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, 2016

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: 001-34686

Hawaiian Telcom Holdco, Inc.

(Exact name of registrant as specified in its charter)

Delaware	16-1710376
(State or other jurisdiction of incorporation or organization)	(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 [X] 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 [X] 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 [X]	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 [X]

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

As of November 3, 2016, 11,513,279 shares of the registrant’s common stock were outstanding.

Table of Contents

Table of Contents

Table of Contents

PART I — FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)

Hawaiian Telcom Holdco, Inc.

Condensed Consolidated Statements of Income (Loss)

(Unaudited, dollars in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Operating revenues	$ 97,848	$ 100,905	$ 296,183	$ 294,208
Operating expenses:				
Cost of revenues (exclusive of depreciation and amortization)	41,903	41,013	124,987	120,415
Selling, general and administrative	29,206	33,146	88,625	92,645
Depreciation and amortization	23,036	22,551	67,479	65,772
Total operating expenses	94,145	96,710	281,091	278,832
Operating income	3,703	4,195	15,092	15,376
Other income (expense):				
Interest expense	(4,156)	(4,148)	(12,879)	(12,651)
Interest income and other	—	4	—	15
Total other expense	(4,156)	(4,144)	(12,879)	(12,636)
Income (loss) before income tax provision (benefit)	(453)	51	2,213	2,740
Income tax provision (benefit)	(174)	(54)	892	1,204
Net income (loss)	$ (279)	$ 105	$ 1,321	$ 1,536
Net income (loss) per common share -				
Basic	$ (0.02)	$ 0.01	$ 0.11	$ 0.14
Diluted	$ (0.02)	$ 0.01	$ 0.11	$ 0.14
Weighted average shares used to compute net income (loss) per common share -				
Basic	11,512,280	11,040,299	11,499,947	10,844,478
Diluted	11,512,280	11,318,641	11,539,828	11,275,655

See accompanying notes to condensed consolidated financial statements.

Table of Contents

Hawaiian Telcom Holdco, Inc.

Condensed Consolidated Statements of Comprehensive Loss

(Unaudited, dollars in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income (loss)	$ (279)	$ 105	$ 1,321	$ 1,536
Other comprehensive loss:				
Unrealized holding loss arising during period	—	(1)	—	(1)
Retirement plan loss	(8,674)	(8,786)	(8,179)	(6,711)
Income tax benefit on comprehensive loss	3,315	3,357	3,126	2,565
Other comprehensive loss, net of tax	(5,359)	(5,430)	(5,053)	(4,147)
Comprehensive loss	$ (5,638)	$ (5,325)	$ (3,732)	$ (2,611)

See accompanying notes to condensed consolidated financial statements.

Table of Contents

Hawaiian Telcom Holdco, Inc.

Condensed Consolidated Balance Sheets

(Unaudited, dollars in thousands, except per share amounts)

	September 30, 2016	December 31, 2015
Assets		
Current assets		
Cash and cash equivalents	$ 20,650	$ 30,312
Receivables, net	28,488	32,736
Material and supplies	8,217	8,499
Prepaid expenses	5,343	4,068
Other current assets	2,666	2,102
Total current assets	65,364	77,717
Property, plant and equipment, net	593,370	579,107
Intangible assets, net	33,254	34,828
Goodwill	12,104	12,104
Deferred income taxes, net	91,610	89,896
Other assets	5,985	6,043
Total assets	$ 801,687	$ 799,695
Liabilities and Stockholders’ Equity		
Current liabilities		
Current portion of long-term debt	$ 3,000	$ 3,000
Accounts payable	50,844	44,841
Accrued expenses	15,656	14,491
Advance billings and customer deposits	15,324	17,551
Other current liabilities	6,070	5,932
Total current liabilities	90,894	85,815
Long-term debt	281,927	283,046
Employee benefit obligations	106,346	104,597
Other liabilities	17,185	18,538
Total liabilities	496,352	491,996
Commitments and contingencies (Note 11)		
Stockholders’ equity		
Common stock, par value of $0.01 per share, 245,000,000 shares authorized and 11,512,502 and 11,466,398 shares issued and outstanding at September 30, 2016 and December 31, 2015, respectively	115	115
Additional paid-in capital	179,387	178,019
Accumulated other comprehensive loss	(34,441)	(29,388)
Retained earnings	160,274	158,953
Total stockholders’ equity	305,335	307,699
Total liabilities and stockholders’ equity	$ 801,687	$ 799,695

See accompanying notes to condensed consolidated financial statements.

Table of Contents

Hawaiian Telcom Holdco, Inc.

Condensed Consolidated Statements of Cash Flows

(Unaudited, dollars in thousands)

	Nine Months Ended September 30, 2016		2015	
Cash flows from operating activities:				
Net income	$	1,321	$	1,536
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization		67,479		65,772
Deferred financing amortization		1,533		1,436
Employee retirement benefits		(6,430)		(3,315)
Provision for uncollectible receivables		2,908		2,640
Stock based compensation		1,722		1,087
Deferred income taxes		1,412		1,633
Changes in operating assets and liabilities:				
Receivables		1,340		(3,558)
Material and supplies		282		211
Prepaid expenses and other current assets		(1,839)		(2,538)
Accounts payable and accrued expenses		6,067		(3,222)
Advance billings and customer deposits		(2,227)		4,054
Other current liabilities		(600)		(693)
Other		(22)		552
Net cash provided by operating activities		72,946		65,595
Cash flows from investing activities:				
Capital expenditures		(78,334)		(76,732)
		—		400

Funds released from restricted cash account				
Net cash used in investing activities		(78,334)		(76,332)
Cash flows from financing activities:				
Proceeds from exercise of warrant		—		3,342
Proceeds from installment financing		1,698		2,779
Repayment of capital lease and installment financing		(2,680)		(3,083)
Repayment of debt		(2,250)		(2,250)
Refinancing and loan amendment costs		(688)		(150)
Taxes paid related to net share settlement of equity awards		(354)		(941)
Net cash used in financing activities		(4,274)		(303)
Net change in cash and cash equivalents		(9,662)		(11,040)
Cash and cash equivalents, beginning of period		30,312		39,885
Cash and cash equivalents, end of period	$	20,650	$	28,845
Supplemental disclosure of cash flow information:				
Interest paid, net of amounts capitalized	$	9,938	$	11,234

See accompanying notes to condensed consolidated financial statements.

6

Hawaiian Telcom Holdco, Inc.

Condensed Consolidated Statement of Changes in Stockholders' Equity

(Unaudited, dollars in thousands)

	Common Stock Shares	Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders' Equity
Balance, January 1, 2016	11,466,398	$ 115	$ 178,019	$ (29,388)	$ 158,953	$ 307,699
Stock based compensation	—	—	1,722	—	—	1,722
Common stock issued for stock compensation plans, net of shares withheld and withholding paid for employee taxes	46,104	—	(354)	—	—	(354)
Net income	—	—	—	—	1,321	1,321
Other comprehensive loss, net of tax	—	—	—	(5,053)	—	(5,053)
Balance, September 30, 2016	11,512,502	$ 115	$ 179,387	$ (34,441)	$ 160,274	$ 305,335
Balance, January 1, 2015	10,673,292	$ 107	$ 170,521	$ (23,947)	$ 157,853	$ 304,534
Stock based compensation	—	—	1,087	—	—	1,087
Exercise of warrant agreement	376,333	4	3,338	—	—	3,342
Common stock issued for stock compensation plans, net of shares withheld and withholding paid for employee taxes	73,255	—	(941)	—	—	(941)
Net income	—	—	—	—	1,536	1,536
Other comprehensive loss, net of tax	—	—	—	(4,147)	—	(4,147)

Balance, September 30, 2015	11,122,880	$ 111	$ 174,005	$ (28,094)	$ 159,389	$ 305,411

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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. The Company offers a variety of telecommunication services to residential and business customers in Hawaii including local telephone, network access and data transport, television, Internet, long distance and wireless phone service. The Company also provides communications equipment sales and maintenance, data center colocation and network managed services.

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. 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 and pursuant to rules and regulations of the U.S. Securities and Exchange Commission. 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 have been made to present fairly the results of operations, comprehensive loss, financial position 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, 2015.

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, 2016 are held in one bank in demand deposit accounts. During the nine months ended September 30, 2015, funds amounting to $0.4 million in a restricted cash account, held in conjunction with a lease agreement provision, were released and deposited into unrestricted cash.

Supplemental Non-Cash Investing and Financing Activities

Accounts payable included $21.7 million and $14.5 million at September 30, 2016 and 2015, 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 Hawaii Public Utility Commission fees. Such taxes and fees amounted to $2.1 million and $6.4 million for the three and nine months ended September 30, 2016, and $2.1 million and $6.1 million for the three and nine months ended September 30, 2015, respectively.

Table of Contents

Earnings (loss) per Share

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Basic earnings (loss) per share - weighted average shares	11,512,280	11,040,299	11,499,947	10,844,478
Effect of dilutive securities:				
Employee and director restricted stock units	—	19,045	39,881	76,058
Warrants	—	259,297	—	355,119
Diluted earnings (loss) per share - weighted average shares	11,512,280	11,318,641	11,539,828	11,275,655

The computation of weighted average dilutive shares outstanding excluded grants of restricted stock units convertible into 227,888 shares and 8,319 shares of common stock for the three and nine months ended September 30, 2016, respectively, and 84,259 shares of common stock for the three months ended September 30, 2015. For the three months ended September 30, 2016, the Company incurred a net loss so the restricted stock units are anti-dilutive to the computation of net loss per share. For the other periods presented, the unrecognized compensation on a per unit basis for these restricted stock units was greater than the average market price of the Company's common stock for the period presented. For the nine months ended September 30, 2015, there were no restricted stock units that were anti-dilutive to earnings per share.

Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (the "FASB") issued a new accounting standard which provides guidance for revenue recognition which was amended most recently in May 2016. The most recent amendments provide revised guidance on when to record revenue gross as the principal or net as the agent in accordance with the new revenue standard's control principal and, provide for narrow scope modifications and practical expedients. The new standard, along with the amendments which must be adopted at the same time as the new standard, is effective for the Company in the first quarter of 2018 with either full retrospective or modified retrospective adoption permitted. The modified retrospective approach requires a cumulative effect adjustment to retained earnings as of the beginning of the first reporting period for which the new accounting guidance is effective. Early adoption is allowed from the first quarter of 2017. The Company is currently evaluating the impact of the adoption of this accounting standard on the Company's consolidated financial statements and financial statement disclosures. As this process is still ongoing, the effect of adoption is not yet known.

In February 2016, the FASB issued a new standard for accounting for leases. The new standard requires lessees to recognize a right-of-use asset and a lease liability on the balance sheet for all leases with the exception of short-term leases. For lessees, leases will continue to be classified as either operating or finance leases in the income statement. Lessor accounting is similar to the current model but updated to align with certain changes to the lessee model. The new standard must be adopted using the modified retrospective approach. The updated standard is effective for the Company beginning in the first quarter of 2019. Early adoption is permitted. The Company is currently evaluating the effect that the new standard will have on the Company's consolidated financial statements and financial statement disclosures.

In March 2016, the FASB issued a new standard that simplifies the accounting for employee share-based payment transactions. The new standard impacts the accounting for related income taxes, forfeitures and statutory tax withholding requirements as well as the classification of certain related payments in the statement of cash flows. The new accounting guidance is effective for the Company in the first quarter of 2017 with early adoption permitted. The adoption method required is specified as retrospective, modified retrospective or prospective for each of the various

Table of Contents

accounting provisions impacted by this new standard. The Company is evaluating the effect of the new guidance on the Company's consolidated financial statements and financial statement disclosures.

In June 2016, the FASB issued amended guidance on accounting for the impairment of financial instruments. The standard requires adoption of an impairment model known as the current expected credit loss model that is based on expected losses rather than incurred losses. For the Company, it is anticipated this will impact primarily the accounting for credit losses on trade receivables. The new standard is effective for the Company in the first quarter of 2020 with early adoption permitted from the first quarter of 2019. The provisions of the new standard expected to impact the Company must be adopted using the modified retrospective approach. The Company is evaluating the effect of the guidance on the Company's consolidated financial statements and financial statement disclosures.

3. Receivables

Receivables consisted of the following (dollars in thousands):

	September 30, 2016	December 31, 2015
Customers and other	$ 32,467	$ 36,667
Allowance for doubtful accounts	(3,979)	(3,931)
	$ 28,488	$ 32,736

4. Long-Lived Assets

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

	September 30, 2016	December 31, 2015
Property, plant and equipment cost	$ 1,014,803	$ 937,927

Less accumulated depreciation	421,433	358,820
	$ 593,370	$ 579,107

Depreciation expense amounted to $22.5 million and $65.9 million for the three and nine months ended September 30, 2016, respectively. Depreciation expense amounted to $22.0 million and $63.9 million for the three and nine months ended September 30, 2015, respectively.

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

	September 30, 2016			December 31, 2015		
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Subject to amortization:						
Customer relationships	$ 21,709	$ 15,783	$ 5,926	$ 21,709	$ 14,238	$ 7,471
Trade name and other	320	292	28	320	263	57
	22,029	16,075	5,954	22,029	14,501	7,528
Not subject to amortization:						
Brand name	27,300	—	27,300	27,300	—	27,300
	27,300	—	27,300	27,300	—	27,300
	$ 49,329	$ 16,075	$ 33,254	$ 49,329	$ 14,501	$ 34,828

Table of Contents

Amortization expense amounted to $0.5 million and $1.6 million for the three and nine months ended September 30, 2016, respectively. Amortization expense amounted to $0.6 million and $1.9 million for the three and nine months ended September 30, 2015, respectively. Estimated amortization expense for the next five years and thereafter is as follows (dollars in thousands):

Year ended December 31,	
2016 (remaining months)	$ 526
2017	1,703
2018	1,307
2019	930
2020	574
Thereafter	914
	$ 5,954

5. Accrued Expenses and Other Current Liabilities

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

	September 30, 2016	December 31, 2015
Salaries and benefits	$ 11,988	$ 12,185
Interest	2,675	1,262
Other taxes	993	1,044
	$ 15,656	$ 14,491

Other current liabilities consisted of the following (dollars in thousands):

	September 30, 2016	December 31, 2015
Other postretirement benefits, current	$ 2,929	$ 2,929
Installment financing contracts, current	2,226	1,849
Other	915	1,154

$ 6,070	$ 5,932

6. Long-Term Debt

Long-term debt consisted of the following (dollars in thousands):

	Interest Rate at September 30, 2016		Final Maturity	September 30, 2016	December 31, 2015
Term loan	5.25	%	June 6, 2019	$ 290,888	$ 293,138
Debt issue costs and original issue discount				(5,961)	(7,092)
				284,927	286,046
Current				3,000	3,000
Noncurrent				$ 281,927	$ 283,046

The term loan outstanding at September 30, 2016 provides for interest at the Alternate Base Rate, a rate which is indexed to the prime rate with certain adjustments as defined, plus a margin of 3.25% or a Eurocurrency rate on deposits of one, two, three or six months but no less than 1.00% per annum plus a margin of 4.25%. The Company has selected the Eurocurrency rate as of September 30, 2016 resulting in an interest rate currently at 5.25%. The interest rate margin is subject to a further increase of 0.25% should there be a downgrade in the Company’s credit rating.

Table of Contents

The term loan provides for interest payments no less than quarterly. In addition, quarterly principal payments of $0.8 million are required. The balance of the loan is due at maturity on June 6, 2019. The Company must prepay, generally within three months after year end, up to 75% of excess cash flow, as defined. The percent of excess cash flow required is dependent on the Company's leverage ratio. There was no excess cash flow payment due for the year ended December 31, 2015. The Company must also make prepayments on loans in the case of certain events such as large asset sales.

In May 2016, the Company amended the term loan allowing for a revised leverage ratio financial covenant. The amendment modifies the maximum allowed leverage ratio, as defined, for the four consecutive fiscal quarters ended from June 30, 2016 to September 30, 2017 to 3.00:1.00, from December 31, 2017 to September 30, 2018 to 2.75:1.00, and from December 31, 2018 and each subsequent quarter to 2.50:1.00. In conjunction with the amendment, the Company paid a fee to the lenders of $0.4 million and such fee was deferred as financing related costs. The Company concluded that the amended lenders' term loans were not substantially different than the lenders' term loans prior to amendment. In addition, the Company paid an arrangement fee and legal costs amounting to $0.3 million. Such fees were expensed as incurred in the second quarter of 2016.

The Company also has a revolving credit facility which matures on December 6, 2018. The facility has an available balance of $30.0 million with no amounts drawn as of or for the periods ended September 30, 2016 and 2015. 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.

Maturities

The annual requirements for principal payments on long-term debt as of September 30, 2016 are as follows (dollars in thousands):

Year ended December 31,		
2016 (remaining months)	$	750
2017		3,000
2018		3,000
2019		284,138
	$	290,888

Capitalized Interest

Interest capitalized by the Company amounted to $0.4 million and $1.1 million for the three and nine months ended September 30, 2016, and $0.3 million and $0.8 million for the three and nine months ended September 30, 2015, respectively.

7. Employee Benefit Plans

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

Table of Contents

The following provides the components of benefit costs (income) for the three and nine months ended September 30, 2016 and 2015 (dollars in thousands):

Pension

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Interest cost	$ 1,703	$ 2,107	$ 5,695	$ 6,164
Expected asset return	(2,159)	(3,146)	(7,513)	(9,906)
Amortization of loss	136	24	392	5
Net periodic benefit income	(320)	(1,015)	(1,426)	(3,737)
Settlement loss	486	4,118	486	6,366
Total benefit (income) expense	$ 166	$ 3,103	$ (940)	$ 2,629

Other Postretirement Benefits

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Service cost	$ 259	$ 259	$ 777	$ 777
Interest cost	655	589	1,964	1,767
Amortization of loss	119	150	356	449
Total benefit cost	$ 1,033	$ 998	$ 3,097	$ 2,993

During the three months ended September 30, 2016, the Company determined it was probable lump sum benefits paid for its union pension plan in 2016 would exceed the threshold requiring settlement accounting. Actual lump sum benefits paid by the union plan amounted to $2.4 million for the nine months ended September 30, 2016. This resulted in recognition of a loss on settlement for the union plan during the three and nine months ended September 30, 2016 amounting to $0.5 million. The Company used a discount rate of 3.28% as of September 30, 2016 to measure the union plan benefit obligation. The new measurement resulted in a retirement plan loss which was recognized in other comprehensive loss of $8.9 million for the three and nine months ended September 30, 2016. For the nine months ended September 30, 2016, lump sum benefits paid for the management pension plan did not exceed the threshold requiring settlement accounting.

During the three and nine months ended September 30, 2015, the Company's pension plan for union employees paid lump-sum benefits to plan participants in full settlement of obligations due amounting to $25.7 million and $45.5 million, respectively. During the nine months ended September 30, 2015, the Company's pension plan for management employees paid lump sum benefits in full settlement amounting to $0.6 million. The Company's pension plan for management employees paid such benefits for the first quarter of 2015 only. This resulted in the recognition of a loss on settlement for both pension plans amounting to $4.1 million and $6.4 million for the three and nine months ended September 30, 2015, respectively. Because of the settlements, the Company measured its union pension plan obligations and plan assets as of September 30, 2015. The Company had previously measured its union pension plan obligations and plan assets as of June 30, 2015 and March 31, 2015 and its management pension plan obligations and plan assets as of March 31, 2015. The Company used discount rates of 4.03%, 4.09% and 3.54% as of September 30, 2015, June 30, 2015 and March 31, 2015, respectively, to measure the union pension plan obligations. The Company used a discount rate of 3.57% to measure the management plan obligations as of March 31, 2015. The new measurements resulted in a retirement plan loss which was recognized in other comprehensive loss of $9.0 million and $7.3 million for the three and nine months ended September 30, 2015, respectively.

The Company previously disclosed in its consolidated financial statements for the year ended December 31, 2015 that it expected to contribute $9.3 million to its pension plan in 2016. As of September 30, 2016, the Company has contributed $7.2 million. The Company presently expects to contribute the full amount during the remainder of 2016.

Table of Contents

8. Income Taxes

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Income tax at federal rate	$ (154)	$ 17	$ 752	$ 932
Increase (decrease) resulting from:				
State income taxes, net of federal income tax	(3)	3	143	116
Permanent difference for compensation limitation	—	14	—	242
Expense not deductible for tax	36	(158)	196	53
Other permanent differences	21	55	126	209
Capital goods excise tax credit	(74)	15	(325)	(348)
Total income tax provision (benefit)	$ (174)	$ (54)	$ 892	$ 1,204

The Company evaluates its tax positions for liability recognition. As of September 30, 2016, the Company had no unrecognized tax benefits. No interest or penalties related to income tax assessments were recognized in the Company's condensed consolidated statements of income for the three and nine months ended September 30, 2016 and 2015. All tax years from 2012 remain open for both federal and Hawaii state tax purposes.

9. Stock Compensation

The Company has an equity incentive plan. 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 equity incentive plan is 1,400,000 shares with 638,000 shares remaining to be issued at September 30, 2016. All grants under the equity incentive plan will be issued to acquire shares at the fair value on date of grant.

As of September 30, 2016, all awards were restricted stock units. Activity with respect to outstanding restricted stock units for the nine months ended September 30, 2016 and 2015 was as follows:

	Shares	Weighted-Average Grant-Date Fair Value Per Share
2016		
Nonvested at January 1, 2016	174,518	$ 26
Granted	127,360	25
Vested	(61,453)	25
Forfeited	(12,537)	25
Nonvested at September 30, 2016	227,888	$ 25
2015		
Nonvested at January 1, 2015	245,752	$ 27
Granted	140,909	26
Vested	(109,426)	28
Forfeited	(101,520)	26
Nonvested at September 30, 2015	175,715	$ 26

Table of Contents

The Company recognized compensation expense of $0.6 million and $1.7 million for the three and nine months ended September 30, 2016, respectively. The Company recognized compensation expense of $0.2 million and $1.1 million for the three and nine months ended September 30, 2015, respectively. The fair value as of the vesting date for the restricted stock units that vested during the nine months ended September 30, 2016 and 2015 was $0.9 million and $2.6 million, respectively. Upon vesting, unit holders have the option to net share-settle to cover the required withholding tax and the remaining amount is converted into an equivalent number of shares of common stock. The total shares withheld were 15,351 and 36,171 for the nine months ended September 30, 2016 and 2015, respectively, and were based on the value of the restricted stock units as determined by the Company's closing stock price on the date of vesting. Total payments for the employees' tax obligations to the tax authorities amounted to $0.4 million and $0.9 million for the nine months ended September 30, 2016 and 2015, respectively. Other than reimbursements for tax withholdings, there was no cash received under the restricted stock unit arrangements.

The Company also has a performance based compensation plan. The incentive compensation is settled in March of each year for the prior year services and is based on Company performance relative to certain company specific metrics. The Company recognizes the expense during the performance period based on the expected compensation amount. The compensation for the performance period ended December 31, 2015 was settled in cash in March 2016. Beginning for the 2016 performance period, a specified portion of the compensation amount for certain employees will be settled in Company shares based on the share price at the date of settlement. Upon settlement, employees may have the option to net share-settle to cover the required withholding tax and the remaining amount is converted into an equivalent number of shares of common stock. The estimated performance based compensation to be settled in stock amounted to $0.2 million and $0.6 million for the three and nine months ended September 30, 2016, respectively.

10. Stockholders' Equity

Warrants

In 2010, the Company issued warrants to purchase 1,481,055 shares of common stock for $14.00 per share. The warrants to purchase shares were exercisable anytime from January 26, 2011 to the maturity on October 28, 2015. The warrants could be exercised on a cashless basis whereby a portion of the exercised warrants were tendered in lieu of payment for the exercise price. During the nine months ended September 30, 2015, warrants were exercised on a cashless basis resulting in the issuance of 137,636 shares of common stock. In addition, another 238,697 warrants were exercised for cash consideration of $3.3 million during the nine months ended September 30, 2015.

Table of Contents

Accumulated Other Comprehensive Loss

The changes in components of accumulated other comprehensive loss, net of tax, are as follows (dollars in thousands):

	Unrealized Gain (Loss) on Investments	Retirement Plans	Total
Three Months Ended September 30, 2016			
July 1, 2016	$ —	$ (29,082)	$ (29,082)
Other comprehensive loss for 2016	—	(5,359)	(5,359)
September 30, 2016	$ —	$ (34,441)	$ (34,441)
Nine Months Ended September 30, 2016			
January 1, 2016	$ —	$ (29,388)	$ (29,388)
Other comprehensive loss for 2016	—	(5,053)	(5,053)
September 30, 2016	$ —	$ (34,441)	$ (34,441)
Three Months Ended September 30, 2015			
July 1, 2015	$ (64)	$ (22,600)	$ (22,664)
Other comprehensive loss for 2015	(1)	(5,429)	(5,430)
September 30, 2015	$ (65)	$ (28,029)	$ (28,094)
Nine Months Ended September 30, 2015			
January 1, 2015	$ (64)	$ (23,883)	$ (23,947)
Other comprehensive loss for 2015	(1)	(4,146)	(4,147)
September 30, 2015	$ (65)	$ (28,029)	$ (28,094)

Reclassifications out of accumulated other comprehensive loss for the three and nine months ended September 30, 2016 and 2015 were as follows (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Retirement plans				
Amortization of loss and settlement loss	$ 741	$ 4,292	$ 1,234	$ 6,820
Income tax provision on comprehensive income	(282)	(1,631)	(469)	(2,592)
Total	$ 459	$ 2,661	$ 765	$ 4,228

The amortization of loss and settlement loss was recognized primarily in selling, general and administrative expense for the periods ended September 30, 2016 and 2015.

11. Commitments and Contingencies

Trans-Pacific Submarine Cable

In August 2014, the Company joined several other telecommunication companies to build and operate a trans-Pacific submarine cable system. The total system cost is expected to be $235 million and is primarily composed of a supply contract with the lead contractor. The Company will contribute $25 million over the multi-year construction period in exchange for a fractional ownership in the system. The Company will recognize its fractional share of the cost. In addition, the Company will construct a cable landing station in Hawaii and provide cable landing services. The system is expected to be completed in the first half of 2017. As of September 30, 2016, the Company had incurred capital costs of $13.6 million primarily to the cable contractor for construction with all such costs capitalized to telephone plant under construction.

The Company will have excess capacity on its share of the trans-Pacific cable that it will make available to other carriers for a fee. The Company has contracted and expects to enter into additional contracts with other carriers for long-term indefeasible right of use, or IRU, agreements for fiber circuit capacity. The Company may receive up-front payments for services to be delivered over a period of up to 25 years. The Company has entered into agreements for the sale of capacity for $27.0 million plus fees to activate assigned capacity, and for operations and maintenance. As of September 30, 2016, the Company had received up-front payments of $5.7 million. As provided for in one of the agreements, funds of $3.5 million were held in escrow. The funds in escrow will be released to the Company when the trans-Pacific cable is ready for service. The restricted cash is reflected in other assets in the condensed consolidated balance sheet. A liability to provide services in the future for all up-front payments is included in other liabilities. The Company will recognize revenue for the circuit, beginning upon activation of the services, on a straight-line basis over the contract term.

Connect America Fund Phase II

In conjunction with reforming the Universal Service Fund, the Federal Communications Commission (“FCC”) established the Connect America Fund (“CAF”) which provides incremental support to broadband service providers. CAF Phase II is the long-term component of the program. In August 2015, the Company notified the FCC that it was accepting CAF Phase II support which amounts to $4.4 million in annual funding. Support is retroactive through the beginning of 2015, net of certain other receipts from the Universal Service Fund, and will continue for six years. Under the terms of the CAF Phase II, the Company will offer broadband service at 10 Mbps downstream and 1 Mbps upstream or better to approximately 11,000 eligible locations in high-cost areas in the State of Hawaii and will provide voice and broadband services at reasonable rates.

For the three and nine months ended September 30, 2016, the Company recognized $1.1 million and $3.3 million, respectively, in CAF Phase II funding as revenue. For the three and nine months ended September 30, 2015, the Company recognized $2.2 million of the first year funds as revenue.

Collective Bargaining Agreement

The Company has a collective bargaining agreement with the International Brotherhood of Electrical Workers Local 1357 (“IBEW”) that expires on December 31, 2017. The agreement covers approximately half of the Company’s work force.

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.

Table of Contents

Litigation

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

12. Fair Value of Financial Instruments

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

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

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, 2016		
Liabilities - long-term debt (carried at cost)	284,927	290,524
December 31, 2015		
Liabilities - long-term debt (carried at cost)	286,046	291,306

Fair Value Measurements

The objective of the fair value measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions.

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).

Liabilities carried at amortized cost with fair value disclosure on a recurring basis represent long-term debt. A summary is as follows (dollars in thousands):

	September 30, 2016	December 31, 2015
Liability value measurements using:		
Quoted prices in active markets for identical liabilities (Level 1)	$ —	$ —
Significant other observable inputs (Level 2)	290,524	291,306
Significant unobservable inputs (Level 3)	—	—
	$ 290,524	$ 291,306

13. Segment Information

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

Table of Contents

The following table provides operating financial information for the Company's reportable segments for the three and nine months ended September 30, 2016 and 2015 (dollars in thousands):

	Tele-communications	Data Center	Intersegment Elimination	Total
Three Months Ended September 30, 2016				
Operating revenues	$ 95,337	$ 3,061	$ (550)	$ 97,848
Depreciation and amortization	22,498	538	—	23,036
Operating income (loss)	3,878	(175)	—	3,703
Capital expenditures	25,599	—	—	25,599
Three Months Ended September 30, 2015				
Operating revenues	$ 98,475	$ 2,762	$ (332)	$ 100,905
Depreciation and amortization	21,978	573	—	22,551
Operating income (loss)	4,352	(157)	—	4,195
Capital expenditures	23,018	121	—	23,139
Nine Months Ended September 30, 2016				
Operating revenues	$ 288,377	$ 9,329	$ (1,523)	$ 296,183
Depreciation and amortization	65,888	1,591	—	67,479
Operating income (loss)	15,630	(538)	—	15,092
Capital expenditures	78,689	746	—	79,435
Nine Months Ended September 30, 2015				
Operating revenues	$ 287,123	$ 8,143	$ (1,058)	$ 294,208
Depreciation and amortization	64,080	1,692	—	65,772
Operating income (loss)	16,170	(794)	—	15,376
Capital expenditures	69,395	699	—	70,094

Intersegment revenue represents primarily network access services provided by the telecommunications segment for data center colocation. For the three and nine months ended September 30, 2016 and 2015, total operating income above reconciles to the condensed consolidated statement of income as follows (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Operating income	$ 3,703	$ 4,195	$ 15,092	$ 15,376
Corporate other expense	(4,156)	(4,144)	(12,879)	(12,636)
Income (loss) before income tax provision (benefit)	$ (453)	$ 51	$ 2,213	$ 2,740

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Local voice and other retail services	$ 81,347	$ 65,280	$ 246,481	$ 191,634
Wholesale carrier data services	13,440	32,863	40,373	94,431
Data center	3,061	2,762	9,329	8,143
	$ 97,848	$ 100,905	$ 296,183	$ 294,208

Table of Contents

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,” “assumptio 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:

- failures in critical back-office systems and IT infrastructure;
- a breach of our data security systems;
- our ability to provide customers with reliable and uninterrupted service;
- our ability to fund capital expenditures for network enhancements;
- the ability to maintain arrangements with third-party service providers;
- changes in regulations and legislation applicable to providers of telecommunications services;
- the ability of our operating subsidiaries to distribute funds or assets to the parent company;
- a reduction in rates we are allowed to charge our customers as dictated by regulatory authorities;
- changes in demand for our products and services;
- technological changes affecting the telecommunications industry;
- our ability to continue to license or enforce the intellectual property rights on which our business depends;
- failure to renegotiate contracts with television content providers on acceptable terms or at all;
- economic conditions in Hawaii;
- our ability to retain experienced personnel;
- our ability to utilize net operating loss carryforwards or fund tax payments;
- the effect our indebtedness could have on our financial condition;
- the effect of severe weather and natural disasters;
- the ability of a few large shareholders to influence corporate decisions; and
- the effect future sales of a substantial amount of common stock may have on our stock price.

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 for a detailed discussion of risks that could materially adversely affect our business, financial condition and 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.

Table of Contents

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.

Segments and Sources of Revenue

We operate in two reportable segments (telecommunication and data center) 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.

Telecommunications

The telecommunication segment derives revenue from the following sources:

Business data which includes data products such as Ethernet and Dedicated Internet Access along with traditional High-Speed Internet (“HSI”) for business customers, and VoIP. Business VoIP, also referred to as BVoIP, is a unified hosted communications solution for business that includes digital voice services bundled with internet service.

Voice services for both business and residential customers includes local telephone service. These revenues include monthly charges for basic service, and enhanced calling features such as voice mail, caller ID and 3 way calling. Voice also includes long distance services and subscriber line charges prescribed by the Federal Communications Commission and imposed on voice customers.

Equipment and managed services includes installation and maintenance of customer premise equipment as well as managed service for customer telephone and IT networks.

High Speed Internet services are provided to residential customers as well.

Video services are marketed as Hawaiian Telcom TV which includes digital television as well as advanced entertainment services.

Wholesale revenue represents wholesale data services provided to both wireline and wireless carriers.

We receive revenue from various other sources such as wireless services which includes the sale of wireless handsets and other wireless accessories, and switched carrier access which compensates us for origination, transport and termination of calls for long distance and other interexchange carriers. Also included in other revenue is government subsidies to provide service in rural or isolated areas.

Data Center

The data center segment provides physical colocation, virtual colocation and various related telephony services. We consider data center services as part of our business channel.

Results of Operations for the Three and Nine Months Ended September 30, 2016 and 2015

Operating Revenues

The following tables summarize our volume information (lines or subscribers) as of September 30, 2016 and 2015, and our operating revenues for the three and nine months ended September 30, 2016 and 2015. For comparability, we also present volume information as of September 30, 2016 compared to June 30, 2016.

Volume information includes certain information by lines. The line counts represent the number of billed units as of the end of the period as reflected in the records of our primary billing system. The separation of units by the business and

Table of Contents

consumer channel is based on the customer account designation in the billing system which is generally consistent with how revenue information is separated by channel. Business data lines represent digital subscriber lines used to provide internet services. Video service subscribers are determined with a count of individual customers as reflected in our primary billing system as of period end. For bulk contracts for multi dwelling units, we count individual residences subject to the bulk contract. Video homes enabled is estimated based on a count of single family homes and homes in multi dwelling units that are able to obtain our television service as of the period end.

Beginning December 2015, we enhanced the presentation of volume information and operating revenue to provide more meaningful information. Prior period information has been revised to reflect the current presentation. Total revenue has not changed from that previously reported but the classification by channel has been modified and we now present product information by channel as well.

Volume Information

As of September 30, 2016 compared to September 30, 2015