

Hawaiian Telcom Holdco, Inc.  
Form 10-K  
March 13, 2018  
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10 K

(Mark one)

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

For the fiscal year ended December 31, 2017

OR

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

Commission File No. 001 34686

HAWAIIAN TELCOM HOLDCO, INC.

(Exact name of registrant as specified in its charter)

Delaware 16 1710376  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

1177 Bishop Street

Honolulu, Hawaii 96813

(Address of principal executive offices) (Zip Code)

808 546 4511

(Registrant's telephone number, including area code)

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

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

Common Stock, par value \$0.01 per share  
(Title of class)

The NASDAQ Stock Market, LLC  
(Name of each exchange on which registered)

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

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

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

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

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

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

Large Accelerated Filer      Accelerated Filer      Non Accelerated Filer      Smaller Reporting Company  
(Do not check if a  
smaller reporting company)

Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of the registrant's common stock held by non affiliates as of June 30, 2017 was \$148,761,372.

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

As of March 1, 2018, 11,587,963 shares of the registrant's common stock, \$0.01 par value, were outstanding.

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## GLOSSARY OF TERMS

Defined below are certain terms used in this report:

Term	Definition
AAIS	Assignment, activation and inventory system
ADM	Add drop multiplexer
AIN	Advanced intelligent network
ATM	Asynchronous transfer mode
AWAS	Automated workforce administration system
BAiO	Business All in One
CAF	Connect America Fund
CLEC	Competitive local exchange carrier
Communications Act	Communications Act of 1934, as amended
CPE	Customer premises equipment
CSRIC	Reliability and Interoperability Council
DEU/DEUCE	Data exchange utility and connection engine systems
FCC	Federal Communications Commission
FTTN	Fiber to the node
FTTP	Fiber to the premise
GPON	Gigabit Passive Optical Network
HPUC	Hawaii Public Utilities Commission
HSI	High speed Internet
IBEW	International Brotherhood of Electrical Workers Local 1357
ILEC	Incumbent local exchange carriers
IP VPN	Internet protocol Virtual Private Network
IP	Internet protocol
ISDN	Integrated service digital network
ISP	Internet Service Providers
LATA	Local Access Transport Area
LQP	Loop qualification system
MDU	Multi dwelling units
MPLS	Multiprotocol Label Switching
MVNO	Mobile virtual network operator
NIST	National Institute of Standards and Technology
NOC	Network Operations Center
Oceanic	Oceanic Time Warner
PBRSU	Performance based restricted stock units
PBX	Private branch exchange
QoS	Quality of service
RBOC	Regional Bell operating companies
RSN	Regional Sports Network
ROADM	Reconfigurable optical add drop multiplexer
OAM	Operations, administration and maintenance
SDH	Synchronous digital hierarchy

SLC	Subscriber line charges
SONET	Synchronous Optical Network
STP	Signal transfer points
SystemMetrics	SystemMetrics Corporation
TDM	Time Division Multiplexing
UNE	Unbundled network element
UNE P	Unbundled network element platform
VoIP	Voice over Internet Protocol
VDSL2	Very High Bit Rate Digital Subscriber Line Generation 2
Wavecom	Wavecom Solutions Corporation
WATS	Wide Area Telephone Service

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Forward Looking Statements

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

Risks, uncertainties and other important factors that could cause actual results to differ materially from those described in forward looking statements and from historical results include, but are not limited to, the following:

- the effect of the pendency of the Merger (See “Part I, Item 1—Business, History and Organizational Structure), including the failure to consummate the Merger for any reason, including the failure to satisfy all of the closing conditions;
- failures in our critical back office systems and IT infrastructure;
- breach of our data security systems;
- increases in the amount of capital expenditures required to execute our business plan;
- the loss of certain outsourcing agreements, or the failure of any third party to perform under these agreements;

- adverse changes to applicable laws and regulations;
- the failure to adequately adapt to technological changes in the telecommunications industry, including changes in consumer technology preferences;
- adverse economic conditions in Hawaii;
- the availability of lump sum distributions under our union pension plan;
- limitations on the ability to utilize net operating losses due to an ownership change under Internal Revenue Code Section 382;
- the inability to service our indebtedness;
- limitations imposed on our business from restrictive covenants in our credit agreements;

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- severe weather conditions and natural disasters;
- network disruptions or other delays or interruptions of service; and
- failure to renegotiate programming contracts with television content providers.



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PART I

Item 1. Business

Business Overview

Hawaiian Telcom Holdco, Inc. (the Company) is the largest full service provider of communications services and products in Hawaii. Through our operating subsidiaries we provide local telephone service including voice and data transport, enhanced custom calling features, network access, directory assistance and private lines. In addition, we provide high speed Internet, long distance services, next generation television service, next generation Internet protocol (IP) based network services, customer premises equipment, data solutions, managed services, data center services including colocation and virtual private cloud, billing and collection and wireless services. Our services are offered on all of Hawaii's major islands, except for our next generation television service, which currently is available only on the island of Oahu. As of December 31, 2017, our telecommunications operations served approximately 271,000 voice access lines, 22,000 business Voice over Internet Protocol (VoIP) lines, 110,000 high-speed Internet lines, and 45,000 video subscribers.

See “—Sources of Revenue” below and “Segment Information” in the notes to the financial statements for additional information regarding revenues and total assets.

History and Organizational Structure

General

The Company was incorporated in Delaware in 2004. Originally incorporated in Hawaii in 1883 as Mutual Telephone Company, our Hawaiian Telcom, Inc. subsidiary has a strong heritage of over 134 years as Hawaii's communications carrier. From 1967 to May 1, 2005, we operated as a division of Verizon Communications Inc. (Verizon) or its predecessors. On May 2, 2005, the Verizon businesses conducted in Hawaii were reorganized and consolidated (2005 Reorganization) into Hawaiian Telcom Communications, Inc., a Delaware corporation and wholly owned subsidiary of the Company. As a result of the 2005 Reorganization, we became a stand-alone provider of communications services, operating as Hawaiian Telcom, Inc. and Hawaiian Telcom Services Company, Inc., both wholly-owned subsidiaries of Hawaiian Telcom Communications, Inc.

On July 9, 2017, the Company, Cincinnati Bell Inc. (Cincinnati Bell), an Ohio corporation, Twin Acquisition Corp., a Delaware corporation and a wholly-owned subsidiary of Cincinnati Bell (Merger Sub), entered into an Agreement and Plan of Merger (Merger Agreement), pursuant to which Merger Sub will merge with and into the Company and the Company will be the surviving corporation (the Merger). On November 7, 2017, our stockholders approved the Merger, but the Merger remains subject to additional closing conditions including certain regulatory approvals. Assuming all closing conditions are met, the Company estimates the Merger to close near the middle of 2018.

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

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### Industry Overview

The telecommunications industry is comprised of companies involved in the transmission of voice, data and video communications over various media and through various technologies. There are two predominant types of local telephone service providers, or carriers, in the telecommunications industry: incumbent local exchange carriers (ILECs) and competitive local exchange carriers (CLECs). An ILEC refers to the regional Bell operating companies (RBOCs), which were the local telephone companies created from the breakup of AT&T in 1984, as well as small and midsize independent telephone companies, such as Hawaiian Telcom, Inc., Cincinnati Bell Inc. and Consolidated Communications, Inc., which sell local telephone service. These ILECs were the traditional monopoly providers of local telephone service prior to the passage of the Telecommunications Act of 1996. In contrast, a CLEC is a competitor to local telephone companies that has been granted permission by a state regulatory commission to offer local telephone service in an area already served by an ILEC.

Over the last decade, the U.S. telecommunications industry has undergone significant structural changes as many of the largest service providers have achieved growth through acquisitions and mergers, while others have restructured or entered bankruptcy to obtain protection from creditors. In addition, the Telecommunications industry continues to see changes in consumer behavior as products and services continue to evolve. Despite these changes, the demand for telecommunications services as a whole, particularly data services, has remained strong, and telecommunications companies increasingly bundle services and provide integrated offerings for customers. Hawaii's telecommunications industry remains active, and demand for telecommunications services overall remains strong, due in part to the State's geographic isolation. Hawaii is connected to the mainland United States and Asia via undersea cables and several satellite networks.

### Our Business Strategy

Our primary objective is to be Hawaii's Technology Leader<sup>SM</sup> and the number one service provider of innovative communications, information and entertainment solutions to the people and businesses of Hawaii. The key elements of our business strategy are to grow our business with a focus on delivering superior service to our customers, which includes the following:

- Leverage our broadband network. Our broadband network is the foundation for our services to our customers, and we continue to expand its footprint and invest in advanced technology platforms that support advanced communications and network services. We completed the build out of our Multiprotocol Label Switching (MPLS) core network statewide and continue to deploy both fiber to the node (FTTN) and fiber to the premise (FTTP) access technologies to enhance and expand the speed and reach of our broadband network. We are deploying high speed technologies such as Very High Bit Rate Digital Subscriber Line Generation 2 (VDSL2), Gigabit Passive Optical Network (GPON), and Metro Ethernet to deliver new 1 Gbps broadband service and other high-bandwidth IP-based services such as our next generation television to consumers, Voice over Internet Protocol (VoIP), Internet protocol Virtual Private Network (IP VPN), managed services, data center services, including colocation and virtual private

cloud, and cloud based services to businesses. In all customer channels, we continue to enhance our services by adding new service options, features and functionality.

- Drive a customer and sales focused organization. Our customer operations team allows us to more effectively focus on customer satisfaction and successful delivery of our services, with the ultimate goal of delivering a consistent and comprehensive customer experience.

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- Deliver new and innovative products and services to attract and retain customers. We have successfully added, and expect to continue to add, new products and services to our customer offerings. We offer a full range of services, including voice, Internet, television, data, customer premises equipment (CPE), wireless, advanced communications and network services, managed services, data center services including colocation and virtual private cloud, and cloud-based services supported by the reach and reliability of Hawaii's largest next-generation fiber network, 24x7 state-of-the-art network operations center and Tier III data center. We believe our suite of next-generation data and IP based services, such as our Fiber-to-the-Home and Fiber-to-the-Business Internet, business VoIP, IP VPN services, and cloud applications better positions us to compete for new customers and drive winback opportunities while also allowing us to improve retention of existing customers by migrating them from legacy services. Our next generation television service, Hawaiian Telcom TV, is an important growth component for our consumer products portfolio and critical to our strategy to win the home and capture a share of the significant television and entertainment market opportunity.
- Improve operating profitability and capital efficiencies. We strive to maintain a disciplined approach to managing operating expenses and capital spending. Our focus on driving operational improvements in our business has resulted in cost savings, and we continue to identify initiatives that we believe will further improve our cost structure. In addition, we continue to review and renegotiate contracts with key IT and outsource suppliers, which has led to additional cost savings. We manage our capital expenditures to optimize returns through disciplined planning and targeted investment of capital. Our strategy is to continue making strategic investments in our business in order to position the Company for long term growth.

In furtherance of our growth strategy, we continue to make important investments that further our business objectives. In August 2014, the Company joined a consortium of national and international companies to build and operate the Southeast Asia to United States (SEA-US) trans Pacific submarine cable system connecting Indonesia, the Philippines, Guam, Hawaii and the mainland United States. The cost to construct the system is expected to be approximately \$235 million. We paid \$25 million for a fractional ownership in the system. As part of this project, we constructed a cable landing station in Makaha, Hawaii, and provide cable landing services to SEA-US. The system became operational in August 2017, and provides an initial 20 Tbps of capacity using state-of-the-art 100Gbps technology to accommodate the statewide increase in data consumption.

### Our Competitive Strengths

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

- **Strong Local Presence.** We have been serving Hawaii's communities for over 134 years and employ approximately 1,200 employees statewide. Each year, we donate to various local charities and our employees volunteer thousands of hours of community service. Moreover, we believe we are able to understand our customers' needs because our employees share many of those same needs. We also share Hawaii's history, heritage, and strive to be an example of

Hawaii's unique values. Because we are locally managed, we believe we are more responsive to Hawaii's consumers and businesses.

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- **Growth Oriented Product Portfolio.** We are the only communications service provider in our market that can provide the same broad array of services to both consumers and business customers that includes voice, Internet, data, CPE, wireless, advanced communications and IP based network services, managed services, data center services including colocation and virtual private cloud, and cloud based services. Our expanding service suite, including high quality enhanced data networking services such as our business VoIP and IP VPN services, our managed services, and our cloud applications are targeted at the key growth areas in our marketplace. Our next generation television service, employing Ericsson Mediaroom™, is targeted at capturing a share of the significant video and entertainment market opportunity and also promotes pull-through sales of Internet service.
- **Advanced Network Infrastructure.** We own one of the State's most extensive and reliable communications networks, including one of the largest fiber optic cable networks in Hawaii. Our statewide MPLS backbone and next-generation fiber network is one of the largest IP networks in Hawaii and allows us to deliver advanced IP-based services to over 99% of the State's population. Our network is supported by a 24x7 state-of-the-art network operations center and Tier III data center. We continue to expand our fiber network and to enhance and expand the speed and reach of our broadband network, which we believe will enable us to offer new products and services that will generate growth in our business and allow us to compete more effectively in the marketplace.
- **Strong Management Team.** We have assembled an experienced management team that we believe is well qualified to lead our company and execute our strategy. Our management team has significant operational experience in the telecommunications industry combined with extensive knowledge of our local market, which we believe will continue to be a critical driver of our success going forward.

## Our Products and Services

### Telecommunications

We generally classify our operations and related products and services into three core customer channels: Business, Consumer, and Wholesale. Presented below is an overview of the products and services we offer in each customer channel.

#### Business Channel

##### Data Services

We provide a broad portfolio of data services, which we believe are a key growth area driven by demand for increasing bandwidth and more advanced data solutions from business customers. We offer a range of broadband services including High-Speed Internet access, an asymmetrical broadband service geared toward small and medium-sized business customers, with speeds up to 1 Gigabits per second (Gbps) depending on the customer's

location, and Dedicated Internet Access (DIA), a symmetrical Internet access delivered over Ethernet with speeds up to 10 Gbps.

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

In addition to advanced communications and network services, we continue to provide special access tariff services such as frame relay, a shared wide area network service, and dedicated private lines. See “—Regulation” for further discussion of special access.



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### Voice Services

Voice services include basic local phone and long distance services for business customers. We provide basic local services generally for a fixed monthly recurring charge and can be enhanced with a variety of value added services such as call waiting, caller ID, voice messaging, three way calling, call forwarding and speed dialing. Value added services may be purchased individually or as part of a package offering for a monthly recurring charge. The rates that can be charged to customers for basic local and certain other services are regulated by the HPUC. We charge business customers higher rates to recover a portion of the costs of providing local service to residential customers, as is customary in the industry. See “—Regulation” for further discussion of regulatory matters.

### Equipment and Managed Services

We have resale relationships and certifications with a number of branded technology vendors, which allows us to competitively sell and install a wide variety of telecommunications equipment such as key, PBX, and other hardware solutions. In addition, we provide managed services as an end-to-end solution that manages, monitors, and supports a business’s network, CPE, and corporate data security. As business networks become more complex, the amount of time and capital businesses must spend to support their networks increases accordingly. Our managed services enable customers to focus on their core business by leaving the day-to-day management of their networks to us. Our managed services product portfolio consists of managed network and security services, IT professional services, and security consulting.

### Consumer Channel

#### Video Services

We introduced our next-generation television service on the island of Oahu in July 2011. Our Hawaiian Telcom TV service is 100% digital with hundreds of local, national, international and music channels, including high-definition, premium, pay per view channels and video on-demand service. During 2017, we continued to invest in our network to provide integrated digital video, high-speed Internet and voice services to new and existing customers by adding over 3,000 new households enabled for our TV service (HHE) bringing the total number of HHE to over 205,600 as of the end of 2017. The addition of new HHE in our single family home footprint is expected to subside going forward. Our IPTV service is expected to be a critical growth component for our consumer products portfolio and an anticipated anchor of our service bundling strategy. With television, we are now able to bundle digital video, high-speed Internet and voice services in certain areas of the island of Oahu.

#### Internet Services

We provide high-speed Internet access to our residential customers with speeds up to 1 Gbps in the FTTP footprint. In 2016, we launched WiFi Plus, a premium program that provides customized solutions to maximize customers' in-home Wi-Fi experience.

#### Voice Services

Consumer voice services include basic local telephone and long distance services. We provide additional value-added features such as call waiting, caller ID, voice messaging, three-way calling, call forwarding and speed dialing. We also offer a variety of long distance plans, including rate plans based on minutes of use, flexible or unlimited long distance calling services. The rates that can be charged to customers for basic local and certain other services are regulated by the HPUC.

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### Wholesale Channel

We provide special access or network transport services to our wholesale customers, network operators and other telecommunications carriers. Special access services include IP-based private networks, Ethernet, as well as Synchronous Optical Network (SONET), and Time Division Multiplexing (TDM) transport services. See “—Regulation” for further discussion of special access. In addition, we also provide wireless backhaul, or fiber-to-the-tower connections to support the growing demand for wireless broadband.

### Other

Other services include interstate and intrastate switched access for the origination, transport and termination of long distance calls (see “—Regulation” for further discussion of access charges), Connect America Fund support (see “—Regulation” for further discussion of universal service), operator services, billing and collection services and space and power rents for colocation services.

In addition, we offer wireless services pursuant to a mobile virtual network operator (MVNO) services agreement with Sprint Spectrum, L.P. (Sprint). That agreement allows us to resell Sprint wireless services, including access to Sprint’s nationwide personal communication service (PCS) wireless network to residential and business customers in Hawaii under the Hawaiian Telcom® brand name. The services agreement with Sprint was renewed in May 2015 for a 3-year term which expires in May 2018.

### Data Center Services

We provide colocation and virtual private cloud data center services to our business customers. Colocation enables our customers to install and remotely operate their IT equipment. Virtual private cloud services include the use of shared virtualized computing resources and a variety of customer control features and services, including back up data storage and cloud-based network security. We also offer a complete cloud service portfolio that includes a Desktop-as-a-Service product, the Microsoft® Office 365 suite of cloud-based Software-as-a-Service products, along with Infrastructure-as-a-Service and Security-as-a-Service. In addition, we provide related professional services, including planning, design, implementation and support services, to enable our customers to better manage and transition between their IT solutions. We consider data center services as part of our business channel.

### Markets and Customers

### Telecommunications

We have been a telecommunications provider in Hawaii for more than 134 years. Our market consists of 86 central offices serving an area of approximately 6,352 square miles on the islands of Oahu, Maui, Hawaii, Kauai, Molokai and Lanai. We are the incumbent provider of local exchange services within this area and own the State's most extensive local telecommunications network, with approximately 272,000 local access lines served as of December 31, 2017, of which 45% served residential customers and 55% served business customers.

Our market is characterized by high population density, with approximately 72% of the state's population concentrated on Oahu over an area of approximately 598 square miles, or approximately 1,500 persons per square mile. In addition, approximately 34% of the households in Hawaii reside in multi-dwelling units (MDUs)—approximately 41% on Oahu—compared with approximately 31% in the U.S. overall. This concentration of customers and commerce provides opportunities to leverage our network infrastructure to deliver products and services efficiently and in a cost effective manner and to market and sell our services more effectively. Given Hawaii's geographic isolation, Hawaii residents and businesses may have telecommunications needs that are different from those in the mainland United States. Furthermore, in 2016, the median household income in Hawaii was estimated to exceed the national median household income by approximately \$15,000. For the foregoing reasons, our strategy is to leverage the distinctive qualities of the Hawaii market to develop customized, local marketing strategies.

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Our business marketplace is dominated by several key industries. The federal government accounts for approximately 12% of gross state product. With the U.S. Pacific Command, one of the largest U.S. unified service commands, based in Hawaii, the federal government, collectively through its many departments and agencies, is one of our largest customers. Similarly, Hawaii state and local government, collectively through their many departments and agencies, constitutes a significant part of our business. The hospitality industry and financial institutions also account for a significant portion of our business. The operations of these leading sectors are communications intensive, and we believe that they are dependent on our modern, reliable services. Hawaii's small business market (in the aggregate) is also a key driver of Hawaii's economy—approximately 95% of the companies in Hawaii employ fewer than 50 employees, and these businesses make up a market of approximately 38,000 businesses. We believe that these business customers represent an underserved segment that we are targeting aggressively with new product and service offerings.

### Data Center Services

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

### Competition

The telecommunications industry is highly competitive. We experience competition from many communications service providers, including Charter Communications d/b/a Spectrum (Spectrum), which acquired local cable operator Oceanic Time Warner (Oceanic) in 2016; wireless carriers; long distance providers; competitive local exchange carriers; Internet service providers; Internet information providers; over-the-top hybrid voice providers; and other companies that offer network services and managed enterprise solutions. Many of these companies have a strong market presence, brand recognition, and existing customer relationships, all of which contribute to competition that may affect our future revenue growth. We expect competition to intensify as a result of the entrance of new competitors and the rapid development of new technologies, products and services.

Spectrum, the second largest cable operator in the United States, is the Company's most significant competitor. Approximately 70% of the occupied households on Oahu that subscribe to television service subscribe to Spectrum's cable television service. Spectrum also has the majority share of the high speed Internet market in Hawaii, which it uses as a platform to offer voice services utilizing VoIP technology, and markets its cable, high speed Internet, and voice services through competitive bundled offerings. In addition, Spectrum (marketing business products under "Spectrum Business") has targeted communications service offerings to small and medium sized businesses. Spectrum competes aggressively with the Company on products, pricing and marketing.

Wireless communications services continue to constitute a significant source of competition with traditional wireline phone service, especially as wireless carriers expand and improve their network coverage and continue to lower their prices. As a result, many customers have chosen to completely forego use of traditional wireline phone service and instead rely solely on wireless services. We anticipate the wireless substitution trend will continue, and could pose additional threat to our high-speed Internet product, particularly if wireless service rates continue to decline and the wireless service providers are able to deliver faster data speeds. Over the top hybrid providers, such as Skype, Magic Jack, Vonage, WhatsApp, Messenger, and LINE, also offer the capability to provide local voice and long distance calls using an Internet-connected smartphone, tablet or personal computer.

The advanced communications and network services business, as well as the managed services, data center services including colocation and virtual private cloud, and cloud based services businesses, are highly competitive due to the absence of significant barriers to entry. The emergence of non-traditional, application centric players in the market is redefining the role of service providers in these fields.

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

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

## Network Architecture and Technology

As the market leader in Hawaii for advanced telecommunications and cloud-based services, in 2017, we invested approximately \$76 million in our network to ensure Hawaii's most technologically advanced broadband communications network provided the reach, capacity, security and resiliency required of our customers and to position ourselves as a key hub for critical trans-Pacific traffic. Pursuing such a strategy has enabled us to add hundreds of miles to our fiber network and to complete the SEA-US trans-pacific submarine cable system which enables us to expand data connectivity beyond Hawaii to both the Asia/Pacific and Continental U.S. locations.

## MPLS and Transport Network

We believe that our statewide MPLS network is unmatched in Hawaii in reach, capacity, security, resiliency, and reliability. Consisting of two provider core routers, eight provider edge routers, and 39 service edge routers meshed for resiliency throughout the island chain, we offer a wide range of Layer 2 and Layer 3 MPLS services with many advanced features, including advanced traffic engineering support of intelligent QoS (Quality of Service) Service OAM (operations, administration, and management) capabilities, multiple access technologies, standards based routing protocols, Internet access across a single physical connection, and up to 100Gb Ethernet access. Driven by strong bandwidth growth from our high-speed Internet service, next-generation television service, wireless backhaul, and other retail and wholesale business requirements, in 2017, we expanded bandwidth capacity in the border and core sections of our MPLS network to accommodate increased demand and utilized our trans-pacific submarine cable

system for direct connections to the world's leading internet carriers with 100Gb connections. These interconnected platforms combine wave division multiplexing (WDM) transport, reconfigurable optical add-drop multiplexers (ROADM), and centralized carrier Ethernet switching in a single converged device allowing us to meet our customers' bandwidth needs economically. In 2017, we also introduced next generation Optical Networking leveraging lower-cost 100Gb Data Center Interconnect (DCI) and Point-to-Point capabilities. Our two border routers are provisioned with diverse trans-Pacific links to mainland carriers, along with expanded peering and content caching arrangements with global providers to reduce latency and buffering to our customers. Streaming Internet video is a major demand on our bandwidth capacity. Thus, in 2017, we expanded our on-island Video Caches from major CDN (Content Delivery Network) Providers and activated direct interconnection to these providers. In 2018, we plan to continue to expand bandwidth capacity in core, edge, and access sections of our MPLS network to accommodate increasing demand.



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Our telecommunication infrastructure includes more than 16,000 sheath miles of fiber optic cable and copper wire distribution lines. We have an ownership interest in the Hawaiian Interisland Cable System (HICS) and Hawaii Interisland Fiber Network (HIFN) interisland cables connecting the islands of Oahu, Kauai, Maui, Hawaii, Molokai, and Lanai through deep sea, submarine fiber. We lease capacity on other systems which provide additional diversity to our interisland network. We also have an ownership interest in the Southeast Asia to United States (SEA-US) trans-Pacific fiber cable network connecting Indonesia, Philippines, Guam, Hawaii, and California. In addition, we lease capacity on other trans-Pacific fiber optic cables to the U.S. Mainland, which provide diversity to protect our communications between the islands and high-speed broadband links in and out of the State.

### Voice Network

Powered by Broadsoft, we continued to add new services and features to our VoIP application servers in 2017, providing Hawaii businesses the communication tools they need to compete locally and globally in a fast, reliable, and secure manner.

Plain Old Telephone Service (POTS) is still provided statewide and as of December 31, 2017, we operated 99 local base and remote switches and five tandem switches spread across all islands. These legacy access lines are served by digital switches provided predominantly by Nokia (formerly Alcatel-Lucent) and Genband.

### Network Optimization Initiatives

To lower our operational costs and migrate our services off legacy systems to more efficient next generation platforms, we embarked on network optimization projects to retire older network elements. In 2017, we shut down our oldest Digital Subscriber Line Access Multiplexers (DSLAMs) in several key offices, transferred thousands of POTS customers off energy inefficient switches, and migrated customers to newer platforms to shut down all remaining frame relay switches. We plan on increasing our optimization initiatives in 2018, which will further shrink our legacy network infrastructure.

### Access Infrastructure

In 2017, we continued to aggressively invest in our high-speed, fiber-based broadband network and now have approximately 206,000 households enabled on this next generation platform. We nearly tripled our direct fiber connections to Hawaii businesses and now have approximately 11,000 business addresses on our Gigabit-capable Passive Optical Network (GPON). This Fiber-To-The-Premises (FTTP) solution provides businesses transmission speeds of over 1 Gbps which is expected to satisfy expected increases in bandwidth demand. FTTP solutions will

continue to serve new (greenfield) MDU, single-family subdivision developments, and targeted business corridors. Our strategic deployment of FTTP solutions is creating a robust fiber network whereby we can leverage our MPLS backbone, provide higher bandwidth services to our customers (including our television service), future proof our customer's needs, and reduce our maintenance costs. Meshed into this strategy for 2017 was also the expansion of our fiber network to approximately 518 cell sites across the state of Hawaii to provide backhaul services to our wireless carrier customers and FTTP/FTTN (Fiber-To-The-Node) build outs to approximately 5,200 (over 3,660 on FTTP) high cost, underserved rural locations through the use of federal Connect America Funds (CAF). These network enhancements allowed the increased penetration and expansion of higher broadband services including our television service. Our 2018 plans include continued expansion of our next-generation broadband network in key business areas, and further FTTP/FTTN expansion in CAF-eligible areas as part of Phase II of our federal grant.

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### Next-Generation Television Service

We believe our IP-based television introduced on the island of Oahu in 2011 continues to provide a superior linear TV experience to our customers over our competitors. Powered by Ericsson Mediaroom™ middleware, we provide a wide range of content and multimedia services over our IP-based network and provide our customers with new viewing experiences and applications, such as Whole Home DVR (Digital Video Recorder), instant channel change, brilliant picture and sound quality, and over 80 TV Everywhere apps that allow customers to view content on mobile devices. We have coupled this service with a WiFi plus service that greatly improves the WiFi performance and experience in our customers' homes.

### Network Surveillance and Operations

Our statewide network infrastructure is monitored and managed by our Network Operations Center (NOC) located in Honolulu. The eNOC provides surveillance 24x7, 365 days-a-year, for our statewide network consisting of 86 central offices, TV head-end facility, associated interoffice facilities, microwave radio towers, and E911 facilities. Our network infrastructure for voice, data, and video is monitored proactively with state-of-the-art performance and fault management systems. Customer networks are also monitored proactively by our Managed Services team. We have a customer service center which also operates on a 24x7, 365 days-a-year basis to handle customer inquiries and repairs, and provide call completion services. All customer installations and repairs requiring a field technician are offered during extended hours and coordinated by our Dispatch Center. All construction activity, for both outside and inside plant, is coordinated by our engineering operations team located at our main office on Oahu.

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

### Information Technology and Support Systems

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

As part of our ongoing commitment to customer service, we implemented improvements in 2017 to our customer-facing applications with the implementation of automated trouble ticketing via the Internet and deployed our first self-service mobile application. We implemented improvements in our contact center systems by automating orders from our outside sales teams, allowing for quicker installation times and increased productivity in both our outside sales and offline contact center teams. We were awarded the honor of providing primary NOC functionality and NOC administration for the SEA-US Consortium. Further, a new online application was implemented to provide international users and local Hawaii-based employees with the ability to create, manage and track circuit orders and service requests for SEA-US services.

We continue to focus efforts on flow-through automation from order entry through billing, and in 2017 we continued to implement improvements which reduced manual processing of complex orders, increased productivity, and enhanced overall data quality. We made further improvements in 2017 through consolidation of order entry process and systems. We replaced our field dispatch system to improve technician and dispatch efficiency and enabled the provisioning of new copper technologies to improve the speed and quality of our high speed internet network. In 2018, we plan to continue to make improvements through automation of more complex Business Orders types, and increase automation via our provisioning and inventory management applications.

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As is the case with other telecommunications companies, we are an on-going target for cyber criminals. In response, we have aggressively pursued initiatives to reduce our cyber security related risks. We continue to provide our employees, contractors and vendors awareness, including evolution of our corporate cybersecurity communications and policies. We also provide cybersecurity awareness to our customers and the Hawaii community in general. In 2017, we continued our investment in security access, control points and systems as our Information Technology evolved in the areas of mobility and cloud services. In addition, we continue to leverage government resources at the federal, state and local levels to enhance the cybersecurity of our network and services as well as improve our internal policies and procedures. These and other investments reflect our on-going commitment to securing our information assets and protecting sensitive data in our information systems.

## Employees

As of December 31, 2017, we employed approximately 1,200 full-time employees in Hawaii. Of the total employees, approximately 55% were represented by the International Brotherhood of Electrical Workers (IBEW) Local 1357 pursuant to a five-year collective bargaining agreement that expires in the third quarter of 2022. We believe that management currently has a constructive relationship with the represented and non-represented employee group.

## Insurance

We have insurance to cover risks incurred in the ordinary course of business, including errors and omissions, cyber liability, general liability, property coverage (which includes business interruption), director and officers and employment practices liability, auto, crime, fiduciary and worker's compensation insurance in amounts typical of similar operators in our industry and with reputable insurance providers. Central office equipment, buildings, furniture and fixtures and certain operating and other equipment are insured under a blanket property insurance program. This program provides substantial coverage against "all risks" of loss including fire, windstorm, flood, earthquake, and other perils not specifically excluded by the terms of the policies. As is typical in the telecommunications industry, we are self insured for damage or loss to certain of our transmission facilities, including our buried, undersea and above ground transmission lines. We believe that our insurance coverage is adequate; however, the incurrence of substantial uninsured liabilities due to damage or loss to such facilities could have a material adverse effect on our financial results.

## Regulation

### Federal and State Regulation of Telecommunications Services

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

## Competition

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

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### Universal Service

As a provider of interstate telecommunications, we are required to contribute to federal universal service programs. The FCC adjusts the contribution amount quarterly and may increase or decrease this amount depending on demand for support and the total base of contributors. We previously drew Interstate Access Support of approximately \$1.9 million annually from this funding, which was phased out in 2015 after we accepted Connect America Fund (CAF) Phase II support, as further described below.

In November 2011, the FCC released its “Connect America Fund” Order which adopted a number of proposals relating to reforming existing universal service support mechanisms. Among other things, the Order transformed the FCC’s universal service and intercarrier compensation systems into the Connect America Fund (CAF), which funds broadband deployment in census blocks that the FCC has determined are unserved by an unsubsidized wireline competitor. For price cap carriers such as our subsidiary Hawaiian Telcom, Inc., CAF Phase II support is distributed pursuant to a forward-looking cost model. In August 2015, we notified the FCC that we would accept CAF Phase II support which amounts to \$4.4 million in annual funding for six years for the calendar years 2015-2020. Under the terms of CAF Phase II, we will offer broadband service at 10 Mbps downstream, and 1 Mbps or better upstream, 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. The FCC is expected to issue additional clarifications relating to CAF Phase II, including the methodology for measuring broadband speeds, but we do not know if this will impact our ability to meet the program obligations and result in a loss of some of the support if program obligations are not fully met.

In December 2017, the FCC released the final list of census blocks eligible for the CAF Phase II auction which includes a list of the census block groups and associated reserve prices. Census block groups are expected to be the minimum geographic areas for which bids may be made. It includes census blocks that are: (1) located in price cap territories that are not served by a price cap ILEC or an unsubsidized competitor with voice and broadband at speeds of 10/1 Mbps or higher; and (2) based on averaged cost, are identified by the Connect America Cost Model as high-cost or extremely high-cost. As required by prior orders, the list is being made available at least three months prior to the deadline for the submission of short-form applications for the auction. On January 9, 2018, the FCC released a draft order, which will be considered at its January 30, 2018 open meeting, which proposes a start date of July 24, 2018, for the auction. We are evaluating whether to submit a bid in the auction.

### Government Regulation of Retail Rates

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

In 2009 and 2010, the Hawaii State Legislature required the HPUC to treat all intrastate retail telecommunications services, including intrastate toll (i.e., inter island), central exchange (Centrex), most residential and business local exchange services, integrated service digital network (ISDN) private lines and special assemblies, and directory assistance, as “fully competitive” under the HPUC’s rules with certain qualifications. HPUC approval and cost support filings are no longer required to establish or reduce rates or to bundle service offerings; however, all service offerings must be priced above the service’s long run incremental cost, and the HPUC can require cost support demonstrating compliance with its costing rules at any time. The HPUC retains the ability to suspend and investigate any offering. In 2012, the Hawaii State Legislature further leveled the regulatory playing field by providing us with pricing flexibility to increase tariffed intrastate rates for any retail telecommunications service without approval from the HPUC with the exception of basic exchange service (i.e., single line residential and single line business services), which continues to require HPUC approval. Competitive forces, however, may cause us to be unable to raise our local rates in the future.



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The classification of retail local exchange intrastate services as fully competitive and the ability to bundle the services with other fully or partially competitive services, or other services that are not within the HPUC's jurisdiction, enable us to charge a discounted rate for bundled service offerings and have helped us to be more competitive.

### State and Federal Regulation of Long Distance Services

We are subject to certain conditions imposed by the HPUC and the FCC on the manner in which we conduct our long distance operations. For example, we are prohibited from joint ownership of local and long distance telephone transmission or switching facilities. The HPUC is responsible for ensuring that our ILEC does not discriminate against other long distance providers.

### Federal Requirements

As an ILEC, we are subject to federal laws governing a number of access and interconnection requirements, and other competitive obligations. Among other things, an ILEC must negotiate in good faith with other carriers requesting interconnection and access to unbundled network elements (UNEs), and must offer its competitors access to UNEs, such as local loops and inter-office transport, at regulated rates. The FCC also has limited our obligation to unbundle fiber facilities to multiple dwelling units, such as apartment buildings, and to homes and offices deployed in FTTC and FTTP arrangements. In addition, federal law regulates competitors' requests to colocate facilities within our central offices and to have access to our subscriber list information in order to produce competing directories. The FCC also has imposed specific rules regarding the manner and time within which a customer's telephone number must be ported to a competing carrier's service, and has strict guidelines prohibiting the ILEC's use of this information for any other purposes. In December 2015, the FCC granted forbearance to ILECs from the equal access rules and dialing parity requirement for connecting interexchange carriers on a prospective basis. The FCC also granted similar forbearance from the requirement to provide 64 kbps voice channels where copper loops have been retired and the requirement to provide access to newly-deployed entrance conduit at regulated rates.

### Interstate and Intrastate Access Charges

The rates that we can charge for interstate access are regulated by the FCC. The FCC has made various reforms to the existing rate structure for access charges, which, combined with greater competition, have caused the aggregate amount of access charges paid by long distance carriers to decrease over time.

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



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### Federal Framework for Intercarrier Compensation

In its “Connect America Fund” Order (see “—Universal Service” above) that reformed universal service, the FCC also fundamentally restructured the regulatory regime for intercarrier compensation, which consists of state and interstate access charges and local reciprocal compensation. Among other things, this comprehensive reform unifies state and interstate intercarrier charges in certain circumstances, provides a mechanism to replace intercarrier revenues lost through rate unification, and resolves prospectively a number of outstanding disputes among carriers regarding interconnection and compensation obligations. In particular, the FCC’s order required that price-cap carriers reduce interstate and intrastate terminating switched access rates to \$.0007 over a six year phase-down period. The FCC also required that most intercarrier compensation be eliminated, and that it be replaced by a system of “bill & keep”, whereby the carrier would have to seek recovery of its costs entirely from its own end users. In the interim, the FCC capped most existing intercarrier compensation rates and established a phase-down of those rates over a six-year period for price-cap companies such as Hawaiian Telcom, Inc. To partially offset the resulting decrease in revenues, the Commission authorized us to assess our end user-customers a limited recovery charge that would increase over the time period during which intercarrier compensation rates decline, then would be phased out gradually beginning in 2017. Finally, the FCC decided that interstate access charges should apply to VoIP or other Internet protocol based service providers on a prospective basis, subject to the same interim phase down requirements described above. The FCC found that carriers should have the opportunity to make up for any loss of revenues either through the established recovery mechanisms or through the sale of additional services, such as broadband and television services.

We have implemented six phases of the intercarrier compensation reform, offsetting a portion of the resulting revenue loss through the FCC-authorized monthly recurring access recovery charge for certain classes of customers. Intercarrier compensation rates have been reduced to either bill & keep or \$.0007 per minute.

In a separate proceeding, the FCC found that Internet bound traffic is not subject to reciprocal compensation under Section 251(b)(5) of the Communications Act. Instead, the FCC established a federal rate cap for this traffic, which is and will remain \$.0007 per minute until the FCC decides otherwise.

### Special Access

In 1999, the FCC adopted rules for special access services, also known as Business Data Services (BDS), that provide for pricing flexibility and ultimately the removal of services from price regulation when prescribed competitive thresholds are met. We currently have pricing flexibility for certain special access services offered throughout our territory. In the first quarter of 2015, Hawaiian Telcom, as a provider of dedicated special access services, complied with the FCC’s order for a mandatory special access data collection by filing detailed information concerning carrier services provided to enterprise and wholesale customers, including special access services. The FCC has used the data collected to evaluate competition in the market for special access services and to help the FCC decide whether to modify the special access pricing rules for price-cap carriers, including whether the pricing flexibility rules should be modified or eliminated.

In October 2015, the FCC initiated an investigation into the terms and conditions of the special access service pricing plans of four large price-cap carriers (AT&T, CenturyLink, Frontier, and Verizon). Issues designated for investigation included whether the following practices were just and reasonable practices under the Communications Act (Act): (1) percentage commitments based on a purchaser's historical or existing levels of purchases; (2) shortfall fees; (3) upper percentage thresholds; (4) overage penalties; (5) certain long-term commitments; and (6) early-termination fees. The investigation also considered whether certain commercial agreements should be subject to the filing requirements of the Act and whether the special access pricing plans inhibit the transition from TDM-based special access to IP-based services. In May 2016, the FCC ordered the affected carriers to remove such provisions from their tariffs by July 1, 2016. This order was appealed to the D.C. Circuit Court of Appeals. In 2017, the FCC requested that the Court remand the decision, sought additional public comments, and is now considering whether to affirm, modify, or reverse the original July 2016 order, which is still pending before the FCC. We do not know if and when we may be required to remove similar provisions from our tariffs.

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In April 2017, the FCC adopted new rules governing BDS. The FCC deregulated and detariffed: (1) all packet-based BDS services and TDM-based services with bandwidths in excess of the level of a DS3; (2) TDM-based DS1 and DS3 transport; and (3) TDM-based DS1 and DS3 end-user channel terminations in counties deemed competitive, and in non-competitive counties where the ILEC had previously been granted Phase II pricing flexibility. In counties deemed non-competitive, ILECs will continue to be subject to price-cap regulation based on ILEC Phase I pricing flexibility rules, which means that contract tariffs and volume and term discounts will be permitted. Four of the five counties in Hawaii were deemed fully competitive. For the remaining county, Kalawao County, we filed an application in November 2017 with the FCC to discontinue offering business data services in Kalawao County. We expect the discontinuance to be approved in January 2018. Once granted, we will no longer provide BDS in a non-competitive county, allowing us to fully detariff BDS across the state. Detariffing applies to both ILECs and CLECs. The Order also terminates the interim wholesale access rule requirements for discontinued TDM-based BDS and UNE-P replacement services that were adopted in 2015. Most of the new BDS rules became effective on August 1, 2017, which began the 36-month transition period for detariffing. Some rules require approval of the Office of Management and Budget (OMB), including: (1) the rule grandfathering special access contract-based tariffs in effect on or before August 1, 2017 (CFR §1.776); and (2) the detariffing rules for ILECs and CLECs (CFR §§61.201 and 61.203, respectively).

## Federal Regulatory Classification of Broadband and Internet Services

The FCC previously considered whether, and under what circumstances, services that employ Internet protocol are “telecommunications services” subject to regulations that apply to other telecommunications services, but it has not definitively ruled on the issue, and instead has made a series of decisions addressing specific services and regulations.

In March 2006, a request of Verizon that sought forbearance from Title II regulation for certain advanced broadband special access services was deemed granted by operation of law. This forbearance grant was applicable to us since we were part of Verizon when the original Verizon petition for forbearance was filed. This action permitted us to deregulate covered advanced broadband special access services, giving us greater flexibility in our pricing and terms and conditions for eligible services. The FCC included the Verizon forbearance in its April 2017 BDS Order, which granted the same type of forbearance for packet-switched services to all providers.

In December 2010, the FCC adopted “net neutrality” rules, termed “open Internet” rules that would bar Internet service providers from blocking or slowing Web content sent to homes and businesses. The rules continue to treat broadband Internet access services under the FCC’s Title I authority, but adopted as rules the existing guidelines applicable to Internet service providers. The FCC also adopted three additional rules concerning blocking, non discrimination, and transparency. The anti-discrimination and no blocking rules were vacated by a federal court of appeals, but the public disclosure requirement remains in place.

In February 2015, the FCC reclassified broadband service, both fixed and mobile, from its longstanding status as a Title I information service to a Title II common carrier telecommunications service. While reasonable network

management was permitted, the open Internet order banned blocking legal content/applications, throttling lawful traffic and paid prioritization or “fast lanes”, expands transparency rules and creates a general conduct rule to bar broadband Internet service providers from unreasonably interfering with or disadvantaging the ability of consumers and edge providers to reach and communicate with each other. In December 2017, the FCC reversed its February 2015 ruling and reclassified broadband service, both fixed and mobile, from a Title II common carrier telecommunications service back to its longstanding status as a Title I information service, including rescinding the previously established rules against blocking and discrimination. The rules were released in January 2018 and are expected to come under intense scrutiny and legal opposition. The change in rules is not expected to have a major impact on us because we do not throttle or block Internet traffic and have no paid prioritization practices. Congress is considering adopting open Internet legislation to effect laws regarding blocking and discrimination. We do not know what the final outcome of these actions will be, or how our broadband services may be affected by any further rules that may be adopted. The FCC’s order is also subject to a court appeal and it is uncertain when this will be resolved.

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In October 2016, the FCC adopted a Broadband Privacy order that required broadband Internet service providers (ISPs) to obtain “opt-in” permission before using or sharing information about the sites their customers visit on the Internet and their online communications. The Broadband Privacy order also imposed data security and breach notification requirements, as well as transparency requirements regarding information collection, such as how such information is used, with whom such information is shared, and customer options for granting or denying permission.

In June 2017, before the requirements of the Broadband Privacy order became effective, the FCC issued a subsequent order stating that the privacy rules in the 2016 order were no longer valid, and re-instated the privacy rules that were effective before the 2016 order was adopted.

## Video Services Regulation

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

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

## Other Federal and State Regulatory Proceedings

The FCC has been exploring whether to modify its rules requiring utilities to provide telecommunications carriers and cable television companies with access to their poles, ducts, and rights of way. In April 2011, the FCC adopted new pole attachment rules that, among other things, require access to poles and conduit within a shorter period of time, and further limit make-ready costs. In addition, these new rules change the rates for pole attachments by mandating that

broadband attachers pay pole attachment rates that are closer to existing cable TV rates, than higher rates applicable to telecommunications carriers. These rules also for the first time allow telephone companies to demand reasonable rates from utility pole owners. These rules tend to increase the burdens and costs of pole and conduit owners such as us. The rules were upheld on appeal in February 2013. In December 2015, the FCC further revised the formula for calculating pole attachment rates for telecommunications carriers. The change will ensure that pole attachment rates for telecommunications attachers, including providers of broadband Internet access service (BIAS), approximate the rates for cable attachers. In November 2017, the FCC adopted various rule changes intended to speed broadband deployment by (1) excluding capital costs recovered via make-ready fees from pole attachment rates; (2) establishing a 180-day shot-clock for pole attachment complaints; and (3) allowing ILECs to access poles owned by CLECs. These rule changes became effective January 2018.



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In August 2015, the FCC adopted rules concerning the transition from the copper-based Time Division Multiplexing (TDM) network to a fiber-based Internet Protocol (IP) network. To address backup power requirements for residential consumers of IP-based voice and data services that replace the traditional telephony used to dial 911, effective February 2016, prior to switching facilities-based, fixed, residential voice services from copper, which is line-powered, to fiber, Hawaiian Telcom must educate affected residential subscribers on the impact of this switch, and offer these subscribers the option to purchase a backup power solution that provides at least eight hours of standby power during a commercial power outage. Within three years, in accordance with FCC requirements, Hawaiian Telcom is required to offer at least one option that provides a minimum of 24 hours standby power. The purpose of the requirement is to ensure consumers can make calls to 911 in the event of a power outage.

In a separate proceeding in 2015, the FCC also adopted rules governing the retirement of copper loops and the discontinuance of legacy services used as a wholesale input. Among other things, the rules required ILECs to: (1) provide interconnecting entities at least six months' advance notice of proposed copper retirement; and (2) consider the impact of their actions on the end-users of carrier-customers when discontinuing, reducing, or impairing a service used as a wholesale input. In order to receive authority to discontinue, reduce, or impair either special access services at DS1 speed and above or commercial wholesale platform service, the rules required ILECs to provide competing carriers with wholesale access to their IP services on reasonably comparable rates, terms, and conditions. In November 2017, the FCC adopted various rule changes intended to speed the transition from copper networks and legacy services to next-generation networks and services by reforming rules that increase costs and slow broadband deployment including: (1) streamlining the copper retirement rules adopted in 2015, including reducing the notice period from 180 to 90 days; (2) accelerating the approval process for applications that grandfather low-speed legacy services, discontinuing legacy data services already grandfathered, or discontinuing low-speed legacy services with no customers; and (3) reversing the 2015 clarification that, when discontinuing a service, a carrier must also take into account the retail end-users of its wholesale customers. These rule changes will not become effective until approved by the Office of Management and Budget. The FCC's order is also subject to a court appeal and it is uncertain when this will be resolved.

## Environmental, Health and Safety Regulations

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

## Available Information

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

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Item 1A. Risk Factors

You should carefully consider the risks described below as well as the other information contained in this Form 10-K. Any of the following risks could materially adversely affect our business, financial condition or results of operations.

Risks Relating to our Business

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

Risks Relating to the Pending Merger.

On July 9, 2017, we, Cincinnati Bell and Merger Sub entered into a Merger Agreement, pursuant to which we will become a wholly-owned subsidiary of Cincinnati Bell. On November 7, 2017, our stockholders approved the Merger. Assuming all closing conditions are met, we estimate the Merger to close near the middle of 2018. However, the Merger remains subject to obtaining required approvals and satisfying closing conditions, which may delay or prevent completion of the Merger and/or result in the incurrence of additional costs. Further, certain events may delay the completion of the Merger or result in a termination of the Merger Agreement. Some of these events are outside of our control. Completion of the Merger is also conditioned upon, among other things, the receipt of certain governmental consents and regulatory approvals including approval by the Federal Communications Commission and Hawaii Public Utilities Commission. No assurance can be given that the required consents and approvals will be obtained or that the required conditions to closing will be satisfied. Even if all such consents and approvals are obtained, no assurance can be given as to the terms, conditions and timing of the consents and approvals or that they will satisfy the terms of the Merger Agreement.

The failure to complete the Merger and delays completing the Merger could adversely affect the market price of our common stock.

Failure to complete the Merger would prevent us from realizing the anticipated benefits of the Merger. In addition, the market price of our common stock may reflect various market assumptions as to whether and when the Merger will be completed. Consequently, the failure to complete, or any delay in the completion of the Merger could result in a significant adverse change in the market price of our common stock, particularly to the extent that the current market price reflects a market assumption that the Merger will be completed.

Whether or not the Merger is completed, the pendency of the transaction could cause disruptions in our business, which could have an adverse effect on our business and financial results.

The pendency of the Merger could cause disruptions in our business, including, but not limited to, the following:

- current and prospective employees may experience uncertainty about their future roles with the combined company or consider other employment alternatives, which might adversely affect our ability to retain or attract key managers and other employees;
- our customers may anticipate changes in how they are served and may, as a result, choose to discontinue their service or choose another provider;
- our management's attention may be diverted from the operation of the business toward the completion of the Merger; and
- the Merger Agreement contains certain negative covenants that limit how we conduct our business during the pendency of the Merger.

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

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

- reduce our customer base;
- require us to lower prices charged to customers in order to compete; or
- require us to increase marketing expenditures and the use of discounting and promotional campaigns.

Any of these events could have a material adverse effect on our business and financial results.

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

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

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

**Internet Services.** We expect that the Internet access services business will continue to be highly competitive due to the absence of significant barriers to entry. We currently compete with a number of established online services

companies, inter exchange carriers and cable companies. Competition is particularly intense for broadband services.

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

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

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

Next Generation Television Service. We launched our television service on the island of Oahu in July 2011. The market for television services in Hawaii is dominated by Spectrum. On the island of Oahu, approximately 70% of occupied households that subscribe to television service subscribe to Spectrum's cable service. There is no assurance we will be able to compete successfully against Spectrum. In particular, the costs to acquire programming is a significant and increasing cost, and there is no assurance our content acquisition costs will be in line with Spectrum's such that we can remain competitive. Direct broadcast satellite companies currently are not significant competitors, but this could change in the future.

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

We have made and expect to continue to make material capital expenditures in connection with improvements to our network and other facilities. Unforeseen increases in the amount of capital expenditures required to execute our current business plan could have a material adverse effect on our business and financial results.

We have made and expect to continue to make significant capital expenditures to, among other things, enhance the capabilities of our network, such as that required to provide digital video service, enhance the functionality of our existing IT systems, and support the deployment of new products and services. We intend to fund future capital expenditures and expenses with operating cash flows and funds available to us under our credit facilities. Increases in the amount of capital expenditures and expenses required to upgrade our network and other facilities above those contemplated by our current business plan, could cause our cash flows and available financing to be insufficient to fund such capital expenditures and operating expenses and have a material adverse effect on our business and financial results.

Failures in our critical back office systems and IT infrastructure could have a material adverse effect on our business and financial results.

We operate our own back office and IT infrastructure, including business processes, software applications (such as billing systems, corporate finance systems, human resources and payroll systems and customer relationship

management systems), and hardware that are vital to our operations. Failures in our back office systems and IT infrastructure could have a material adverse effect on our business and financial results.

Our success will depend on our ability to attract and retain qualified management and other personnel.

Our success depends upon the talents and efforts of our senior management team. The loss of any member of our senior management team, due to retirement or otherwise, and the inability to attract and retain highly qualified technical and management personnel in the future, could have a material adverse effect on our business, financial condition, results of operations, liquidity and/or the market price of our outstanding securities.



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An IT and/or network security breach may lead to unauthorized use or disabling of our network, theft of customer data, unauthorized use or publication of our intellectual property and/or confidential business information and could have a material adverse effect on our business and financial results.

We are subject to cyber and other data security risks. This risk may be heightened as we expand our managed services, data center services, and cloud-based services. We seek to effectively prevent, detect and respond to all cyber-attacks, but, in some cases, we might be unaware of an incident or its magnitude. Significant security failures could result in the theft, loss, damage, unauthorized use or publication of our intellectual property and/or confidential business information; the theft, loss, damage, unauthorized use or publication of our customers' personally identifiable information, intellectual property and/or confidential business information; or the unauthorized use or disabling of our network elements. While we have technology and information security processes and cybersecurity risk management in place to mitigate these risks and respond to any incidents, there is no assurance these measures will be adequate to prevent an incident, including incidents involving sophisticated criminal organizations and nation-state actors. A disabling of our network elements or a loss of confidential or proprietary data or other data security breaches could materially and adversely affect our customers, employees and vendors, damage our reputation among customers and the public, disrupt operations, and subject us to possible financial losses, any of which could have a material adverse effect on our financial condition and results of operations and our ability to expand our services.

A network disruption could cause delays or interruptions of service, which could cause us to lose customers.

To be successful, we will need to continue to provide our customers with reliable and uninterrupted service over our expanded network. Disruptions in our service could occur as a result of events that are beyond our control. Some of the risks to our network and infrastructure include, without limitation:

- physical damage to our transmission network including poles, cable and access lines;
- widespread power surges or outages;
- software defects in critical systems; and
- damage or disruption inflicted by third parties, whether intentionally or unintentionally, upon the network or our other infrastructure.

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From time to time, in the ordinary course of business, we have experienced and in the future may experience short disruptions in our service due to factors such as cable damage, inclement weather and service failures of our third party service providers. We could experience more significant disruptions in the future. In addition, certain portions of our network may lack adequate redundancy to allow for expedient recovery of service to affected customers. Disruptions may cause interruptions in service or reduced capacity for customers, either of which could cause us to lose customers and incur expenses, which could have a material adverse effect on our business, financial condition, results of operations, liquidity and/or the market price of our outstanding securities.

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

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

Upon expiration or termination of these agreements, we may not be able to replace the services provided to us in a timely manner or on terms and conditions, including service levels and cost, favorable to us, or at all. The failure of these third party service providers to satisfy their obligations under their agreements with us, without a suitable replacement, could have a material adverse effect on our business and financial results. Additionally, if these third party service providers were to seek U.S. bankruptcy law protection, our agreements with such service providers, and such service providers' ability to provide the services under those agreements, could be adversely impacted, and although we may have a claim for damages against the bankruptcy estate, the claim may or may not be paid in the bankruptcy proceeding.

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

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

The "Connect America Fund" Order adopted by the FCC in November 2011 comprehensively reformed both the universal service program and intercarrier compensation and has had a significant impact on us. See "—Universal Service" above for a discussion of the impact of the Order on the universal service program, and "—Federal Framework for

Intercarrier Compensation” above for a discussion of the impact of the Order on intercarrier compensation. Changes in other FCC policies under review also could have a significant impact on us by increasing our obligations and/or reducing our revenue.

State government regulation also is a source of business uncertainty. We cannot predict whether state proceedings will be initiated or the possible outcome of such proceedings at this time.

The HPUC could limit the ability of Hawaiian Telcom, Inc., one of our indirect operating subsidiaries, to distribute funds or assets to its parent company.

All of our operations are conducted through our subsidiaries. Any revenue we may receive is derived from distributions from such subsidiaries. Hawaiian Telcom, Inc., one of our indirect operating subsidiaries, is subject to HPUC regulatory authority which could potentially limit the ability of Hawaiian Telcom, Inc. to distribute funds or assets to its parent company. The inability of any of our regulated subsidiaries to make a distribution would, thus, limit the ability and amount of funds available for us to make a distribution to our stockholders.

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

The rates we charge our local telephone customers are based, in part, on a rate-of-return authorized by the HPUC on capital invested in our network. These authorized rates, as well as allowable investment and expenses, are subject to review and change by the HPUC at any time. If the HPUC orders us to reduce our rates, our revenues would be reduced and our earnings also could be reduced absent corresponding reductions in costs or offsetting revenue increases in other segments. We cannot assure you that our rates will remain at their current levels. The HPUC order received in connection with the 2007 sale of our directories publishing business imposed a condition requiring the imputation of revenues. Specifically, a directory publishing revenue credit in the annual amount of \$42.6 million per year must be added as regulated revenues into the calculation of Hawaiian Telcom, Inc.'s earnings from 2008 to 2022 in all future rate cases, alternative form of regulation proceedings, or other proceedings before the HPUC investigating Hawaiian Telcom, Inc.'s earnings or financial performance. This condition may adversely affect our ability to obtain rate increases in the future.

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

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

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

The telecommunications industry is subject to rapid and significant changes in technology, frequent new product and service introductions and evolving industry standards which could reduce the competitiveness of our services. Adapting to technological developments could require unbudgeted upgrades or the procurement of additional products that could be expensive and time consuming to implement. If we fail to adapt successfully to technological changes or fail to obtain access to important new technologies, we could lose customers and be limited in our ability to attract new customers and sell new services to our existing customers.



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Our business may be adversely affected if we cannot continue to license or enforce the intellectual property rights on which our business depends.

We rely on patent, copyright, trademark and trade secret laws and licenses and other agreements with our employees, customers, suppliers and other parties to establish and maintain our intellectual property rights in technology and the products and services used in our operations. Also, because of the rapid pace of technological change, we develop our own technologies, products and services and rely on technologies developed or licensed by third parties. However, any of our intellectual property rights could be challenged or invalidated, or such intellectual property rights may not be sufficient to permit us to take advantage of current industry trends or otherwise to provide competitive advantages, which could result in costly redesign efforts, discontinuance of certain product or service offerings or other competitive harm. We may not be able to obtain or continue to obtain licenses from these third parties on reasonable terms, if at all. In addition, claims of intellectual property infringement could require us to enter into royalty or licensing agreements on unfavorable terms, incur substantial monetary liability or be enjoined preliminarily or permanently from further use of the intellectual property in question, which could require us to change our business practices or offerings and limit our ability to compete effectively. Even unsuccessful claims can be time consuming and costly to defend and may divert management's attention and resources away from our businesses. In recent years, the number of intellectual property infringement claims has been increasing in the communications industry and this could negatively impact us as a company.

The failure to renegotiate programming contracts with television content providers on acceptable terms or at all could have a material adverse effect on our business and results of operations.

We expect television content costs to continue to be one of our largest operating costs associated with providing television service. In recent years, the cable industry has experienced rapid increases in the cost of programming, especially the costs for sports programming and for local broadcast station retransmission content.

Programming costs are generally assessed on a per-subscriber basis, and therefore, are related directly to the number of subscribers to which the programming is provided. Our relatively small base of subscribers limits our ability to negotiate lower per-subscriber programming costs. As our programming contracts with content providers expire, there can be no assurance that they will be renewed on acceptable terms or that they will be renewed at all, in which case we may be unable to provide such programming as part of our video services packages. The loss of this content could have a material adverse effect on our business and results of operations.

The geographic concentration of our operations in Hawaii make our business susceptible to local economic and regulatory conditions and consumer trends, and an economic downturn, recession or unfavorable legislative or regulatory action affecting Hawaii could have a disproportionate and material adverse effect on our business, financial condition, results of operations, liquidity and/or the market price of our outstanding securities.

Substantially all of our customers and operations are located in Hawaii. Because of Hawaii's geographic isolation, the successful operation and growth of our businesses is dependent on favorable economic and regulatory conditions in the state. The Hawaii economy, in turn, is dependent upon many factors, including:

- the level of government and military spending;
- the legal, regulatory and political environment;
- the strength of the Hawaii tourism industry, which is in turn dependent on global economic conditions principally those in the U.S. mainland and Pacific rim;
- the availability and cost of skilled labor;
- the continued growth in services industries; and
- the absence of hurricanes or other natural disasters and terrorism incidents.

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The customer base for telecommunications services in Hawaii is small and geographically concentrated. The population of Hawaii is approximately 1.4 million, approximately 70% of whom live on the island of Oahu. Any adverse economic conditions affecting Oahu, or Hawaii generally, could materially impair our ability to operate our business. Labor shortages or increased labor costs in Hawaii could also have a material adverse effect on our business.

In addition, we may be subject to increased costs for goods and services that it is unable to control or defray. Increased expenses including, but not limited to, energy and health care could have a material adverse effect on our business and results of operations.

Limitations on our ability to use NOL carryforwards, and other factors requiring us to pay cash to satisfy our tax liabilities in future periods, may affect our ability to fund our operations, make capital expenditures and repay our indebtedness.

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

Our indebtedness could adversely affect our financial condition.

We have a significant amount of indebtedness. We maintain a Term Loan in the amount of \$320 million and a revolving credit facility which may be drawn in an amount up to \$30 million (Revolving Credit Facility), each with a first priority lien on all assets.

The debt service requirements of our indebtedness could:

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



- increase our vulnerability to general adverse economic and industry conditions;
- require us to dedicate a higher than desired portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures, research and development efforts and other general corporate purposes;
- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- make it difficult to secure credit terms with our vendors;
- place us at a competitive disadvantage compared to our competitors that have less debt; and
- limit our ability to borrow additional funds.

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

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

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

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

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

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

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

- incur additional indebtedness;
- pay dividends or make distributions in respect of our capital stock or to make certain other restricted payments or investments;
- sell assets, including capital stock of subsidiaries;
- consolidate, merge, sell or otherwise dispose of all or substantially all of our assets;

- enter into transactions with our affiliates;
- make capital expenditures; and
- incur liens.

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

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Severe weather conditions and natural disasters which occur in Hawaii could have a material adverse effect on our operations and financial results.

From time to time, Hawaii experiences severe weather conditions such as high winds and heavy rainfall, and natural disasters such as earthquakes, volcanic eruptions and tsunamis, which can overwhelm our employees, disrupt our services and severely damage our property. Such disruptions in service and damage to property could materially decrease our revenues and materially increase our expenses. For example, in 2015, seven hurricanes and six tropical storms passed near Hawaii, resulting in record rainfall which damaged infrastructure and adversely affected our financial results. In 2016, one tropical storm and two hurricanes either made landfall or passed near Hawaii causing heavy rainfall and high surf. While these events did not have a material adverse effect on our operating results or financial condition, we cannot assure you that these types of events will not become more common or severe in the future or not result in material harm to our business, financial condition, results of operations, liquidity and/or the market price of our securities. Moreover, it is impossible to predict the extent to which climate change could cause extreme weather conditions to become more frequent or more extreme.

Concentration of ownership among stockholders may prevent new investors from influencing significant corporate decisions.

As of December 31, 2017, two of our stockholders collectively (with their affiliates) own approximately 45% of our outstanding common stock. Each of these two stockholder groups filed a Schedule 13D in 2015 indicating that it may, among other things, engage in communications with our representatives or other stockholders of the Company, purchase additional shares of Company common stock or propose directors for our Board of Directors. In 2016, we entered into a Nomination, Standstill and Support Agreement with our largest stockholder, Black Diamond Capital Management, L.L.C. (BD), and a Nomination, Standstill and Support Agreement (collectively, the Standstill Agreements) with our second largest beneficial stockholder, Twin Haven Capital Partners, L.L.C., Twin Haven Special Opportunities Fund III, L.P., Twin Haven Special Opportunities Partners III, L.L.C., Twin Haven Special Opportunities Fund IV, L.P. and Twin Haven Special Opportunities Partners IV, L.L.C. (collectively, Twin Haven). Pursuant to each of the Standstill Agreements, among other things, we agreed to nominate one designee of each of BD and Twin Haven to our Board of Directors at each of the 2016, 2017 and 2018 annual meetings of stockholders. In return, each of BD and Twin Haven has agreed during the three-year term, among other things, to refrain from taking certain actions with respect to us and our securities (including soliciting proxies, proposing any sale transaction or tender offer, seeking representation on our Board of Directors in excess of one designee, or acquiring additional shares of Company common stock beyond an agreed-upon level) and, subject to limited exceptions, to vote all of its shares in accordance with the recommendation of our Board of Directors on any matter submitted for stockholder approval. Although the Standstill Agreements limit BD's and Twin Haven's influence over us, each of our major stockholders still has significant influence on the outcome of matters requiring stockholder approval, even if these stockholders are not acting in a coordinated manner, including the election of directors and significant corporate transactions, such as mergers, consolidations or the sale of substantially all of our assets. This concentration of ownership may make some transactions more difficult or impossible without the support of these stockholders, or more likely with the support of these stockholders, and may have the effect of delaying or preventing a change of control, including a merger, consolidation or other business combination involving us, or discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control, even if that change of control may otherwise benefit our other stockholders.

Future sales or the possibility of future sales of a substantial amount of our common stock may depress the price of our common stock.

Future sales, or the availability for sale in the public market, of substantial amounts of our common stock could adversely affect the prevailing market price of our common stock and could impair our ability to raise capital through future sales of equity securities. The market price of our common stock could decline as a result of sales of a large number of shares of our common stock in the market or the perception that these sales could occur. Additionally, the high concentration of ownership of our stock could increase the risk that such a large block sale could occur. These sales, or the possibility that these sales may occur, may also make it more difficult for us to obtain additional capital by selling equity securities in the future at a time and at a price that we deem appropriate.

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Item 1B. Unresolved Staff Comments.

None

Item 2. Properties.

We own our corporate headquarters, which is located in 1177 Bishop Street, Honolulu, Hawaii 96813 and consists of over 465,000 square feet of office space. We also have other properties consisting primarily of approximately 126 owned (including part owned) and approximately 61 leased or licensed real estate properties, including our administrative facilities and facilities for call centers, customer service sites for the television business, switching equipment, fiber optic networks, microwave radio and cable and wire facilities, cable head end equipment, coaxial distribution networks, routers and servers used in our telecommunications business, as well as a state of the art data center facility with up to 6,500 square feet of data center capacity and room for expansion. See Item 1, “Business—Network Architecture and Technology.” For purposes of Hawaii state law, we are classified as a public utility and, accordingly, do not pay any property taxes on properties used in providing telecommunication services. Substantially all of our assets (including those of our subsidiaries) are pledged for the Term Loan.

Item 3. Legal Proceedings

We are involved in various claims, legal actions and regulatory proceedings arising from time to time in the ordinary course of business. In the opinion of management, the ultimate disposition of the legal matters in which the Company is currently involved will not have a material adverse effect on our combined financial position, results of operations or cash flows.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

## Market Information

Our Common Stock trades on The NASDAQ Stock Market under the symbol "HCOM". The holders of our Common Stock are entitled to one vote per share on any matter to be voted upon by stockholders. The following table sets forth the high and low sales prices of our Common Stock for the period from January 1, 2016 through December 31, 2017:

	Market Price	
	High	Low
2017		
First Quarter	\$ 26.59	\$ 22.80
Second Quarter	\$ 26.45	\$ 23.12
Third Quarter	\$ 31.20	\$ 24.33
Fourth Quarter	\$ 31.57	\$ 29.72
2016		
First Quarter	\$ 25.26	\$ 20.75
Second Quarter	\$ 24.66	\$ 19.14
Third Quarter	\$ 24.09	\$ 21.28
Fourth Quarter	\$ 25.50	\$ 20.11

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## Holders

As of December 31, 2017, there were 15 holders of record of our Common Stock and approximately 1,360 beneficial owners.

## Dividends

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

## Securities Authorized for Issuance Under Equity Compensation Plans.

Securities authorized for issuance under equity compensation plans as of December 31, 2017 included:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights(2) (a)	Weighted average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column(a)) (c)
Equity Compensation Plans Approved by Security Holders	—	—	—
Equity Compensation Plans not Approved by Security Holders(1)(2)	367,043	—	468,826
Total	367,043	—	468,826

(1) The 2010 Equity Incentive Plan was authorized by the Plan of Reorganization. Under the 2010 Equity Incentive Plan, the securities remaining available for future issuance may be issued either as restricted stock, restricted stock units, stock appreciation rights, stock options, or other stock or stock based awards.

(2) For performance based restricted stock units granted in 2017, amounts reflected in this table assume payout in shares at 156.25% of target. The actual number of shares issued can range from 0% to 156.25% of target



depending upon achievement of applicable performance goals.

Sale of Unregistered Securities

None.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

None.

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Stockholder Return Performance Graph

The graph below compares the cumulative total stockholder return on our Common Stock with the cumulative total return on the Standards & Poor's (S&P) 500 Stock Index, and the NASDAQ Telecommunications Index for the five years ending December 31, 2017, assuming an initial investment of \$100 with reinvestment of dividends.

COMPARISON OF CUMULATIVE TOTAL RETURN

Among Hawaiian Telcom Holdco, Inc., S&P 500 and NASDAQ Telecommunications

	At December 31,					
	2012	2013	2014	2015	2016	2017
Hawaiian Telcom Holdco, Inc.	\$ 100.00	\$ 150.62	\$ 141.38	\$ 127.49	\$ 127.08	\$ 158.26
S&P 500	\$ 100.00	\$ 132.39	\$ 150.51	\$ 152.59	\$ 170.84	\$ 208.14
NASDAQ Telecommunications	\$ 100.00	\$ 127.28	\$ 141.93	\$ 134.40	\$ 158.04	\$ 190.00

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

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## Item 6. Selected Financial Data

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

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

	Year Ended December 31,				
	2017 (2)	2016	2015	2014	2013 (1)
Statements of income (loss) data:					
Operating revenues	\$ 368,419	\$ 392,963	\$ 393,413	\$ 390,739	\$ 391,150
Depreciation and amortization	88,424	89,916	87,879	78,014	77,301
Operating income	2,001	18,792	19,262	30,471	41,771
Interest expense	16,414	17,095	16,786	16,496	18,875
Income tax provision	88,002	591	1,357	5,910	8,782
Net income (loss)	(107,241)	1,106	1,100	8,099	10,488
Earnings (loss) per common share—					
Basic	\$ (9.27)	\$ 0.10	\$ 0.10	\$ 0.76	\$ 1.01
Diluted	(9.27)	0.10	0.10	0.72	0.95
Statements of cash flow data—net cash provided by (used in):					
Operating activities	\$ 98,710	\$ 90,088	\$ 90,596	\$ 90,490	\$ 76,961
Investing activities	(95,256)	(97,841)	(98,229)	(96,243)	(85,030)
Financing activities	16,409	(5,238)	1,335	(3,363)	(9,373)
Balance Sheets data (as of end of period):					
Cash and cash equivalents	\$ 40,759	\$ 15,821	\$ 30,312	\$ 39,885	\$ 49,551
Property, plant and equipment, net	608,298	595,997	579,107	565,956	524,375
Total assets	739,506	803,921	799,695	796,724	771,724
Long term debt (3)	309,316	284,699	286,046	287,179	288,388
Stockholders’ equity	220,209	304,914	307,699	304,534	313,012

(1) The Company acquired SystemMetrics Corporation on September 30, 2013. The results of operations are included in the above financial information from the acquisition date.

(2) During the year ended December 31, 2017, the Company established a full valuation allowance for deferred income tax assets resulting in an income tax expense of \$88.0 million for the year ended December 31, 2017.

(3) Long term debt includes the related current portion and is net of debt issuance costs and original issue discount.

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

Background

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

The statements in the discussion and analysis regarding the anticipated closing of the merger, industry outlook, our expectations regarding the future performance of our business and the other non-historical statements in the discussion and analysis are forward-looking statements. These forward-looking statements are subject to numerous risks and uncertainties, including, but not limited to, the risks and uncertainties described in Item 1A, “Risk Factors.” Our actual results may differ materially from those contained in any forward-looking statements. You should read the following discussion together with Item 6, “Selected Financial Data” and our consolidated financial statements and related notes thereto included elsewhere in this annual report. We undertake no obligation to update publicly any forward-looking statements for any reason even if new information becomes available or other events occur in the future.

Pending Merger with Cincinnati Bell

On July 9, 2017, Hawaiian Telcom Holdco, Inc. (“Holdco”), a Delaware corporation, Cincinnati Bell Inc. (“Cincinnati Bell”), an Ohio corporation, Twin Acquisition Corp., a Delaware corporation and a wholly owned subsidiary of Cincinnati Bell (“Merger Sub”), entered into an Agreement and Plan of Merger (the “Merger Agreement”), pursuant to which Merger Sub will merge with and into Holdco and Holdco will be the surviving corporation (the “Merger”).

Sources of Revenue

We derive revenue from the following sources in three main customer channels:

## Business Channel

Business data services include high bandwidth data products such as Ethernet, Routed Network Services 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 include local telephone service for business customers. 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.

Hosted and managed services includes physical colocation, virtual colocation and various related security, network management and network installation related services.

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

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Consumer Channel

Video services are marketed as Hawaiian Telcom TV which includes digital television as well as advanced entertainment services. High-Speed Internet services are provided to residential customers as well. Voice services include basic local phone and long distance services, as well as enhanced features.

Wholesale Channel

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

Other

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 generally to provide service in rural or isolated areas.

Results of Operations for the Years Ended December 31, 2017, 2016 and 2015

For the year ended December 31, 2017, we incurred a net loss of \$107.2 million. The net loss for the current year period was most significantly impacted by the income tax provision of \$88.0 million. In part, because of recent pretax losses from operations, we concluded it was not appropriate to factor in future income in our assessment of the realization of deferred income tax assets. As such, we established a full valuation allowance for our deferred income tax assets during the year ended December 31, 2017 resulting in the large income tax provision.

Operating Revenues

The following tables summarize our volume information (lines or subscribers) as of December 31, 2017, 2016 and 2015, and our operating revenues for the years ended December 31, 2017, 2016 and 2015.

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 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 and are rounded to the nearest thousand.

Beginning in 2017, we discontinued separate reporting of data center services revenue. As discussed in Note 16 to the consolidated financial statements, we no longer separately report data center services as a separate segment. All revenue is now reported by channel and product/service offering on a company-wide basis. Prior period information has been revised to reflect the current presentation.



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## Volume Information

	December 31,		2017 vs 2016		2016 vs 2015				
	2017	2016	2015	Change Number	Percentage	Change Number			
<b>Business</b>									
Data lines	18,289	19,596	20,081	(1,307)	(6.7)	% (485)	(2.4)	%	
BVoIP lines	22,457	19,091	16,749	3,366	17.6	% 2,342	14.0	%	
Voice access lines	149,959	160,829	168,058	(10,870)	(6.8)	% (7,229)	(4.3)	%	
<b>Consumer</b>									
Video subscribers	45,183	41,557	35,876	3,626	8.7	% 5,681	15.8	%	
Internet lines	91,883	91,089	93,002	794	0.9	% (1,913)	(2.1)	%	
Voice access lines	121,169	135,363	151,996	(14,194)	(10.5)	% (16,633)	(10.9)	%	
Homes enabled for video	206,000	202,000	190,000	4,000	2.0	% 12,000	6.3	%	

## Operating Revenues (dollars in thousands)

	For the Year Ended		Change Amount	Percentage	
	December 31, 2017	2016			
<b>Business</b>					
Data services	\$ 60,354	\$ 65,134	\$ (4,780)	(7.3)	%
Voice services	82,582	87,370	(4,788)	(5.5)	%
Hosted and managed services	6,368	6,430	(62)	(1.0)	%
Equipment and related services	20,173	21,729	(1,556)	(7.2)	%
	169,477	180,663	(11,186)	(6.2)	%
<b>Consumer</b>					
Video services	43,595	40,558	3,037	7.5	%
Internet services	26,750	28,993	(2,243)	(7.7)	%
Voice services	64,981	73,388	(8,407)	(11.5)	%
	135,326	142,939	(7,613)	(5.3)	%
Wholesale carrier data	50,741	53,664	(2,923)	(5.4)	%
Other	12,875	15,697	(2,822)	(18.0)	%
	\$ 368,419	\$ 392,963	\$ (24,544)	(6.2)	%

## Business Channel

We continue to transform our business channel by replacing traditional voice services with next generation strategic services. We consider strategic service revenues in the business channel to include business data services, and hosted and managed services.

Business data services, including internet and BVoIP, decreased for the year ended December 31, 2017 compared to the same period in the prior year. Demand for data services continues to rise as reflected in the growth of BVoIP lines but revenues were adversely impacted by competitive pricing pressure and declining revenue associated with one large institutional customer. For the years ended December 31, 2017 and 2016, business data services revenue from this customer amounted to \$1.5 million and \$6.2 million, respectively, including non-recurring fee revenue on certain upfront billed amounts that ended with the fixed contract term on June 30, 2016. In addition, during the year ended December 31, 2016, we recognized the remaining balance of deferred up-front charges of \$0.8 million when another institutional customer terminated the related services.

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Continued competition in the telecommunications industry has increasingly resulted in customers using technologies other than traditional phone lines for voice and data. Business customers are moving local voice services to VoIP technology. Generally, VoIP technology is less expensive than traditional wireline phone service, requiring us to respond with more competitive bundled unified services such as our BVoIP product.

The decrease in voice service revenues for the business channel for the year ended December 31, 2017 compared to the year ended December 31, 2016 was caused primarily by the decline of voice access lines. Business voice access lines decreased 6.8% as of December 31, 2017 compared to December 31, 2016. The decline in traditional voice access lines was partially offset by an increase in BVoIP lines of 17.6% for the same period.

Hosted and managed services revenues for the year ended December, 2017 were comparable to the prior year period.

Equipment and related services revenues decreased for the year ended December 31, 2017 when compared to the prior year period because of large contract installations for certain commercial and institutional customers completed in 2016. Revenue from equipment sales varies from period to period based on the volume of large installation projects.

## Consumer Channel

We continue to transform our consumer channel by replacing traditional voice services with next generation strategic services. We consider strategic service revenues in the consumer channel to include video and internet services. Consumer strategic revenues now represent 52% of the total consumer channel revenues for the current year compared to 49% in the prior year.

Video services revenue increased for the year ended December 31, 2017 compared to the prior year because of an increase in video subscribers of 8.7%.

Internet revenues for the year ended December 31, 2017 decreased compared to the prior year as a result of the combined effect of competitive pricing and a decline in low-bandwidth internet subscribers.

The decrease in voice services revenue for the year ended December 31, 2017 compared to the year ended December 31, 2016 was caused primarily by a decline in voice access lines. Consumer voice access lines decreased 10.5% from the year ago period which contributed an estimated \$7.7 million to the decline in consumer voice services. Residential customers are increasingly using wireless services in place of traditional wireline phone services

as well as using VoIP technology offered by cable competitors.

In an effort to slow the rate of internet and voice line loss, we are continuing retention and acquisition programs, and are increasingly focusing efforts on bundling of services. We have instituted various “saves” campaigns designed to focus on specific circumstances where we believe customer churn is controllable. These campaigns include targeted offers to “at risk” customers as well as other promotional tools designed to enhance customer retention. We also emphasize win back and employee referral programs. Additionally, we are intensifying our efforts relative to developing tools and training to enhance our customer service capability to improve customer retention and growth.

#### Wholesale and Other Channel

Wholesale carrier revenue decreased for the year ended December 31, 2017 compared to the prior year as certain carriers have replaced older legacy circuits with more cost effective higher bandwidth solutions.

Other revenue decreased for the year ended December 31, 2017 compared to 2016 because of a decline in ancillary services. There has been a reduction in marketing effort on certain ancillary products, such as wireless, as we focus on other telecommunication services.

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## Operating Revenues (dollars in thousands)

	For the Year Ended		Change Amount	Percentage	
	December 31, 2016	2015			
Business					
Data services	\$ 65,134	\$ 54,588	\$ 10,546	19.3	%
Voice services	87,370	93,972	(6,602)	(7.0)	%
Hosted and managed services	6,430	5,583	847	15.2	%
Equipment and related services	21,729	20,546	1,183	5.8	%
	180,663	174,689	5,974	3.4	%
Consumer					
Video services	40,558	33,666	6,892	20.5	%
Internet services	28,993	32,687	(3,694)	(11.3)	%
Voice services	73,388	79,273	(5,885)	(7.4)	%
	142,939	145,626	(2,687)	(1.8)	%
Wholesale carrier data	53,664	56,430	(2,766)	(4.9)	%
Other	15,697	16,668	(971)	(5.8)	%
	\$ 392,963	\$ 393,413	\$ (450)	(0.1)	%

## Business Channel

Business data services, including internet and BVoIP, for the year ended December 31, 2016 increased compared to the prior year primarily due to non-recurring fees associated with one large institutional customer. For the year ended December 31, 2016 and 2015, business data services revenue from this customer amounted to \$6.2 million and \$1.1 million, respectively, including non-recurring fee revenue. In addition, during the year ended December 31, 2016, we recognized the remaining balance of deferred up-front charges of \$0.8 million when another institutional customer terminated the related services. In general, the demand for data services continues to rise as reflected in the growth in BVoIP lines.

The decrease in voice service revenues for the business channel for the year ended December 31, 2016 compared to the year ended December 31, 2015 was caused primarily by the decline of voice access lines. Business voice access lines decreased 4.3% as of December 31, 2016 compared to 2015. The decline in traditional voice access lines was partially offset by an increase in BVoIP lines of 14%.

Hosted and managed services revenues for the year ended December 31, 2016 increased when compared to the prior year period as a result of year-over-year increased security and hardware sales.

Equipment and related services sales increased for the year ended December 31, 2016 when compared to the prior year because of large contract installations for certain commercial and institutional customers.

#### Consumer Channel

Video services revenue increased for the year ended December 31, 2016 compared to the prior year due to an increase in video subscribers of 5,681 as well as an increase in the rates charged subscribers.

Internet revenues for the year ended December 31, 2016 decreased compared to the prior year as a result of the combined effect of competitive pricing and decline in internet subscribers.

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The decrease in voice services revenue for the year ended December 31, 2016 compared to the year ended December 31, 2015 was caused primarily by a decline in voice access lines. Consumer voice access lines decreased 10.9% during the year which contributed an estimated \$8.7 million to the decline in consumer voice services revenue. Residential customers are increasingly using wireless services in place of traditional wireline phone services as well as using VoIP technology offered by cable competitors.

Wholesale and Other Channel

Wholesale carrier revenue decreased for the year ended December 31, 2016 compared to the prior year as certain carriers have replaced older legacy circuits with more cost effective higher bandwidth solutions.

Other revenue decreased for the year ended December 31, 2016 compared to the year ended December 31, 2015 because of a decline in ancillary services. There has been a reduction in marketing effort on certain ancillary products, such as wireless, as we focus on other telecommunication and data center services.

Operating Costs and Expenses

The following table summarizes our costs and expenses for the year ended December 31, 2017 compared to the costs and expenses for year ended December 31, 2016 (dollars in thousands):

	For the Year Ended		Change Amount	Percentage	
	December 31, 2017	2016			
Cost of revenues (exclusive of depreciation and amortization)	\$ 163,101	\$ 165,835	\$ (2,734)	(1.6)	%
Selling, general and administrative expenses	114,893	118,420	(3,527)	(3.0)	%
Depreciation and amortization	88,424	89,916	(1,492)	(1.7)	%
	\$ 366,418	\$ 374,171	\$ (7,753)	(2.1)	%

Our total headcount as of December 31, 2017 was 1,220 compared to 1,290 as of December 31, 2016. Employee related costs are included in both cost of revenues and selling, general and administrative expenses.

Cost of revenues consists of costs we incur to provide our products and services including those for operating and maintaining our networks, installing and maintaining customer premise equipment, video content costs and other cost of services directly associated with various products. Costs of revenue for the year ended December 31, 2017 when compared to the prior year period decreased with reduced labor costs of \$1.9 million with our emphasis on labor efficiency. In addition, for the year 2017 compared to 2016, we incurred \$1.5 million less in third party labor costs primarily due to enhanced management of repair activity. These declines were partially offset by a net increase in direct costs of providing certain services, such as video content costs, for the year ended December 31, 2017 compared to the prior year period of \$1.9 million.

Selling, general and administrative expenses include costs related to sales and marketing, information systems and other administrative functions. The change for the year ended December 31, 2017 relative to the year ended December 31, 2016 is primarily due to lower wage costs of \$3.2 million on lower headcount. Included in selling, general and administrative expenses are professional fees of \$2.4 million for the year ended December 31, 2017 in conjunction with the pending merger. This increased expense was offset by declines in other outside contractor related costs on cost savings initiatives.



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Depreciation and amortization for the year ended December 31, 2017 was lower than in the prior year due to certain assets becoming fully depreciated in the latter part of 2016.

The following table summarizes our costs and expense for the year ended December 31, 2016 compared to the year ended December 31, 2015 (dollars in thousands).

	For the Year Ended		Change Amount	Percentage	
	December 31, 2016	2015			
Cost of revenues (exclusive of depreciation and amortization)	\$ 165,835	\$ 162,474	\$ 3,361	2.1	%
Selling, general and administrative expenses	118,420	123,798	(5,378)	(4.3)	%
Depreciation and amortization	89,916	87,879	2,037	2.3	%
	\$ 374,171	\$ 374,151	\$ 20	0.0	%

Our total headcount as of December 31, 2016 was 1,290 compared to 1,315 as of December 31, 2015. Costs of revenue for the year ended December 31, 2016 increased when compared to the prior year because of higher content costs for Hawaiian Telcom TV of \$6.8 million as we add subscribers. These increases were offset by lower electricity charges of \$1.9 million on lower rates and usage from various power saving initiatives. In addition, wages were lower by \$1.9 million related to less time needed for rain related repairs and efficiencies in the use of our workforce.

Selling, general and administrative expenses decreased for the year ended December 31, 2016 compared to the prior year period due to lower pension costs of \$4.7 million. There was a significantly higher volume of retirements involving lump sum pension settlements in 2015 resulting in much higher pension settlement losses being recognized in 2015. The balance of the decrease is due to various cost savings measures initiated during 2016.

Depreciation and amortization for the year ended December 31, 2016 was higher by \$2.0 million than the prior year due to asset additions to support growth in the business for next-generation services such as video, and higher speed internet and data.

Other Income and (Expense)

The following table summarizes other income (expense) for the years ended December 31, 2017 and 2016 (dollars in thousands).

	For the Year Ended		Change Amount	Percentage	
	December 31, 2017	2016			
Interest expense	\$ (16,414)	\$ (17,095)	\$ 681	(4.0)	%
Loss on early extinguishment of debt	(4,826)	—	(4,826)	NA	%
	\$ (21,240)	\$ (17,095)	\$ (4,145)	24.2	%

Interest expense for the year ended December 31, 2017 decreased compared to 2016 due to lower interest rates associated with our new financing. Interest capitalized amounted to \$1.9 million and \$1.6 million for the years ended December 31, 2017 and 2016, respectively.

In February 2017, we entered into a delayed draw credit agreement for new term loans and a new revolving credit facility. The new facility fully funded the repayment of the existing term loan and replacement of the existing revolving credit facility on May 4, 2017. We recognized the repayment of the existing debt instruments as a debt extinguishment incurring a loss on early extinguishment of debt of \$4.8 million.

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The following table summarizes other income (expense) for the years ended December 31, 2016 and 2015 (dollars in thousands).

	For the Year Ended		Change Amount	Percentage	
	December 31, 2016	2015			
Interest expense	\$ (17,095)	\$ (16,786)	\$ (309)	1.8	%
Interest income and other	—	(19)	19	(100.0)	%
	\$ (17,095)	\$ (16,805)	\$ (290)	1.7	%

Interest expense for the year ended December 31, 2016 compared to the prior year increased due to the term loan amendment entered into in May 2016 which resulted in a higher interest rate and certain financing costs expensed as part of the amendment process. Interest capitalized amounted to \$1.6 million and \$1.1 million for the years ended December 31, 2016 and 2015, respectively.

## Income Tax

For the year ended December 31, 2017, we recognized an income tax provision of \$88.0 million. The large tax provision was primarily attributed to the full valuation allowance established for deferred income tax assets in the current year period.

We assess the ability to realize our deferred tax assets and assess the need for a valuation allowance on an ongoing basis. We are required to consider all available positive and negative evidence in evaluating the likelihood that we will be able to realize the benefit of our deferred tax assets in the future. Such evidence includes scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies and the results of recent operations.

In considering the impact of recent operations on our deferred tax asset assessment, we utilize a rolling three years of financial results as the primary measure of cumulative income or losses. These are adjusted for permanent differences between financial reporting and taxable income. For the year ended December 31, 2017, we incurred a pretax loss from operations. In addition, as of December 31, 2017, we had a cumulative loss from operations for the three year period. Because of the three year cumulative losses, we are required to look only to sources of income that are deemed objective and verifiable based on historical experience. We considered that the cumulative loss was caused, in part, by costs not expected to recur in future periods, such as merger costs. However, the loss was also caused by costs, such as pension settlement losses, that are not deemed part of core operations but the frequency of which is hard to predict. For example, during 2017, the level of retirements and related pension settlements ramped up making it more challenging to conclude such expenses will not recur in future periods. With the challenge of predicting future taxable income based on actual historical results, we had to limit the amount of taxable income included in our

assessment of deferred income tax asset recoverability.

Based on the more likely than not criteria for realization of deferred income tax assets, we established a full valuation allowance for our deferred income tax assets during the year ended December 31, 2017. If, in future periods, new positive evidence becomes available, the conclusion regarding the need for a full valuation allowance may change resulting in the reversal of some or all of the valuation allowance.

For the year ended December 31, 2017, the income tax provision differs from amounts determined by applying the statutory federal income tax rate of 34% to the loss before income taxes primarily because of changes in the valuation allowance established for the recovery of deferred income tax assets. Excluding the effects of the valuation allowance, we consider a variety of factors in determining the effective tax rate, including our pretax results, the U.S. federal statutory rate, expected nondeductible expenses and estimated state taxes.

We had effective tax rates of 34.8% and 55.2% for the years ended December 31, 2016 and 2015, respectively. The rate for the year ended December 31, 2016 was lower than for the year ended December 31, 2015 as certain permanent differences between financial reporting and income tax income were proportionally larger related to the pretax income in 2015. The largest such permanent difference was the deduction limitation for compensation.

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As of December 31, 2017, net operating losses available for carry forward through 2037 amounted to \$222.6 million for federal purposes and \$227.0 million for state purposes. Availability of net operating losses in future periods may be subject to additional limitations if there is a deemed change in control for income tax reporting purposes. Such change in control will be determined for income tax reporting purposes based on cumulative changes in stock ownership over a defined period.

On December 22, 2017, the United States enacted tax reform legislation through the Tax Cuts and Jobs Act which significantly changes the existing U.S. tax laws including a reduction in the corporate tax rate from 34% to 21%. We gave recognition to the new law as of the effective date with a revised measurement of our deferred federal income tax assets and liabilities. The impact was to reduce our net deferred income tax asset by \$28.0 million. The Company also reduced its valuation allowance by the same amount as of that date as it had previously established a full valuation allowance as discussed above. Going forward, the new law provides for numerous changes to U.S. tax laws that may impact our determination of taxable income or loss. In addition, net operating losses generated in future periods will be subject to carry forward indefinitely but there are restrictions on the percentage of net operating losses that can be used to offset future taxable income in any one year.

## Liquidity and Capital Resources

As of December 31, 2017, we had cash and cash equivalents of \$40.8 million. From an ongoing operating perspective, our cash requirements in 2018 will consist of supporting the development and introduction of new products, capital expenditure projects, pension funding obligations and other changes in working capital. A combination of cash-on-hand, cash generated from operating activities and available financing will be used to fund our cash requirements.

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

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

Cash Flows

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

Net cash provided by operations amounted to \$98.7 million for the year ended December 31, 2017. Net cash provided by operations amounted to \$90.1 million for the year ended December 31, 2016. The increase in cash provided by operations was because of up-front payments received for fiber circuit capacity on our trans-Pacific cable that was completed in August 2017. Net cash provided by operating activities was comparable for the years ended December 31, 2016 and 2015.

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Cash used in investing activities for 2017 was comprised of capital expenditures of \$95.3 million which were lower than capital expenditures of \$97.8 million in 2016. Beginning in 2017, we scaled back capital on certain elements of our network expansion initiatives, such as for enabling large areas for video service, focusing on those directly related to sales opportunities. Cash used in investing activities for 2016 was comprised of capital expenditures of \$97.8 million which was comparable to capital expenditures of \$99.0 million in 2015.

During the year ended December 31, 2017, we received the proceeds of our new term loan borrowing of \$320.0 million. Prior to funding the term loan, we had made borrowings on our existing line of credit of \$10.0 million in 2017. The drawing was used, in part, to fund capital costs of our trans-Pacific submarine cable. The new term loan funded the repayment of the existing term debt and the outstanding balance on our existing line of credit. Total repayments of debt amounted to \$305.3 million for the year ended December 31, 2017. In addition, during the same period we paid for costs of the new financing amounting to \$6.3 million. Cash used in financing activities for years ended December 31, 2016 and 2015 was related primarily to the repayment of our debt and satisfaction of other obligations. In addition, during the year ended December 31, 2015, we received \$6.9 million upon the exercise of warrants for cash.

## Outstanding Debt and Financing Arrangements

As of December 31, 2017, we had outstanding \$314.9 million in aggregate long term debt and an undrawn \$30.0 million revolving line of credit.

Our bank credit facilities contain various negative and affirmative covenants that restrict, among other things, incurrence of additional indebtedness, payment of dividends, redemptions of stock, other distributions to shareholders and sales of assets. In addition, there are financial covenants which have the following metrics as of December 31, 2017: debt service coverage with minimum allowed ratio of 2.75:1 of earnings before interest, taxes, depreciation and amortization to debt service which includes scheduled principal payments and cash interest; leverage with maximum allowed ratio of 3.25:1 of indebtedness to earnings before interest, taxes, depreciation and amortization; and a maximum level of annual capital expenditures of \$105.0 million. We were in compliance with these covenants as of December 31, 2017.

With our debt structure, we do not expect to generate the necessary cash flows from operations to repay the facility in its entirety by the maturity dates of 2022 and 2023. Repayment is dependent on our ability to refinance the credit facility at reasonable terms. The ability to refinance the indebtedness at reasonable terms before maturity cannot be assured.

## Contractual Obligations

The following table sets forth our long term debt and contractual obligations for the next several years. The term loan facility and debt interest obligation are based on the balance and provisions of the term loan as of December 31, 2017. Pension funding obligations are based on known fixed funding. Additional obligations are expected in future periods for retirement related costs. Obligations are as follows (dollars in thousands):

	2018	2019 and 2020	2021 and 2022	2023 and Thereafter	Total
Term loan facility	\$ 10,250	\$ 29,125	\$ 97,250	\$ 178,250	\$ 314,875
Debt interest	16,747	31,598	25,816	3,184	77,345
Pension funding obligations	5,360	—	—	—	5,360
Operating leases	2,097	3,793	1,699	5,481	13,070
Supplier contracts	9,936	3,312	—	—	13,248
Other installment contracts	3,544	3,268	2,263	5,746	14,821
Total	\$ 47,934	\$ 71,096	\$ 127,028	\$ 192,661	\$ 438,719

We do not maintain any off balance sheet financing or other arrangements.



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### Critical Accounting Policies and Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in consolidated financial statements. Changes in these estimates and assumptions are considered reasonably possible and may have a material effect on the consolidated financial statements and thus actual results could differ from the amounts reported and disclosed herein. The following is a summary of certain policies considered critical by management.

### Goodwill and Indefinite Lived Intangible Assets

Goodwill and intangible assets not subject to amortization are tested for impairment annually, or when events or changes in circumstances indicate that the asset might be impaired. For goodwill, we compare the fair value of a reporting unit with its carrying amount. For indefinite lived intangible assets, the impairment test consists of a comparison of the fair value of the intangible asset with its carrying value. If the carrying value of a reporting unit or an indefinite lived intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess. Fair value is an estimate based on an approach using market capitalization or on the present value of an expected range of future cash flows, or a combination of the two.

The expected range of future cash flows is based on internal forecasts developed utilizing management's knowledge of the business and the anticipated effects of market forces. The use of different assumptions or estimates of future cash flows could produce different impairment amounts (or none at all) for goodwill and indefinite lived intangible assets. A significant amount of judgment is involved in developing these internal forecasts and determining if an impairment has occurred. Assumptions and estimates that could generate an impairment loss include lower-than-expected future cash flows resulting from slower than anticipated revenue growth or lower than anticipated profitability. Any adverse changes in the projected cash flows could affect our conclusions as to the recoverability of goodwill and indefinite-lived intangible assets.

In addition to projection of cash flows, we must also determine an appropriate discount rate to determine the present value of such cash flows. The discount rates used are based on the estimated weighted average cost of capital which is subject to change based on various economic factors. Changes in the rate can have a fairly significant impact on the estimated value. For example, for the intangible asset impairment, a one percent increase in the discount rate would reduce the estimated fair value of the intangible asset by over ten percent.

### Impairment of Long Lived Assets and Definite Lived Intangibles

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

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### Revenue Recognition

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

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

Universal Service revenue subsidies, such as Connect America Fund Phase II, are government sponsored support received in association with providing service in mostly rural, high cost areas. These revenues are typically calculated by the government agency responsible for administering the support program. These revenues are recognized as granted by the government agency.

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

### Allowance for Doubtful Accounts

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

### Income Taxes

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

#### Employee Related Benefits

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

The discount rate used for determining the year end benefit plan obligation was calculated using a weighting of expected benefit payments and rates associated with high quality U.S. corporate bonds for each year of expected payment to derive a single estimated rate at which the benefits could be effectively settled. A change in the estimated discount rate would have a direct inverse impact on the recorded employee benefit obligation liability. Based on past experience, relatively small changes in the discount rate do not have a significant impact on the pension and other postretirement benefit cost but a substantial change in the rate is likely to have a large impact.

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

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

As of December 31, 2017, our floating rate obligations consisted of \$314.9 million of debt outstanding under our term loan facility. Accordingly, our earnings and cash flow are affected by changes in interest rates. Based on our borrowings at December 31, 2017 and assuming a 1.0 percentage point increase or decrease in the average interest rate under these borrowings, we estimate that our annual interest expense would increase or decrease by approximately \$3.1 million.

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Item 8. Financial Statements and Supplementary Data

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Management's Annual Report on Internal Control over Financial Reporting

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

The Company conducted an evaluation of the effectiveness of its internal control over financial reporting based on the criteria in Internal Control—Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. This evaluation included review of the documentation of controls, evaluation of the design effectiveness of controls, testing of the operating effectiveness of controls and a conclusion on this evaluation. There are inherent limitations in the effectiveness of any system of internal control over financial reporting; however, based on the evaluation, management has concluded the Company's internal control over financial reporting was effective as of December 31, 2017.

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

/s/ Scott K. Barber  
Scott K. Barber  
Chief Executive Officer  
March 13, 2018

/s/ Dan T. Bessey  
Dan T. Bessey  
Senior Vice President and Chief Financial Officer  
March 13, 2018

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Hawaiian Telcom Holdco, Inc. and subsidiaries (the "Company") as of December 31, 2017 and 2016, the related consolidated statements of income (loss), comprehensive income (loss), changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2017, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control — Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 13, 2018, expressed an unqualified opinion on the Company's internal control over financial reporting.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.



/s/ DELOITTE & TOUCHE LLP

Honolulu, Hawaii

March 13, 2018

We have served as the Company's auditor since 2005.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

Opinion on Internal Control over Financial Reporting

We have audited the internal control over financial reporting of Hawaiian Telcom Holdco, Inc. and subsidiaries (the “Company”) as of December 31, 2017, based on criteria established in Internal Control — Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control — Integrated Framework (2013) issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated financial statements as of and for the year ended December 31, 2017 of the Company and our report dated March 13, 2018, expressed an unqualified opinion on those financial statements.

Basis for Opinion

The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

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

Definition and Limitations of Internal Control over Financial Reporting

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

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Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ DELOITTE & TOUCHE LLP

Honolulu, Hawaii

March 13, 2018

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Hawaiian Telcom Holdco, Inc.

Consolidated Statements of Income (Loss)

(Dollars in thousands, except per share amounts)

	For the Year Ended December 31,		
	2017	2016	2015
Operating revenues	\$ 368,419	\$ 392,963	\$ 393,413
Operating expenses:			
Cost of revenues (exclusive of depreciation and amortization)	163,101	165,835	162,474
Selling, general and administrative	114,893	118,420	123,798
Depreciation and amortization	88,424	89,916	87,879
Total operating expenses	366,418	374,171	374,151
Operating income	2,001	18,792	19,262
Other income (expense):			
Interest expense	(16,414)	(17,095)	(16,786)
Loss on early extinguishment of debt	(4,826)	—	—
Interest income and other	—	—	(19)
Total other expense	(21,240)	(17,095)	(16,805)
Income (loss) before income tax provision	(19,239)	1,697	2,457
Income tax provision	88,002	591	1,357
Net income (loss)	\$ (107,241)	\$ 1,106	\$ 1,100
Net income (loss) per common share -			
Basic	\$ (9.27)	\$ 0.10	\$ 0.10
Diluted	\$ (9.27)	\$ 0.10	\$ 0.10
Weighted average shares used to compute net income (loss) per common share -			
Basic	11,573,435	11,503,296	10,977,341
Diluted	11,573,435	11,555,997	11,386,303
See accompanying notes to consolidated financial statements.			

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Hawaiian Telcom Holdco, Inc.

Consolidated Statements of Comprehensive Income (Loss)

(Dollars in thousands)

	For the Year Ended December 31,		
	2017	2016	2015
Net income (loss)	\$ (107,241)	\$ 1,106	\$ 1,100
Other comprehensive income (loss):			
Unrealized holding gain on investments arising during period	—	—	64
Retirement plan gain (loss)	24,257	(9,437)	(8,863)
Income tax benefit (provision) on other comprehensive income (loss)	(5,003)	3,607	3,358
Other comprehensive income (loss), net of tax	19,254	(5,830)	(5,441)
Comprehensive loss	\$ (87,987)	\$ (4,724)	\$ (4,341)

See accompanying notes to consolidated financial statements.

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Hawaiian Telcom Holdco, Inc.

Consolidated Balance Sheets

(Dollars in thousands, except per share information)

	December 31,	
	2017	2016
Assets		
Current assets		
Cash and cash equivalents	\$ 40,759	\$ 15,821
Receivables, net	32,229	33,377
Material and supplies	6,810	8,090
Prepaid expenses	4,899	4,093
Other current assets	1,328	7,229
Total current assets	86,025	68,610
Property, plant and equipment, net	608,298	595,997
Intangible assets, net	31,026	32,728
Goodwill	12,104	12,104
Deferred income taxes, net	—	92,171
Other assets	2,053	2,311
Total assets	\$ 739,506	\$ 803,921
Liabilities and Stockholders' Equity		
Current liabilities		
Current portion of long-term debt	\$ 10,250	\$ 3,000
Accounts payable	56,874	53,506
Accrued expenses	11,736	15,293
Advance billings and customer deposits	14,807	15,013
Other current liabilities	6,774	6,327
Total current liabilities	100,441	93,139
Long-term debt	299,066	281,699
Employee benefit obligations	79,953	105,930
Deferred income taxes, net	910	—
Other liabilities	38,927	18,239
Total liabilities	519,297	499,007
Commitments and contingencies (Note 13)		
Stockholders' equity		
Common stock, par value of \$0.01 per share, 245,000,000 shares authorized and 11,587,963 and 11,513,279 shares issued and outstanding at December 31, 2017 and 2016, respectively	116	115
Additional paid-in capital	182,689	179,958
Accumulated other comprehensive loss	(15,964)	(35,218)
Retained earnings	53,368	160,059
Total stockholders' equity	220,209	304,914
Total liabilities and stockholders' equity	\$ 739,506	\$ 803,921
See accompanying notes to consolidated financial statements.		





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Hawaiian Telcom Holdco, Inc.

## Consolidated Statements of Cash Flows

(Dollars in thousands)

	For the Year Ended		
	December 31, 2017	2016	2015
Cash flows from operating activities:			
Net income (loss)	\$ (107,241)	\$ 1,106	\$ 1,100
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	88,424	89,916	87,879
Deferred financing amortization	1,442	2,068	1,922
Loss on early extinguishment of debt	4,826	—	—
Employee retirement benefits	(1,720)	(8,103)	(3,634)
Provision for uncollectible receivables	3,797	4,031	3,648
Stock based compensation	2,827	2,303	1,584
Deferred income taxes	88,628	1,332	1,958
Changes in operating assets and liabilities:			
Receivables	(2,649)	(4,672)	(3,722)
Material and supplies	1,280	409	838
Prepaid expenses and other current assets	95	(153)	9
Accounts payable and accrued expenses	(1,059)	3,935	(9,973)
Advance billings and customer deposits	20,377	(1,038)	8,565
Other current liabilities	(653)	(344)	(759)
Other	336	(702)	1,181
Net cash provided by operating activities	98,710	90,088	90,596
Cash flows from investing activities:			
Capital expenditures	(95,256)	(97,841)	(99,034)
Proceeds on sale of investments	—	—	805
Net cash used in investing activities	(95,256)	(97,841)	(98,229)
Cash flows from financing activities:			
Proceeds from borrowing	330,000	—	—
Proceeds from exercise of warrant	—	—	6,870
Proceeds from installment financing	2,423	2,155	2,780
Repayment of capital lease and installment financing	(3,961)	(3,341)	(4,217)
Repayment of borrowings	(305,263)	(3,000)	(3,000)
Refinancing and loan amendment costs	(6,295)	(688)	(150)
Taxes paid related to net share settlement of equity awards	(495)	(364)	(948)
Net cash provided by (used in) financing activities	16,409	(5,238)	1,335
Net change in cash, cash equivalents and restricted cash	19,863	(12,991)	(6,298)
Cash, cash equivalents and restricted cash, beginning of period	21,146	34,137	40,435
Cash, cash equivalents and restricted cash, end of period	\$ 41,009	\$ 21,146	\$ 34,137
See accompanying notes to consolidated financial statements.			



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Hawaiian Telcom Holdco, Inc.

## Consolidated Statements of Changes in Stockholders' Equity

(Dollars in thousands, except share information)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders' Equity
Balance, January 1, 2015	10,673,292	\$ 107	\$ 170,521	\$ (23,947)	\$ 157,853	\$ 304,534
Stock based compensation	—	—	1,584	—	—	1,584
Exercise of warrant	719,075	7	6,863	—	—	6,870
Common stock issued for stock compensation plans, net of shares withheld and withholding paid for employee taxes	74,031	1	(949)	—	—	(948)
For the Year Ended December 31, 2015:						
Net income	—	—	—	—	1,100	1,100
Other comprehensive loss, net of tax	—	—	—	(5,441)	—	(5,441)
Balance, December 31, 2015	11,466,398	115	178,019	(29,388)	158,953	307,699
Stock based compensation	—	—	2,303	—	—	2,303
Common stock issued for stock compensation plans, net of shares withheld and withholding paid for employee taxes	46,881	—	(364)	—	—	(364)
For the Year Ended December 31, 2016:						
Net income	—	—	—	—	1,106	1,106
Other comprehensive loss, net of tax	—	—	—	(5,830)	—	(5,830)
Balance, December 31, 2016	11,513,279	115	179,958	(35,218)	160,059	304,914
Cumulative effect of adoption of new accounting standard for stock compensation	—	—	—	—	550	550

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Stock based compensation	—	—	2,827	—	—	2,827
Common stock issued for stock compensation plans, net of shares withheld and withholding paid for employee taxes	74,684	1	(96)	—	—	(95)
For the Year Ended December 31, 2017:	—	—	—	—	(107,241)	(107,241)
Net loss	—	—	—	—	(107,241)	(107,241)
Other comprehensive income, net of tax	—	—	—	19,254	—	19,254
Balance, December 31, 2017	11,587,963	\$ 116	\$ 182,689	\$ (15,964)	\$ 53,368	\$ 220,209

See accompanying notes to consolidated financial statements.

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Hawaiian Telcom Holdco, Inc.

Notes to Consolidated Financial Statements

1. Description of Business

Business Description

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

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

Proposed Merger

On July 9, 2017, Hawaiian Telcom Holdco, Inc. (“Holdco”), a Delaware corporation, Cincinnati Bell Inc. (“Cincinnati Bell”), an Ohio corporation, Twin Acquisition Corp., a Delaware corporation and a wholly owned subsidiary of Cincinnati Bell (“Merger Sub”), entered into an Agreement and Plan of Merger (the “Merger Agreement”), pursuant to which Merger Sub will merge with and into Holdco and Holdco will be the surviving corporation (the “Merger”).

Pursuant to the Merger Agreement and as consideration for the Merger, Holdco shareholders will have the option to elect either \$30.75 in cash, 1.6305 shares of Cincinnati Bell common stock, or a mix of \$18.45 in cash and 0.6522 shares of Cincinnati Bell common stock for each Holdco share. The final distribution to Holdco shareholders is subject to proration such that the aggregate consideration to be paid to Holdco stockholders will be 60 percent cash and 40 percent Cincinnati Bell common stock. Such distribution will be made upon closing of the Merger.

The completion of this transaction is subject to closing conditions including the receipt of regulatory approvals from, among others, the Hawaii Public Utilities Commission, and approval by the Holdco shareholders which occurred on November 7, 2017. The Merger Agreement contains certain termination rights for Holdco and Cincinnati Bell. The Merger Agreement stipulates that in the event of a termination of the Merger Agreement under specified circumstances, primarily related to if the Company receives and favors a competing merger offer, the Company will be required to pay a fee of \$11.9 million.

In connection with entering into the Merger Agreement with Cincinnati Bell, the Company incurred professional fees related to the transaction of \$2.4 million for the year ended December 31, 2017.

#### Organization

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

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### 2. Summary of Significant Accounting Policies

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

#### Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates.

#### Principles of Consolidation

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

#### Revenue Recognition

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

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

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

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

For long-term indefeasible right of use, or IRU, contracts for fiber circuit capacity, the Company may receive up-front payments for services to be delivered for a period of up to 25 years. In these situations, the Company defers the revenue and amortizes it on a straight-line basis to earnings over the term of the contract.

Universal Service revenue subsidies, including those related to Connect America Fund Phase II, are government sponsored support received in association with providing service in mostly rural, high cost areas. These

revenues are typically calculated by the government agency responsible for administering the support program. These revenues are recognized as granted by the government agency.



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

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

### Taxes Collected from Customers

The Company presents taxes collected from customers and remitted to governmental authorities on a gross basis, including such amounts in the Company's reported operating revenues and selling, general and administrative expenses. Such amounts represent primarily Hawaii state general excise taxes and HPUC fees. Such taxes and fees amounted to \$8.4 million, \$8.4 million and \$8.2 million for the years ended December 31, 2017, 2016 and 2015, respectively.

### Cash and Cash Equivalents

Cash and cash equivalents include cash and money market accounts with maturities at acquisition of three months or less. The majority of cash balances at December 31, 2017 are held in one bank in demand deposit accounts.

### Supplemental Non Cash Investing and Financing Activities

Accounts payable included \$27.4 million, \$26.1 million and \$20.6 million at December 31, 2017, 2016 and 2015, respectively, for additions to property, plant and equipment.

### Receivables

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

### Material and Supplies

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

### Property and Depreciation

Property, plant and equipment are carried at cost. Depreciation has been calculated using the composite remaining life method and straight-line depreciation. The composite method depreciates the remaining net investment in telephone plant over remaining economic asset lives by asset category. This method requires periodic review and revision of depreciation rates. The average economic lives utilized for assets are as follows: building – 18 to 34 years; cable and

wire – 11 to 37 years; switching and circuit equipment – 6 to 15 years; and other property – 4 to 17 years.

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### Software

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

### Goodwill and Other Intangible Assets

Goodwill and other indefinite lived intangible assets are not amortized. Such assets are reviewed annually, or more frequently under various conditions, for impairment. The goodwill impairment test involves comparing the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying value of the reporting unit, for goodwill, or the indefinite-lived intangible asset exceeds its fair value, the impairment loss is recognized for the amount of the excess. The Company performs its annual impairment test during the fourth quarter, primarily using a market valuation and discounted cash flows methodology.

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

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

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

### Debt Issuance

Deferred financing costs and original issue discount are amortized over the term of the related debt issuance using the effective interest method and presented as a direct deduction of the carrying amount of the debt.

### Income Taxes

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

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

### Employee Benefit Plans

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

period or expected life of participants as applicable.

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## Maintenance and Repairs

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

## Advertising

Advertising costs are expensed as incurred. Advertising expense amounted to \$5.8 million, \$6.1 million and \$5.9 million for the years ended December 31, 2017, 2016 and 2015, respectively.

## Stock Based Compensation

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

## Earnings per Share

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

	For the Year Ended		
	December 31,		
	2017	2016	2015
Basic earnings per share - weighted average shares	11,573,435	11,503,296	10,977,341
Effect of dilutive securities:			
Employee and director restricted stock units	—	52,701	83,727
Warrants	—	—	325,235
Diluted earnings per share - weighted average shares	11,573,435	11,555,997	11,386,303

The computation of weighted average dilutive shares outstanding excluded grants of restricted stock units convertible into 311,090 shares for the year ended December 31, 2017. For the year ended December 31, 2017, the Company incurred a net loss so the restricted stock units are anti-dilutive to the computation of diluted net loss per share. For the years ended December 31, 2016 and 2015, the antidilutive restricted stock units excluded from the computation of weighted average dilutive shares outstanding were not significant.

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### Recently Adopted Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board (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 was effective for the Company in 2017. The adoption method required is specified as retrospective, modified retrospective or prospective for each of the various accounting provisions impacted by this new standard. The Company is accounting for forfeitures on its share-based transactions as they occur beginning January 1, 2017. The impact of the modified retrospective adoption of this provision was not significant. In addition, the Company began accounting for excess tax benefits and tax deductions on share-based award settlements prospectively as income tax expense or benefit in its consolidated statements of income (loss) beginning January 1, 2017. Excess tax benefits that were not recognized prior to January 1, 2017 because the related tax deduction had not reduced taxes currently payable have been recognized on a modified retrospective basis through a cumulative effect adjustment which increased retained earnings as of January 1, 2017 by \$0.6 million.

In January 2017, the FASB issued new accounting guidance simplifying the test for goodwill impairment. The new guidance eliminates the requirement to determine the fair value of individual assets and liabilities of a reporting unit to measure goodwill impairment. Under the amendments in the standard, goodwill impairment testing will be performed by comparing the fair value of the reporting unit with its carrying amount and recognizing an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value. The Company adopted the standard effective December 31, 2017 on a prospective basis with no current impact.

### Recently Issued Accounting Pronouncement on Revenue Recognition

In May 2014, the FASB issued a new accounting standard which provides guidance for revenue recognition. The new accounting standard supersedes existing revenue recognition requirements and most industry-specific guidance. The standard’s core principal is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects consideration to which the company expects to be entitled in exchange for those goods and services. The Company adopted the new standard effective January 1, 2018. The Company selected the modified retrospective method of adoption which requires a cumulative effect adjustment to retained earnings as of the adoption date. The initial application of the new standard was limited to contracts not yet completed as of the effective date. The details of significant changes in the Company’s revenue recognition and the quantitative impact are provided below.

Prior to 2018, the Company recognized revenue for telecommunication and structured cabling project revenues on a percentage of completion basis, generally based on the relative portion of costs incurred to total estimated costs of a project, except for short duration projects which were recognized upon completion of the project. Beginning in 2018, the Company is recognizing revenue on all projects as completed. In addition, beginning in 2018, the Company began recognizing a financing component to the up-front payments for services to be delivered under indefeasible right of use contracts for fiber circuit capacity.

Beginning in 2018, the Company began deferring certain costs to obtain a contract and is recognizing such costs over the expected contract term. Prior to 2018, the Company had deferred certain costs related to activation in an amount that approximated the related revenue and recognized such costs over the expected customer life. The Company has concluded that such costs are no longer significant or are accounted for under other accounting standards such as those related to capitalization in conjunction with installation of an asset.

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The new accounting standard also provides guidance on presentation of contract assets and liabilities in the consolidated balance sheet. The standard provides specific guidance on presentation of advance billings. Beginning in 2018, a liability is recognized for advance billings where cash has been received in advance of delivery of goods or services, or when payment is due and the contract is noncancellable. Prior to 2018, a liability was recognized when the related goods or services were invoiced in advance of delivery of goods or services.

The cumulative effect of application of the new accounting standard as of January 1, 2018, net of estimated tax, was to increase retained earnings by an amount estimated at \$4.0 million to \$6.0 million. The impact will be reflected in the Company's condensed consolidated financial statements beginning with the quarter ended March 31, 2018.

In preparation for adoption of the new accounting standard, the Company has implemented internal controls, system functionality and revised business processes to prepare financial information in accordance with the standard. These new processes and procedures ensure data utilized for financial reporting is complete and accurate and is assessed in accordance with the guidelines of the standard. The Company is implementing new internal controls to address risks associated with applying the new revenue recognition model as well as monitoring controls to identify new sales arrangements or changes in the business environment that will affect the Company's current accounting assessment.

### Other Recently Issued Accounting Pronouncements

In February 2016, the FASB issued a new standard which revises the accounting for leases. The new standard is effective for the Company in the first quarter of 2019. The standard requires a dual approach for lessee accounting under which a lessee would account for leases as finance leases or operating leases. Both finance leases and operating leases will result in the lessee recognizing a right-of-use asset and a corresponding lease liability. For finance leases, the lessee would recognize interest expense and amortization of the right-of-use asset and for operating leases the lessee would recognize lease expense on a straight-line basis. The standard requires use of a modified retrospective transition approach beginning with the earliest period presented in the period of transition. The Company is currently assessing the impact that adoption of this guidance will have on its consolidated financial statements.

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.

In March 2017, the FASB issued a new standard that amends the income statement presentation of the components of net periodic benefit cost for defined benefit and other postretirement plans. The new standard requires that the current service cost component be disaggregated from the other components of net benefit cost. The other components must be presented elsewhere in the income statement outside of income from operations. In addition, only the service-cost component of net benefit cost is eligible for capitalization related to self-constructed assets. The new standard is effective for the Company beginning January 1, 2018 with early adoption permitted. The presentation requirements must be adopted on a retrospective basis and the change in capitalization methodology applied on a prospective basis. The Company currently presents the entire net benefit cost in income from operations but has disclosed the components of net benefit costs in Note 8 to the consolidated financial statements. The Company has adopted this



standard effective January 1, 2018 and will reflect the new presentation of net periodic benefit cost beginning with its condensed consolidated financial statements for the quarter ended March 31, 2018.

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In May 2017, the FASB issued additional guidance for stock compensation accounting. The guidance provides clarification on when modification accounting should be used for changes to the terms or conditions of a share-based payment award. The standard does not change the accounting for modifications but clarifies that modification accounting guidance should only be applied if there is a change to the value, vesting conditions, or award classification and would not be required if the changes are considered non-substantive. The amendment to the accounting standard is effective for interim and annual periods beginning after December 15, 2017. Early adoption is permitted and the provisions must be applied prospectively to a stock award modified on or after the adoption date. The Company adopted the new standard effective January 1, 2018 with no current impact.

In February 2018, the FASB amended accounting rules to allow for a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act (see Note 9). Accounting rules generally require deferred tax liabilities and assets to be adjusted for the effect of a change in tax laws or rates with the effect included in income from continuing operations in the reporting period that includes the enactment date. Therefore, the tax effects of items within accumulated other comprehensive income may not reflect the appropriate tax rate (referred to as stranded tax effects). Consequently, the amendment allows for an optional elimination of the stranded tax effects resulting from the Tax Cuts and Jobs Act. The amendment is effective for the Company in the first quarter of 2018. The Company has chosen not to adopt the standard early, though allowed. The Company is still evaluating the potential impact of the accounting amendment and has not yet concluded if it will adopt the optional provisions of the amendment. If the provisions are adopted, the Company expects to apply the standard in the period of adoption rather than retrospectively.

## 3. Receivables, Net

Receivables consisted of the following (dollars in thousands):

	December 31,	
	2017	2016
Customers and other	\$ 36,118	\$ 37,408
Allowance for doubtful accounts	(3,889)	(4,031)
	\$ 32,229	\$ 33,377

The Company grants credit to customers in the normal course of business. At December 31, 2017 and 2016, the Company did not have customer balances representing more than 10% of total receivables. During the years ended December 31, 2017, 2016 and 2015, the Company had no customers that represented more than 10% of total revenues.

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

	Beginning Balance	Additional Charges to Costs and Expenses	Deductions from Allowance	Ending Balance
January 1 to December 31, 2017	\$ 4,031	\$ 3,797	\$ (3,939)	\$ 3,889
January 1 to December 31, 2016	3,931	4,031	(3,931)	4,031

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January 1 to December 31, 2015	3,755	3,648	(3,472)	3,931
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## 4. Property, Plant and Equipment

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

	December 31,	
	2017	2016
Land	\$ 67,278	\$ 67,278
Buildings	120,999	115,775
Central office equipment	222,248	208,004
Outside communications plant	479,655	412,244
Other equipment, vehicles and furniture	104,846	87,849
Construction in progress	34,759	55,606
Software	90,652	78,547
Other	10,834	10,834
Property, plant and equipment cost	\$ 1,131,271	\$ 1,036,137
Less accumulated depreciation	(522,973)	(440,140)
	\$ 608,298	\$ 595,997

Depreciation expense amounted to \$86.7 million, \$87.8 million and \$85.4 million for the years ended December 31, 2017, 2016 and 2015, respectively.

## 5. Goodwill and Other Intangible Assets

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

	December 31, 2017			December 31, 2016		
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Subject to amortization:						
Customer relationships	\$ 21,709	\$ 17,983	\$ 3,726	\$ 21,709	\$ 16,299	\$ 5,410
Trade name and other	320	320	—	320	302	18
	22,029	18,303	3,726	22,029	16,601	5,428
Not subject to amortization:						
Brand name	27,300	—	27,300	27,300	—	27,300
	27,300	—	27,300	27,300	—	27,300
	\$ 49,329	\$ 18,303	\$ 31,026	\$ 49,329	\$ 16,601	\$ 32,728

Amortization expense amounted to \$1.7 million, \$2.1 million and \$2.5 million for the years ended December 31 2017, 2016 and 2015, respectively. Estimated amortization expense for the next five years and thereafter is as follows (dollars in thousands):

Year ended December 31,	
2018	\$ 1,307
2019	930
2020	574
2021	270
2022	223
Thereafter	422
	\$ 3,726

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As of December 31, 2017, the Company has goodwill of \$12.1 million. Prior to 2017, the Company recognized \$10.5 million of goodwill as part of the data center services segment and \$1.6 million in the telecommunications segment. As further discussed in Note 16, because of recent operational, organizational and reporting changes, the Company has concluded it now has only one segment and one reporting unit. As such, the Company now classifies all goodwill in the one segment.

## 6. Accrued Expenses and Other Liabilities

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

	December 31,	
	2017	2016
Salaries and benefits	\$ 7,875	\$ 11,662
Interest	2,890	2,583
Other taxes	971	1,048
	\$ 11,736	\$ 15,293

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

	December 31,	
	2017	2016
Other postretirement benefits, current	\$ 3,226	\$ 3,332
Installment financing contracts, current	2,978	2,157
Other	570	838
	\$ 6,774	\$ 6,327

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

	December 31,	
	2017	2016
Deferred revenue, noncurrent	\$ 28,036	\$ 7,453
Installment financing contracts, noncurrent	8,982	8,692
Other	1,909	2,094
	\$ 38,927	\$ 18,239

Deferred revenue includes advance billings of capacity and other services related to the Company's trans-Pacific cable as more fully described in Note 13.

7. Long Term Debt

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

	Average Interest Rate December 31, 2017	Final Maturity	December 31,	
			2017	2016
Term loan A-1	5.13	% May 4, 2022	\$ 87,750	\$ —
Term loan A-2	5.38	May 4, 2023	227,125	—
Term loan retired	NA	NA	—	290,138
Debt issue costs and issue discount			(5,559)	(5,439)
			309,316	284,699
Current			10,250	3,000
Noncurrent			\$ 299,066	\$ 281,699

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In February 2017, the Company entered into a delayed draw credit agreement for new term loans and a new revolving credit facility. The new facility fully funded the repayment of the existing term loan and replacement of the existing revolving credit on May 4, 2017. Included in the new facility is a term loan A-1 for \$90.0 million with quarterly principal payments of \$1.1 million with the balance due at maturity in May 2022. Interest, payable at least quarterly, is at the Alternate Base Rate plus a margin of 2.75% or a Eurocurrency rate plus a margin of 3.75%. In addition, the facility provides for a second term loan A-2 for \$230.0 million with quarterly principal payments of \$1.4 million for the first eight quarters and \$2.9 million per quarter thereafter with the balance due at maturity in May 2023. Interest, payable at least quarterly, is at the Alternate Base Rate plus a margin of 3.0% or a Eurocurrency rate plus a margin of 4.0%.

The new facility also provides for a line of credit in the amount of \$30.0 million with maturity in May 2022. A commitment fee is payable quarterly to the lender under the facility. Interest on the line of credit is at the Alternate Base Rate plus a margin of 2.75% or a Eurocurrency rate plus a margin of 3.75%. There were no drawings as of or for the periods ended December 31, 2017 on the new line of credit.

The interest rate margins on the facility are subject to a decrease of 0.25% with a defined improvement in the Company's leverage ratio. The obligations under the bank facilities are guaranteed by the Company and each subsidiary with certain exceptions. In addition, the bank credit facilities are collateralized by substantially all of the Company's assets.

The bank credit facilities contain various negative and affirmative covenants that restrict, among other things, incurrence of additional indebtedness, payment of dividends, redemptions of stock, other distributions to shareholders and sales of assets. In addition, there are financial covenants which have the following metrics as of December 31, 2017: debt service coverage with minimum allowed ratio of 2.75:1 of earnings before interest, taxes, depreciation and amortization to debt service which includes scheduled principal payments and cash interest; leverage with maximum allowed ratio of 3.25:1 of indebtedness to earnings before interest, taxes, depreciation and amortization; and a maximum level of annual capital expenditures of \$105.0 million. The Company was in compliance with these covenants as of December 31, 2017.

The Company incurred \$6.3 million in underwriting fees, original issue discount and legal costs in 2017 in conjunction with the new debt facility. Such costs and the existing debt original issue discount, deferred financing costs, underwriting fees and legal costs were accounted for in accordance with accounting standards for extinguishment of debt instruments. The Company compared each syndicated lenders' loan under the old term loan with the syndicated lenders' loan under the new term loans. All loans under the new term loan were deemed substantially different. As such, the Company deferred the costs of the new debt as a reduction of the carrying value of the new debt. In addition, the Company recognized the repayment of the existing debt instruments as a debt extinguishment incurring a loss on early extinguishment of debt of \$4.8 million.



The Company had an existing revolving credit facility which was repaid and terminated on May 4, 2017. Drawings for the year ended December 31, 2017 amounted to \$10.0 million. Such draws were used primarily to fund the construction of the SEA-US submarine cable system described in Note 13. There were no amounts drawn as of or for the years ended December 31, 2016 or 2015.

One of the syndicated lenders in both the new term loan and the term loan retired is a cooperative bank owned by its customers. Annually, this bank distributes patronage in the form of cash and stock in the cooperative based on the Company's average outstanding loan balance. The Company recognizes the patronage, generally as declared, as a reduction of interest expense. The stock component is recognized at its stated cost basis with the accumulated stock investment included in other noncurrent assets. The investment balance as of December 31, 2017 was not significant.

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## Loan Amendment in 2016

In May 2016, the Company amended its term loan allowing for a revised leverage ratio financial covenant. The amendment modified the maximum allowed leverage ratio. 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 2016.

## Capitalized Interest

Interest capitalized by the Company amounted to \$1.9 million, \$1.6 million and \$1.1 million for the years ended December 31, 2017, 2016 and 2015, respectively.

## Maturities

The maturities of debt at December 31, 2017 are as follows (dollars in thousands):

Year ended December 31,	
2018	\$ 10,250
2019	13,125
2020	16,000
2021	16,000
2022	81,250
Thereafter	178,250
	\$ 314,875

## 8. Employee Benefit Plans

## Pension and Other Postretirement Benefits

The Company sponsors a defined benefit pension plan, with benefits frozen as of March 1, 2012, and postretirement health and life insurance benefits for union employees. The Company also sponsors a cash balance pension plan for

nonunion employees, with benefits frozen as of April 1, 2007, and certain management employees receive postretirement health and life insurance under grandfathered provisions of a formerly active plan.

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

	Pension Benefits		Other Postretirement Benefits			
	December 31,		December 31,			
	2017	2016	2017	2016	2017	2016
Change in projected benefit obligation:						
Obligation at beginning of period	\$ 203,316	\$ 203,455	\$ 73,789	\$ 60,749		
Service cost	—	—	898	1,104		
Interest cost	6,705	7,347	2,193	2,637		
Actuarial (gain) loss	11,574	3,686	(1,641)	11,036		
Plan change	—	—	(18,262)	—		
Benefits paid	(26,962)	(11,172)	(1,844)	(1,737)		
Projected benefit obligation at end of period	194,633	203,316	55,133	73,789		
Change in plan assets:						
Fair value of plan assets at beginning of period	167,843	156,678	—	—		
Return on plan assets	22,525	13,032	—	—		
Employer contributions	3,181	9,305	1,844	1,737		
Benefits paid	(26,962)	(11,172)	(1,844)	(1,737)		
Fair value of plan assets at end of period	166,587	167,843	—	—		
Funded status:						
Plan assets less than projected benefit obligation	\$ (28,046)	\$ (35,473)	\$ (55,133)	\$ (73,789)		
Amounts recognized on balance sheet:						
Other current liabilities	\$ —	\$ —	\$ (3,226)	\$ (3,332)		
Employee benefit obligation, noncurrent	(28,046)	(35,473)	(51,907)	(70,457)		
Net amount recognized	\$ (28,046)	\$ (35,473)	\$ (55,133)	\$ (73,789)		
Actuarial loss recognized in accumulated other comprehensive income (loss)	\$ (31,886)	\$ (36,919)	\$ (816)	\$ (20,040)		
Actuarial assumptions:						
Measurement date, December 31	2017	2016	2017	2016		
Discount rate ranges from a low of	3.50 %	3.81 %	3.62 %	4.03 %		
Discount rate ranges to a high of	3.50 %	3.85 %	3.63 %	4.25 %		
Assumed health care cost trend rate, current	NA	NA	7.00 %	7.25 %		
Assumed health care cost trend rate, ultimate	NA	NA	5.00 %	5.00 %		
Assumed health care cost trend rate, ultimate year	NA	NA	2026	2026		

The Company's pension plans paid lump sum payments to participants resulting in settlement accounting for the applicable plans and a loss on settlement. The Company's lump-sum benefits to plan participants in full settlement of obligations due resulting in settlement accounting amounted to \$23.0 million, \$7.1 million and \$55.9 million for the years ended December 31, 2017, 2016 and 2015, respectively.

In January 2017, the Company amended the postretirement health benefits plan for management employees by implementing a cap on the amount of the premium subsidy at 2017 levels. This resulted in recognition of a negative plan amendment as of January 31, 2017. The new measurement resulted in a retirement plan gain which was recognized in other comprehensive income of \$19.7 million for the year ended December 31, 2017.

The estimated amount of the actuarial gain or loss to be amortized from accumulated other comprehensive income (loss) during 2018 is \$0.4 million of loss for pension benefits and \$0.9 million of gain for other postretirement benefits.

The Company accrues the service costs of pension and postretirement benefits over the period from the date of hire until the date the employee becomes fully eligible for benefits. The following provides the components of benefit costs and weighted average actuarial assumptions for the years ended December 31, 2017, 2016 and 2015 (dollars in thousands):

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## Pension Benefits

	For the For the Year Ended					
	December 31,		December 31,		December 31,	
	2017		2016		2015	
Interest cost	\$ 6,705		\$ 7,347		\$ 7,994	
Expected asset return	(10,376)		(10,172)		(12,565)	
Amortization of loss	464		574		186	
Net periodic benefit income	(3,207)		(2,251)		(4,385)	
Settlement loss	3,995		1,277		8,088	
Total benefit (income) expense	\$ 788		\$ (974)		\$ 3,703	
Actuarial assumptions:						
Discount rate ranges from a low of	3.56	%	3.28	%	3.54	%
Discount rate ranges to a high of	3.85	%	4.10	%	4.09	%
Expected return on plan assets	7.00	%	7.00	%	7.25	%

## Other Postretirement Benefits

	For the For the Year Ended					
	December 31,		December 31,		December 31,	
	2017		2016		2015	
Service cost	\$ 898		\$ 1,104		\$ 1,088	
Interest cost	2,193		2,637		2,355	
Amortization of (gain) loss	(678)		573		588	
Total benefit expense	\$ 2,413		\$ 4,314		\$ 4,031	
Actuarial assumptions:						
Discount rate ranges from a low of	4.03	%	4.32	%	3.97	%
Discount rate ranges to a high of	4.25	%	4.56	%	4.15	%
Assumed health care cost trend rate, current	7.25	%	7.50	%	6.75	%
Assumed health care cost trend rate, ultimate	5.00	%	5.00	%	5.00	%
Assumed health care cost trend rate, ultimate year	2026		2026		2022	

The measurement date for all plans was December 31, 2017, 2016 and 2015. At December 31, 2017 and 2016, the accumulated benefit obligation was the same as the projected benefit obligation.

The Company based its selection of an assumed discount rate for 2018 net periodic benefit cost and December 31, 2017 disclosure on a cash flow matching analysis that utilized bond information provided from a bond index for all non-callable, high quality bonds (i.e., rated AA- or better) as of December 31, 2017. The matching of bond income to anticipated benefit cash flows and the basic methods of selecting the assumed discount rate and expected return on plan assets at December 31, 2017 did not change from December 31, 2016.

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In selecting the expected rate of return on plan assets of 7.00% for 2018 net periodic benefit cost, the Company considered economic forecasts for the types of investments held by the plans (primarily equity and fixed income investments), the plans' asset allocations and the past performance of the plans' assets. The expected rate of return on plan assets was based on various factors including historical experience and long-term inflation assumptions. The Company's expected long-term rate of return on plan assets is determined using the target allocation of assets which is based on the goal of earning the highest rate of return while maintaining risk at acceptable levels. The plan strives to have assets sufficiently diversified so that adverse or unexpected results from a security class will not have a significant adverse impact on the entire portfolio.

The Company's overall investment strategy is to primarily invest for long term growth with sufficient investments available to fund near term benefit payments. The Company aims for diversification of asset types, fund strategies and fund managers. The target allocations for plan assets are 65 percent equity securities and 35 percent fixed income securities. Equity securities primarily include investments in equity funds and common stock of individual companies. Together these investments are diversified in companies located in the United States and internationally. Fixed income securities are in funds that invest in bonds of companies from diversified industries, mortgage backed securities and U.S. Treasuries.

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

The fair values of the Company's pension plan assets at December 31, 2017 and 2016, based on trading values or fund net asset value, by asset category and basis of valuation, are as follows (dollars in thousands):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
2017				
Common stocks - domestic large cap	\$ 9,660	\$ —	\$ —	\$ 9,660
Equity funds - large cap index	—	92,731	—	92,731
Fixed income funds - diversified bond	—	63,768	—	63,768
Short term investment funds	—	428	—	428
	\$ 9,660	\$		