

HICKORY TECH CORP
Form 10-K
March 07, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark one)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal period ending December 31, 2012

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

For the transition period from to .

Commission File Number 0-13721

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

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

221 East Hickory Street
Mankato, MN 56002-3248
(Address of principal executive offices)

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

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

Title of Class	Name of Exchange on Which Registered
Common Stock, no par value	NASDAQ Global Select Market

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

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

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 T

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 or a smaller reporting company. See the definition of "large accelerated filer, accelerated filer, a non-accelerated filer or smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

The number of shares of the registrant's common stock, no par value, outstanding as of February 22, 2013 was 13,586,903. The aggregate market value of the registrant's common stock held by non-affiliates as of June 30, 2012 was \$138,257,395 based on the closing sale price of \$11.11 per share on The NASDAQ Global Select Market.

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the Company's Proxy Statement for the Annual Meeting of Shareholders to be held on May 7, 2013 ("Proxy Statement") are incorporated by reference in Part III of this Form 10-K.

TABLE OF CONTENTS

PART I

Item 1.	<u>Business</u>	3
Item 1A.	<u>Risk Factors</u>	16
Item 1B.	<u>Unresolved Staff Comments</u>	23
Item 2.	<u>Properties</u>	24
Item 3.	<u>Legal Proceedings</u>	24
Item 4.	<u>Mining Safety Disclosures</u>	24

PART II

Item 5.	<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	25
Item 6.	<u>Selected Financial Data</u>	28
Item 7.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	29
Item 7A.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	46
Item 8.	<u>Financial Statements and Supplementary Data</u>	50
Item 9.	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	77
Item 9A.	<u>Controls and Procedures</u>	77
Item 9B.	<u>Other Information</u>	79

PART III

Item 10.	<u>Directors, Executive Officers and Corporate Governance</u>	79
Item 11.	<u>Executive Compensation</u>	79
Item 12.	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	79
Item 13.	<u>Certain Relationships and Related Transactions and Director Independence</u>	80
Item 14.	<u>Principal Accountant Fees and Services</u>	80

PART IV

Item 15.	<u>Exhibits and Financial Statement Schedules</u>	80
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<u>SIGNATURES</u>	83
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Table of Contents

Forward-Looking Statements

The Private Securities Litigation Reform Act of 1995 contains certain safe harbor provisions regarding forward-looking statements. This 2012 Annual Report on Form 10-K ("Report") and other documents filed by HickoryTech Corporation under the federal securities laws, including Form 10-Q and Form 8-K and amendments to those reports, and future verbal or written statements by HickoryTech and its management, may include forward-looking statements. These statements may include, without limitation, statements with respect to anticipated future operating and financial performance, growth opportunities and growth rates, acquisition and divestiture opportunities, business strategies, business and competitive outlook and other similar forecasts and statements of expectation. Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," "targets," "projects," "will," "may," "continues," and "should," and variations of these words and similar expressions, are intended to identify these forward-looking statements. Such forward-looking statements are subject to risks and uncertainties that could cause HickoryTech's actual results to differ materially from such statements. These risks and uncertainties include those identified under Part I – Item 1A – "Risk Factors" beginning on page 16.

Because of these risks, uncertainties and assumptions and the fact that any forward-looking statements made by HickoryTech and its management are based on estimates, projections, beliefs and assumptions of management, they are not guarantees of future performance and you should not place undue reliance on them. In addition, forward-looking statements speak only as of the date they are made which is the filing date of this Form 10-K. With the exception of the requirements set forth in the federal securities laws or the rules and regulations of the Securities and Exchange Commission, we do not undertake any obligation to update or review any forward-looking information, whether as a result of new information, future events or otherwise.

PART I

Website Access to Securities and Exchange Commission Reports

Our website at www.hickorytech.com provides information about our products and services, along with general information about HickoryTech and its management, financial results and press releases. Copies of our most recent Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 can be obtained, free of charge, as soon as reasonably practical after such material is electronically filed, or furnished to the Securities and Exchange Commission. To obtain this information visit our website noted above and click on "Investor Relations," or call (507) 387-3355.

Item 1. Business

"HickoryTech" or the "Company" refers to HickoryTech Corporation alone or with its wholly owned subsidiaries, as the context requires. When this report uses the words "we," "our," or "us," it refers to the Company and its subsidiaries unless the context otherwise requires.

Company Overview and History

HickoryTech Corporation (dba HickoryTech and Enventis) is a leading integrated communications provider serving business and residential customers in the upper Midwest. Headquartered in Mankato, Minnesota, HickoryTech has a five-state fiber network spanning 4,100 fiber route miles with facilities-based operations across Minnesota, Iowa, North Dakota, South Dakota and Wisconsin.

Enventis provides business services including: voice, Voice over Internet Protocol ("VoIP"), advanced data services, Multi-Protocol Label Switching ("MPLS") networking, data center, managed hosted services, equipment solutions and IT consulting. HickoryTech delivers broadband, Internet, digital TV, voice and data services to businesses and consumers in its telecom service area of southern Minnesota and northwest Iowa.

We currently operate in three segments: (1) Fiber and Data, (2) Equipment and (3) Telecom. The Company trades on the NASDAQ Stock Exchange, symbol: HTCO.

Table of Contents

Our purchase of Enventis Telecom on December 30, 2005 provided the base for what is now our Fiber and Data and Equipment Segments. This portion of our business serves customers of all sizes across a five-state region with advanced data services, Ethernet, transport, Internet, VoIP, unified hosted communications, managed services, equipment, network integration and IT consulting. By leveraging our regional fiber network, we also provide wholesale fiber and data services to regional and national service providers, including interexchange and wireless carriers. Residential customers are not targeted by either the Fiber and Data Segment or Equipment Segment.

Our Telecom Segment provides residential and business services including: high-speed Internet, broadband services, digital TV, long distance and voice services across our legacy telecom markets. Telecom is comprised of the operation of both local telephone companies or incumbent local exchange carriers ("ILEC") and a competitive local exchange carrier ("CLEC") where we own the infrastructure and network in all communities. Our company was founded in 1898 as a single ILEC. In 1985, we formed HickoryTech Corporation as a holding company for our current ILECs and to serve as a platform to expand our business. In 1998, we formed a CLEC, which provides competitive local service, long distance, high-speed Internet access, Digital Subscriber Line ("DSL") and digital TV services to communities surrounding our ILEC operations. All of our Telecom operations are operated as one integrated unit including the ILEC and CLEC operations.

Our Telecom Segment is the primary user of the services provided by our subsidiary, National Independent Billing, Inc. ("NIBI") dba HickoryTech Information Solutions. NIBI provides a strategic alliance to us with the billing and support services it provides to all our companies. NIBI also sells its services externally to other companies in the communications industry. The goals, objectives and management of the NIBI product line are closely aligned with, and its operating results included with, those of our Telecom Segment.

No customer accounted for more than 10% of our consolidated operating revenues during the years ended December 31, 2012, 2011 and 2010.

Our operations are conducted through the following nine subsidiaries:

Fiber and Data Segment

- Enventis Telecom, Inc. (dba Enventis)
- IdeaOne Telecom, Inc. (dba Enventis)

Equipment Segment

- Enterprise Integration Services, Inc. ("EIS") (dba Enventis)

Telecom Segment

- Mankato Citizens Telephone Company ("MCTC"), an ILEC (dba HickoryTech)
- Mid-Communications, Inc. ("Mid-Com"), an ILEC (dba HickoryTech)
- Heartland Telecommunications Company of Iowa, Inc. ("Heartland"), an ILEC (dba HickoryTech)
- Crystal Communications, Inc. ("Crystal"), a CLEC (dba HickoryTech)
- Cable Network, Inc. ("CNI"), an independent fiber network provider (dba HickoryTech)
- National Independent Billing, Inc. ("NIBI"), computer processing for communications companies (dba HickoryTech Information Solutions)

We have Minnesota offices located in: Duluth, Edina, Mankato, Minneapolis, Plymouth and Rochester. We also have offices in: Des Moines, Iowa; Rock Valley, Iowa; and Fargo, North Dakota.

Fiber and Data Segment

Through our Fiber and Data Segment, we provide IP-based voice, advanced data services, fiber and network solutions to business customers in the upper Midwest.

4

Table of Contents

Fiber and Data Segment

Product portfolio includes:

- Fiber, data and internet
- Voice and VoIP
- Managed and hosted services
- Data center services

We own or have long-term leases to approximately 2,950 fiber route miles of fiber optic cable in this segment, which includes 250 miles acquired with the IdeaOne acquisition completed on March 1, 2012 and have extensive metro fiber optic rings that directly connect our network to businesses (e.g. interexchange carriers, wireless carriers, enterprise and commercial retail customers, health care, government and education customers, etc.). Additional local fiber rings connect our network to local telephone central offices and to our Telecom Segment network which has 1,150 fiber route miles. These connections allow us to utilize other communication providers' networks when company owned facilities are not available, effectively extending our reach in order to provide end-to-end solutions to customers. We also service customers through interconnections that are leased from third-party service providers (commonly referred to as "the last mile") or when feasible and profitable, we build the last-mile fiber connection to the building, tower or business customer premise extending our own network.

In August 2009, we acquired Computer Pro Inc., dba CP Telecom, to expand our commercial customer base, develop our business product portfolio and grow our agent sales channel. The operations of CP Telecom have been integrated within our Fiber and Data Segment. CP Telecom is no longer an operating subsidiary nor marketed as a brand or as a stand-alone entity. In 2011, CP Telecom was merged with Enventis Telecom.

On March 1, 2012, we acquired IdeaOne Telecom Group, LLC, a metro fiber network provider in Fargo, North Dakota, for \$26,337,000 with routine adjustments for capital expenditures and working capital. In addition, we assumed and paid liabilities of the acquired company using additional cash reserves of \$1,843,000 on the closing date of the acquisition. IdeaOne provides data, Internet, colocation, voice and hosting services to business customers primarily in the Fargo area. The acquisition added 250 fiber route miles to HickoryTech's regional network. The fiber network facilities extend to 650 on-net fiber-lit buildings and include multiple 10 GB fiber rings, ethernet capabilities, soft-switching infrastructure and colocation services. The Fargo operations are integrated with our Fiber and Data Segment.

We have authority to operate from the Public Utility Commissions in the majority of states in the U.S. for interexchange carrier (private line or long distance) services and, where necessary, have or are seeking authority in states to provide regulated services to augment our VoIP services. Our services directly compete with other ILECs, CLECs, cable companies and communication providers in the regions we serve.

Equipment Segment

Through our Equipment Segment, we provide network, equipment and consulting solutions to business customers.

Equipment Segment

Product portfolio includes:

- Equipment hardware
- IT Services, including Advisory, Implementation and Development
- Total Care support and monitoring

We have a leading market relationship with Cisco Systems, Inc. and are an accredited Master Level Unified Communications and Gold Certified Cisco Partner. The strategic relationship with Cisco (as the supplier) and EIS (as the distributor) allows us to deploy a wide range of collaboration, data center and network technology solutions. We maintain numerous Cisco specializations and authorizations as well as relationships with EMC, NetApp, VMware and other industry-leading vendors in order to provide integrated communication solutions that best fit our customers' needs.

5

Table of Contents

We provide converged IP services that allow all communications (e.g. voice, video and data) to use the same IP data infrastructure. Equipment solutions include: Advisory, Implementation, Development and Support Services for data center, collaboration, unified communications, security, wireless and networks.

Telecom Segment

The Telecom Segment provides local voice service, long distance, calling features, DSL, Internet, digital TV, data services and a phone book directory to residents and businesses in our legacy telecom markets. As an auxiliary business, the data processing services of NIBI are also included within the Telecom Segment.

Telecom includes three ILECs: MCTC, Mid-Com and Heartland. MCTC and Mid-Com provide telephone services in south central Minnesota, specifically the Mankato, Minnesota region, and 11 rural communities surrounding Mankato. Heartland, our third ILEC, provides telephone services for 11 rural communities in northwest Iowa. In total, there are 23 ILEC exchanges within the Telecom Segment. Also included is a CLEC, Crystal, which provides competitive services in south central Minnesota and near Des Moines, Iowa. There are eight Minnesota CLEC exchanges and two Iowa CLEC exchanges included in the Telecom Segment. We own and operate our network in both the ILEC and CLEC exchanges.

NIBI, an auxiliary part of this Segment, provides data processing and related services for our affiliated companies, as well as for other ILECs, CLECs, interexchange network carriers, wireless companies and cable TV providers throughout the United States and Canada.

We operate a 1,150 fiber route mile network and have facilities in Minnesota and Iowa. These facilities are used to transport voice, data and video services between our exchanges, to connect customers to interexchange carriers and to provide service directly to end users. This network is interconnected with our 2,950 fiber mile network in the Fiber and Data Segment. We operate an unregulated fiber network provider, CNI, to own and manage part of the southern Minnesota fiber network. Our Minnesota ILECs and CLECs are the primary users of these fiber optic facilities.

We derive our principal revenue and income from local voice services charged to subscribers in our service area, network access services charged to interexchange carriers and the operation of a toll tandem-switching center based in Mankato, Minnesota. The local and interexchange services for our telephone companies utilize the same facilities and equipment and are managed and maintained by a common workforce. We provide interexchange telephone access by connecting the communications networks of interexchange carriers and wireless carriers with the equipment and facilities of end-users through our switched networks or private lines.

As local exchange telephone companies, we provide end office switching and dedicated circuits to long distance interexchange carriers. These relationships allow our telephone subscribers to place long distance telephone calls to other networks. We provide access to our network for interexchange carriers to conduct long distance business with individual customers who select a long distance carrier for the origination and termination of calls to all customers. This interexchange access business is separate and distinct from our own long distance retail service, which is operated through Crystal.

Strategy

Our vision is to be the leader in connecting business and consumers with advanced, integrated communications solutions in the regions we serve. In 2009, we began implementing a long-term growth strategy for our company focused on the growth of business and broadband services. This growth plan includes making strategic investments to significantly grow our Fiber and Data Segment (business-to-business and wholesale customers) while continuing to focus on stabilizing the performance of our legacy telecom business by offering competitive broadband services

within our Telecom Segment.

6

Table of Contents

We have committed to expanding our fiber network as part of this growth plan. In 2010, we increased bandwidth capacity within our core network, expanded our fiber network to Sioux Falls, South Dakota, and Fargo, North Dakota, and increased network capacity to our Des Moines, Iowa facilities. In 2011, we continued to expand our fiber footprint through our Greater Minnesota Broadband Collaborative Project, supported in part by a federal broadband stimulus grant, to expand our network in northern Minnesota by building two long-haul fiber routes and to extend our network through middle-mile fiber laterals in southern Minnesota. In 2012, we acquired IdeaOne, a facilities based CLEC with significant metro fiber in Fargo, North Dakota and successfully integrated it into our existing Fiber and Data Segment.

Our strategy to maximize growth in our business customer segments and stabilize our Telecom Segment supports our goal to generate solid and sustainable cash flow over the long-term and diversify our revenue stream to help us offset revenue declines in our legacy business. This strategy has required increased capital expenditures to support fiber network expansion for organic growth initiatives as well as for acquisitions.

While we realize there is some risk in this strategy (see "Risks Related to Our Business"), we believe this plan could generate long-term success for us and increase shareholder value. This success depends on the following strategies:

- Grow monthly recurring revenue services through business-to-business sales. Our focus remains on supporting business customers ranging in size from small to large enterprise businesses and wholesale customers. We offer a wide array of fiber based data and transport services, Internet, voice, VoIP and IT consulting services. We believe we have created a competitive advantage by utilizing a consultative, value-based sales approach and developing innovative and flexible solutions for our customers. We will expand our business-to-business focus through the expansion and extension of our fiber network to communities and corridors near our primary fiber routes where we believe we can offer competitive services and gain market share. We are able to do this by utilizing our IP expertise and industry experience, leveraging our regional fiber network and offering a full suite of high-quality communication products and services.
- Deploy advanced communications technologies. We have and will continue to upgrade our networks to take advantage of the fastest growing areas of technology including advanced, high-bandwidth capabilities and the expansion of our network for wholesale and retail customers, Fiber-to-the-Tower ("FTTT") services for wireless carriers and last-mile fiber builds to data centers and business customer premises. We believe our technical capabilities and the use of VoIP technologies combined with our support offering will allow us to attract and maintain customers by providing competitive pricing and quality local support. Our SingleLink service, which provides customers with a single, centrally managed and hosted VoIP-based communications system, allows businesses to leverage the powerful benefits of integrated IP communications without the time and capital necessary for on-premise solutions. In addition, we have strategic business relationships in order to provide integrated communication solutions that best fit our clients' needs.
- Execute on our local telecom market strategy; grow broadband services. We will continue to leverage our strong reputation in our legacy telecom markets and offer a competitive, multi-service bundle of voice, high-speed Internet and digital TV in the majority of our markets. We will focus on growing our broadband services and increasing advanced services penetration. We will manage the decline in Telecom network access and local service revenue by focusing on profitability, controlling expenses and marketing a competitive broadband bundle and provide quality local support.
- Maintain stable cash flows from operations and disciplined capital spending. The majority of our customer base provides a recurring revenue stream generating stable cash flow. Our focus remains on growing our services and support product lines that will over time generate cash flow well in excess of capital expenditure needs. We have allocated resources to maintain and upgrade our network while focusing on optimizing returns by completing strategic capital outlays that will make our network more efficient and cost effective.

Table of Contents

·Grow through select strategic growth initiatives that fit our current strategic initiatives. We will continue to invest in organic growth initiatives to expand and extend our fiber network to new markets and customers and develop and enhance our product portfolio through market analysis and a focus on providing business and broadband solutions to meet our customers' future needs. We also intend to pursue a disciplined process of evaluating selective business acquisitions which fit our focus areas and growth strategy.

Revenue Sources

We currently divide our company operations into three segments for reporting: (1) Fiber and Data, (2) Equipment and (3) Telecom. The following table summarizes our primary sources of revenue within our segments for the past three years:

For Year Ended December 31	2012			2011			2010		
	Amount	Percent		Amount	Percent		Amount	Percent	
Fiber and Data	\$60,109	33	%	\$45,149	28	%	\$44,685	28	%
Equipment:									
Equipment	52,219	29	%	39,816	24	%	39,406	24	%
Support services	7,914	4	%	9,116	5	%	8,138	5	%
Telecom:									
Local service	12,955	7	%	14,363	9	%	15,288	9	%
Network access	19,160	10	%	22,489	14	%	23,150	14	%
Broadband	19,748	11	%	20,371	12	%	18,832	12	%
Long distance	2,473	1	%	2,892	2	%	3,185	2	%
Other	8,618	5	%	9,342	6	%	9,563	6	%
Total revenue	\$183,196	100	%	\$163,538	100	%	\$162,247	100	%

Fiber and Data

We service wholesale, enterprise and commercial business customers with advanced data services, Internet, voice and VoIP services. We have an extensive regional fiber network and community access rings supported by our 24x7x365 network operations center. As an experienced IP network integrator, we are able to provide both custom and broad network solutions which can be extended beyond our regional network through relationships and interconnections to provide customers end-to-end national connectivity. This revenue stream is primarily based on multi-year contracts with retail businesses, regional and national service providers and wireless carriers providing a solid monthly recurring revenue base. The Fiber and Data Segment includes revenue from Ethernet, Private Line, MPLS, Data Center, Dedicated Internet and Hosted VoIP SingleLink services. Fiber and Data services are marketed throughout our core regions: northern Minnesota and the Minneapolis-Saint Paul metropolitan area; southern Minnesota; Des Moines, Iowa; and Fargo, North Dakota.

Equipment

Equipment — We are a Master Unified Communications and Gold Certified Cisco Partner providing Cisco equipment solutions and support for a broad spectrum of business customers ranging in size from medium to large enterprise. Our equipment business plans, designs and implements networks utilizing emerging Cisco technology such as TelePresence Video, Unified Communications and Data Center solutions. We also have business relationships with EMC, NetApp, VMware and other industry-leading vendors to provide integrated communication solutions that best fit our customers' needs.

Equipment sales and services are marketed primarily in our Minnesota core regions and specifically the Minneapolis-Saint Paul metropolitan area. Equipment hardware sales are non-recurring in nature making this revenue dependent upon new sales from existing and new customers.

8

Table of Contents

Support Services — We provide a comprehensive set of services including: Advisory, Implementation, Development and Support. These services support equipment solutions and include: professional services, maintenance and total care support. Maintenance contracts ("Smartnet" contracts) are offered in collaboration with Cisco solutions. Our Total Care support team provides a proactive approach to monitor and support customer networks, unified communications environments and data centers as well as a single-point-of-contact for the support of applications, systems and infrastructure.

Telecom

Telecom services are provided within our ILEC and CLEC communities located in southern Minnesota, northwest Iowa and near Urbandale, Iowa.

Local Service — We receive recurring revenue for local residential and business voice services which enable end-user customers to make and receive telephone calls within a defined local calling area for a flat monthly fee. In addition to local telephone services, we offer numerous calling features and voicemail. We also receive reciprocal compensation revenue based on interconnection agreements with wireless carriers who use our network to terminate calls from their wireless subscribers.

Network Access — We provide access services to other communications carriers to terminate or originate long distance calls on our network. Additionally, we bill subscriber line charges to our residential and business customers for access to the public switched network. The monthly subscriber line charges are regulated and approved by the Federal Communications Commission ("FCC"). In addition, network access revenue is derived from several federally administered pooling arrangements designed to provide support and distribute funding to ILECs.

Broadband — We provide residential and business broadband services for a monthly recurring revenue stream. Broadband services include DSL/high-speed Internet access, digital TV, business Ethernet and data services. Our broadband services are bundled with local service and calling features to offer a competitive service package and valued discounts when customers commit to a term bundle agreement.

Long Distance — Our residential and business customers are billed for toll or long distance service on either a per call or flat rate basis. This also includes the provision of directory assistance, operator service and long distance private lines. We offer regional, nationwide and unlimited long distance plans.

Other — We generate revenue from directory publishing, customer premise equipment sales, bill processing, and add/move/change services. Our directory publishing revenue is monthly recurring revenue from businesses for annual yellow page contract advertising. Our bill processing revenue is earned through a combination of monthly recurring revenue generated from providing data processing as a service to other communication service providers (wireline/wireless), SuiteSolution software license fees and integration services revenue provided by our Information Solutions group. SuiteSolution is a web-centric, user-friendly graphical user interface on the front end of a time-tested billing engine designed to bill for voice and broadband communications services. SuiteSolution is targeted at providers of wireline, wireless, broadband, IP and video services.

Competition

We compete in a rapidly evolving and highly competitive industry, and expect competition will continue to intensify