HICKORY TECH CORP
Form 10-Q
November 05, 2013
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)
þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2013

OR

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 number 0-13721

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

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

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

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

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

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

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

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

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

The total number of shares of the Registrant's common stock outstanding as of November 1, 2013: 13,581,683.

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Part I Financial Information

Item 1. Financial Statements

HICKORY TECH CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Three Months Ended September 30		Nine Months Ended September 30	
(Dollars in thousands, except share and per share amounts)	2013	2012	2013	2012
Operating revenue:				
Equipment	$12,849	$12,915	$41,123	$38,954
Services	34,239	32,898	101,875	97,660
Total operating revenue	47,088	45,813	142,998	136,614
Costs and expenses:				
Cost of sales, excluding depreciation and amortization	10,929	10,906	35,011	33,664
Cost of services, excluding depreciation and amortization	17,406	16,358	50,976	47,589
Selling, general and administrative expenses	6,953	7,123	21,449	21,270
Asset impairment	-	-	638	-
Depreciation and amortization	7,514	6,869	21,775	19,795
Total costs and expenses	42,802	41,256	129,849	122,318
Operating income	4,286	4,557	13,149	14,296
Other income and expense:				
Interest and other income	1	3	16	37
Interest expense	(1,155)	(1,625)	(3,425)	(4,635)
Total other expense	(1,154)	(1,622)	(3,409)	(4,598)
Income before income taxes	3,132	2,935	9,740	9,698
Income tax provision	1,270	1,194	3,931	3,925
Net income	$1,862	$1,741	$5,809	$5,773
Basic earnings per share	$0.14	$0.13	$0.43	$0.43
Weighted average common shares outstanding	13,543,062	13,427,883	13,543,479	13,394,224
Diluted earnings per share	$0.14	$0.13	$0.43	$0.43
Weighted average common and equivalent shares outstanding	13,592,577	13,485,143	13,594,198	13,452,642
Dividends per share	$0.145	$0.14	$0.435	$0.42

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

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HICKORY TECH CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

(Dollars in thousands)	Three Months Ended September 30 2013	2012	Nine Months Ended September 30 2013	2012
Net income	$1,862	$1,741	$5,809	$5,773
Other comprehensive income:				
Designated interest rate swaps:				
Changes in fair value	(99)	-	(39)	-
Income tax benefit	40	-	16	-
Unrealized holding loss on designated interest rate swaps	(59)	-	(23)	-
Post-retirement benefit plan:				
Amounts included in net periodic benefit cost:				
Amortization of net actuarial loss	119	203	359	473
Amortization of prior service credit	(236)	(19)	(708)	(57)
Amortization of transition obligation	-	15	-	45
Adjustment to post-retirement benefit plan	-	-	-	(1,034)
Income tax benefit (expense)	47	(80)	139	228
Change in post-retirement benefit plan	(70)	119	(210)	(345)
Other comprehensive (loss) income	(129)	119	(233)	(345)
Comprehensive income	$1,733	$1,860	$5,576	$5,428

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

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HICKORY TECH CORPORATION
CONSOLIDATED BALANCE SHEETS
(Unaudited)

(Dollars in thousands except share and per share amounts)	September 30, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$6,516	$8,305
Receivables, net of allowance for doubtful accounts of $312 and $278	22,598	22,530
Inventories	5,408	8,379
Income taxes receivable	-	596
Deferred income taxes, net	1,623	1,887
Prepaid expenses	2,610	2,092
Other	1,106	1,399
Total current assets	39,861	45,188
Investments	3,414	3,213
Property, plant and equipment	455,290	437,623
Accumulated depreciation and amortization	(273,608)	(254,664)
Property, plant and equipment, net	181,682	182,959
Other assets:		
Goodwill	29,028	29,028
Intangible assets, net	4,108	4,811
Deferred costs and other	2,865	3,105
Total other assets	36,001	36,944
Total assets	$260,958	$268,304
LIABILITIES & SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$3,191	$5,818
Extended term payable	7,520	8,115
Deferred revenue	5,415	7,362
Accrued expenses and other	8,734	10,881
Financial derivative instruments	318	-
Current maturities of long-term obligations	1,584	1,648
Total current liabilities	26,762	33,824
Long-term liabilities:		
Debt obligations, net of current maturities	134,018	135,133
Accrued income taxes	222	236
Deferred revenue	2,867	1,085
Financial derivative instruments	1,356	2,432
Accrued employee benefits and deferred compensation	12,857	12,481
Deferred income taxes	34,111	34,265

Total long-term liabilities	185,431	185,632
Total liabilities	212,193	219,456
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value, $0.10 stated value		
Shares authorized: 100,000,000		
Shares issued and outstanding: 13,553,160 in 2013 and 13,519,131 in 2012	1,355	1,352
Additional paid-in capital	16,188	15,950
Retained earnings	30,896	30,987
Accumulated other comprehensive income	326	559
Total shareholders' equity	48,765	48,848
Total liabilities and shareholders' equity	$260,958	$268,304

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

HICKORY TECH CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30	
(Dollars in thousands)	2013	2012
OPERATING ACTIVITIES:		
Net income	$5,809	$5,773
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	21,775	19,795
Asset impairment	638	-
Accrued patronage refunds	(529)	(527)
Stock based compensation expense	616	555
Loss on financial derivative instruments	83	295
Excess tax benefit	(94)	-
Other	741	1,410
Changes in operating assets and liabilities, net of effect from acquired net assets		
Receivables	(218)	(2,130)
Prepaid expenses	(518)	(810)
Inventories	3,186	2,116
Accounts payable and accrued expenses	(5,711)	(1,031)
Deferred revenue, billings and deposits	(165)	(1,511)
Income taxes	594	(643)
Other	861	330
Net cash provided by operating activities	27,068	23,622
INVESTING ACTIVITIES:		
Additions to property, plant and equipment	(21,582)	(21,761)
Broadband stimulus grant received	831	2,941
Redemption of investments	-	1,415
Acquisition of IdeaOne Telecom	-	(26,337)
Proceeds from sale of assets	134	1
Net cash used in investing activities	(20,617)	(43,741)
FINANCING ACTIVITIES:		
Borrowings on extended term payable arrangement	48,084	41,370
Payments on extended term payable arrangement	(48,679)	(34,281)
Borrowings on credit facility	-	22,000
Payments on credit facility and capital lease obligations	(1,235)	(6,753)
Proceeds from issuance of common stock	671	435
Stock repurchase	(1,275)	-
Dividends paid	(5,900)	(5,658)
Excess tax benefit	94	-
Net cash (used in) provided by financing activities	(8,240)	17,113
Net decrease in cash and cash equivalents	(1,789)	(3,006)
Cash and cash equivalents at beginning of the period	8,305	13,057

Cash and cash equivalents at the end of the period	$6,516	$10,051
Supplemental disclosure of cash flow information:		
Cash paid for interest	$4,435	$4,453
Net cash paid for income taxes	$2,986	$4,568
Non-cash investing and financing activities:		
Property, plant and equipment acquired with capital leases	$56	$90

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

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HICKORY TECH CORPORATION
Notes to Consolidated Financial Statements (Unaudited)
September 30, 2013

Note 1. Basis of Presentation and Consolidation

The accompanying unaudited consolidated financial statements of HickoryTech Corporation and its subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and disclosures normally included in annual financial statements prepared in accordance with GAAP have been omitted or condensed pursuant to such rules and regulations. In the opinion of management, the unaudited consolidated financial statements reflect all adjustments (consisting only of normal and recurring accruals) considered necessary for the fair presentation of the financial statements and present fairly the results of operations, financial position and cash flows for the interim periods presented as required by Regulation S-X, Rule 10-01. These unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto, together with the audited consolidated financial statements and notes thereto contained in our Form 10-K for the year ended December 31, 2012.

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

Our consolidated financial statements report the financial condition and results of operations for HickoryTech Corporation and its subsidiaries in three business segments: Fiber and Data, Equipment and Telecom. Intercompany transactions have been eliminated from the consolidated financial statements.

Recent Accounting Developments

In the first quarter of 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2013-02 to improve the disclosure of reclassifications out of accumulated other comprehensive income. The Update requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. Also, an entity is required to present significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income (only if the amount reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period) either on the face of the statement where net income is presented or in the notes thereto. Our adoption of this guidance did not have a material impact on our disclosures or consolidated financial statements.

In the second quarter of 2013, the FASB issued ASU 2013-11 to bring conformity in the presentation of unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. ASU 2013-11 becomes effective for us on January 1, 2014. We do not believe the adoption of this guidance will have a material impact on our consolidated financial statements or notes to the consolidated financial statements.

We reviewed other recently issued accounting pronouncements and determined they are either not applicable to our business or that no material effect is expected on our financial position, results of operations, cash flows or disclosures.

Note 2. Earnings and Dividends per Share

Basic earnings per share ("EPS") is calculated by dividing net income by the weighted average number of shares of common stock outstanding during the applicable period. Shares used in the diluted earnings per share calculation are based on the weighted average number of shares outstanding during the period increased by potentially dilutive common equivalent shares. Potentially dilutive common shares include stock options, stock subscribed under the HickoryTech Corporation Amended and Restated Employee Stock Purchase Plan ("ESPP"), retention stock awards and stock awarded under the Long-Term Executive Incentive Program ("LTEIP"). Dilution is determined using the treasury stock method. The Company does not use the two-class method to report its earnings per share. The two-class method includes an earnings allocation formula that determines earnings per share for common stock and unvested restricted stock issued under the LTEIP, which contain the right to receive dividends. However, the application of this method would result in an immaterial change in earnings per share and is therefore not presented.

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(Dollars in thousands, except share and earnings per share amounts)	Three Months Ended September 30		Nine Months Ended September 30	
	2013	2012	2013	2012
Net income	$1,862	$1,741	$5,809	$5,773
Weighted average shares outstanding	13,543,062	13,427,883	13,543,479	13,394,224
Stock options (dilutive only)	6,770	15,316	5,725	14,628
Stock subscribed (ESPP)	-	550	-	282
Retention awards	20,115	20,006	21,366	22,417
Stock subscribed (LTEIP)	22,630	21,388	23,628	21,091
Total dilutive shares outstanding	13,592,577	13,485,143	13,594,198	13,452,642
Earnings per share:				
Basic and diluted	$0.14	$0.13	$0.43	$0.43
Dividends per share	$0.145	$0.14	$0.435	$0.42

Options to purchase 72,950 and 78,900 shares for the three months ended September 30, 2013 and 2012, respectively, and 82,150 and 78,900 shares for the nine months ended September 30, 2013 and 2012, respectively, were not included in the computation of diluted EPS, because their effect on earnings per share would have been anti-dilutive.

Cash dividends are based on the number of common shares outstanding at their respective record dates. The number of shares outstanding as of the record date for the first three quarters of 2013 and 2012, respectively, are as follows:

Shares outstanding on record date	2013	2012
First quarter (February 15)	13,586,903	13,409,941
Second quarter (May 15)	13,559,043	13,479,677
Third quarter (August 15)	13,544,964	13,494,599

Dividends per share are based on the quarterly dividend per share as declared by the HickoryTech Board of Directors. HickoryTech paid dividends of $0.145 and $0.14 per share in the third quarter of 2013 and 2012, respectively. During the first nine months of 2013 and 2012, shareholders have elected to reinvest $229,000 and $223,000, respectively, of dividends into HickoryTech common stock pursuant to the HickoryTech Corporation Dividend Reinvestment Plan.

In the nine months ended September 30, 2013, we acquired and retired 124,285 shares of HickoryTech common stock. There were no share repurchases or retirements during the three months ended September 30, 2013.

Note 3. Acquisition

On March 1, 2012, we acquired IdeaOne Telecom Group, LLC for cash consideration of $26,337,000 expanding our business and broadband services in the Fargo, North Dakota market. The acquisition was funded with existing liquidity through cash reserves of $4,337,000 and $22,000,000 of term loan debt which is integrated with our senior credit facility. 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.

Note 4. Long-Lived Assets

We review long-lived assets, including intangible assets subject to amortization, for impairment if certain events or changes in circumstances indicate impairment may be present. Impairment exists if the carrying value of a long-lived asset exceeds the sum of the undiscounted future cash flows expected to result from the use and eventual disposal of the asset at the date it is tested. If the carrying value is no longer recoverable based upon the undiscounted future cash flows of the asset, an impairment equal to the difference between the carrying amount and the fair value of the asset is recognized.

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In the first quarter of 2013, an impairment test was performed in response to indicators that the carrying amount of certain customer relationship intangible assets and property, plant and equipment related to providing wireless Internet to customers in the Fargo, North Dakota market may not be recoverable due to our decision to phase out this service. During the impairment review, we determined the carrying value of these particular intangibles, property and equipment were impaired. Fair value was calculated using the income approach of valuation. The income approach utilizes the discounted cash flow method. It requires the use of estimates and judgments about the future income expected to be derived from the use or ownership of an asset.

During the nine months ended September 30, 2013, an impairment charge of $638,000 was recognized within our Fiber and Data Segment. There were no such charges in the third quarter of 2013 or in the 2012 fiscal year.

Note 5. Goodwill and Other Intangible Assets

We have goodwill in each of our reportable segments: Fiber and Data Segment goodwill resulted from our acquisitions of IdeaOne Telecom in 2012, CP Telecom in 2009 and Enventis Telecom in 2005. Equipment Segment goodwill resulted from our acquisition of Enventis Telecom in 2005 and Telecom Segment goodwill resulted from our acquisition of Heartland Telecommunications in 1997. The tax deductible portion of goodwill is $26,964,000.

(Dollars in thousands)	September 30, 2013	December 31, 2012
Fiber and Data	$ 5,384	$ 5,384
Equipment	$ 596	$ 596
Telecom	$ 23,048	$ 23,048

The components of intangible assets are as follows:

(Dollars in thousands)		September 30, 2013		December 31, 2012	
	Useful Lives	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Definite-lived intangible assets					
Customer relationships	1 - 8 years	$8,459	$ 5,888	$8,499	$ 5,368
Other intangibles	1 - 5 years	2,930	1,393	2,930	1,250
Total		$11,389	$ 7,281	$11,429	$ 6,618

In the first quarter of 2013, we reduced the carrying value of the customer relationships by $40,000. This impairment loss was directly related to our decision to no longer provide wireless Internet service in the Fargo, North Dakota market. See Note 4 "Long-Lived Assets."

Amortization expense related to the definite-lived intangible assets was $220,000 and $223,000 for the three months ended September 30, 2013 and 2012, respectively and $663,000 and $580,000 for the nine months ended September 30, 2013 and 2012, respectively.

The estimated future amortization expense of identifiable intangible assets is as follows:

(Dollars in thousands) For fiscal years ending December 31:	
Remainder of fiscal 2013	$220

2014	749
2015	616
2016	565
2017	554
2018	554
Thereafter	850

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Note 6. Fair Value of Financial Instruments

Fair value of financial and non-financial assets and liabilities is the price that would be received for an asset or paid to transfer a liability (exit price) in an orderly transaction between market participants. The three levels of the fair value hierarchy for assessing the inputs used in fair value measurements are as follows:

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

The highest priority is given to quoted prices in active markets for identical assets and liabilities (Level 1) and the lowest priority is given to unobservable inputs (Level 3).

The carrying value of cash and cash equivalents, net accounts receivables, payables, and other short-term monetary assets and liabilities was estimated by management to approximate fair value due to the relatively short period of time to maturity for these instruments.

Our long-term debt agreement allows us to select short-term LIBOR pricing options, which we have elected. Therefore, the carrying amounts of our long-term debt approximate its fair value. The fair value estimate of our interest rate swaps represent the net present value of future cash flows based on projections of the three-month LIBOR rate over the life of each swap. It also incorporates credit valuation adjustments to appropriately reflect both our own non-performance risk and the non-performance risk of the respective counterparties. See Note 8 "Financial Derivative Instruments" for further discussion regarding our interest rate swaps.

The carrying amount and the fair value of our long-term debt, after deducting current maturities, interest rate swaps and our investments are as follows at September 30, 2013 and December 31, 2012:

(Dollars in thousands)		September 30, 2013		December 31, 2012	
	Input Level	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term debt	2	$134,018	$134,018	$135,133	$135,133
Interest rate swaps	2	$1,674	$1,674	$2,432	$2,432
Investments	3	$3,414	n/a	$3,213	n/a

Our investments at September 30, 2013 and December 31, 2012 consist primarily of minority positions in various cooperatives and our investment in CoBank, ACB ("CoBank") and are accounted for under the cost method. CoBank is a cooperative bank owned by its customers, which is a lender in our credit facility. Annually, CoBank distributes patronage based on our outstanding debt balance with them; therefore, our investment represents the accumulation of the equity patronage paid to us by CoBank. All of these investment holdings result from patronage and our business relationship with various banks and vendors. It is impractical to determine fair value of these investments because there is no established market for these equity interests. We did not evaluate any of the investments for impairment during the three or nine months ended September 30, 2013 as there were no events or changes in circumstances indicating impairment may be present.

Note 7. Debt and Other Obligations

Our long-term obligations as of September 30, 2013 and December 31, 2012 were as follows:

(Dollars in thousands)	September 30, 2013	December 31, 2012
Debt (current and long-term)	$ 135,270	$ 136,335
Capital leases	332	446
Total debt	135,602	136,781
Current portion of:		
Debt	1,353	1,420
Capital leases	231	228
Current maturities of long-term obligations	1,584	1,648
Long-term debt obligations, net of current maturities	$ 134,018	$ 135,133

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On October 30, 2013 we amended our credit facility with a syndicate of banks, led by CoBank, ACB. Under the terms of the amended credit facility, we have the option to pay interest at LIBOR or at a Base Rate, as defined in the agreements, plus an applicable margin. The amendment combined the various term loan components of our previous credit facility into one term loan and extended the maturity date of the credit facility to December 31, 2019. We estimate that $1,287,000 of additional financing charges will be deferred, and $143,000 of unamortized debt issuance costs and new issuance costs are expected to be recognized in interest expense during the fourth quarter of 2013. The amendment did not change the amount of the outstanding debt. We expect our interest rate derivative contracts to maintain their designation as effective cash flow hedges. See Note 8 "Financial Derivative Instruments."

Key components of our credit facility remain. Similarly, our amended credit facility will be comprised of a $30,000,000 revolving credit component and a $135,270,000 Term Loan B component. The amendment lowered our margin by approximately 25 basis points, and based on our current leverage ratio our interest rate is 275 basis points over LIBOR.

We are required to make quarterly principal payments of approximately $338,000 on the amended term loan. The revolving credit component does not require quarterly principal payments.

The term loan component has a provision whereby we periodically receive patronage capital refunds from certain lenders. Patronage refunds are recorded as an offset to interest expense and amounted to $529,000 in the first nine months of 2013 compared to $527,000 in the first nine months of 2012.

At September 30, 2013, we are in full compliance with specified financial ratios and tests required by our credit facility. The credit facility includes allowances for continued payment of dividends and specific limits on common stock repurchases.

Our obligations under the amended credit facility are secured by a first-priority lien on the property and assets, tangible and intangible, of HickoryTech and its subsidiaries, which includes total assets with the exception of the Equipment Segment accounts receivable and inventory and assets purchased or constructed through Federal funding, reflecting the National Telecommunications Information Administration ("NTIA") Federal interest in the Broadband Technology Opportunities Program ("BTOP") grant-funded network. We have also given a first-priority pledge of the capital stock of our subsidiaries to secure the credit facility. The credit facility contains certain restrictions that, among other things, limit or restrict our ability to create liens or encumbrances; incur additional debt; issue stock; make asset sales, transfers, or dispositions; and engage in certain mergers and acquisitions; pay dividends or purchase/redeem Company stock over specified maximum values. None of these restrictions inhibit our business plan.

Note 8. Financial Derivative Instruments

We utilize interest-rate swap agreements to manage our exposure to interest rate fluctuations on a portion of our variable-interest rate debt. We have effectively changed our exposure to varying cash flows on the variable-rate portion of our debt into fixed-rate cash flows, therefore reducing the impact of interest rate changes on future cash interest payments. We do not enter into derivative instruments for any purpose other than to manage interest rate exposure. We do not engage in interest rate speculation using derivative instruments.

We account for derivatives in accordance with FASB ASC Topic 815, "Derivatives and Hedging." ASC 815 requires all derivative instruments be recorded on the balance sheet as either an asset or a liability measured at its fair value, and changes in the derivatives' fair value be recognized in earnings unless specific hedge accounting criteria are met. If a derivative is designated as a hedge, the effective portion of changes in the fair value of derivatives is recorded as a component of accumulated other comprehensive income in shareholders' equity, net of tax, which is subsequently, reclassified into earnings when the underlying hedged transaction is recognized in earnings. Amounts related to our derivatives will be reclassified from accumulated other comprehensive income to interest expense as interest payments are accrued or made on our variable rate debt. The estimated amount expected to be reclassified as an increase to interest expense within the next twelve months is $74,000 at September 30, 2013. The ineffective portion of the fair value of derivatives is recognized directly in earnings. Hedge ineffectiveness is attributable to the swaps having a non-zero fair value at the time they were designated. If we were to terminate our interest rate swap positions, any related balance in accumulated other comprehensive income would immediately be recognized in earnings or reclassified into earnings as the interest payments are made dependent on the facts and circumstances of the termination. The changes in the fair value of derivatives that are not designated as hedges are recognized immediately in earnings. As of January 1, 2013 our interest rate swaps were designated as cash flow hedging instruments. As of December 31, 2012 our interest rate swaps were not designated as hedging instruments.

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Listed below are the interest rate swap agreements outstanding as of September 30, 2013 which were designated as cash flow hedges of interest rate risk and have the effect of locking our interest rates on a portion of our existing variable interest rate debt.

Interest Rate Swap Agreement Effective Dates	Notional Amount	Rate
September 2011 - September 2014	$24,000,000	1.66%
September 2011 - March 2015	$24,000,000	1.91%
September 2011 - September 2015	$24,000,000	2.14%

The following table presents the fair value of our derivative instruments included in our Consolidated Balance Sheets as either current or long-term liabilities as of September 30, 2013 and December 31, 2012.

(Dollars in thousands)		Fair value as of September 30, 2013	December 31, 2012
Interest rate derivatives designated as cash flow hedges			
Pay-fixed swaps liabilities	Financial derivative instruments	$1,674	$ -
Interest rate derivatives not designated as cash flow hedges			
Pay-fixed swaps liabilities	Financial derivative instruments	$-	$ 2,432

The table below illustrates the effect of derivative instruments on consolidated operations for the three and nine months ended September 30, 2013 and 2012. Our derivative instruments were designated as cash flow hedges for the periods ended September 30, 2013. For the periods ended September 30, 2012 our derivative instruments were not designated as hedges.

		Three Months Ended September 30		Nine Months Ended September 30	
(Dollars in thousands)	Location of Loss	2013	2012	2013	2012
Interest rate derivatives designated as cash flow hedges					
Losses recognized on effective portion of derivative instruments	Other comprehensive income	$99	$-	$39	$-
Losses reclassified from accumulated OCI into income	Interest expense	28	-	74	-
Losses recognized in income on ineffective portion and amount excluded from effectiveness testing	Interest expense	8	-	9	-
Interest rate derivatives not designated as cash flow hedges					
Losses recognized on derivative instruments	Interest expense	$-	$131	$-	$295

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Note 9. Extended Term Payable

Enterprise Integration Services, Inc., a wholly owned subsidiary of HickoryTech, has an $18,000,000 wholesale financing agreement with a financing company to fund equipment purchases from certain approved vendors. Advances under this financing arrangement are collateralized by the inventory and accounts receivable of our Equipment Segment and a guarantee of an amount up to $2,500,000 by HickoryTech. The agreement requires Enterprise Integration Services, Inc. to maintain specific levels of collateral relative to the outstanding balance due, provide selected monthly financial information, and make all payments when due or on demand in the event of a collateral shortfall, among other requirements. A default on the financing agreement by Enterprise Integration Services, Inc. would require HickoryTech to perform under the guarantee. The financing agreement provides 60 day, interest-free payment terms for working capital and can be terminated at any time by either party. The balance outstanding under the financing arrangement was $7,520,000 and $8,115,000 at September 30, 2013 and December 31, 2012, respectively. The balance fluctuates on a quarterly basis dependent upon timing of customer orders. These balances are classified as current liabilities in the accompanying Consolidated Balance Sheets and are not considered part of our debt financing.

Note 10. Employee Post-Retirement Benefits

HickoryTech provides post-retirement health care and life insurance benefits for eligible employees. We are currently not funding these post-retirement benefits, but have accrued these liabilities. We are required to recognize the funded status of our post-retirement benefit plans on our consolidated balance sheet and recognize as a component of accumulated other comprehensive income, net of tax, the gains or losses and prior service costs or credit that arise during the period but are not recognized as components of net periodic benefit cost. Employees hired on or after January 1, 2007 are not eligible for post-retirement health care and life insurance benefits.

	Three Months Ended September 30		Nine Months Ended September 30	
(Dollars in thousands)	2013	2012	2013	2012
Components of net periodic benefit cost				
Service cost	$			