operating revenues				
Local voice and other retail services	\$ 67,113	\$ 1,524	\$ (368)	\$ 68,269
Network access services	33,186			33,186
	\$ 100,299	\$ 1,524	\$ (368)	\$ 101,455
Depreciation and amortization	\$ 41,572	\$ 32	\$	\$ 41,604
Net loss	(22,639)	(839)		(23,478)
For the nine months ended September 30, 2010				
Operating revenues				
Local voice and other retail services	\$ 198,761	\$ 4,676	\$ (1,092)	\$ 202,345
Network access services	98,984			98,984
	\$ 297,745	\$ 4,676	\$ (1,092)	\$ 301,329
Depreciation and amortization	\$ 126,189	\$ 86	\$	\$ 126,275
Net loss	(66,742)	(2,360)		(69,102)
Capital expenditures	52,156			52,156

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Item 2. Management's Discussion and Analysis of

Financial Condition and Results of Operations

Forward-Looking Statements

This quarterly report contains forward-looking statements. These statements relate to future events or our future financial performance (including our anticipated cost structure) and involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as may, should, expects, intends, plans, anticipates, believes, estimates, predicts, potential, continues, assumption or the negative of these terms or other comparable terminology. These statements (including statements related to our anticipated cost structure) are only predictions. Actual events or results may differ materially from those anticipated or projected due to a number of factors. These factors include, but are not limited to:

- our ability to execute our strategic plan;
- our ability to operate as a stand-alone telecommunications provider;
- our ability to maintain arrangements with third-party service providers;
- our ability to negotiate a collective bargaining agreement on reasonable terms with minimal disruption to our customers;
- changes in regulations and legislation applicable to providers of telecommunications services;
- changes in demand for our products and services;
- technological changes affecting the telecommunications industry; and
- our indebtedness could adversely affect our financial condition.

These and other factors may cause our actual results to differ materially from any forward-looking statement. Refer to our Annual Report on Form 10-K and Part II, Item 1A of this Form 10-Q for a detailed discussion of risks that could materially adversely affect our business, financial condition or results of operations. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also materially adversely affect our business operations.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. These forward-looking statements are made as of the date of issuance of these quarterly condensed consolidated financial statements, we assume no obligation to update or revise them or to provide reasons why actual results may differ.

We do not undertake any responsibility to release any revisions to these forward-looking statements to take into account events or circumstances that occur after the date of issuance of these quarterly condensed consolidated financial statements. Additionally, we do not undertake any responsibility to update you on the occurrence of any unanticipated events which may cause actual results to differ from those expressed or implied by the forward-looking statements contained in this quarterly report.

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.

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Chapter 11 Reorganization

On December 1, 2008, we and certain of our subsidiaries filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code and on October 28, 2010, we emerged from Chapter 11. For further information regarding these petitions, see Note 2 to the condensed consolidated financial statements. Under the Plan of reorganization, all of the existing common stock and stock options were cancelled upon emergence and the equity holders received no recovery. Our emergence from Chapter 11 on the Emergence Date resulted in a new reporting entity and the new shares of common stock were issued to the former secured lenders. We adopted fresh-start reporting as of October 31, 2010. As required by fresh-start accounting, our assets and liabilities have been adjusted to fair value. Accordingly, our financial condition and results of operations after October 31, 2010 are not comparable to the financial condition and result of operations for periods prior to and on October 31, 2010.

Operational Matters

We have operated as a stand-alone service provider since the acquisition of the Company from Verizon Communications, Inc. on May 2, 2005. Our original strategic plan was designed to focus on opportunities to leverage our incumbent market position, enhance the penetration of certain underperforming products, introduce new products, services and bundles tailored to the specific needs of the local market, and reposition the Company as a locally branded, managed and operated full service telecommunications provider. Our ability to execute the initiatives contemplated in our original strategic plan were hindered by functionality deficiencies experienced after we cutover from the legacy Verizon systems to our new back-office and IT infrastructure in 2006. Management was required to commit substantial resources to respond to the lack of functionality in the Company's critical back-office systems. As a result, our ability to invest in new technologies, introduce new products and enhance our customer service experience was delayed and negatively impacted our financial performance and financial condition.

We have implemented revised strategies designed to stabilize our business and position the Company for growth. We have introduced a number of innovative new products and advanced communications solutions into the marketplace, successfully deployed MPLS core network technologies capable of reaching over 90% of the State population, improved the automation of our systems, grown our broadband market share and made significant progress in rebuilding the brand and image of the Company. We believe the successful execution of these strategies assisted in stabilizing our operating results.

We are in the process of implementing new strategies which focus on growing the business, delivering superior service and improving financial performance. We continue to evaluate the feasibility of various new product and service offerings in order to respond to customer demand and gain market share in our business, consumer and wholesale channels. We may also pursue other business development opportunities, cost reduction initiatives and asset rationalization options to improve financial performance and liquidity. There can be no assurance that these new strategies will be successful or even if successful whether we will have the resources to fund such strategies, or that the investments in these new strategies will be recovered.

In the second quarter of 2011, we initiated a restructuring of selective operations in our wireline segment to align such operations with our current strategic plan. The restructuring has resulted in termination of approximately six percent of our workforce in the second half of 2011. The restructuring includes closure of our remaining retail stores, outsourcing of toll operators and downsizing of various other legacy functions. Costs of the restructuring of \$1.9 million were recognized in the second quarter of 2011.

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On June 24, 2011, the State of Hawaii's Department of Commerce and Consumer Affairs approved our video franchise application, allowing us to offer video services on the island of Oahu. On July 1, 2011, we commercially launched our digital television services to selected areas of Oahu. We are rolling out Hawaiian Telcom TV gradually to selected areas to ensure the delivery of superior service and an ongoing excellent customer experience. We have converted the majority of our trial customers for television service to paying connections and have initiated targeted marketing efforts resulting in penetration rates consistent with our plan for initial deployment. This volume is anticipated to ramp up significantly 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.

On October 24, 2011, after several extensions beyond the original September 12, 2011 expiration date, our collective bargaining agreement with the International Brotherhood of Electrical Workers Local 1357 (IBEW) expired. The agreement covers approximately half of our work force. On October 31, 2011, the IBEW announced that a majority of union-represented employees rejected our last, best, and final offer and authorized union leadership to call a strike. On November 10, 2011, the IBEW declared a work stoppage. We cannot predict the ultimate outcome of the work stoppage including whether we will be able to negotiate a new collective bargaining agreement on terms we believe are necessary to be competitive.

On October 27, 2011, the Federal Communications Commission (FCC) adopted new rules governing Universal Service Fund (USF) support and inter-carrier compensation (ICC) reform. Among other things, the FCC adopted a new ICC regime that will result in the elimination of terminating switched access revenue charges over six years. Additionally, the FCC will redirect high-cost USF support that is used currently for basic telephone service to support for broadband (including mobile broadband) service in unserved geographical areas. While the full order pertaining to these new rules has not been released, we are evaluating the new rules and assessing the potential impact on our results of operations.

Segments and Sources of Revenue

We operate in two reportable segments (Wireline Services and Other) 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.

Overview

We operate the incumbent local telecommunications company that serves business and residential customers in the State of Hawaii. We offer our customers a variety of telecommunication services including local telephone, network access, long distance, High-Speed Internet (HSI) and other Internet, television, and other telecommunication services and sales, and wireless services.

Wireline Services

The Wireline Services segment derives revenue from the following sources:

Local 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.

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Network Access Services We receive revenue from charges established to compensate us for origination, transport and termination of calls for long distance and other interexchange carriers. These include subscriber line charges imposed on end users, and switched and special access (data line and Dedicated Internet Access) charges paid by carriers and others.

Long Distance Services We receive revenue from providing toll, or long distance, services to our customers.

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High-Speed Internet and Other Internet Services We provide HSI to our residential and business customers.

Other Services and Sales Other services and sales include managed services, inside wire maintenance, and installation and maintenance of customer premise equipment. In 2010, the Company began offering customers a digital television service in select areas on a no-fee trial basis and launched this service commercially in July 2011.

Other

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

Results of Operations for the Three and Nine Months Ended September 30, 2011 and 2010

As discussed above, we emerged from Chapter 11 and adopted fresh-start reporting on October 31, 2010. References to "Predecessor" refer to the Company prior to and on October 31, 2010. References to "Successor" refer to the Company after October 31, 2010 after giving effect to the plan of reorganization and application of fresh-start reporting. As a result of the application of fresh-start reporting, the Successor's financial statements are not comparable with the Predecessor's financial statements. However, for purposes of the discussion of the results of operations, the Successor results for the three and nine months ended September 30, 2011 have been compared to the Predecessor results for the three and nine months ended September 30, 2010. In this discussion, we will disclose the fresh-start and other impacts on our results of operations that vary from historical Predecessor periods to aid in the understanding of our performance.

The Successor reported net income of \$7.4 million and \$19.6 million for the three and nine months ended September 30, 2011. The Predecessor reported a net loss of \$23.5 million and \$69.1 million for the three and nine months ended September 30, 2010.

Operating Revenues

The following tables summarize our volume information as of September 30, 2011 and 2010, and our operating revenues for the three and nine months ended September 30, 2011 and 2010. For comparability, we also present customer activity as of September 30, 2011 compared to June 30, 2011.

Volume Information

September 2011 compared to September 2010

September 30, 2011	September 30, 2010	Number	Change	Percentage
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Voice access lines				
Residential	227,064	245,102	(18,038)	-7.4%
Business	189,927	196,710	(6,783)	-3.4%
Public	4,657	4,795	(138)	-2.9%
	421,648	446,607	(24,959)	-5.6%
High-Speed Internet lines				
Residential	83,636	79,993	3,643	4.6%
Business	17,176	16,624	552	3.3%
Wholesale	1,164	1,227	(63)	-5.1%
	101,976	97,844		