SHENANDOAH TELECOMMUNICATIONS CO/VA/
Form 10-Q
November 07, 2006

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2006

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

For the transition period from__________ to __________

Commission File No.: 000-09881

SHENANDOAH TELECOMMUNICATIONS COMPANY
(Exact name of registrant as specified in its charter)

VIRGINIA (State or other jurisdiction of incorporation or organization)	54-1162807 (I.R.S. Employer Identification No.)

500 Shentel Way, Edinburg, Virginia (Address of principal executive offices)	22824 (Zip Code)

(540) 984-4141
(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer x Non-accelerated filer o

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

The number of shares of the registrant s common stock outstanding on October 31, 2006 was 7,740,810.

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SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

ASSETS	September 30, 2006	December 31, 2005
Current Assets		
Cash and cash equivalents	$ 15,073	$ 2,572
Accounts receivable, net	11,522	11,864
Income taxes receivable		795
Materials and supplies	2,772	2,702
Prepaid expenses and other	1,966	2,336
Deferred income taxes	482	532
Total current assets	31,815	20,801
Investments	6,950	7,365
Property, Plant and Equipment		
Plant in service	263,472	248,321
Plant under construction	6,939	9,061
	270,411	257,382
Less accumulated amortization and depreciation	112,873	95,144
Net property, plant and equipment	157,538	162,238
Other Assets		
Intangible assets, net	2,983	3,346
Cost in excess of net assets of businesses acquired	10,103	10,103
Deferred charges and other assets, net	1,307	1,068
Net other assets	14,393	14,517
Total assets	$ 210,696	$ 204,921

See accompanying notes to unaudited condensed consolidated financial statements.

(Continued)

SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

LIABILITIES AND SHAREHOLDERS EQUITY	September 30, 2006	December 31, 2005
Current Liabilities		
Current maturities of long-term debt	$ 4,075	$ 4,526
Accounts payable	5,991	6,928
Advanced billings and customer deposits	4,818	4,247
Accrued compensation	1,731	3,294
Income taxes payable	316	
Accrued liabilities and other	3,084	3,746
Total current liabilities	20,015	22,741
Long-term debt, less current maturities	22,947	31,392
Other Long-Term Liabilities		
Deferred income taxes	23,495	24,599
Pension and other	3,155	2,359
Deferred lease payable	2,461	2,230
Total other liabilities	29,111	29,188
Commitments and Contingencies		
Shareholders Equity		
Common stock	10,441	8,128
Retained earnings	128,286	113,576
Accumulated other comprehensive (loss)	(104)	(104)
Total shareholders equity	138,623	121,600
Total liabilities and shareholders equity	$ 210,696	$ 204,921

See accompanying notes to unaudited condensed consolidated financial statements.

SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share amounts)

	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
		(Restated)		(Restated)
Operating revenues	$ 42,594	$ 37,314	$ 123,820	$ 107,166
Operating expenses:				
Cost of goods and services, exclusive of depreciation and amortization shown separately below	18,253	15,446	52,691	44,657
Selling, general and administrative, exclusive of depreciation and amortization shown separately below	11,801	10,858	36,012	31,609
Depreciation and amortization	6,613	5,354	20,266	16,269
Total operating expenses	36,667	31,658	108,969	92,535
Operating income	5,927	5,656	14,851	14,631
Other income (expense):				
Interest expense, net	(599)	(777)	(1,857)	(2,400)
Gain (loss) on investments, net	(48)	55	10,681	(224)
Non-operating income, net	227	211	659	744
Income before income taxes and cumulative effect of a change in accounting	5,507	5,145	24,334	12,751
Income tax expense	2,126	2,044	9,547	4,856
Income before cumulative effect of a change in accounting	3,381	3,101	14,787	7,895
Cumulative effect of a change in accounting, net of income taxes			(77)	
Net income	$ 3,381	$ 3,101	$ 14,710	$ 7,895
Income (loss) per share:				
Basic net income (loss) per share:				
Income before cumulative effect of a change in accounting	$ 0.44	$ 0.40	$ 1.92	$ 1.03
Cumulative effect of a change in accounting, net of income taxes			(0.01)	
	$ 0.44	$ 0.40	$ 1.91	$ 1.03
Weighted average shares outstanding, basic	7,722	7,666	7,702	7,652
Diluted net income (loss) per share:				

Income before cumulative effect of a change in accounting	$	0.43	$	0.40	$	1.90	$	1.02
Cumulative effect of a change in accounting, net of income taxes						(0.01)		
	$	0.43	$	0.40	$	1.89	$	1.02
Weighted average shares, diluted		7,778		7,810		7,764		7,728

See accompanying notes to unaudited condensed consolidated financial statements.

SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY AND COMPREHENSIVE INCOME
(in thousands, except per share amounts)

	Shares	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2004, as restated	7,630	$ 6,319	$ 106,373	$ 65	$ 112,757
Comprehensive income:					
Net income			10,735		10,735
SERP additional minimum pension liability				(104)	(104)
Net unrealized change in securities available-for-sale, net of tax of $(40)				(65)	(65)
Total comprehensive income					10,566
Dividends declared ($0.46 per share)			(3,532)		(3,532)
Stock-based compensation		347			347
Common stock issued through exercise of incentive stock options	57	1,169			1,169
Excess tax benefit from stock options exercised		293			293
Balance, December 31, 2005	7,687	$ 8,128	$ 113,576	$ (104)	$ 121,600
Comprehensive income:					
Net income			14,710		14,710
Total comprehensive income					14,710
Stock-based compensation		232			232
Conversion of liability classified awards to equity classified awards		1,013			1,013
Common stock issued through exercise of incentive stock options	41	868			868
Excess tax benefit from stock options exercised		200			200
Balance, September 30, 2006	7,728	$ 10,441	$ 128,286	$ (104)	$ 138,623

See accompanying notes to unaudited condensed consolidated financial statements.

SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Nine Months Ended September 30, 2006	2005 (Restated)
Cash Flows from Operating Activities from Continuing Operations		
Net income	$ 14,710	$ 7,895
Adjustments to reconcile net income to net cash provided by operating activities from continuing operations:		
Cumulative effect of change in accounting principle	77	
Depreciation	19,870	15,928
Amortization	395	341
Stock-based compensation expense	469	811
Deferred income taxes	(1,054)	(1,707)
Loss on disposal of assets	1,063	258
Net gain on disposal of investments	(10,542)	(74)
Net (income) loss from patronage and equity investments	(208)	84
Other	(55)	(824)
Changes in assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	342	(359)
Materials and supplies	(70)	(599)
Increase (decrease) in:		
Accounts payable	(937)	2,018
Deferred lease payable	231	269
Other prepaids, deferrals and accruals	915	3,982
Net cash provided by operating activities from continuing operations	$ 25,206	$ 28,023
Cash Flows From Investing Activities		
Purchase and construction of plant and equipment, net of retirements	$ (16,165)	$ (20,535)
Purchase of investment securities	(300)	(156)
Proceeds from investment activities	11,464	133
Proceeds from sale of equipment	323	94
Net cash used in investing activities from continuing operations	$ (4,678)	$ (20,464)

(Continued)

SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Nine Months Ended September 30, 2006	2005
		(Restated)
Cash Flows From Financing Activities		
Principal payments on long-term debt	$ (7,717)	$ (3,267)
Net payments on lines of credit	(1,178)	(12,000)
Proceeds from exercise of incentive stock options	868	701
Net cash used in financing activities from continuing operations	$ (8,027)	$ (14,566)
Net cash provided by (used in) continuing operations	$ 12,501	$ (7,007)
Net cash provided by operating activities from discontinued operations (as revised) (1)		5,000
Net increase (decrease) in cash and cash equivalents	$ 12,501	$ (2,007)
Cash and cash equivalents:		
Beginning	2,572	14,172
Ending	$ 15,073	$ 12,165
Supplemental Disclosures of Cash Flow Information		
Cash payments for:		
Interest paid	$ 1,877	$ 2,388
Income taxes	$ 9,278	$ 3,798

(1) See Note 3 for further discussion on the revised disclosure of discontinued operations.

See accompanying notes to unaudited condensed consolidated financial statements.

SHENANDOAH TELECOMMUNICATIONS COMPANY AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. The interim condensed consolidated financial statements of Shenandoah Telecommunications Company and Subsidiaries (collectively, the Company) are unaudited. In the opinion of management, all adjustments necessary for a fair presentation of the interim results have been reflected therein. All such adjustments were of a normal and recurring nature. These statements should be read in conjunction with the consolidated financial statements and related notes in the Company s Annual Report on Form 10-K for the year ended December 31, 2005. The balance sheet information at December 31, 2005 was derived from the audited December 31, 2005 consolidated balance sheet.

2. The Company s financial statements as of and for the years ended December 31, 2004 and 2003, including the beginning retained earnings for the year ended December 31, 2003, all quarters in 2004 and the first three quarters of the year ended December 31, 2005, were restated to correct errors relating to the Company s accounting for operating leases. While management believes that the impact of this error is not material to any previously issued financial statements, it determined that the cumulative adjustment required to correct this error was too large to record in 2005. The restated annual financial statements were included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005.

The Company s method of accounting for operating leases did not comply with the requirements of SFAS No. 13, Accounting for Leases and FASB Technical Bulletin No. 85-3, Accounting for Operating Leases with Scheduled Rent Increases. Historically, the Company has not assumed the exercise of available renewal options in accounting for operating leases. The Company has operating leases, primarily for cell sites owned by third parties, land leases for towers owned by the Company and leases with third parties for space on the Company s towers that have escalating rentals during the initial lease term and during succeeding optional renewal periods. In light of the Company s investment in each site, including acquisition costs and leasehold improvements, the Company determined that the exercise of certain renewal options was reasonably assured at the inception of the leases. Accordingly, the Company corrected its accounting to recognize rent expense on a straight-line basis over the initial lease term and renewal periods that are reasonably assured. Where the Company is the lessor, it recognizes revenue on a straight-line basis over the current term of the lease.

The impact of these restatements to the Company s statement of income for the three and nine months ended September 30, 2005, was a decrease to net income of $57 thousand and $171 thousand, respectively. The impact associated with correcting the Company s accounting for operating leases was an increase to lease expense of $90 thousand and $269 thousand, respectively, reflected in Cost of goods and services and a reduction in lease income of $6 thousand and $18 thousand, respectively, reflected in Operating revenues. The adjustments do not affect historical net cash flows from operating, investing or financing activities, future cash flows or the timing of payments under related leases.

In the Reclassifications column, in the tables presented below, certain amounts reported in prior period financial statements have been reclassified to conform to the current period presentation, with no effect on net income or shareholders equity.

The reclassification and restatement adjustments to amounts previously presented in the consolidated statements of income are summarized below (in thousands except per share data):

	Three Months Ended September 30, 2005			
	Reported	Reclassifications	Restatement Adjustments	Restated
Operating revenues	$ 37,320	$	$ (6)	$ 37,314
Cost of goods and services	14,533	823	90	15,446
Selling, general and administrative	11,681	(823)		10,858
Depreciation and amortization	5,354			5,354
Operating income	5,752		(96)	5,656
Income tax provision	2,083		(39)	2,044
Net income	$ 3,158	$	$ (57)	$ 3,101
Net income per share, basic	$ 0.41	$	$ (0.01)	$ 0.40
Net income per share, diluted	$ 0.41	$	$ (0.01)	$ 0.40

	Nine Months Ended September 30, 2005			
	Reported	Reclassifications	Restatement Adjustments	Restated
Operating revenues	$ 107,184	$	$ (18)	$ 107,166
Cost of goods and services	41,405	2,983	269	44,657
Selling, general and administrative	34,592	(2,983)		31,609
Depreciation and amortization	16,269			16,269
Operating income	14,918		(287)	14,631
Income tax provision	4,973		(117)	4,856
Net income	$ 8,066	$	$ (171)	$ 7,895
Net income per share, basic	$ 1.05	$	$ (0.02)	$ 1.03
Net income per share, diluted	$ 1.05	$	$ (0.02)	$ 1.02

3. Certain amounts reported in the prior period financial statements have been reclassified to conform to the current period presentation, with no effect on net income or shareholders equity, including the following reclassifications and changes in presentation:

During the current period, the Company recorded commission expense to selling, general and administrative expense. During 2005, a portion of these costs were recorded to cost of goods and services. To conform to the current period presentation, for the three and nine months ended September 30, 2005, the Company reclassified $0.8 million and $3.0 million in commission expense from selling, general and administrative expense to cost of goods and services.

The Company has separately disclosed the operating portion of the cash flows attributable to its discontinued operations, which for the nine months ended September 30, 2005, was not separately disclosed. During the nine months ended September 30, 2005, there were no cash flows from investing or financing activities for discontinued operations. In 2006, there were no cash flows attributable to discontinued operations.

4. Operating revenues and income from operations for any interim period are not necessarily indicative of results that may be expected for the entire year.

5. Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standard No. 123, Share-Based Payment (Revised 2004) (SFAS 123(R)) using the modified prospective application transition method, which establishes accounting for stock-based awards exchanged for employee services. Accordingly, for equity classified awards, stock-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized over the requisite service period. For those tandem awards of stock options and stock appreciation rights (SARs) which are liability classified awards, fair value is calculated at the grant date and each subsequent reporting date during both the requisite service period and each subsequent period until settlement.

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In periods prior to the adoption of SFAS 123(R), the Company accounted for its stock options granted under the Company Stock Incentive Plan (the Plan) by applying the intrinsic value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations, including Financial Accounting Standards Board (FASB) Interpretation No. 44, Accounting for Certain Transactions involving Stock Compensation, an interpretation of APB Opinion No. 25 issued in March 2000. Under this method, compensation expense was recorded on the date of the grant only if the current market price of the underlying stock exceeded the exercise price. SFAS No. 123, Accounting for Stock-Based Compensation established accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans. The Company provided the disclosures required under SFAS No. 123, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosures. No compensation expense was recognized under the Plan for years prior to 2004 since all such options were granted with an exercise price equal to the market price at the date of the grant. During the year ended December 31, 2004, the Company issued SARs which were accounted for as stock appreciation rights and, therefore, the Company recorded a liability for the related expense since it was assumed the awards will be settled in cash. Effective July 1, 2006, certain holders of 2004 SARs voluntarily relinquished their right to receive cash from the Company upon exercise. The fair value of these awards was calculated as of the date of modification and transferred from a liability to equity. These awards will, going forward, be accounted for as equity options. On March 21, 2005, the Company issued SARs with a net-share settlement feature. The cash-settlement feature was eliminated for the 2005 option grant. However, due to the net-share settlement feature, the Company accounted for these awards as stock appreciation rights and recognized compensation expense over the vesting period to the extent the current stock price exceeded the exercise price of the options. For both the 2004 and 2005 SARs grants, the adoption of SFAS 123(R) resulted in a change in the measurement of compensation expense from an intrinsic method to a fair value method.

The following table presents the effect on net income and net income per share as if the Company had applied the fair value recognition provisions of SFAS 123(R) to options granted under the Plan prior to the adoption. Disclosures for the three and nine months ended September 30, 2006 are not presented because stock-based payments were accounted for under SFAS 123(R) s fair-value method during this period.

(in thousands, except per share amounts)	**Three Months Ended September 30, 2005 (Restated)**	**Nine Months Ended September 30, 2005 (Restated)**
Net income		
As reported	$ 3,101	$ 7,895
Add: Recorded stock-based compensation expense included in reported net income, net of related income tax effects		
Deduct: Pro forma compensation expense, net of related income tax effects	7	48
Pro forma	$ 3,094	$ 7,847
Earnings per share, basic and diluted		
As reported, basic	$ 0.40	$ 1.03
As reported, diluted	0.40	1.02
Pro forma, basic	0.40	1.03
Pro forma, diluted	$ 0.40	$ 1.02

The Company maintains a shareholder-approved Company Stock Incentive Plan approved in 1996 (the 1996 Plan), providing for the grant of incentive compensation to essentially all employees in the form of stock options. The 1996 Plan authorized grants of options to purchase up to 480,000 shares of common stock over a ten-year period beginning in 1996. The term of the 1996 Plan expired in February of 2006. During 2005, a new Company Stock Incentive Plan was approved, the 2005 Plan, under which 480,000 shares may be issued over a ten-year period beginning in 2005. The option price for all grants has been at the current market price at the time of the grant. Grants have generally provided that one-half of the options vest and become exercisable on each of the first and second anniversaries of the grant date, with the options expiring on the fifth anniversary of the grant date. In the year ended December 31, 2003, the Company also issued a grant pursuant to which the options are vested over a five-year period beginning on the third anniversary of the grant date. The participant may exercise 20% of the total grant after each anniversary date from the third through the seventh year, with the options expiring on the tenth anniversary of the grant date. In the years ended December 31, 2005 and 2004, the Company also made grants pursuant to which the options are vested over a four-year period beginning on the third anniversary of the grant date. The participants may exercise 25% of the total grant after each anniversary date from the third through the sixth year, with the options expiring on the seventh anniversary of the grant date. The Company did not grant any options during the first nine months of 2006.

The impact of initially applying SFAS 123(R) is recognized as of the effective date using the modified prospective method. Under the modified prospective method the Company recognized stock-based compensation expense from January 1, 2006, as if the fair value based accounting method had been used to account for all outstanding unvested employee awards granted in prior years. Results of prior periods have not been restated. The effect of recording stock-based compensation for the three and nine month periods ended September 30, 2006 was as follows:

(in thousands, except per share amounts)	**Three Months Ended September 30, 2006**	**Nine Months Ended September 30, 2006**	**Three Months Ended September 30, 2005**	**Nine Months Ended September 30, 2005**
Stock-based compensation expense	$ (3)	$ 344	$ 212	$ 811
Cumulative effect of change in accounting		125		
Total stock compensation expense	(3)	469	212	811
Tax effect on stock-based compensation expense	(1)	182	81	315
Net effect on net income	$ (2)	$ 287	$ 131	$ 496
Effect on net income per share:				
Basic and diluted	$	$ (0.04)	$ (0.02)	$ (0.07)

For the three and nine month periods ended September 30, 2005, stock-based compensation expense was recorded under APB Opinion No. 25.

As required by SFAS 123(R), management has made an estimate of expected forfeitures and is recognizing compensation costs only for those awards expected to vest. For outstanding options previously classified as a liability and which continue to be classified as a liability under SFAS 123(R), the Company recognized the effect of initially re-measuring the liability from its intrinsic value to its fair value as a cumulative effect of a change in accounting principle. The cumulative effect of initially adopting SFAS 123(R) was $77 thousand, net of the tax effect. During the three and nine months ended September 30, 2006, the total cash received as a result of employee stock option exercises was $0.3 million and $0.9 million, respectively, and the actual tax benefit realized for the tax deductions was $45,000 and $200,000, respectively.

The fair value of each option grant is estimated using a Black-Scholes option pricing model with the following weighted average assumptions:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2006	**2005**	**2006**	**2005**
Expected term (in years)	2.50	3.50	2.62	3.50
Volatility	36.10%	45.73%	39.85%	45.73%
Risk free rate	4.63%	4.30%	4.97%	4.30%
Expected dividends	1.04%	1.42%	1.01%	1.42%

For the three and nine months ended September 30, 2006, the assumptions were used to calculate the fair value of the options classified as a liability. The fair value of options classified as a liability is calculated at the grant date and each subsequent reporting date until the options are settled.

Volatility is based on the historical volatility of the price of the Company s stock over the expected term of the options. The expected term represents the period of time that the options granted are expected to be outstanding. The risk free rate is based on the U.S. Treasury yield curve, in effect at the date the fair value of the options is calculated, with an equivalent term.

The following table summarizes option activity for the first nine months of 2006:

	Options	Weighted Average Grant Price Per Option
Outstanding December 31, 2005	240,863	$ 24.73
Granted		
Cancelled	(3,302)	28.96
Exercised	(16,394)	18.47
Outstanding March 31, 2006	221,167	25.13
Granted		
Cancelled	(20,560)	24.88
Exercised	(13,717)	23.85
Outstanding June 30, 2006	186,890	25.26
Granted		
Cancelled	(11,485)	38.45
Exercised	(12,862)	22.98
Outstanding September 30, 2006	162,543	$ 24.50

The following table summarizes information about stock options outstanding at September 30, 2006: