

HICKORY TECH CORP  
Form 10-Q  
October 30, 2007

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

# FORM 10-Q



(Mark One)

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

For the quarterly period ended September 30, 2007

OR

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

For the transition period from            to            .

Commission file number 0-13721

## HICKORY TECH CORPORATION

(Exact name of registrant as specified in its charter)

**Minnesota**  
(State or other jurisdiction of  
incorporation or organization)

**41-1524393**  
(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  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

The total number of shares of the registrant's common stock outstanding as of October 30, 2007: 13,276,158.

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## HICKORY TECH CORPORATION

## Consolidated Statements of Operations

(Unaudited)

| (In Thousands Except Per Share Amounts)  | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|--|-------------------------------------|-----------|------------------------------------|-----------|
|  | 2007                                | 2006      | 2007                               | 2006      |
| <b>Operating revenues:</b>   |                                     |           |                                    |           |
| Telecom sector   | \$ 18,647                           | \$ 18,698 | \$ 58,132                          | \$ 56,264 |
| Eventis sector   | 17,212                              | 13,972    | 60,256                             | 43,234    |
| Total operating revenues   | 35,859                              | 32,670    | 118,388                            | 99,498    |
| <b>Costs and expenses:</b>   |                                     |           |                                    |           |
| Cost of sales, Eventis   | 8,705                               | 7,183     | 35,578                             | 23,322    |
| Cost of services (excluding depreciation and amortization)                             | 11,137                              | 11,131    | 32,832                             | 32,468    |
| Selling, general and administrative expenses (excluding depreciation and amortization) | 5,900                               | 5,598     | 17,627                             | 17,490    |
| Depreciation   | 4,254                               | 4,235     | 13,190                             | 12,488    |
| Amortization of intangibles  | 289                                 | 293       | 867                                | 879       |
| Total costs and expenses   | 30,285                              | 28,440    | 100,094                            | 86,647    |
| Operating income   | 5,574                               | 4,230     | 18,294                             | 12,851    |
| <b>Other income/(expense):</b>   |                                     |           |                                    |           |
| Interest and other income  | 68                                  | 40        | 199                                | 109       |
| Interest expense   | (2,028)                             | (1,913)   | (6,241)                            | (5,392)   |
| Total other income/(expense)   | (1,960)                             | (1,873)   | (6,042)                            | (5,283)   |
| Income before income taxes   | 3,614                               | 2,357     | 12,252                             | 7,568     |
| Income taxes   | 1,532                               | 728       | 5,148                              | 2,819     |
| Income from continuing operations  | 2,082                               | 1,629     | 7,104                              | 4,749     |
| <b>Discontinued operations:</b>  |                                     |           |                                    |           |
| Loss from operations of discontinued component   | (12)                                | (308)     | (27)                               | (902)     |
| Income tax benefit   | (4)                                 | (124)     | (10)                               | (361)     |
| Loss from discontinued operations  | (8)                                 | (184)     | (17)                               | (541)     |
| Net income   | \$ 2,074                            | \$ 1,445  | \$ 7,087                           | \$ 4,208  |
| <b>Basic earnings per share - continuing operations</b>                                |                                     |           |                                    |           |
| Basic earnings per share - continuing operations                                       | \$ 0.16                             | \$ 0.12   | \$ 0.54                            | \$ 0.36   |
| <b>Basic loss per share - discontinued operations</b>                                  |                                     |           |                                    |           |
| Basic loss per share - discontinued operations   | \$ 0.16                             | \$ 0.11   | \$ 0.54                            | \$ 0.32   |
| <b>Basic weighted average common shares outstanding</b>                                |                                     |           |                                    |           |
| Basic weighted average common shares outstanding                                       | 13,268                              | 13,172    | 13,250                             | 13,152    |
| <b>Diluted earnings per share - continuing operations</b>                              |                                     |           |                                    |           |
| Diluted earnings per share - continuing operations                                     | \$ 0.16                             | \$ 0.12   | \$ 0.54                            | \$ 0.36   |
| <b>Diluted loss per share - discontinued operations</b>                                |                                     |           |                                    |           |
| Diluted loss per share - discontinued operations                                       | \$ 0.16                             | \$ 0.11   | \$ 0.54                            | \$ 0.32   |
| <b>Diluted weighted average common and equivalent common shares outstanding</b>        |                                     |           |                                    |           |
| Diluted weighted average common and equivalent common shares outstanding               | 13,273                              | 13,172    | 13,251                             | 13,155    |
| <b>Dividends per share</b>   |                                     |           |                                    |           |
| Dividends per share  | \$ 0.12                             | \$ 0.12   | \$ 0.36                            | \$ 0.36   |

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





## HICKORY TECH CORPORATION

## Consolidated Balance Sheets

(Unaudited)

| (In Thousands Except Per Share Amounts)                                  | September 30,<br>2007 | December 31,<br>2006 |
|--|-----------------------|----------------------|
| <b>ASSETS</b>  |                       |                      |
| Current assets:  |                       |                      |
| Cash and cash equivalents  | \$ 2,588              | \$ 84                |
| Receivables, net of allowance for doubtful accounts of \$1,049 and \$851 | 21,222                | 20,780               |
| Inventories  | 7,297                 | 11,294               |
| Deferred income taxes  | 815                   | 815                  |
| Prepaid expenses   | 1,294                 | 1,903                |
| Other  | 1,061                 | 1,662                |
| Total current assets   | 34,277                | 36,538               |
| Investments  | 3,830                 | 3,554                |
| Property, plant and equipment  | 316,083               | 309,264              |
| Less accumulated depreciation  | 164,602               | 156,429              |
| Property, plant and equipment, net                                       | 151,481               | 152,835              |
| Other assets:  |                       |                      |
| Goodwill   | 25,239                | 25,239               |
| Intangible assets, net   | 2,273                 | 3,140                |
| Financial derivative instruments   |                       | 2,489                |
| Deferred costs and other   | 2,775                 | 3,105                |
| Total other assets   | 30,287                | 33,973               |
| Total assets   | \$ 219,875            | \$ 226,900           |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                              |                       |                      |
| Current liabilities:   |                       |                      |
| Checks written in excess of available cash balances                      | \$                    | \$ 1,475             |
| Short-term financing   | 10,141                | 7,719                |
| Accounts payable   | 4,065                 | 4,211                |
| Accrued expenses   | 6,750                 | 5,826                |
| Accrued income taxes   | 347                   | 4,528                |
| Advanced billings and deposits   | 4,889                 | 3,488                |
| Current maturities of long-term obligations                              | 1,587                 | 1,560                |
| Total current liabilities  | 27,779                | 28,807               |
| Long-term liabilities:   |                       |                      |
| Debt obligations, net of current maturities                              | 127,722               | 141,529              |
| Financial derivative instruments   | 461                   |                      |
| Accrued income taxes   | 6,900                 |                      |
| Deferred income taxes  | 14,097                | 15,332               |
| Deferred revenue   | 1,505                 | 2,596                |
| Accrued employee benefits and deferred compensation                      | 8,893                 | 8,550                |
| Total long-term liabilities  | 159,578               | 168,007              |
| Total liabilities  | 187,357               | 196,814              |
| Commitments and contingencies (Note 8)                                   |                       |                      |

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Shareholders' equity:

|  |                   |            |
|--|-------------------|------------|
| Common stock, no par value, \$.10 stated value shares authorized: 100,000 Shares issued and outstanding: 13,276 in 2007 and 13,208 in 2006 | <b>1,328</b>      | 1,321      |
| Additional paid-in capital   | <b>10,757</b>     | 9,992      |
| Retained earnings  | <b>20,708</b>     | 18,323     |
| Accumulated other comprehensive income/(loss)  | <b>(275)</b>      | 450        |
| Total shareholders' equity   | <b>32,518</b>     | 30,086     |
| <br>   |                   |            |
| Total liabilities and shareholders' equity   | <b>\$ 219,875</b> | \$ 226,900 |

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

**HICKORY TECH CORPORATION**

## Consolidated Statements of Cash Flows

(Unaudited)

| (Dollars In Thousands)  | Nine Months Ended<br>September 30, |          |
|---|------------------------------------|----------|
|   | 2007                               | 2006     |
| <b>Cash flows from operating activities:</b>                                      |                                    |          |
| Net income  | \$ 7,087                           | \$ 4,208 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                    |          |
| Loss from discontinued operations   | 17                                 | 541      |
| Depreciation and amortization   | 14,057                             | 13,367   |
| Amortization of gain on sale of financial derivative instrument                   | (940)                              |          |
| Accrued patronage refunds   | (70)                               | (796)    |
| Deferred income tax provision/(benefit)   | (60)                               | 148      |
| Other   | 682                                | 566      |
| Changes in operating assets and liabilities:                                      |                                    |          |
| Receivables, net  | (688)                              | (3,884)  |
| Inventories   | 3,996                              | (5,384)  |
| Accounts payable and accrued expenses   | 718                                | (296)    |
| Deferred revenue, billings and deposits   | 310                                | 485      |
| Prepaid expenses  | 607                                | 3,531    |
| Income taxes  | 2,780                              | 1,004    |
| Other   | 1,181                              | 1,439    |
| Net cash provided by operating activities   | 29,677                             | 14,929   |
| <b>Cash flows from investing activities:</b>                                      |                                    |          |
| Additions to property, plant and equipment  | (11,388)                           | (16,773) |
| Other   | 100                                | 183      |
| Net cash used in investing activities   | (11,288)                           | (16,590) |
| <b>Cash flows from financing activities:</b>                                      |                                    |          |
| Short-term financing, net   | 2,422                              | 5,734    |
| Checks written in excess of available cash balances                               | (1,475)                            | (514)    |
| Payments of capital lease obligations   | (295)                              | (374)    |
| Repayments on credit facility   | (21,475)                           | (19,510) |
| Borrowings on credit facility   | 7,500                              | 20,500   |
| Proceeds from the sale of financial derivative instrument                         | 1,936                              |          |
| Proceeds from issuance of common stock  | 283                                | 470      |
| Dividends paid  | (4,764)                            | (4,732)  |
| Net cash provided by/(used in) financing activities                               | (15,868)                           | 1,574    |
| <b>Cash flows from discontinued operations</b>                                    |                                    |          |
| Net cash provided by/(used in) operating activities                               | (17)                               | 631      |
| Net cash used in investing activities   |                                    | (26)     |
| Net cash provided by/(used in) discontinued operations                            | (17)                               | 605      |
| Net increase in cash and cash equivalents   | 2,504                              | 518      |
| Cash and cash equivalents at beginning of period                                  | 84                                 | 601      |
| Cash and cash equivalents at end of period  | \$ 2,588                           | \$ 1,119 |
| Supplemental disclosure of cash flow information:                                 |                                    |          |

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|  |    |       |    |       |
|--|----|-------|----|-------|
| Cash paid for interest                                     | \$ | 7,033 | \$ | 5,646 |
| Net cash paid for income taxes                             | \$ | 2,375 | \$ | 1,290 |
| Non-cash investing activities:                             |    |       |    |       |
| Property, plant and equipment acquired with capital leases | \$ | 490   | \$ | 162   |

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

**HICKORY TECH CORPORATION**

**SEPTEMBER 30, 2007**

**PART 1. FINANCIAL INFORMATION**

**ITEM 1. CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

**NOTE 1 BASIS OF PRESENTATION AND CONSOLIDATION**

The accompanying unaudited condensed consolidated financial statements of Hickory Tech Corporation (HickoryTech or the Company) have been prepared in accordance with accounting principles generally accepted in the United States (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 the Company's management, the unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal and recurring accruals) considered necessary for the fair presentation of the Company's financial statements and present fairly the results of operations, financial position and cash flows of the Company for the interim periods presented as required by Regulation S-X, Rule 10-01. These unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto, together with the Company's audited consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

The preparation of financial statements in conformity with GAAP require management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures at the date of the financial statements and during the reporting period. Actual results could 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.

The condensed consolidated financial statements of HickoryTech include Hickory Tech Corporation and its subsidiaries in the following two business segments: the Telecom Sector and the Enventis Sector. All inter-company transactions have been eliminated from the consolidated financial statements.

**Cost of Sales**

Cost of sales for the Enventis Sector includes the material costs associated with the installation of products for customers.

**Cost of Services (excluding depreciation and amortization)**

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Cost of services includes all costs related to the delivery of communication services for all HickoryTech Sectors. Those operating costs include engineering, customer service, billing and collections, network monitoring and transport costs.

### Selling, General and Administrative Expenses (excluding depreciation and amortization)

Selling, general and administrative expenses include direct and indirect selling expenses, advertising, and all other general and administrative costs associated with the operations of the business.

### Reclassifications

Certain reclassifications of prior period data have been made to conform to the current period's presentation. The most significant of these reclassifications was to reclassify approximately \$1,600,000 of transport costs from cost of sales to cost of services for the first and second quarters of 2006. This reclassification resulted in reporting these costs for the Enventis Sector in a manner consistent with the remainder of the organization. These reclassifications did not affect the Company's cash flows, financial position or net income.

Recently Issued Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements . SFAS No. 157, which defines fair value, establishes a framework for measuring fair value in accordance with GAAP, and expands disclosures about fair value measurements. SFAS No. 157 will apply whenever another standard requires (or permits) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value to any new circumstances. SFAS No. 157 is effective for the calendar year 2008. The Company is currently assessing the impact of SFAS No. 157 on its results of operations, cash flows and financial condition.

In February 2007, FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 . SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 is effective for the calendar year 2008. The Company is currently assessing the impact of SFAS No. 159 on its results of operations, cash flows and financial condition.

## NOTE 2 EARNINGS AND CASH DIVIDENDS PER COMMON SHARE

Basic earnings per share (EPS) are computed by dividing net income by the weighted average number of shares of common stock outstanding during the applicable period. Shares used in the EPS dilution calculation are based on the weighted average number of shares of common stock outstanding during the period increased by potentially dilutive common shares. Potentially dilutive common shares include stock options and stock subscribed under the Hickory Tech Corporation Amended and Restated Employee Stock Purchase Plan (ESPP). Dilution is determined using the treasury stock method. The dilutive effect shown below for 2006 has been revised from what was previously reported to reflect the treasury stock method, which is consistent with the method currently applied. There was no impact to EPS due to this revision.

|                                     | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|-------------------------------------|-------------------------------------|------------|------------------------------------|------------|
|                                     | 2007                                | 2006       | 2007                               | 2006       |
| Income from continuing operations   | \$ 2,082                            | \$ 1,629   | \$ 7,104                           | \$ 4,749   |
| Loss from discontinued operations   | (8)                                 | (184)      | (17)                               | (541)      |
| Net Income                          | \$ 2,074                            | \$ 1,445   | \$ 7,087                           | \$ 4,208   |
| Weighted average shares outstanding | 13,267,649                          | 13,171,658 | 13,250,033                         | 13,152,435 |
| Stock options (dilutive only)       | 5,655                               |            | 712                                |            |
| Stock subscribed (ESPP)             |                                     | 427        |                                    | 2,353      |
| Total dilutive shares outstanding   | 13,273,304                          | 13,172,085 | 13,250,745                         | 13,154,788 |
| Earnings (loss) per share:          |                                     |            |                                    |            |
| Basic - continuing operations       | \$ 0.16                             | \$ 0.12    | \$ 0.54                            | \$ 0.36    |
| Basic - discontinued operations     | \$                                  | \$ (0.01)  | \$                                 | \$ (0.04)  |
| Diluted - continuing operations     | \$ 0.16                             | \$ 0.12    | \$ 0.54                            | \$ 0.36    |
| Diluted - discontinued operations   | \$                                  | \$ (0.01)  | \$                                 | \$ (0.04)  |

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Options to purchase 415,551 shares and 565,251 shares for the three months ended September 30, 2007 and 2006, respectively, and 415,551 shares and 502,161 shares for the nine months ended September 30, 2007 and 2006, respectively, were not included in the computation of diluted EPS, because their effect on diluted EPS would have been anti-dilutive.



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Cash dividends are based on the number of common shares outstanding at their respective record dates. Listed below is the number of shares outstanding as of the record date for the first, second and third quarters of 2007 and 2006, respectively.

| Shares outstanding on record date | 2007       | 2006       |
|-----------------------------------|------------|------------|
| First quarter (Feb. 15)           | 13,207,970 | 13,133,928 |
| Second quarter (May 15)           | 13,243,525 | 13,153,067 |
| Third quarter (August 15)         | 13,253,812 | 13,156,490 |

Dividends per share are based on the quarterly dividend per share as declared by the HickoryTech Board of Directors. HickoryTech paid dividends of \$0.12 per share for both the third quarter of 2007 and 2006, respectively.

During the first nine months of 2007 and 2006, shareholders have elected to reinvest \$179,000 and \$186,000, respectively, of dividends into HickoryTech common stock pursuant to the Hickory Tech Corporation Dividend Reinvestment Plan.

### NOTE 3 ACCUMULATED OTHER COMPREHENSIVE INCOME/(LOSS)

HickoryTech follows the provisions of SFAS No. 130, Reporting Comprehensive Income. This statement established rules for the reporting of comprehensive income and its components. In addition to net income, HickoryTech's comprehensive income includes changes in unrealized gains and losses on derivative instruments qualifying and designated as cash flow hedges and recognized Net Periodic Benefit Cost related to the Company's Post-Retirement Benefit Plans. Comprehensive income for the three months ended September 30, 2007 and 2006 was \$1,125,000 and \$847,000, respectively. Comprehensive income for the nine months ended September 30, 2007 and 2006 was \$6,362,000 and \$3,820,000, respectively.

In March 2007, the Company terminated its two outstanding interest-rate swap agreements with original maturities in June 2008, in exchange for \$1,936,000 in proceeds. Immediately following the termination of these two agreements, HickoryTech executed a new interest-rate swap agreement, effectively locking in the interest rate on \$60,000,000 of variable-interest rate debt through March 2010.

The market value of the cumulative gain or (loss) on financial derivative instruments is reported as a component of accumulated other comprehensive income (loss) in shareholders' equity and will be recognized in earnings over the term of the original swap agreement.

The following summary sets forth the components of accumulated other comprehensive income (loss), net of tax:

|                     | Unrecognized<br>Net Actuarial<br>Loss (1) | Unrecognized<br>Prior Service<br>Credit (1) | Unrecognized<br>Transition<br>Asset (1) | Unrealized<br>Gain/(Loss)<br>on Derivatives | Accumulated<br>Other<br>Comprehensive<br>Income/(Loss) |
|---------------------|---|---|---|---|--|
| December 31, 2006   | \$ (867)                                  | \$ 37                                       | \$ (217)                                | \$ 1,497                                    | \$ 450   |
| Derivative Activity |   |   |   | 123   | 123  |

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|                     |    |       |       |          |                 |
|---------------------|----|-------|-------|----------|-----------------|
| Net Periodic        |    |       |       |          |                 |
| Benefit Cost        |    | 11    | (2)   | 9        | 18              |
| March 31, 2007      | \$ | (856) | \$ 35 | \$ (208) | \$ 1,620 \$ 591 |
| Derivative Activity |    |       |       |          | 65 65           |
| Net Periodic        |    |       |       |          |                 |
| Benefit Cost        |    | 11    | (2)   | 9        | 18              |
| June 30, 2007       | \$ | (845) | \$ 33 | \$ (199) | \$ 1,685 \$ 674 |
| Derivative Activity |    |       |       |          | (967) (967)     |
| Net Periodic        |    |       |       |          |                 |
| Benefit Cost        |    | 11    | (2)   | 9        | 18              |
| September 30, 2007  | \$ | (834) | \$ 31 | \$ (190) | \$ 718 \$ (275) |

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(1) Amounts pertain to our postretirement benefit plans.

NOTE 4 ACQUISITION, DISPOSITION and DISCONTINUED OPERATIONS

Acquisition of Enventis

On December 30, 2005, HickoryTech purchased all of the capital stock of Enventis from ALLETE, Inc. The initial purchase price was \$35,500,000, paid in cash, with the possibility of further purchase price adjustments and transition costs. After purchase price adjustments, the total consideration was \$38,602,000. Enventis had no debt at the time of the acquisition and there were no contingent payments or earnouts.

The financing for the estimated \$38,602,000 total purchase consideration for Enventis, plus an additional \$8,500,000 for Enventis working capital, was obtained entirely from HickoryTech's credit agreement, as established on December 30, 2005. The credit facility is comprised of a \$30,000,000 revolving credit component, which expires on December 30, 2011 and a \$130,000,000 term loan component, which has partial maturities during its term, with a final maturity on June 30, 2013.

Disposition of Collins

Effective December 31, 2006, HickoryTech sold all of the outstanding capital stock in Collins Communications Systems Co. to Skyview Capital for an initial price of \$100,000, paid by delivery of a promissory note, plus up to \$1,650,000 of earn-out payments. Skyview repaid HickoryTech \$100,000 in February 2007. The remaining selling price is due in contingent payments payable over the next four years if financial targets are reached by Skyview. The \$100,000 mentioned above has been included in the calculation of the net loss mentioned below, while the contingent payments have not been included in the net loss. The agreement contains covenants against competition by the new owner in south-central Minnesota. HickoryTech recorded a pre-tax loss on the sale of \$3,385,000 (\$2,040,000 net of income taxes). The Collins results of operations were formerly reported in the Enterprise Solutions Sector. The consolidated statements of operations for all periods presented have been restated to reflect the Collins operations as discontinued operations.

NOTE 5 INVENTORIES

Inventory includes parts, materials and supplies stored in HickoryTech warehouses to support basic levels of service and maintenance as well as scheduled telecom sector capital projects and equipment awaiting configuration for customers. Inventory also includes parts and equipment shipped directly from vendors to customer locations while in transit and parts and equipment returned from customers which is being returned to vendors for credit, as well as maintenance contracts associated with customer sales which have not yet transferred to the customer. The inventory value in the Telecom Sector, comprised of raw materials, as of September 30, 2007 and December 31 2006 was \$3,769,000 and \$2,850,000, respectively. The inventory value in the Enventis Sector, comprised of finished goods, as of September 30, 2007 and December 31 2006, was \$3,528,000 and \$8,444,000, respectively.

Inventories are valued using the lower of cost (perpetual weighted average-cost or specific identification) or market method. HickoryTech adjusts its inventory carrying value for estimated obsolescence or unmarketable inventory to the estimated market value based upon assumptions about future demand and market conditions. As market and other conditions change, additional inventory reserves may be established at the time that the facts that give rise to the lower value become known.

NOTE 6 INTANGIBLE ASSETS

Goodwill is subject to an impairment test annually as well as upon certain events that indicate that impairment may be present. The goodwill impairment test includes two steps, the first of which requires management to determine the fair value of several of the Company's reporting units (as defined by SFAS No. 142 "Goodwill and Other Intangible Assets"). The Company determines the fair value of its reporting units by the application of a discounted cash flow analysis. Management makes estimates that are included in its discounted cash flow analysis based upon the best available information at the time that the determinations of fair value are made. If circumstances change, HickoryTech's estimates of fair value may also change and could result in a determination of additional impairment charges to reduce the carrying value of goodwill.

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The carrying value of HickoryTech's goodwill is \$25,239,000 as of September 30, 2007 and December 31, 2006.

The components of HickoryTech's other intangible assets are as follows:

| (Dollars in Thousands)                  | Useful Lives | September 30, 2007    |                          | December 31, 2006     |                          |
|---|--------------|-----------------------|--------------------------|-----------------------|--------------------------|
|   |              | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| <b>Definite-lived intangible assets</b> |              |                       |                          |                       |                          |
| Customer relationships                  | 1 - 8 years  | \$ 4,229              | \$ 2,218                 | \$ 4,229              | \$ 1,504                 |
| Other intangibles                       | 1 - 5 years  | 730                   | 468                      | 730                   | 315                      |
| <b>Total</b>                            |              | <b>\$ 4,959</b>       | <b>\$ 2,686</b>          | <b>\$ 4,959</b>       | <b>\$ 1,819</b>          |

As required by SFAS No. 142, we periodically reassess the carrying value, useful lives and classifications of identifiable assets. Amortization expense relating to the definite-lived intangible assets for the three months ended September 30, 2007 and 2006 was \$289,000 and \$293,000, respectively. Amortization expense relating to the definite-lived intangible assets for the nine months ended September 30, 2007 and 2006 was \$867,000 and \$879,000, respectively. Total estimated amortization expense for the remaining three months of 2007 and the five years subsequent to 2007 is as follows: 2007 (October 1 through December 31) - \$290,000; 2008 - \$1,127,000; 2009 - \$853,000; 2010 - \$3,000; 2011 and 2012 - \$0.

## NOTE 7 QUARTERLY SECTOR FINANCIAL SUMMARY

| <b>(Dollars In Thousands)</b>                |                |                 |                                       |                                     |    |         |
|--|----------------|-----------------|---------------------------------------|-------------------------------------|----|---------|
|  | <b>Telecom</b> | <b>Enventis</b> | <b>Corporate and<br/>Eliminations</b> | <b>HickoryTech<br/>Consolidated</b> |    |         |
| <b>Three Months Ended September 30, 2007</b> |                |                 |                                       |                                     |    |         |
| Revenue from unaffiliated customers          | \$ 18,647      | \$ 17,212       | \$                                    | \$                                  | \$ | 35,859  |
| Intersegment revenues                        | 116            | 152             |                                       | (268)                               |    |         |
| Total operating revenues                     | 18,763         | 17,364          |                                       | (268)                               |    | 35,859  |
| Depreciation and amortization                | 3,616          | 916             |                                       | 11                                  |    | 4,543   |
| Operating income/(loss)                      | 3,972          | 1,689           |                                       | (87)                                |    | 5,574   |
| Interest expense                             | (19)           |                 |                                       | (2,009)                             |    | (2,028) |
| Income taxes/(benefit)                       | 1,585          | 684             |                                       | (737)                               |    | 1,532   |
| Income/(loss) from continuing operations     | 2,376          | 1,026           |                                       | (1,320)                             |    | 2,082   |
| Identifiable assets                          | 153,074        | 57,895          |                                       | 8,906                               |    | 219,875 |
| Property, plant and equipment, net           | 116,746        | 34,575          |                                       | 160                                 |    | 151,481 |
| Capital expenditures                         | 3,345          | 1,928           |                                       | 80                                  |    | 5,353   |
| <b>Three Months Ended September 30, 2006</b> |                |                 |                                       |                                     |    |         |
| Revenue from unaffiliated customers          | \$ 18,698      | \$ 13,972       | \$                                    | \$                                  | \$ | 32,670  |
| Intersegment revenues                        | 58             |                 |                                       | (58)                                |    |         |
| Total operating revenues                     | 18,756         | 13,972          |                                       | (58)                                |    | 32,670  |
| Depreciation and amortization                | 3,781          | 732             |                                       | 15                                  |    | 4,528   |
| Operating income/(loss)                      | 3,633          | 680             |                                       | (83)                                |    | 4,230   |
| Interest expense                             | (12)           |                 |                                       | (1,901)                             |    | (1,913) |
| Income taxes/(benefit)                       | 1,448          | 274             |                                       | (994)                               |    | 728     |
| Income/(loss) from continuing operations     | 2,174          | 403             |                                       | (948)                               |    | 1,629   |
| Identifiable assets                          | 157,617        | 57,420          |                                       | 10,318                              |    | 225,355 |
| Property, plant and equipment, net           | 120,982        | 31,828          |                                       | 80                                  |    | 152,890 |
| Capital expenditures                         | 5,300          | 1,240           |                                       | (35)                                |    | 6,505   |

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| (Dollars In Thousands)                      | Telecom   | Enventis  | Corporate and Eliminations | HickoryTech Consolidated |
|---|-----------|-----------|----------------------------|--------------------------|
| <b>Nine Months Ended September 30, 2007</b> |           |           |                            |                          |
| Revenue from unaffiliated customers         | \$ 58,132 | \$ 60,256 | \$                         | \$ 118,388               |
| Intersegment revenues                       | 334       | 299       | (633)                      |                          |
| Total operating revenues                    | 58,466    | 60,555    | (633)                      | 118,388                  |
| Depreciation and amortization               | 11,318    | 2,718     | 21                         | 14,057                   |
| Operating income/(loss)                     | 14,314    | 4,718     | (738)                      | 18,294                   |
| Interest expense                            | (54)      |           | (6,187)                    | (6,241)                  |
| Income taxes/(benefit)                      | 5,732     | 1,902     | (2,486)                    | 5,148                    |
| Income/(loss) from continuing operations    | 8,551     | 2,838     | (4,285)                    | 7,104                    |
| Identifiable assets                         | 153,074   | 57,895    | 8,906                      | 219,875                  |
| Property, plant and equipment, net          | 116,746   | 34,575    | 160                        | 151,481                  |
| Capital expenditures                        | 7,279     | 4,029     | 80                         | 11,388                   |

|   | Telecom   | Enventis  | Corporate and Eliminations | HickoryTech Consolidated |
|---|-----------|-----------|----------------------------|--------------------------|
| <b>Nine Months Ended September 30, 2006</b> |           |           |                            |                          |
| Revenue from unaffiliated customers         | \$ 56,264 | \$ 43,234 | \$                         | \$ 99,498                |
| Intersegment revenues                       | 122       |           | (122)                      |                          |
| Total operating revenues                    | 56,386    | 43,234    | (122)                      | 99,498                   |
| Depreciation and amortization               | 11,070    | 2,237     | 60                         | 13,367                   |
| Operating income/(loss)                     | 11,895    | 1,978     | (1,022)                    | 12,851                   |
| Interest (expense)/benefit                  | 91        |           | (5,483)                    | (5,392)                  |
| Income taxes/(benefit)                      | 4,800     | 801       | (2,782)                    | 2,819                    |
| Income/(loss) from continuing operations    | 7,198     | 1,178     | (3,627)                    | 4,749                    |
| Identifiable assets                         | 157,617   | 57,420    | 10,318                     | 225,355                  |
| Property, plant and equipment, net          | 120,982   | 31,828    | 80                         | 152,890                  |
| Capital expenditures                        | 12,374    | 4,340     | 59                         | 16,773                   |

NOTE 8 - COMMITMENTS AND CONTINGENCIES

HickoryTech is involved in certain contractual disputes in the ordinary course of business. HickoryTech does not believe the ultimate resolution of any of these existing matters will have a material adverse effect on its financial position, results of operations or cash flows. HickoryTech did not experience any changes to material contractual obligations in the first nine months of 2007. Refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2006 for the discussion relating to commitments and contingencies.

## NOTE 9 STOCK COMPENSATION

Refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2006 for a complete description of its stock-based compensation plans.

On January 1, 2006, the Company adopted SFAS No. 123(R) (revised 2004), Share-Based Payment, (SFAS No. 123(R)), which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors, including employee stock options and employee stock purchases related to the ESPP, based on estimated fair values. SFAS No. 123(R) supersedes the Company's previous accounting under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB No. 25) for periods beginning in 2006. In March 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB No. 107) relating to SFAS No. 123(R). The Company has applied the provisions of SAB No. 107 in its adoption of SFAS No. 123(R). The Company adopted SFAS No. 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006.

Share-based compensation expense recognized under SFAS No. 123(R) for the three and nine months ended September 30, 2007 and 2006 is as follows:

|                          | Three Months Ended September 30, |              |                 |              | Nine Months Ended September 30, |              |                 |              |
|--------------------------|----------------------------------|--------------|-----------------|--------------|---------------------------------|--------------|-----------------|--------------|
|                          | Options<br>2007                  | ESPP<br>2007 | Options<br>2006 | ESPP<br>2006 | Options<br>2007                 | ESPP<br>2007 | Options<br>2006 | ESPP<br>2006 |
| Compensation expense     | \$ 21,000                        | \$ 6,000     | \$ 38,000       | \$ 4,000     | \$ 63,000                       | \$ 18,000    | \$ 116,000      | \$ 12,000    |
| Tax                      | 8,000                            |              | 16,000          |              | 25,000                          |              | 50,000          |              |
| Net compensation expense | \$ 13,000                        | \$ 6,000     | \$ 22,000       | \$ 4,000     | \$ 38,000                       | \$ 18,000    | \$ 66,000       | \$ 12,000    |

Share-based compensation expense recognized in the Company's Consolidated Statement of Operations for the first nine months of 2007 and 2006 included compensation expense for share-based payment awards granted prior to, but not yet vested as of September 30, 2007 and 2006. Compensation expense for awards granted prior to 2006 is based on the grant date fair value estimated in accordance with the fair value provisions of SFAS No. 123. Compensation expense for awards granted in 2006 and subsequent periods is determined in accordance with the provisions of SFAS No. 123(R). Historical data is used to estimate pre-vesting forfeitures. SFAS No. 123(R) requires forfeitures to be estimated at the time of the grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The Company accounted for forfeitures as they occurred for the periods prior to 2006. The cumulative adjustment for the change in accounting principle was immaterial.

The fair value of each option award is estimated on the date of the grant using a Black-Scholes option valuation model. The Company uses a seven-year period to calculate the historical volatility of its stock price for use in the valuation model. The dividend yield rate is based on the Company's current dividend payout pattern and current market price. The risk-free rate for options is based on a U.S. Treasury rate commensurate with the expected terms. The expected term of options granted is derived from historical experience and represents the period of time that options granted are expected to be outstanding.

There were no stock option awards granted during the nine months ended September 30, 2007. In September 2006, Mr. John W. Finke, current Chief Executive Officer, received a one-time grant of 15,000 options associated with his acceptance of the Chief Executive Officer position. The Stock Award Plan provides for the issuance of stock options, however, no current compensation programs have options as a component. The weighted average grant date fair value for options granted in 2006 was \$1.43.





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As of September 30, 2007 there was \$35,000 of total unrecognized compensation costs related to non-vested stock options granted under the Company's Stock Award Plan. This expense is expected to be recognized over a weighted average period of 2 years.

A summary of stock option activity is as follows:

|                                   | Shares   | Weighted Average<br>Exercise Price |
|-----------------------------------|----------|------------------------------------|
| Outstanding at January 1, 2007    | 515,884  | \$ 12.75                           |
| Granted                           |          |                                    |
| Exercised                         |          |                                    |
| Forfeited                         | (499)    | 10.76                              |
| Expired                           | (29,834) | 11.43                              |
| Outstanding at September 30, 2007 | 485,551  | \$ 12.83                           |
| Exercisable at September 30, 2007 | 460,721  | \$ 13.02                           |

The following table provides certain information with respect to stock options outstanding at September 30, 2007:

| Range of<br>Exercise Prices | Stock Options<br>Outstanding | Weighted Average<br>Exercise Price | Weighted Average<br>Remaining<br>Contractual Life |
|-----------------------------|------------------------------|------------------------------------|---|
| \$6.00 - \$8.00             | 15,000                       | \$ 6.95                            | 8.9 years   |
| \$8.00 - \$12.00            | 182,001                      | 10.27                              | 5.7 years   |
| \$12.00 - \$16.00           | 230,050                      | 13.87                              | 3.3 years   |
| \$16.00 - \$21.00           | 58,500                       | 18.21                              | 3.5 years   |
|                             | 485,551                      | \$ 12.83                           | 4.4 years   |
| Aggregate intrinsic value:  | \$ 101,100                   |                                    |   |

The following table provides certain information with respect to stock options exercisable at September 30, 2007:

| Range of<br>Exercise Prices | Stock Options<br>Exercisable | Weighted Average<br>Exercise Price | Weighted Average<br>Remaining<br>Contractual Life |
|-----------------------------|------------------------------|------------------------------------|---|
| \$6.00 - \$8.00             | 5,000                        | \$ 6.95                            | 8.9 years   |
| \$8.00 - \$12.00            | 167,171                      | 10.22                              | 5.5 years   |
| \$12.00 - \$16.00           | 230,050                      | 13.87                              | 3.3 years   |
| \$16.00 - \$21.00           | 58,500                       | 18.21                              | 3.5 years   |
|                             | 460,721                      | \$ 13.02                           | 4.2 years   |
| Aggregate intrinsic value:  | \$ 73,700                    |                                    |   |

As of September 30, 2007, the following amount of shares, were available for each stock-based compensation plan:

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|                                       |         |
|---------------------------------------|---------|
| Employee Stock Purchase Plan          | 486,208 |
| Retainer Stock Plan for Directors     | 232,211 |
| Non-Employee Directors Incentive Plan | 190,000 |
| Stock Award Plan                      | 983,644 |

Shares issued under stock-based compensation plans are as follows:

|  | <b>For Three Months Ended<br/>September 30, 2007</b> |               | <b>For Nine Months Ended<br/>September 30, 2007</b> |               |
|--|--|---------------|---|---------------|
| Retainer Stock Plans for Directors       |  | 1,664 shares  |   | 4,133 shares  |
| market price/fair value at time of grant | \$   | 9.77          | \$  | 7.86          |
| Employee Stock Purchase Plan             |  | 13,792 shares |   | 13,792 shares |
| market price/fair value at time of grant | \$   | 8.87          | \$  | 8.87          |
| Stock Award Plan                         |  | 1,000 shares  |   | 37,044 shares |
| market price/fair value at time of grant | \$   | 9.22          | \$  | 7.25          |

#### NOTE 10 FINANCIAL DERIVATIVE INSTRUMENTS

HickoryTech uses financial derivative instruments to manage its overall exposure to fluctuations in interest rates. HickoryTech accounts for derivative instruments in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 149, *Amendment of Statement 133 Accounting for Derivative Instruments and Hedging Activities*, which requires derivative instruments to be recorded on the balance sheet at fair value. Changes in fair value of derivative instruments must be recognized in earnings unless specific hedge accounting criteria are met, in which case the gains and losses are included in other comprehensive income rather than in earnings.

The Company utilizes interest-rate swap agreements that qualify as cash-flow hedges to manage its exposure to interest rate fluctuations on a portion of the Company's variable-interest rate debt. In March 2007 the Company terminated its two outstanding interest-rate swap agreements, with original maturities of June 2008, in exchange for \$1,936,000 in proceeds. Proceeds of \$940,000 were recognized as an offset to interest expense in the first, second and third quarters of 2007. The remaining proceeds will be recognized as an offset to interest expense over the remaining original term of the agreements, a period of nine months, ending in June 2008. Immediately following the termination of the two swap agreements discussed above, HickoryTech executed a new interest-rate swap agreement, effectively locking in the interest rate on \$60,000,000 of variable-interest rate debt through March, 2010.

The market value of the cumulative gain or (loss) on financial derivative instruments is reported as a component of accumulated other comprehensive income (loss) in shareholders' equity and will be recognized in earnings over the term of the swap agreement. The fair value of HickoryTech's derivatives at September 30, 2007 and December 31, 2006 is a net liability of \$461,000 and a net asset of \$2,489,000, respectively.

## NOTE 11 EMPLOYEE POST-RETIREMENT BENEFITS

HickoryTech provides post-retirement health care and life insurance benefits for certain employees. HickoryTech accounts for these post-retirement benefits in accordance with SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans* an amendment of FASB Statements No. 87, 88, 106 and 132(R). New employees hired on or after January 1, 2007 are not eligible for post-retirement health care and life insurance benefits.

| (Dollars in Thousands)                  | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |        |
|---|-------------------------------------|--------|------------------------------------|--------|
|   | 2007                                | 2006   | 2007                               | 2006   |
| Components of net periodic benefit cost |                                     |        |                                    |        |
| Service cost                            | \$ 71                               | \$ 81  | \$ 213                             | \$ 243 |
| Interest cost                           | 114                                 | 107    | 342                                | 321    |
| Expected return on plan assets          |                                     |        |                                    |        |
| Amortization of transition obligation   | 15                                  | 15     | 45                                 | 45     |
| Amortization of prior service cost      | (3)                                 | (3)    | (9)                                | (9)    |
| Recognized net actuarial loss           | 18                                  | 31     | 54                                 | 93     |
| Net periodic benefit cost               | \$ 215                              | \$ 231 | \$ 645                             | \$ 693 |

|   | September 30, 2007 |     |
|---|--------------------|-----|
| Employer's contributions for current premiums                   |                    |     |
| Contributions made for the nine months ended September 30, 2007 | \$                 | 202 |
| Expected contributions for remainder of 2007                    |                    | 68  |
| Total estimated employer contributions for fiscal year 2007     | \$                 | 270 |

## NOTE 12 - INCOME TAXES

The effective income tax rate from continuing operations of approximately 42.4% for the third quarter of 2007 and 37.2% for the third quarter of 2006 exceeds the federal statutory rate primarily due to state income taxes and accrued interest expense on unrecognized tax benefits. The change in effective tax rate from 2006 to 2007 is the result of interest accrued on uncertain tax positions according to FASB Interpretation No. 48 (FIN No. 48) *Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109*, and a one time reversal of a tax reserve in 2006.

HickoryTech adopted the provisions of FIN No. 48 on January 1, 2007. Among other things, FIN No. 48 provides guidance to address uncertainty in tax positions and clarifies the accounting for income taxes by prescribing a minimum recognition threshold which income tax positions must achieve before being recognized in the financial statements. As of the date of adoption, HickoryTech had approximately \$7,414,000 of unrecognized tax benefits. Approximately \$748,000 of the unrecognized tax benefits relate to a deferred tax asset that is fully reserved for financial reporting purposes. The unrecognized tax benefits in their entirety, if recognized, would affect the effective income tax rate in any future periods. As a result of adoption, the Company recognized a credit of approximately \$62,000 in the January 1, 2007 retained earnings balance. There have been no significant changes to these amounts during the nine months ended September 30, 2007.

The Company recognizes interest and penalties related to income tax matters as income tax expense. As of the date of the adoption, the Company had \$172,000 (net of tax) accrued for interest and nothing accrued for penalties related to tax matters. As of September 30, 2007, the

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Company has accrued \$406,000 (net of tax) for interest related to unrecognized tax benefits.

The Company files consolidated income tax returns in the United States federal jurisdiction and combined or separate income tax returns in various state jurisdictions. In general, the Company is no longer subject to United States federal income tax examinations for the years prior to 2004 and is no longer subject to examinations by state tax authorities for the years prior to 2002.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION.**

**FORWARD-LOOKING STATEMENTS**

*This Quarterly Report on Form 10-Q contains certain forward-looking statements within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Statements in this Quarterly Report on Form 10-Q that are not historical fact, are forward-looking statements that are based on our current expectations, estimates and projections about the industry in which we operate and our beliefs and assumptions. Forward-looking statements may be identified by the use of terminology such as may, will, believes, seeks, projects, expects, plans, intends, estimates, continues, should or anticipates and similar expressions. Such forward-looking statements are subject to important risks and uncertainties that could cause our future actual results to differ materially from such statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and probabilities, which are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements, whether as a result of new information, future events or otherwise. Factors that might cause such a difference include, but are not limited to, those contained in Item 1A of Part II, Risk Factors of this quarterly report on Form 10-Q and Item 1A, Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2006, which is incorporated herein by reference. The Cautionary Statement in Part I of our Annual Report on Form 10-K provides a comprehensive list of sources for risks and uncertainties, which may influence forward looking statements and is incorporated herein by reference. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date on which they were made. Except as otherwise required by federal securities law, we undertake no obligation to update any of its forward-looking statements for any reason.*

## RESULTS OF OPERATIONS

### OVERVIEW-TRENDS

We operate in two business segments: the Telecom Sector and the Enventis Sector. The Telecom Sector includes our historical rural telephone business operations, including three incumbent local exchange carriers ( ILECs ), a competitive local exchange carrier ( CLEC ) and a company providing data processing services for the telecommunications industry (National Independent Billing, Inc.).

The Enventis Sector operations are conducted through Enventis Telecom, Inc, which we acquired on December 30, 2005. Enventis provides integrated fiber network, internet protocol telephony and data services, through 1,500 route miles of fiber network serving more than 300 business customers in over 40 communities in the Upper Midwest. Enventis offers these services through two major product line offerings: Enterprise Network Services, which is a telecom equipment provision service, and Enterprise Transport Services, which is a fiber optic transmission service for wholesale and retail use by customers as well as our hosted IP telephony product.

Our consolidated revenues increased 9.8% and our income from continuing operations increased 27.8% in the three months ended September 30, 2007 compared to the three months ended September 30, 2006. Our consolidated revenues increased 19.0% and our income from continuing operations increased 49.6% in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. These substantial improvements in the results of operations were a function of improvements in both the Telecom and Enventis Sectors. Enventis Sector revenues increased 24.3% during the three months and 40.1% during the nine months ended September 30, 2007, and income more than doubled as compared to the same periods in the prior year. The Enventis Sector recorded acquisition integration costs of approximately \$550,000 and \$1,650,000 in the three and nine months ended September 30, 2006, respectively, which did not reoccur in 2007. While the Telecom Sector revenues remained stable in the third quarter of 2007, expense reductions enabled the Telecom Sector to post a 9.3% increase in operating income for that same period. The combination of a \$1,890,000 recovery from a switched access dispute with a large interexchange carrier in the second quarter of 2007, as well as expense reductions, enabled the Telecom Sector to post a 20.3% increase in operating income in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006.



Longer term, we expect local service and network access revenues in our Telecom Sector to continue to trend downward because of competition from CLECs, cable TV providers, voice over internet protocol, wireless telephone, other telephone competitors and due to reduced usage and pricing on the network access service we provide. We were largely successful in the nine months ended September 30, 2007 in offsetting this declining revenue with increased revenue from digital subscriber line (DSL) and digital TV customers. In addition, our network access revenues and Telecom margins were further impacted by a reduction in interstate network access rates that went into effect on July 1, 2007, as well as by the competitive voice services that were offered by the primary cable TV provider in Mankato, our largest market, in the third quarter of 2007. As a result, network access revenue declined 6.3% in the third quarter of 2007 compared to the third quarter of 2006. Accordingly, while we will continue to work to offset declining revenue with new services to our customers in the Telecom Sector, the trend toward decreasing profitability in this Sector may resume.

We believe that our Enventis Sector provides a platform for longer-term growth. Enventis revenues for 2006 represented a 14.1% increase over the unaudited Enventis revenues for 2005. The 2007 first quarter revenues for Enventis were 27.5% higher than those in the first quarter of 2006, the second quarter revenues were 66.3% higher than those in the second quarter of 2006 and the third quarter revenues were 24.3% higher than those in the third quarter of 2006. Enventis has provided profitable operations and recorded positive operating income in each of the seven quarters since its acquisition. The Enventis Enterprise Network Services product line is subject to cyclical highs and lows depending on customer demand. Enterprise Transport Services contains more of a recurring revenue stream and is supported by long-term contracts. Both the Enterprise Network Service and the Enterprise Transport Service product lines have shown excellent growth characteristics.

## SECTOR RESULTS OF OPERATIONS FROM CONTINUING OPERATIONS

TELECOM The following table provides a breakdown of the Telecom Sector operating results.

## TELECOM SECTOR

| (Dollars in Thousands)   | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|--|-------------------------------------|-----------|------------------------------------|-----------|
|  | 2007                                | 2006      | 2007                               | 2006      |
| Revenues before intersegment eliminations:   |                                     |           |                                    |           |
| <b>Revenues</b>  |                                     |           |                                    |           |
| Local Service  | \$ 4,247                            | \$ 4,550  | \$ 12,922                          | \$ 13,721 |
| Network Access   | 7,086                               | 7,562     | 23,823                             | 22,318    |
| Long Distance  | 1,248                               | 1,252     | 3,877                              | 3,654     |
| Data   | 1,781                               | 1,645     | 5,172                              | 4,521     |
| Internet   | 1,164                               | 1,072     | 3,420                              | 3,355     |
| Digital TV   | 581                                 | 386       | 1,606                              | 990       |
| Directory  | 1,037                               | 939       | 2,821                              | 2,736     |
| Message Processing & Billing   | 661                                 | 482       | 1,864                              | 1,705     |
| Intersegment   | 116                                 | 58        | 334                                | 122       |
| Other  | 842                                 | 810       | 2,627                              | 3,264     |
| Total telecom revenues   | \$ 18,763                           | \$ 18,756 | \$ 58,466                          | \$ 56,386 |
| Total Telecom revenues before intersegment eliminations:                                   |                                     |           |                                    |           |
| Unaffiliated customers   | \$ 18,647                           | \$ 18,698 | \$ 58,132                          | \$ 56,264 |
| Intersegment   | 116                                 | 58        | 334                                | 122       |
|  | 18,763                              | 18,756    | 58,466                             | 56,386    |
| Cost of services (excluding depreciation and amortization)                                 |                                     |           |                                    |           |
|  | 7,794                               | 7,818     | 22,807                             | 23,555    |
| Selling, general, and administrative expenses<br>(excluding depreciation and amortization) |                                     |           |                                    |           |
|  | 3,381                               | 3,524     | 10,027                             | 9,866     |
| Depreciation and amortization  |                                     |           |                                    |           |
|  | 3,616                               | 3,781     | 11,318                             | 11,070    |
| Operating income   | \$ 3,972                            | \$ 3,633  | \$ 14,314                          | \$ 11,895 |
| Net income   | \$ 2,376                            | \$ 2,174  | \$ 8,551                           | \$ 7,198  |
| Capital expenditures   |                                     |           |                                    |           |
|  | \$ 3,345                            | \$ 5,300  | \$ 7,279                           | \$ 12,374 |
| <u>Key metrics</u>   |                                     |           |                                    |           |
| Access lines   | 66,290                              | 68,829    |                                    |           |
| Long distance customers  | 41,259                              | 40,959    |                                    |           |
| Internet customers   | 20,911                              | 19,678    |                                    |           |
| Digital Subscriber Line customers  | 17,250                              | 15,076    |                                    |           |
| Digital TV customers   | 5,706                               | 4,254     |                                    |           |

Revenues

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Telecom Sector operating revenues before intersegment eliminations were \$18,763,000, which is \$7,000 or 0.04% higher in the three months ended September 30, 2007 compared to the three months ended September 30, 2006, and were \$58,466,000, which is 2,080,000 or 3.7% higher in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. The increase in revenues in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006 was primarily due to increases in network access, data, digital TV and long distance, offset by decreases in local service and other revenues. Without the non-recurring settlement of a switched access dispute with a large interexchange carrier (see below), which increased revenues by \$1,890,000 in the second quarter of 2007, revenues in the nine months ended September 30, 2007 would have only increased by 0.3% compared to the revenues in the nine months ended September 30, 2006.

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Local service revenue was \$4,247,000, which is \$303,000 or 6.7% lower in the three months ended September 30, 2007 compared to the three months ended September 30, 2006. Local service revenue was \$12,922,000, which is \$799,000 or 5.8% lower in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. The decrease in both periods was primarily due to a 2,539 or 3.7% decrease in access lines from September 30, 2006 to September 30, 2007. Also contributing to the decrease in local service revenues is a decline in reciprocal compensation received from wireless carriers under contract using minute-of-use pricing. Many of these contracts and their associated pricing were renegotiated in the first nine months of 2007. A higher degree of competition from ILECs, CLECs and cable TV providers serving in our markets and from wireless substitution, could impact our local service revenue in future periods.

Network access revenue was \$7,086,000, which is \$476,000 or 6.3% lower in the three months ended September 30, 2007 compared to the three months ended September 30, 2006. This decrease was primarily due to lower interstate network access rates that went into effect on July 1, 2007 and lower minutes of use (MOU). Network access revenue was \$23,823,000, which is \$1,505,000 or 6.7% higher in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. Despite the lower interstate network access rates mentioned above and lower MOUs, network access revenue increased in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006 primarily due to the settlement of a switched access dispute with a large interexchange carrier, which resulted in a non-recurring increase in revenue of \$1,890,000 in the second quarter of 2007. A combination of MOUs, carriers optimizing their network costs and lower demand for dedicated lines may negatively impact future access revenues. In addition, future federal or state access reform may provide further negative influences. As a result of FCC regulations, we receive federally administered universal service support, which represented approximately 2.3% of our total revenues for the first nine months of 2007. Network access revenues are based on tariff rates filed with federal and state regulatory authorities.

Long distance revenue was \$1,248,000, which is \$4,000 or 0.3% lower in the three months ended September 30, 2007 compared to the three months ended September 30, 2006. Despite a 300 or 0.7% increase in the customer base at September 30, 2007 compared to September 30, 2006 and higher MOUs, revenue was lower due to a higher number of customers subscribing to lower rate per-minute plans in the current period. Long distance revenue was \$3,877,000, which is \$223,000 or 6.1% higher in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. This increase was primarily due to an increase in MOUs and an increase in the long distance customer base mentioned above.

Data revenue was \$1,781,000, which is \$136,000 or 8.3% higher in the three months ended September 30, 2007 compared to the three months ended September 30, 2006, and was \$5,172,000, which is \$651,000 or 14.4% higher in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. The increase in both periods was primarily due to a \$133,000 increase in the three month period and a \$383,000 increase in the nine month period of Ethernet services to business customers. We believe that Ethernet service revenues will continue to provide growth opportunities. Expanded networking opportunities among medium and large enterprise customers are key drivers for this growth. Also contributing to the growth in data revenue was an increase in DSL customers of 2,174 or 14.4% between September 30, 2007 and September 30, 2006.

Internet revenue was \$1,164,000, which is \$92,000 or 8.6% higher in the three months ended September 30, 2007 compared to the three months ended September 30, 2006, and was \$3,420,000, which is \$65,000 or 1.9% higher in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. The increase in both periods was primarily due to an increase in Internet customers of 1,233 or 6.3% between September 30, 2007 and September 30, 2006.

Digital TV revenue was \$581,000, which is \$195,000 or 50.5% higher in the three months ended September 30, 2007 compared to the three months ended September 30, 2006 and \$1,606,000, which is \$616,000 or 62.2% higher in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. This increase was primarily the result of the offering of digital TV in three additional communities in 2006 and two additional communities in 2007, which resulted in a 1,452 or 34.1% increase in digital TV customers at September 30, 2007 compared to September 30, 2006. Also contributing to the increase in digital TV revenue was an increase in rates charged to customers of approximately 5.0%, which went into effect in April 2007.



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Directory revenue was \$1,037,000, which is \$98,000 or 10.4% higher in the three months ended September 30, 2007 compared to the three months ended September 30, 2006, and was \$2,821,000, which is \$85,000 or 3.1% higher in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. The increase in both periods was the result of increased sales of yellow-page advertising in the Company directories, which went into effect in the beginning of the third quarter of 2007.

Message processing and billing revenue was \$661,000, which is \$179,000 or 37.1% higher in the three months ended September 30, 2007 compared to the three months ended September 30, 2006, and was \$1,864,000, which is \$159,000 or 9.3% higher in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. The increase in both periods was primarily due to the recognition of \$96,000 and \$285,000 of non-recurring license fee revenue in the three and nine month periods ended September 30, 2007, compared to the three and nine month periods ended September 30, 2006, respectively. The increase in revenue in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006 was offset by a rate decrease negotiated with a carrier access billing processing customer, which resulted in reduced revenues from that customer.

Other revenue, consisting primarily of revenues from cable network services, sales of Customer Premise Equipment (CPE), circuit private lines, maintenance, and add, moves and changes was \$842,000, which is \$32,000 or 4.0% higher in the three months ended September 30, 2007 compared to the three months ended September 30, 2006. This increase was primarily due to an increase in contract service revenues of \$85,000, partially offset by the loss of \$73,000 from Project SOCRATES. Until June 2006, HickoryTech had been providing Internet access and video conferencing for Project SOCRATES, which is a distance-learning network connecting schools and libraries in a 12-county region in south central Minnesota. HickoryTech's contract with Project SOCRATES ended on June 30, 2006, although HickoryTech did provide some services for Project SOCRATES in the third quarter of 2006 as they transitioned to their new vendor.

Other revenue was \$2,627,000, which is \$637,000 or 19.5% lower in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. This decrease was primarily due to the loss of \$766,000 from Project SOCRATES (see above), partially offset by an increase in contract service revenues of \$116,000.

### Cost of Services (excluding Depreciation and Amortization)

Telecom Sector cost of services (excluding depreciation and amortization) was \$7,794,000, which is \$24,000 or 0.3% lower in the three months ended September 30, 2007 compared to the three months ended September 30, 2006, and was \$22,807,000, which is \$748,000 or 3.2% lower in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. The decrease in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006 was primarily due to a \$568,000 decrease in professional fees due to lower fees associated with the conversion of the Company's enterprise resource planning software and provisioning software, a \$551,000 decrease in contract labor largely due to the retirement of mainframe computer functions in the National Independent Billing, Inc. business in 2006 and the settlement of a switched access dispute with a large interexchange carrier in the second quarter of 2007, which resulted in the reversal of bad debt expense of \$325,000. The above decrease was offset by a \$562,000 increase in programming expense to support the increase in digital TV services and a \$374,000 increase in wages and benefits, which was the result of fewer dollars being capitalized in 2007 than in 2006 in connection with the enhancement of the Company's network infrastructure.

### Selling, General and Administrative Expenses (excluding Depreciation and Amortization)

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Telecom Sector selling, general and administrative expenses (excluding depreciation and amortization) were \$3,381,000, which is \$143,000 or 4.1% lower in the three months ended September 30, 2007 compared to the three months ended September 30, 2006. This decrease was primarily due to a \$198,000 decrease in costs used to support CPE sales. Telecom Sector selling, general and administrative expenses (excluding depreciation and amortization) were \$10,027,000, which is \$161,000 or 1.6% higher in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006.

Depreciation and Amortization

Telecom Sector depreciation and amortization were \$3,616,000, which is \$165,000 or 4.4% lower in the three months ended September 30, 2007 compared to the three months ended September 30, 2006. Telecom Sector depreciation was \$3,589,000, which is \$162,000 or 4.3% lower in the three months ended September 30, 2007 compared to the three months ended September 30, 2006. This trend is dependent on the net level of capital assets placed in service and retirements on a quarter by quarter basis. Telecom Sector amortization was \$27,000, which is \$3,000 or 10.0% lower in the three months ended September 30, 2007 compared to the three months ended September 30, 2006.

Telecom Sector depreciation and amortization were \$11,318,000, which is \$248,000 or 2.2% higher in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. Telecom Sector depreciation was \$11,238,000, which is \$259,000 or 2.4% higher in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. This increase was primarily due to an increase in fixed asset spending in 2006. Telecom Sector amortization was \$80,000, which is \$11,000 or 12.1% lower in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006.

Operating Income

Telecom Sector operating income was \$3,972,000, which is \$339,000 or 9.3% higher in the three months ended September 30, 2007 compared to the three months ended September 30, 2006. This increase was due to the \$165,000 decrease in depreciation and amortization; the \$143,000 decrease in selling, general and administrative expenses (excluding depreciation and amortization); the \$24,000 decrease in cost of services (excluding depreciation and amortization) and the \$7,000 increase in revenues, all of which are discussed above.

Telecom Sector operating income was \$14,314,000, which is a \$2,419,000 or 20.3% higher in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. This increase was due to the \$2,080,000 increase in revenues, the \$748,000 decrease in costs of services (excluding depreciation and amortization) and the \$11,000 decrease in amortization, offset by the \$259,000 increase in depreciation and the \$161,000 increase in selling, general and administrative expenses (excluding depreciation and amortization), all of which are described above.

Net Income

Telecom Sector net income from operations was \$2,376,000, which is \$202,000 or 9.3% higher in the three months ended September 30, 2007 compared to the three months ended September 30, 2006 and \$8,551,000, which is \$1,353,000 or 18.8% higher in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. This increase was primarily due to the increase in operating income mentioned above, offset by the change in taxes.



ENVENTIS The following table provides a breakdown of the Enventis Sector operating results.

### ENVENTIS SECTOR

| (Dollars in Thousands)   | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|--|-------------------------------------|-----------|------------------------------------|-----------|
|  | 2007                                | 2006      | 2007                               | 2006      |
| Revenues before intersegment eliminations:   |                                     |           |                                    |           |
| Enterprise Network Services  | \$ 12,076                           | \$ 9,741  | \$ 45,221                          | \$ 30,916 |
| Enterprise Transport Services  | 5,136                               | 4,231     | 15,035                             | 12,318    |
| Intersegment   | 152                                 |           | 299                                |           |
|  | \$ 17,364                           | \$ 13,972 | \$ 60,555                          | \$ 43,234 |
| Total Enventis revenues before intersegment eliminations:                                  |                                     |           |                                    |           |
| Unaffiliated customers   | \$ 17,212                           | \$ 13,972 | \$ 60,256                          | \$ 43,234 |
| Intersegment   | 152                                 |           | 299                                |           |
|  | 17,364                              | 13,972    | 60,555                             | 43,234    |
| Cost of sales  | 8,705                               | 7,183     | 35,578                             | 23,322    |
| Cost of services<br>(excluding depreciation and amortization)                              | 3,578                               | 3,320     | 10,562                             | 8,939     |
| Selling, general and administrative expenses,<br>(excluding depreciation and amortization) | 2,476                               | 2,057     | 6,979                              | 6,758     |
| Depreciation and amortization  | 916                                 | 732       | 2,718                              | 2,237     |
| Operating income   | \$ 1,689                            | \$ 680    | \$ 4,718                           | \$ 1,978  |
| Net income   | \$ 1,026                            | \$ 403    | \$ 2,838                           | \$ 1,178  |
| Capital expenditures   | \$ 1,928                            | \$ 1,240  | \$ 4,029                           | \$ 4,340  |

### ENVENTIS PRODUCT LINE REPORTING

| (Dollars in Thousands)   | Three Months Ended September 30, |          |                    |          | Nine Months Ended September 30, |           |                    |           |
|--|----------------------------------|----------|--------------------|----------|---------------------------------|-----------|--------------------|-----------|
|  | Network Services                 |          | Transport Services |          | Network Services                |           | Transport Services |           |
|  | 2007                             | 2006     | 2007               | 2006     | 2007                            | 2006      | 2007               | 2006      |
| Revenues before intersegment eliminations:   |                                  |          |                    |          |                                 |           |                    |           |
| Revenues   | \$ 12,076                        | \$ 9,741 | \$ 5,136           | \$ 4,231 | \$ 45,221                       | \$ 30,916 | \$ 15,035          | \$ 12,318 |
| Intersegment   |                                  |          | 152                |          |                                 |           | 299                |           |
|  | 12,076                           | 9,741    | 5,288              | 4,231    | 45,221                          | 30,916    | 15,334             | 12,318    |
| Cost of sales  | \$ 8,481                         | \$ 7,183 | \$ 224             | \$       | \$ 35,345                       | \$ 23,252 | \$ 233             | \$ 70     |
| Cost of services<br>(excluding depreciation and amortization)                              | 1,074                            | 891      | 2,504              | 2,429    | 3,254                           | 2,496     | 7,308              | 6,443     |
| Selling, general and administrative expenses,<br>(excluding depreciation and amortization) | 1,374                            | 1,169    | 1,102              | 888      | 3,643                           | 3,646     | 3,336              | 3,112     |
| Depreciation and amortization  | 128                              | 73       | 788                | 659      | 376                             | 246       | 2,342              | 1,991     |

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|                      |    |              |    |     |    |              |    |       |    |              |    |       |    |              |    |       |
|----------------------|----|--------------|----|-----|----|--------------|----|-------|----|--------------|----|-------|----|--------------|----|-------|
| Operating income     | \$ | <b>1,019</b> | \$ | 425 | \$ | <b>670</b>   | \$ | 255   | \$ | <b>2,603</b> | \$ | 1,276 | \$ | <b>2,115</b> | \$ | 702   |
| Net income           | \$ | <b>614</b>   | \$ | 251 | \$ | <b>412</b>   | \$ | 152   | \$ | <b>1,561</b> | \$ | 758   | \$ | <b>1,277</b> | \$ | 420   |
| Capital expenditures | \$ | <b>438</b>   | \$ | 60  | \$ | <b>1,490</b> | \$ | 1,180 | \$ | <b>518</b>   | \$ | 210   | \$ | <b>3,511</b> | \$ | 4,130 |

Revenues:

Enventis Sector operating revenues before intersegment eliminations were \$17,364,000, which is \$3,392,000 or 24.3% higher in the three months ended September 30, 2007 compared to the three months ended September 30, 2006. Enventis Sector operating revenues before intersegment eliminations were \$60,555,000, which is \$17,321,000 or 40.1% higher in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. The increase in both periods was primarily due to the increase in revenues in the Enterprise Network Services product line.

Enterprise Network Services revenues were \$12,076,000, which is \$2,335,000 or 24.0% higher in the three months ended September 30, 2007 compared to the three months ended September 30, 2006. This increase was largely the result of revenue recognized from a large equipment installation contract with a customer of approximately \$5,500,000. Enterprise Network Services revenues were \$45,221,000, which is \$14,305,000 or 46.3% higher in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. This increase was largely the result of revenue recognized from a large equipment installation contract with a customer of approximately \$12,100,000 and revenue recognized from a maintenance contract of approximately \$1,400,000 with another customer.

Enterprise Transport Services revenues were \$5,136,000, which is \$905,000 or 21.4% higher in the three months ended September 30, 2007 compared to the three months ended September 30, 2006. This increase was primarily due to increases in wholesale business revenues (services provided to other communications carriers) of \$808,000 and the Encompass line of business of \$134,000. Enterprise Transport Services revenues were \$15,035,000, which is \$2,717,000 or 22.1% higher in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. This increase was primarily due to increases in wholesale business revenues of \$1,692,000 and the Encompass line of business of \$382,000. Also contributing to the increase in revenues were one-time gains associated with the early termination of several customer contracts of \$264,000.

Cost of Sales

Enventis Sector cost of sales was \$8,705,000, which is \$1,522,000 or 21.2% higher in the three months ended September 30, 2007 compared to the three months ended September 30, 2006. Enventis Sector cost of sales was \$35,578,000, which is \$12,256,000 or 52.6% higher in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. The increases in both periods were primarily due to the costs incurred to support the increased revenue in the Enterprise Network Services product line. These costs are primarily equipment material costs. Labor associated with installation work is not included in this category, but is included in cost of services (excluding depreciation and amortization) described below.

Cost of Services (excluding Depreciation and Amortization)

Enventis Sector cost of services (excluding depreciation and amortization) was \$3,578,000, which is \$258,000 or 7.8% higher in the three months ended September 30, 2007 compared to the three months ended September 30, 2006. This increase was primarily due to a \$180,000 increase in circuit expenses associated with an increase in off-net revenues and a \$108,000 increase in professional fees due to external project management consulting. Offsetting the increase in cost of services was a decrease of \$63,000 in bad debt expense associated with the collection of several previously written-off customer accounts and a lower amount of bad debt accruals in the third quarter of 2007.

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Enventis Sector cost of services (excluding depreciation and amortization) was \$10,562,000, which is \$1,623,000 or 18.2% higher in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. This increase was primarily due to an \$871,000 increase in circuit expenses associated with an increase in off-net revenues and an \$847,000 increase in wages and benefits due to increased staffing. Offsetting the increase in cost of services was a decrease of \$348,000 in bad debt expense associated with the collection of several previously written-off customer accounts and a lower amount of bad debt accruals in 2007.

### Selling, General and Administrative Expenses (excluding Depreciation and Amortization)

Enventis Sector selling, general and administrative expenses (excluding depreciation and amortization) were \$2,476,000, which is \$419,000 or 20.4% higher in the three months ended September 30, 2007 compared to the three months ended September 30, 2006. This increase was primarily due to a \$238,000 increase in corporate expense allocations and a \$153,000 increase in commissions paid as a result of the increase in business activity.

Enventis Sector selling, general and administrative expenses (excluding depreciation and amortization) were \$6,979,000, which is \$221,000 or 3.3% higher in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. This increase was primarily due to a \$710,000 increase in corporate expense allocations, a \$307,000 increase in commissions paid as a result of the increase in business activity and a \$157,000 increase in computer expenses. Offsetting the increase in selling, general and administrative expenses was a \$992,000 decrease in wages and benefits which was largely the result of a decrease in retention payments made to certain employees.

The Enventis Sector recorded acquisition integration costs of approximately \$550,000 and \$1,650,000 in the three and nine months ended September 30, 2006, respectively, which did not reoccur in 2007. Without these one-time costs, Enventis Sector selling, general and administrative expenses (excluding depreciation and amortization) would have increased 64.3% and 36.6% in the three and nine months ended September 30, 2007, respectively, compared to the same periods in 2006. This substantial increase in costs was used to support the higher activity levels of the Enventis Sector operations in 2007.

#### Depreciation and Amortization

Enventis Sector depreciation and amortization were \$916,000, which is \$184,000 or 25.1% higher in the three months ended September 30, 2007 compared to the three months ended September 30, 2006. Enventis Sector depreciation was \$654,000, which is \$186,000 or 39.7% higher in the three months ended September 30, 2007 compared to the three months ended September 30, 2006. This increase was primarily due to the increase in assets placed in service in 2006 and 2007. Enventis Sector amortization was \$262,000 in the three months ended September 30, 2007 and 2006.

Enventis Sector depreciation and amortization were \$2,718,000, which is \$481,000 or 21.5% higher in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. Enventis Sector depreciation was \$1,931,000, which is \$482,000 or 33.3% higher in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. This increase was primarily due to the increase in assets placed in service in 2006 and 2007. Enventis Sector amortization was \$787,000 in the nine months ended September 30, 2007 and 2006.

#### Operating Income

Enventis Sector operating income was \$1,689,000, which is \$1,009,000 or 148.4% higher in the three months ended September 30, 2007 compared to the three months ended September 30, 2006, and was \$4,718,000, which is \$2,740,000 or 138.5% higher in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. The increase in both periods was due to the increase in revenues, offset by the increases in cost of sales, cost of services (excluding depreciation and amortization), selling, general and administrative expenses (excluding depreciation and amortization) and depreciation, all of which are described above.

#### Net Income

Enventis Sector net income was \$1,026,000, which is \$623,000 or 154.6% higher in the three months ended September 30, 2007 compared to the three months ended September 30, 2006, and was \$2,838,000, which is \$1,660,000 or 140.9% higher in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. This increase was primarily due to the increase in operating income

mentioned above, offset by the change in taxes.

INTEREST EXPENSE:

Consolidated interest expense was \$2,028,000, which is \$115,000 or 6.0% higher in the three months ended September 30, 2007 compared to the three months ended September 30, 2006, and was \$6,241,000, which is \$849,000 or 15.8% higher in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. These increases were primarily due to lower cooperative dividends received in 2007 from one of the Company's participating lenders. Cooperative dividends are accounted for as an offset to interest expense when earned. In addition, the Company's effective interest rate is also higher in 2007 than 2006. The previously mentioned reasons offset the fact that the Company's outstanding debt balance is lower in 2007 than 2006.

The outstanding balance of the revolving credit facility was \$128,725,000 at September 30, 2007 and \$142,700,000 at December 31, 2006. The interest expense level of future quarters, while not affected by the receivable change, is expected to remain at approximately the same level experienced in the second and third quarters of 2007 due to the new interest rate swap agreements initiated in March 2007. The average effective interest rate on outstanding debt was 5.92% for the three months ended September 30, 2007 compared to 5.42% for the three months ended September 30, 2006.

#### INCOME TAXES

The effective income tax rate from continuing operations of approximately 42.4% for the third quarter of 2007 and 37.2% for the third quarter of 2006 exceeds the federal statutory rate primarily due to state income taxes and interest expense accrued on unrecognized tax benefits. The change in the effective tax rate from 2006 to 2007 is the result of interest accrued on uncertain tax positions according to FASB Interpretation No. 48 (FIN No. 48), Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109, and a one time reversal of a tax reserve in 2006.

#### CONSOLIDATED INCOME FROM CONTINUING OPERATIONS

Consolidated income from continuing operations was \$2,082,000, which is \$453,000 or 27.8% higher in the three months ended September 30, 2007 compared to the three months ended September 30, 2006, and was \$7,104,000, which is \$2,355,000 or 49.6% higher in the nine month ended September 30, 2007 compared to the nine months ended September 30, 2006. The increase in both periods was primarily due to the increase in overall Company profitability, offset by the increase in income taxes.

#### LIQUIDITY AND CAPITAL RESOURCES

##### CASH FLOWS

Cash generated from operations was \$29,677,000 in the first nine months of 2007 compared to \$14,929,000 in the first nine months of 2006. Cash provided by operations in the first nine months of 2007 was primarily attributable to net income plus non-cash expenses, including depreciation and amortization of \$14,057,000. Also contributing to the increase in cash generated from operations was a decrease in inventory on hand within the Enventis sector of \$4,916,000, offset by an increase in the Telecom sector inventory of \$920,000 due to seasonal projects.

Cash generated from operations in the first nine months of 2006 was \$14,748,000 lower than the cash generated from operations in 2007. Contributing to this decrease in cash provided by operations was an increase in inventory of \$5,384,000 due to seasonal construction projects in the Telecom sector combined with increased projects in process in the Enventis sector. Also contributing to the decrease in cash provided by operations were increased outstanding accounts receivable balances in the Enventis sector as a result of the increased sales activity. The decrease in cash provided by operations was partially offset by a decrease of \$3,529,000 in prepaid inventory acquired in the Enventis acquisition.

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Cash used in investing activities was \$11,288,000 in the first nine months of 2007 compared to \$16,590,000 in the first nine months of 2006. We experienced a decrease of \$5,385,000 in capital spending, which was primarily related to reduced expenditures in our network enhancement program, which is nearly complete and a concentrated effort to focus spending on revenue generating products, services and key strategic initiatives.

Cash used in financing activities in the first nine months of 2007 was \$15,868,000 compared to cash provided by financing activities during the first nine months of 2006 of \$1,574,000. This is primarily due to continual efforts to reduce borrowings under our long-term credit facility. The total long-term credit facility balance has been reduced by \$13,975,000 in 2007 and now totals \$128,725,000 as of September 30, 2007. Also contributing to the change in net cash used in financing activities was the receipt of proceeds of \$1,936,000 relating to the termination of two outstanding interest-rate swap agreements and an increase in short-term financing of \$2,422,000, which was offset by the payment of dividends totaling \$4,764,000.



WORKING CAPITAL

Working capital (i.e. current assets minus current liabilities) was \$6,498,000 as of September 30, 2007, compared to working capital of \$7,731,000 as of December 31, 2006. The ratio of current assets to current liabilities was 1.2 to 1.0 as of September 30, 2007 and 1.3 to 1.0 as of December 31, 2006.

SHORT-TERM FINANCING ARRANGEMENT

Enventis has a \$13,000,000 credit facility with a financing company to purchase inventories from certain approved vendors. Advances under the financing arrangement are collateralized by the accounts receivable and inventory of Enventis and a guaranty of the principal indebtedness by Hickory Tech Corporation. The credit facility provides sixty-day payment terms without interest accrual for working capital and can be terminated at any time by either party. Borrowings outstanding under the credit facility were \$10,141,000 and \$7,719,000 at September 30, 2007 and December 31, 2006, respectively. These balances are classified as current liabilities in the accompanying Balance Sheet and are not considered part of the Company's debt financing.

LONG-TERM OBLIGATIONS

Long-term obligations as of September 30, 2007 were \$127,722,000 excluding current maturities of \$1,300,000 on debt and \$287,000 on capital leases. On December 30, 2005, we entered into a \$160,000,000 credit agreement with a syndicate of banks (subsequently amortized to a \$158,700,000 facility as of December 31, 2006), which amended our previous credit facility. The credit facility is comprised of a \$30,000,000 revolving credit component that expires on December 30, 2011 and a \$130,000,000 term loan component.

The term loan component is comprised of two components, which are defined as term loan B and term loan C. The outstanding principal balance of term loan B is \$108,075,000 as of September 30, 2007 and is held in varying amounts by three of the lenders in the syndicate (US Bank, GE Commercial Distribution Finance Corporation and CoBank). Under the terms of term loan B, we are required to make quarterly principal payments of \$275,000 from September 30, 2007 through December 31, 2011 with the remainder of the aggregate principal due in two payments on March 31, 2012 and June 30, 2012. The outstanding principal balance of term loan C is \$19,650,000 as of September 30, 2007 and is held entirely by Rural Telephone Finance Cooperative (RTFC). Under the terms of term loan C, we are required to make quarterly principal payments of \$50,000 on the aggregate principal amount from September 30, 2007 through December 31, 2012 with the remainder of the aggregate principal due in two payments on March 31, 2013 and June 30, 2013.

Under the terms of the revolving credit facility, any outstanding principal is payable in full on December 30, 2011. The outstanding balance of the revolving credit facility is \$1,000,000 as of September 30, 2007.

For all components of the total credit facility, interest will be payable at an applicable margin in excess of a prevailing pricing level. The prevailing pricing level will be based on a Base Rate, LIBOR Rate Loans or RTFC rate table. The prevailing rate for Base Rate Loans is the higher of Prime Rate or the Federal Funds Rate plus 0.5%. The prevailing rate for LIBOR Rate Loans is publicly available. The RTFC rate tables are established based on RTFC policies, which are not publicly available and change from time to time. The applicable margin for the revolving credit facility, term loan B and term loan C will be determined quarterly, based on our leverage ratio. The credit facility also provides

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for payment of a fee on any un-drawn commitment of the revolving credit facility and is payable quarterly. The credit facility requires us to enter into or maintain in effect, interest rate protection agreements on at least 50% of the facility's outstanding balance in order to manage our exposure to interest rate fluctuations. We continually monitor the interest rates on our bank loans and have implemented interest rate protection agreements on various portions of the overall debt outstanding for varying terms.

Our debt requires us to comply, on a consolidated basis, with specified financial ratios and tests including maximum leverage ratio, minimum interest coverage ratio and maximum capital expenditures. Our obligations under the credit facility are secured by a first-priority lien on all of our property and assets, tangible and intangible, and all of the property of our subsidiaries including, but not limited to accounts receivable, inventory, equipment and intellectual property; general intangibles, cash and proceeds of the foregoing. We have also pledged the capital stock of our subsidiaries to secure the credit facility.

Our Telecom Sector leases certain computer equipment under capital lease arrangements. During the three months ended September 30, 2007 and 2006, this Sector recorded additions to property, plant and equipment of \$490,000 and \$162,000, respectively, related to these capital lease arrangements.

#### COMMITMENTS AND CONTINGENCIES

We are involved in certain contractual disputes in the ordinary course of business. We do not believe the ultimate resolution of any of these existing matters will have a material adverse effect on our financial position, results of operations or cash flows. We did not experience any changes to material contractual obligations in the first nine months of 2007. Refer to our Annual Report on Form 10-K for the year ended December 31, 2006 for the discussion relating to commitments and contingencies.

#### OTHER

The Company has not conducted a public equity offering and operates with original equity capital, retained earnings and indebtedness in the form of bank term and revolving lines of credit.

By utilizing cash flow from operations and current cash balances, the Company feels it has adequate resources to meet its anticipated operating, capital expenditures and debt service requirements.

#### CRITICAL ACCOUNTING POLICIES

Management's discussion and analysis of financial condition and results of operations stated in this Quarterly Report on Form 10-Q are based on HickoryTech's consolidated financial statements, which have been prepared in accordance with GAAP and where applicable, conform to the accounting principles as prescribed by federal and state telephone utility regulatory authorities. We presently give accounting recognition to the actions of regulators where appropriate, as prescribed by SFAS No. 71, Accounting for the Effects of Certain Types of Regulation. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities. We believe that the application of the accounting policies, which are important to our financial position and results of operations, requires significant judgments and estimates on the part of management. A description of the critical accounting policies that we adhere to is contained in the Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2006.

#### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not have operations subject to risks of foreign currency fluctuations. We do, however, use derivative financial instruments to manage exposure to interest rate fluctuations. Our objectives for holding derivatives are to minimize interest rate risks using the most effective methods to eliminate or reduce the impact of these exposures. Variable rate debt instruments are subject to interest rate risk. In March 2007, we

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terminated two outstanding interest-rate swap agreements, with original maturities of June 2008, in exchange for \$1,936,000 in proceeds. Proceeds of \$940,000 were recognized as an offset to interest expense in the first nine months of 2007. The unrecognized portion of the proceeds is recorded as a component of accumulated other comprehensive income (loss) in shareholders' equity and will be recognized as an offset to interest expense over the remaining original term of the agreement (nine months ending in June 2008). Immediately following the termination of the two agreements discussed above, we executed a new interest-rate swap agreement, effectively locking in the interest rate on \$60,000,000 of variable-rate debt through March of 2010.

The cumulative gain or loss on current derivative instruments is reported as a component of accumulated other comprehensive income (loss) in shareholders' equity and is recognized in earnings when the term of the protection agreement is concluded. Our earnings are affected by changes in interest rates as a portion of its long-term debt has variable interest rates based on LIBOR. If interest rates for the portion of our long-term debt based on variable rates had averaged 10% more for the quarter ended September 30, 2007 our interest expense would have increased \$103,000.

**ITEM 4. CONTROLS AND PROCEDURES**

Evaluation of Disclosure Controls and Procedures.

As of the end of the period covered by this Quarterly Report on Form 10-Q (the Evaluation Date), we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, regarding the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities and Exchange Act of 1934, as amended). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this Quarterly Report, our disclosure controls and procedures were effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in applicable rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, in a manner that allows timely decisions regarding required disclosure.

There have been no changes in our internal control over financial reporting during our most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

Item 1. Legal Proceedings.

Other than routine litigation incidental to our business, including the item listed below, there are no pending material legal proceedings to which we are a party or to which any of our property is subject.

HickoryTech is investigating a potential civil dispute being discussed with a municipality regarding contract payments from HickoryTech to the municipality in support of the Company's CLEC product line. No formal dispute or claim has been filed to-date.

Item 1A. Risk Factors.

There have not been any material changes to the risk factors previously disclosed in Item 1A, Risk Factors, of our Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

Item 5. Other Information.

None.

Item 6. Exhibits Listing.

Exhibit 31.1 Certification pursuant to Rule 13a-14(a) under the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 31.2 Certification pursuant to Rule 13a-14(a) under the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 32.1 Certification pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Exhibit 32.2 Certification pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: October 30, 2007

HICKORY TECH CORPORATION

By: /s/ John W. Finke  
John W. Finke, President and Chief Executive Officer

By: /s/ David A. Christensen  
David A. Christensen, Senior Vice President and  
Chief Financial Officer