HICKORY TECH CORP
Form 10-Q
May 03, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2011

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to .

Commission file number 0-13721

HICKORY TECH CORPORATION
(Exact name of registrant as specified in its charter)

Minnesota (State or other jurisdiction of incorporation or organization)	41-1524393 (I.R.S. Employer Identification No.)

221 East Hickory Street
Mankato, Minnesota 56002-3248
(Address of principal executive offices and zip code)

(800) 326-5789
(Registrant's telephone number, including area code)

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 þNo ¨

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the 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 þ Non-accelerated filer ¨ Smaller reporting company ¨

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No þ

The total number of shares of the Registrant’s common stock outstanding as of April 29, 2011: 13,358,971.

TABLE OF CONTENTS

PART I Financial Information

Item 1.	Financial Statements	3
	Consolidated Statements of Operations (unaudited) for the Three Months Ended March 31, 2011 and 2010	3
	Consolidated Balance Sheets (unaudited) as of March 31, 2011 and December 31, 2010	4
	Consolidated Statements of Cash Flows (unaudited) for the Three Months Ended March 31, 2011 and 2010	5
	Condensed Notes to Consolidated Financial Statements (unaudited)	6
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	14
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	24
Item 4.	Controls and Procedures	24

PART II Other Information

Item 1.	Legal Proceedings	24
Item 1A.	Risk Factors	24
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	25
Item 3.	Defaults Upon Senior Securities	25
Item 4.	Removed and Reserved	25
Item 5.	Other Information	25
Item 6.	Exhibit Listing	25
	Signatures	26
	Exhibits	

Part I Financial Information

Item 1. Financial Statements

HICKORY TECH CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

(Dollars in thousands, except share and per share amounts)	Three Months Ended March 31 2011	2010
Operating revenue:		
Equipment	$ 8,195	$ 9,884
Services	30,427	28,836
Total operating revenue	38,622	38,720
Costs and expenses:		
Cost of sales, excluding depreciation and amortization	6,999	8,475
Cost of services, excluding depreciation and amortization	14,735	14,178
Selling, general and administrative expenses	6,543	6,196
Depreciation	5,591	5,322
Amortization of intangibles	88	89
Total costs and expenses	33,956	34,260
Operating income	4,666	4,460
Other income and expense:		
Interest and other income	10	37
Interest expense	(1,068)	(1,591)
Total other (expense)	(1,058)	(1,554)
Income before income taxes	3,608	2,906
Income tax provision	1,466	1,479
Net income	$ 2,142	$ 1,427
Basic earnings per share	$ 0.16	$ 0.11
Weighted average common shares outstanding	13,329,603	13,154,781
Diluted earnings per share	$ 0.16	$ 0.11
Weighted average common and equivalent shares outstanding	13,341,871	13,159,326

Dividends per share	$	0.135	$	0.13

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

Table of Contents

HICKORY TECH CORPORATION
CONSOLIDATED BALANCE SHEETS
(Unaudited)

(Dollars in thousands except share and per share amounts)	March 31, 2011	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 9,859	$ 73
Receivables, net of allowance for doubtful accounts of $535 and $570	19,647	24,642
Inventories	4,959	5,205
Income taxes receivable	-	3,814
Deferred income taxes, net	2,008	2,008
Prepaid expenses	2,719	2,026
Other	600	1,030
Total current assets	39,792	38,798
Investments	4,224	4,512
Property, plant and equipment	381,900	379,433
Accumulated depreciation	(228,639)	(224,356)
Property, plant and equipment, net	153,261	155,077
Other assets:		
Goodwill	27,303	27,303
Intangible assets, net	2,580	2,668
Deferred costs and other	1,717	1,830
Total other assets	31,600	31,801
Total assets	$ 228,877	$ 230,188
LIABILITIES & SHAREHOLDERS' EQUITY		
Current liabilities:		
Extended term payable	$ 6,958	$ 8,254
Accounts payable	2,182	2,840
Accrued expenses and other	6,962	7,929
Accrued income taxes	611	-
Financial derivative instruments	740	1,079
Deferred revenue	5,468	5,073
Current maturities of long-term obligations	62,368	4,892
Total current liabilities	85,289	30,067
Long-term liabilities:		
Debt obligations, net of current maturities	56,418	114,067
Accrued income taxes	562	562
Deferred income taxes	27,046	26,868
Deferred revenue	1,283	1,397
Accrued employee benefits and deferred compensation	16,041	15,923

Total long-term liabilities		101,350		158,817
Total liabilities		186,639		188,884
Commitments and contingencies				
Shareholders' equity:				
Common stock, no par value, $.10 stated value				
Shares authorized: 100,000,000				
Shares issued and outstanding: 13,366,179 in 2011 and 13,298,626 in 2010		1,337		1,330
Additional paid-in capital		14,641		14,328
Retained earnings		30,186		29,841
Accumulated other comprehensive (loss)		(3,926)		(4,195)
Total shareholders' equity		42,238		41,304
Total liabilities and shareholders' equity	$	228,877	$	230,188

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

Table of Contents

HICKORY TECH CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(Dollars in thousands)	Three Months Ended March 31 2011	2010
OPERATING ACTIVITIES:		
Net income	$ 2,142	$ 1,427
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,679	5,411
Accrued patronage refunds	(97)	(124)
Stock based compensation	254	352
Other	122	263
Changes in operating assets and liabilities, net of effect from acquired net assets		
Receivables	5,036	(648)
Prepaids	(693)	(687)
Inventories	246	(1,830)
Accounts payable and accrued expenses	(1,427)	(1,283)
Deferred revenue, billings and deposits	280	(1,218)
Income taxes	4,427	447
Other	928	181
Net cash provided by operating activities	16,897	2,291
INVESTING ACTIVITIES:		
Additions to property, plant and equipment	(3,742)	(3,429)
Acquisition, adjustment to purchase price	-	120
Proceeds from sale of assets	69	33
Net cash (used in) investing activities	(3,673)	(3,276)
FINANCING ACTIVITIES:		
Borrowings on extended term payable arrangement	11,382	14,909
Payments on extended term payable arrangement	(12,678)	(10,274)
Borrowings on credit facility	16,000	800
Payments on credit facility and capital lease obligations	(16,173)	(5,161)
Proceeds from issuance of common stock	66	59
Change in cash overdraft	(238)	-
Dividends paid	(1,797)	(1,706)
Net cash (used in) financing activities	(3,438)	(1,373)
Net increase (decrease) in cash and cash equivalents	9,786	(2,358)
Cash and cash equivalents at beginning of the period	73	2,420
Cash and cash equivalents at the end of the period	$ 9,859	$ 62
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 1,078	$ 1,804

Net cash paid (received) for income taxes	$	(2,961)	$	1,032
Non-cash investing and financing activities:				
Property, plant and equipment acquired with capital leases	$	-	$	35
Change in other comprehensive income (loss) from financial derivatives and post-retirement benefits	$	269	$	228

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

Table of Contents

HICKORY TECH CORPORATION

March 31, 2011

Item 1. Condensed Notes to Consolidated Financial Statements (Unaudited)

Note 1. Basis of Presentation and Consolidation

The accompanying unaudited condensed consolidated financial statements of HickoryTech Corporation and its subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and disclosures normally included in annual financial statements prepared in accordance with GAAP have been omitted or condensed pursuant to such rules and regulations. In the opinion of management, the unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal and recurring accruals) considered necessary for the fair presentation of the financial statements and present fairly the results of operations, financial position, and cash flows for the interim periods presented as required by Regulation S-X, Rule 10-01. These unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto, together with our audited consolidated financial statements and notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2010.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expenses and related disclosures at the date of the financial statements and during the reporting period. Actual results could differ from these estimates. The results of operations for the interim periods presented are not necessarily indicative of the results that may be expected for the fiscal year as a whole or any other interim period.

Our consolidated financial statements include HickoryTech Corporation and its subsidiaries in the following two business segments: the Business Sector and the Telecom Sector. All inter-company transactions have been eliminated from the consolidated financial statements.

Cost of Sales (excluding depreciation and amortization)
Cost of sales for the Business Sector includes costs associated with the installation of products for customers. These costs are primarily for equipment and materials. Labor associated with installation work is not included in this category, but is included in cost of services (excluding depreciation and amortization) described below.

Cost of Services (excluding depreciation and amortization)
Cost of services includes all costs related to delivery of communication services and products for all sectors. These operating costs include all costs of performing services and providing related products including engineering, customer service, billing and collections, network monitoring and transport costs.

Selling, General and Administrative Expenses
Selling, general and administrative expenses include direct and indirect selling expenses, advertising and all other general and administrative costs associated with the operations of the business.

Depreciation Expense
Depreciation expense is determined using the straight-line method based on the lives of various classes of depreciable assets. Business and Telecom Sector depreciation is entirely associated with services revenue.

6

Table of Contents

Recent Accounting Developments

In January 2010, the FASB issued new guidance related to disclosures about the transfer in and out of levels 1 and 2 and the activity in level 3 fair value measurements. It also clarifies disclosures about the level of disaggregation, inputs and valuation techniques. Our adoption of this guidance, which was effective in Q1 2010 except for the new requirements relating to a Level 3 activity, did not have a material impact on our disclosures. Our adoption of the Level 3 requirements on January 1, 2011 did not have a material impact on our disclosures.

In the first quarter of 2011 we adopted new guidance for separating consideration in multiple-deliverable arrangements. This guidance addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting and how the consideration should be allocated among the separate units of accounting. We have multiple-deliverable arrangements with several units of accounting within our Business and Telecom Sectors which are described below. The adoption of this guidance did not have a material impact on our financial statements.

Business Sector (This is a discussion of multi-deliverable arrangements only. It does not attempt to describe all types of service agreements available within our Business Sector.)

Multiple-deliverable arrangements primarily include the sale of Cisco communications equipment and associated support contracts, along with professional services providing design, configuration, and installation consulting. Cisco equipment, maintenance contracts and professional services all meet the criteria to qualify as separate units of accounting.

We utilize Cisco list prices as third party evidence for standalone value for our equipment and support contracts. We analyze professional services billings quarterly to determine vendor-specific objective evidence of selling price. We calculate the median of all services performed on a standalone basis and consider fair value of professional services performed as part of a multiple element arrangement to be any rate that is within 15% of the median.

In instances where we sell Cisco voice and data communications equipment with no installation obligations (equipment only sales), all warranty obligations reside with Cisco. Therefore, revenue is recognized when the equipment is delivered to the customer site.

In instances where we sell Cisco voice and data communications equipment with installation obligations, terms of the agreements typically provide for installation services without customer-specific acceptance provisions and we recognize revenue for the equipment when title passes to the customer and services revenue when work is performed based on the relative fair value of the element being sold on a stand-alone basis.

For contracts with customer specific acceptance provisions, we recognize revenue upon formal customer acceptance for the elements for which the acceptance provisions apply assuming that all other revenue recognition criteria have been met.

Support contracts state that Cisco will provide all support services and therefore revenue is recognized immediately. Support services also include "24x7" support of a customer's voice and data systems. Most of these contracts are billed on a time and materials basis and revenue is recognized either as services are provided or over the term of the contract. Support services also include professional support services, which are typically sold on a time and materials basis but may be sold as a pre-paid block of time.

Telecom Sector (This is a discussion of multi-deliverable arrangements only. It does not attempt to describe all types of service agreements available within our Telecom Sector.)

Our Telecom Sector markets competitive service bundles which may contain several deliverables. Our base bundles consist of voice services including a business or residential phone line, features and long distance. Customers may choose to add additional services including internet, digital subscriber line (DSL) and digital/IP TV services to the base bundle packages. Separate units of accounting within the bundled packages include voice services, internet, DSL and digital or IP TV services. Revenue for services included in our bundles are recognized over the same service period which is the time period in which service is provided to the customer, creating no overall impact on the Telecom Sector operating revenue. Service bundle discounts are recognized concurrently with the associated revenue and are allocated to the various services in the bundled offering based on the relative selling price of the services included in each bundled combination.

Table of Contents

We reviewed all other significant newly issued accounting pronouncements and determined they are either not applicable to our business or that no material effect is expected on our financial position and results of operations.

Note 2. Earnings and Cash Dividends per Common Share

Basic earnings per share (EPS) are computed by dividing net income by the weighted average number of shares of common stock outstanding during the applicable period. Shares used in the EPS dilution calculation are based on the weighted average number of shares of common stock outstanding during the period increased by potentially dilutive common shares. Potentially dilutive common shares include stock options and stock subscribed under the HickoryTech Corporation Amended and Restated Employee Stock Purchase Plan (ESPP). Dilution is determined using the treasury stock method.

	Three Months Ended March 31	
(Dollars in thousands, except share and earnings per share amounts)	2011	2010
Net Income	$ 2,142	$ 1,427
Weighted average shares outstanding	13,329,603	13,154,781
Stock options (dilutive only)	10,667	4,545
Stock subscribed (ESPP)	1,601	-
Total dilutive shares outstanding	13,341,871	13,159,326
Earnings per share:		
Basic	$ 0.16	$ 0.11
Diluted	$ 0.16	$ 0.11
Dividends per share	$ 0.135	$ 0.13

Options to purchase 238,250 and 341,950 shares for the three months ended March 31, 2011 and 2010, respectively, were not included in the computation of diluted EPS, because their effect on diluted EPS would have been anti-dilutive.

Cash dividends are based on the number of common shares outstanding at their respective record dates. The number of shares outstanding as of the record date for the first quarter of 2011 and 2010, respectively, are as follows:

Shares outstanding on record date	2011	2010
First quarter (February 15)	13,311,817	13,120,514

Dividends per share are based on the quarterly dividend per share as declared by the HickoryTech Board of Directors. HickoryTech paid dividends of $0.135 and $0.13 per share in the first quarter of 2011 and 2010, respectively. During the first three months of 2011 and 2010, shareholders have elected to reinvest $66,000 and $59,000, respectively, of dividends into HickoryTech common stock pursuant to the HickoryTech Corporation Dividend Reinvestment Plan.

Table of Contents

Note 3. Accumulated Other Comprehensive Income (Loss)

In addition to net income, our comprehensive income includes changes in the market value of the cumulative unrealized gain or loss, net of tax, on financial derivative instruments qualifying and designated as cash flow hedges and unrecognized Net Periodic Benefit Cost related to our Post-Retirement Benefit Plans. Additional information on our interest-rate swap agreements, which are classified as financial derivative instruments, can be found under Note 10. "Financial Derivative Instruments." Comprehensive income for the three months ended March 31, 2011 and 2010 was $2,411,000 and $1,655,000 respectively, in relation to reported net income of $2,142,000 and $1,427,000 for those periods. The following summary sets forth the components of accumulated other comprehensive income (loss), net of tax.

(Dollars in thousands)	Unrecognized Net Actuarial Loss (1)	Unrecognized Prior Service Credit (1)	Unrecognized Transition Asset (1)	Unrealized Gain/(Loss) on Derivatives	Accumulated Other Comprehensive Income/(Loss)
December 31, 2010	$ (3,651)	$ 180	$ (73)	$ (651)	(4,195)
2011 Q1 Activity				204	204
Q1 Net Periodic Benefit Cost	64	(8)	9		65
March 31, 2011	$ (3,587)	$ 172	$ (64)	$ (447)	$ (3,926)

(1) Amounts pertain to our post-retirement benefit plans.

Note 4. Fair Value of Financial Instruments

The fair value of our long-term obligations, after deducting current maturities, is estimated to be $64,462,000 at March 31, 2011 and $116,483,000 at December 31, 2010, compared to carrying values of $56,418,000 and $114,067,000, respectively. A portion of our credit facility with a bank syndicate is due to mature on December 31, 2011 causing the large decrease in the fair and carrying value of our long-term obligations at March 31, 2011 as compared to December 31, 2010. The fair value estimates are based on the overall weighted average interest rates and maturity compared to rates and terms currently available in the long-term financing markets. Our financial instruments also include cash equivalents, trade accounts receivable and accounts payable for which current carrying amounts approximate fair market value.

Note 5. Inventories

Inventory includes parts, materials and supplies stored in our warehouses to support basic levels of service and maintenance as well as scheduled capital projects and equipment awaiting configuration for customers. Inventory also includes parts and equipment shipped directly from vendors to customer locations while in transit and parts and equipment returned from customers which is being returned to vendors for credit, as well as maintenance contracts associated with customer sales which have not yet transferred to the customer. The inventory value in the Business Sector, comprised of finished goods in transit to customers as of March 31, 2011 and December 31, 2010 was $3,107,000 and $3,460,000, respectively. The inventory level in the Business Sector is subject to the variations in the equipment revenue and the timing of individual customer orders. The inventory value in the Telecom Sector, comprised of raw materials, as of March 31, 2011 and December 31, 2010 was $1,852,000 and $1,745,000, respectively.

We value inventory using the lower of cost (perpetual weighted average-cost or specific identification) or market method. We make estimates related to the valuation of inventory. We adjust our inventory carrying value for estimated obsolescence or unmarketable inventory to the estimated market value based upon assumptions about future demand and market conditions. As market and other conditions change, we may establish additional inventory reserves.

Note 6. Goodwill and Other Intangible Assets

We have goodwill in two of our reporting units. In our Business Sector, we have $4,255,000 of goodwill carrying value as of March 31, 2011, resulting from our acquisition of Enventis Telecom in 2005 and our acquisition of CP Telecom in 2009. In our Telecom Sector, we have $23,048,000 of goodwill carrying value as of March 31, 2011, resulting from our acquisition of Heartland Telecommunications in 1997.

Table of Contents

We test acquired goodwill for impairment annually using a fair value approach. We also test goodwill for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of an entity below its carrying value. We completed our annual impairment test for acquired goodwill as of December 31, 2010, which resulted in no impairment charges to goodwill. In the first three months of 2011, there was no event or change in circumstance that would have more likely than not reduced the fair value below its carrying value.

Intangible assets with finite lives are amortized over their respective estimated useful lives to their estimated residual value. Identifiable intangible assets that are subject to amortization are evaluated for impairment. The components of other intangible assets are as follows:

		As of March 31, 2011		As of December 31, 2010	
(Dollars in thousands)	Useful Lives	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Definite-Lived Intangible Assets					
Customer relationships	1 - 8 years	$ 5,299	$ 4,585	$ 5,299	$ 4,532
Other intangibles	1 - 5 years	2,830	964	2,830	929
Total		$ 8,129	$ 5,549	$ 8,129	$ 5,461

We periodically reassess the carrying value, useful lives and classifications of identifiable assets. Amortization expense related to the definite-lived intangible assets was $88,000 and $89,000 for the three months ended March 31, 2011 and 2010, respectively. Total estimated amortization expense for the remaining nine months of 2011 and the five years subsequent to 2011 is as follows: 2011 (April 1 – December 31) – $266,000; 2012 - $354,000; 2013 - $354,000; 2014 - $265,000; 2015 - $140,000; 2016 - $140,000.

Note 7. Quarterly Sector Financial Summary

Our operations are conducted in two segments as: (i) Business Sector and (ii) Telecom Sector. Segment information for the three months ended March 31, 2011 and 2010 is as follows:

(Dollars in thousands) Three Months Ended March 31, 2011	Business	Telecom	Corporate and Eliminations	Consolidated
Revenue from unaffiliated customers	$ 21,285	$ 17,337	$ -	$ 38,622
Intersegment revenue	161	412	(573)	-
Total operating revenue	21,446	17,749	(573)	38,622
Depreciation and amortization	1,654	4,003	22	5,679
Operating income (loss)	1,983	2,901	(218)	4,666
Interest expense	-	18	1,050	1,068
Income tax provision (benefit)	806	1,168	(508)	1,466
Net Income (loss)	1,178	1,716	(752)	2,142
Total assets	84,127	129,109	15,641	228,877
Property, plant and equipment, net	56,107	97,008	146	153,261
Additions to property, plant and equipment	1,812	1,930	-	3,742

Table of Contents

(Dollars in thousands) Three Months Ended March 31, 2010	Business	Telecom	Corporate and Eliminations	Consolidated
Revenue from unaffiliated customers	$ 21,354	$ 17,366	$ -	$ 38,720
Intersegment revenue	133	429	(562)	-
Total operating revenue	21,487	17,795	(562)	38,720
Depreciation and amortization	1,364	4,016	31	5,411
Operating income (loss)	1,907	2,825	(272)	4,460
Interest expense	-	25	1,566	1,591
Income tax provision (benefit)	810	1,398	(729)	1,479
Net Income (loss)	1,122	1,406	(1,101)	1,427
Total assets	76,249	138,233	6,653	221,135
Property, plant and equipment, net	47,598	103,776	252	151,626
Additions to property, plant and equipment	2,064	1,365	-	3,429

Note 8. Commitments and Contingencies

We are involved in certain contractual disputes in the ordinary course of business. We do not believe the ultimate resolution of any of these existing matters will have a material adverse effect on our financial position, results of operations or cash flows. We did not experience any changes to material contractual obligations in the first three months of 2011. Refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2010 for the discussion relating to commitments and contingencies.

Note 9. Stock Compensation

Refer to our Annual Report on Form 10-K for the year ended December 31, 2010 for a complete description of all stock-based compensation plans.

Our stock award plan provides for granting non-qualified stock options, stock awards and restricted stock awards to employees. We recognize stock compensation charges related to stock award plans when management concludes it is probable the participant will earn the award. Share-based compensation expense includes amounts recognized related to the Company Employee Stock Purchase Plan. This plan allows participating employees to acquire shares of common stock at 85% of fair market value on one specified date. Stock-based compensation expense was $254,000 and $352,000 respectively in the three months ended March 31, 2011 and 2010.

As of March 31, 2011, no stock options have been granted under the Company's Stock Award Plan since September 2006 and all options are fully vested and the associated compensation costs related to these options have been recognized.

A summary of stock option activity is as follows:

	Shares	Weighted Average Exercise Price
Outstanding at January 1, 2011	343,250	$ 12.45
Granted	-	-
Exercised	-	-
Forfeited	-	-

Expired	(35,000)		7.21
Outstanding at March 31, 2011	308,250	$	11.82
Exercisable at March 31, 2011	308,250	$	11.82

Table of Contents

The following table provides certain information with respect to stock options outstanding and exercisable at March 31, 2011:

Range of Exercise Prices	Stock Options Outstanding	Stock Options Exercisable	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life
$6.00 - $8.00	15,000	15,000	$ 6.95	5.42
$8.00 - $12.00	156,950	156,950	10.22	2.68
$12.00 - $16.00	126,000	126,000	13.97	0.73
$16.00 - $21.00	10,300	10,300	16.98	0.67
	308,250	308,250	$ 11.82	1.95
Aggregate intrinsic value:			$ 56,300	

Note 10. Financial Derivative Instruments

We utilize interest-rate swap agreements that qualify as cash-flow hedges to manage our exposure to interest rate fluctuations on a portion of our variable-interest rate debt. Our interest-rate swaps increase or decrease the amount of cash paid for interest depending on the increase or decrease of interest required on the variable rate debt. We account for derivative instruments on the balance sheet at fair value.

Fair value is the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Three levels of inputs may be used to measure fair value:

- Level 1 – quoted prices in active markets for identical assets and liabilities.
- Level 2 – observable inputs other than quoted prices in active markets for identical assets and liabilities.
- Level 3 – unobservable inputs in which there is little or no market data available, which require the reporting entity to develop its own assumptions.

The fair value of our interest rate swap agreements were determined based on Level 2 inputs. We currently have an interest-rate swap agreement effectively locking in the LIBOR rate portion of the interest rate on $80,000,000 of variable-interest rate debt until September 2011. The LIBOR rate portion of the swap is a fixed rate of 2.15%. This swap rate is in addition to the applicable margin under our credit agreement, which is currently 1.5%.

As our interest-rate swap agreement is set to expire September 2011, the fair value of our derivatives at March 31, 2011 and December 31, 2010 are recorded as financial derivative instruments under the short-term liabilities section of our balance sheet. The fair value of our derivatives at March 31, 2011 and December 31, 2010 is a net liability of $740,000 and $1,079,000, respectively. The cumulative gain or (loss) on the market value of financial derivative instruments is reported as a component of accumulated other comprehensive income (loss) in shareholders' equity, net of tax. If we were to terminate our interest rate swap positions, the cumulative change in fair value at the date of termination would be reclassified from accumulated other comprehensive income (loss), which is classified in shareholder's equity, into earnings in the Consolidated Statements of Operations. The table below illustrates the effect of derivative instruments on consolidated operations for the periods ending March 31, 2011 and 2010, respectively.

(Dollars in thousands) Derivative Instruments in Cash Flow Hedging Relationships	Gain Reported in Accumulated Other Comprehensive Loss		Location of Gain/Proceeds Reclassified from Accumulated Other Comprehensive Income into Income	Amount of Gain/Proceeds Recognized in Income on Derivative	
	2011	2010		2011	2010
Interest Rate Contracts	$204	$168	Interest Expense	$-	$-

12

Table of Contents

Note 11. Employee Post-Retirement Benefits

HickoryTech provides post-retirement health care and life insurance benefits for eligible employees. We are currently not funding these post-retirement benefits, but have accrued these liabilities. We are required to recognize the funded status of our post-retirement benefit plans on our consolidated balance sheet and recognize as a component of accumulated other comprehensive income (loss), net of tax, the gains and losses and prior service costs or credit that arise during the period but are not recognized as components of net periodic benefit cost. New employees are not eligible for post-retirement health care and life insurance benefits.

(Dollars in thousands)	Three Months Ended March 31 2011		2010	
Components of net periodic benefit cost				
Service cost	$	127	$	113
Interest cost		200		181
Amortization of transition obligation		15		15
Amortization of prior service cost		(14)		(14)
Recognized net actuarial loss		107		98
Net periodic benefit cost	$	435	$	393

Employer's contributions for current premiums:	March 31, 2011	
Contributions made for the three months ended March 31, 2011	$	88
Expected contributions for remainder of 2011		259
Total estimated employer contributions for fiscal year 2011	$	347

Note 12. Income Taxes

The effective income tax rate from operations for the first quarter of 2011 and 2010 was 40.7% and 50.9% which exceeds the federal statutory rate primarily due to state income taxes. In the first quarter of 2010, we recognized $279,000 of noncash income tax expense due to the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010. The $279,000 charge increased the effective tax rate for the first quarter of 2010 by 9.6%.

As of March 31, 2011, we had unrecognized tax benefits totaling $510,000 excluding interest. The amount of the unrecognized tax benefits, if recognized, that would affect the effective income tax rates of future periods is $490,000. It is reasonably possible that the total amount of unrecognized tax benefits may decrease by approximately $405,000, including interest, during the next 12 months as a result of expirations of the statute of limitations. Subsequent to March 31, 2011, we have recognized approximately $277,000 of previously unrecognized tax benefits and $41,000 of associated interest as a result of the expiration of statute of limitations.

We recognize interest and penalties related to income tax matters as income tax expense. As of March 31, 2011, we have accrued $51,000 (net of tax) for interest related to unrecognized tax benefits.

We file consolidated income tax returns in the United States federal jurisdiction and combined or separate income tax returns in various state jurisdictions. In general, we are no longer subject to United States federal income tax examinations for the years prior to 2007 except to the extent of losses utilized in subsequent years.

Note 13. Acquisition

On August 1, 2009, we purchased all of the capital stock of CP Telecom for an adjusted purchase price of $6,625,000 to grow our small to medium-sized business customer base. In the first quarter of 2010, an adjustment associated with a change in working capital of CP Telecom at closing, reduced the purchase price and associated goodwill by $120,000, resulting in an adjusted purchase price of $6,505,000.

Table of Contents

The initial purchase price allocation resulted in goodwill of $2,184,000 which was reduced by $120,000 to $2,064,000 as a result of the change in working capital. Goodwill in our CP Telecom acquisition is a result of the value of acquired employees along with the expected synergies from the combination of CP Telecom and our operations. Goodwill resulting from the acquisition of CP Telecom is not deductible for tax purposes. CP Telecom has been fully integrated with our fiber and data product line.

Note 14. Subsequent Events

On March 4, 2011, the Board of Directors approved the merger of CP Telecom, Inc. and Enventis Telecom, Inc. effective April 30, 2011. Both entities are reported within the Business Sector and this will have no effect on the financial statements or material impact on operations.

On April 4, 2011, the company announced the addition of the position of chief operating officer who was also appointed as a corporate officer, vice president of HickoryTech. Please see the exhibits for additional information regarding the agreements associated with her employment. As part of the employment agreement the chief operating officer received a one-time grant of options to acquire 10,000 shares with one-third of the options vesting over the next three years.

We have evaluated and disclosed subsequent events through the filing date of the Quarterly Report on Form 10-Q.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward Looking Statements

The Private Securities Litigation Reform Act of 1995 contains certain safe harbor provisions regarding forward-looking statements. This Quarterly Report on Form 10-Q may include forward-looking statements. These statements may include, without limitation, statements with respect to anticipated future operating and financial performance, growth opportunities and growth rates, acquisition and divestiture opportunities, business strategies, business and competitive outlook, and other similar forecasts and statements of expectation. Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," "targets," "projects," "will," "may," "continues," and "shou of these words and similar expressions, are intended to identify these forward-looking statements. Such forward-looking statements are subject to risks and uncertainties that could cause HickoryTech's actual results to differ materially from such statements. Factors that might cause such a difference include, but are not limited to, those contained in Item 1A of Part II, "Risk Factors" of this quarterly report on Form 10-Q and Item 1A, "Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2010 which is incorporated herein by reference.

Because of these risks, uncertainties, and assumptions and the fact that any forward-looking statements made by HickoryTech and its management are based on estimates, projections, beliefs, and assumptions of management, they are not guarantees of future performance and you should not place undue reliance on them. In addition, forward-looking statements speak only as of the date they are made. With the exception of the requirements set forth in the federal securities laws or the rules and regulations of the Securities and Exchange Commission, we do not undertake any obligations to update any forward-looking information, whether as a result of new information, future events or otherwise.

Critical Accounting Policies

The preparation of our financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and the related disclosure of contingent assets and liabilities. A description of the accounting policies that we consider particularly important for the portrayal of our results of operations and financial position, and which may require a higher level of judgment by our management, is contained under the caption, “Critical Accounting Policies,” in the Management’s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2010.

Table of Contents

Results of Operations

Overview-Trends and Highlights

We conduct our operations in two business segments: (i) Business Sector and (ii) Telecom Sector. Our Business Sector serves customers across a five-state region with IP-based voice, transport, data and network solutions, managed services, network integration and support services. Through its regional fiber network, this Sector provides wholesale services to regional and national service providers, such as interexchange and wireless carriers within the communications business. It also specializes in providing integrated unified communication solutions for businesses of all sizes - from enterprise multi-office organizations to small and medium-sized businesses, primarily in the upper Midwest.

Our Telecom Sector provides bundled residential and business services including high-speed Internet, broadband services, digital TV, local voice and long distance services in our legacy telecom service area. Telecom is comprised of two markets. The first includes an incumbent local exchange carrier ("ILEC") operating in 13 south central Minnesota communities and 13 rural northwest Iowa communities. The second market is a competitive local exchange carrier ("CLEC") operation. We own our network in both the ILEC and CLEC communities. The Telecom Sector, through National Independent Billing, Inc., also provides data processing and related billing services to HickoryTech and external communication providers including wireline, wireless, and entertainment providers.

First quarter consolidated net income increased by $715,000 or 50% impacted by a $523,000 decline in interest expense paid on a year-over-year basis. The decline in interest expense is due to the implementation of interest rate protection strategies and lower interest rates due to our debt to EBITDA ratio. As of March 31, 2011 a significant portion of our credit facility is presented as a current liability. We are in the process of renewing this facility, as we have successfully done on three previous occasions since the year 2000. In addition, the first quarter of 2010 contained a $279,000 non-cash income tax expense due to the Patient Protection and Affordable Care Act and Health Care and Education Reconciliation Act of 2010.

Operating income for the first quarter increased $206,000 or 5% with a decline in operating costs offsetting a slight decline in overall operating revenue. Recurring revenue streams within our Business Sector grew $1,620,000 or 14% while sales of Cisco equipment declined $1,689,000 or 17%. Due to the one-time nature of equipment sales, the equipment revenue fluctuates quarterly. Telecom revenue remained stable in the first quarter compared to last year, offsetting the gradual decline we have experienced in local service and network access revenue with strong broadband growth.

In 2010, we initiated several key investments to strategically grow our Business Sector fiber and data services. We increased bandwidth capacity on our core network, expanded our fiber network to Sioux Falls, South Dakota and Fargo, North Dakota, constructed a local fiber route in Des Moines, Iowa and increased network capacity to our Des Moines facilities. Additionally we secured a grant of federal stimulus funds providing the means by which we can extend our fiber-optic network in northern Minnesota connecting health care organizations, educational institutions and state offices. This project, which will begin in 2011, is expected to be completed in 2013 and is funded by $16,800,000 in future federal grant money and $7,200,000 of our own capital.

Business Sector fiber and data service revenue grew by $1,248,000 or 13% in the first quarter. We are aggressively targeting business services gaining market share within the small-to-medium business, enterprise and wholesale customer segments. We continue to leverage our existing network, secure opportunities in new markets and designate success-based capital for projects that provide a solid rate-of-return.

In the first quarter of 2011 Telecom broadband services grew by 14% driven by demand for business Ethernet services and continued market penetration for our DSL and digital TV services. Our Telecom broadband revenues are further enhanced by our success in serving a regional consortium of schools and libraries. We continue to invest in our broadband infrastructure to ensure that we offer the highest quality broadband services in order to retain customers and preserve the strong cash flow generated by this sector. Overall Telecom Sector revenue remained stable year-over-year while operating income increased by $76,000 or 3% for the first quarter.

Table of Contents

Sector Results of Operations

Business Sector

The following table provides a breakdown of the Business Sector operating results.

We manage and evaluate our business operations in their entirety. The following table provides an illustration of the contributions and associated trends from each of the primary product lines. Certain allocations have been made, particularly in the area of selling, general and administrative expenses, in order to develop these tables.

BUSINESS SECTOR

(Dollars in thousands)	Three Months Ended March 31 2011	2010	% Change
Operating revenue before intersegment eliminations			
Equipment	$ 8,195	$ 9,884	-17 %
Support Services	2,229	1,857	20 %
Equipment	10,424	11,741	-11 %
Fiber and Data	10,861	9,613	13 %
Intersegment	161	133	21 %
Total operating revenue	$ 21,446	$ 21,487	0 %
Total Business revenue before intersegment eliminations			
Unaffiliated customers	$ 21,285	$ 21,354	
Intersegment	161	133	
	21,446	21,487	
Cost of sales (excluding depreciation and amortization)	6,999	8,475	-17 %
Cost of services (excluding depreciation and amortization)	7,499	6,699	12 %
Selling, general and administrative expenses	3,311	3,042	9 %
Depreciation and amortization	1,654	1,364	21 %
Total Business costs and expenses	19,463	19,580	-1 %
Operating income	$ 1,983	$ 1,907	4 %
Net income	$ 1,178	$ 1,122	5 %
Capital expenditures	$ 1,812	$ 2,064	-12 %

Table of Contents

BUSINESS PRODUCT LINE REPORTING

(Dollars in thousands)	Three Months Ended March 31 Equipment 2011	2010	% Change	Three Months Ended March 31 Fiber and Data 2011	2010	% Change
Operating revenue before intersegment eliminations:						
Equipment	$ 8,195	$ 9,884	-17 %	$ -	$ -	0 %
Service	2,229	1,857	20 %	10,861	9,613	13 %
Intersegment	-	-		161	133	21 %
Total operating revenue	$ 10,424	$ 11,741	-11 %	$ 11,022	$ 9,746	13 %