

# **LICT CORPORATION**

## **Description of Business, Management's Discussion of Operations, and Audited Financial Statements**

**2016**



**LICT Corporation is no longer required to file an Annual Report on Form 10-K with the United States Securities and Exchange Commission. In lieu thereof, LICT Corporation is providing its shareholders and the financial community with enclosed financial data and analysis.**



## **DESCRIPTION OF BUSINESS**

### **BACKGROUND AND HISTORY OF LICT CORPORATION**

LICT Corporation (“LICT” or the “Company”) was incorporated under the laws of the State of Delaware in 1996 as a subsidiary of Lynch Corporation (now “LGL Group Inc.”), and was originally named Lynch Interactive Corporation. The Company was spun off from Lynch Corporation in 1999 and has been named LICT Corporation since March 2007. LICT’s executive offices are located at 401 Theodore Fremd Avenue, Rye, New York 10580-1430. Its telephone number is 914-921-8821.

The Company, together with its subsidiaries, is an integrated provider of broadband, voice and video services. On the voice side, the Company has traditionally operated as both a Rural Local Exchange Carrier (“RLEC”, an incumbent local telephone company serving a rural area) and a Competitive Local Exchange Carrier (“CLEC”, a local telecommunications provider which competes with the incumbent telephone company). It provides high speed broadband services, including internet access, through copper-based digital subscriber lines (“DSL”), fiber optic facilities, fixed wireless, and cable modems. The Company also provides a number of other services, including: video services through both traditional cable television services (“CATV”) and internet protocol television services (“IPTV”); Voice over Internet Protocol (“VoIP”); wireless voice communications; and several related telecommunications services. As used herein, “LICT” and the “Company” include our subsidiaries.

The Company’s business development strategy is to expand its existing operations through both internal growth and acquisitions. It may also, from time to time, consider the acquisition of other assets or businesses that are not directly related to its present businesses.

In 2007, we spun off shares in a wholly-owned subsidiary named CIBL, Inc. (“CIBL”) to our shareholders. In 2010, we spun off ICTC Group, Inc. (“ICTC”), which consisted of two telecommunications companies operating in North Dakota, Inter-Community Telephone Company, LLC (an RLEC) and Valley Communications, Inc. (a CLEC), to our shareholders. Both of these spin-offs have benefited the Company and the spun-off entities in a number of ways, serving to optimize their efficiency and future development.

In 2014, we sold our DFT Communications (“DFT”) subsidiary, which held the telephone companies serving Dunkirk/Fredonia and Casadaga, New York, as well as a CLEC operation. This sale generated additional liquidity for the Company and returned ownership of DFT to the Maytum family, who had originally founded the telephone companies over a century ago. As part of the transaction, we retained, and subsequently exercised, the right to acquire a 20% minority equity interest in DFT. This transaction has also benefited the Company as well as DFT and its customers.

The Company’s shares are quoted on OTC Pink<sup>®</sup> under the symbol “LICT”. The Company has approximately 85 stockholders of record. LICT disseminates quarterly and audited annual financial statements as well as press releases to its shareholders and the financial community.

### **COMMUNICATIONS OPERATIONS**

#### **Broadband Data and Voice Services**

**Organization and Locations.** We provide services through subsidiary companies. The broadband data and voice services group has been expanded through the selective acquisition of RLECs and other service providers, and by offering additional services such as broadband internet access service, long distance, cable television service, VoIP and CLEC services. Since 1989, the Company has acquired thirteen telephone companies, excluding ICTC and DFT which have been disposed of as described above. These

operations range in size from approximately 800 to over 7,000 access lines and are located in California, Illinois, Iowa, Kansas, Michigan, Nevada, New Hampshire, New Mexico, Oregon, Utah and Wisconsin. At December 31, 2016, LICT's operations were deploying 4,206 miles of fiber optic cable, 11,430 miles of copper cable, and 513 miles of coaxial cable.

## **Principal Products and Services:**

### ***Non-Regulated Services***

*Broadband and voice services.* We provide non-regulated broadband services, including internet access and data transport, in our traditional RLEC territories and adjacent areas. We also provide local telephone and other telecommunications services outside certain of our franchise areas through CLEC operations in nearby areas. The Company has established CLECs in such varied locations as Dubuque, IA; the Quad Cities area (Davenport/Bettendorf, IA and Moline/Rock Island, IL); Holton, Wichita and Topeka, KS; Escanaba, MI; Silver City and Deming, NM; Klamath Falls, OR; and Provo/Orem, UT.

*Hosted voice services.* Hosted voice services are a cost-effective, scalable alternative to traditional on-premise business telephone systems. We are currently serving 5,722 "seats". (A "seat" is the unit by which hosted voice services are sold. Seats are equivalent to the number of IP, or Internet Protocol phones, or devices, at the customer's premises that can access the hosted voice service.). We believe that this is an attractive service offering which we can deliver in large markets near our existing RLEC operations.

*Cellular backhaul and other data transport services.* We have constructed a number of fiber optic facilities to cell tower sites and are continuing to expand these facilities. This allows us to participate in the growing demand for wireless broadband services and also opens new broadband opportunities in our markets. We expect continued demand for transport services from the wireless providers as mobile data usage grows, and we have secured a number of long-term contracts that will help support our revenue growth objectives for years to come. In addition, we are experiencing significant demand from schools, health care facilities, government agencies and other public institutions for data transport, particularly at our operations in Utah and California.

*Subscription video.* We provide CATV service in our Utah, Kansas and Iowa locations, including cable modem service for high-speed internet access, and IPTV service in our New Hampshire and Iowa operations. We have 6,219 video subscribers and are considering further acquisitions as we develop this aspect of the Company's overall business.

### ***Traditional Regulated (RLEC) Services***

*Local network services.* We provide telephone wireline access services to residential and business customers in our service areas with a full range of calling features including call forwarding, conference calling, caller identification, voicemail and call waiting. We also provide broadband services, historically by means of DSL technology but increasingly by fiber optic technology, to both business and residential users. In our RLEC service territories, the broadband penetration levels of our subsidiaries are currently in the 75% range, and rank among the highest in the industry. We are continuing our efforts to increase our broadband customer base and to expand all of our broadband services. We also offer packages of telecommunications services which permit customers to bundle their basic telephone line with their choice of enhanced services, or to customize a set of selected enhanced features that fit their specific needs. As of December 31, 2016, total voice lines, including both access and CLEC but excluding hosted seats, were 33,029, comparable with 2015.

*Network access services.* We provide network access services to long distance and other carriers which involve the use of our network to originate and terminate interstate and intrastate telephone calls. Such services are generally offered on a month-to-month basis and the service is billed on a minutes-of-use basis. Access charges to long distance carriers and other customers are based on access rates filed with the Federal Communications Commission (“FCC”) for interstate services and with the respective state regulatory agencies for intrastate services.

This table summarizes certain operational data:

|   | <b>Years Ended December 31,</b> |               |               |
|---|---------------------------------|---------------|---------------|
|   | <b>2016</b>                     | <b>2015</b>   | <b>2014</b>   |
| <b>Operations:</b>                      |                                 |               |               |
| RLEC access lines <sup>(a)</sup>        | 26,680                          | 27,690        | 28,001        |
| CLEC lines                              | 6,243                           | 5,353         | 5,019         |
| <b>Total voice lines</b>                | <b>33,923</b>                   | <b>33,043</b> | <b>33,020</b> |
| % Residential                           | 75%                             | 79%           | 76%           |
| % Business                              | 25%                             | 21%           | 24%           |
| <br>                                    |                                 |               |               |
| Broadband Lines                         | 17,679                          | 17,226        | 17,274        |
| Cable Modems (Utah and Kansas)          | 10,637                          | 9,327         | 7,075         |
| Wireless                                | 1,877                           | 1,815         | 1,690         |
| <b>Total Broadband Connections</b>      | <b>30,193</b>                   | <b>28,368</b> | <b>26,039</b> |
| <br>                                    |                                 |               |               |
| Hosted voice seats <sup>(b)</sup>       | 5,722                           | 4,424         | 2,044         |
| Video subscribers                       | 6,219                           | 6,570         | 6,177         |
| <br>                                    |                                 |               |               |
| <b><u>Total Revenues</u></b>            |                                 |               |               |
| Local service                           | 9%                              | 9%            | 10%           |
| Network access                          | 43%                             | 48%           | 53%           |
| Non-Regulated businesses <sup>(c)</sup> | 48%                             | 43%           | 37%           |
| <b>Total revenues</b>                   | <b>100%</b>                     | <b>100%</b>   | <b>100%</b>   |

(a) An “access line” is a telecommunications circuit between the customer’s establishment and the central switching office.

(b) A “seat” is the unit by which we sell Hosted Voice services. Seats are equivalent to the number of IP phones or devices at the customer’s premises that can access the service.

(c) Non-Regulated Businesses include Broadband Internet, CLEC, Hosted Voice, CATV, IPTV, and several other related services.

**Expansion and Development of New Products and Services.** The Company continually seeks to introduce new services based on technological advances and expanding commercial initiatives. Our subsidiaries constantly seek to expand their service offerings beyond their regulated geographic territories, primarily by establishing and developing CLECs in adjoining or nearby areas where economically feasible. This is accomplished by: building facilities, almost entirely fiber optic cable, directly to the customer premises to provide services; and leasing facilities from the local telephone company (the serving RLEC or, in non-rural areas, the Incumbent Local Exchange Carrier or “ILEC”) or other carriers to reach customers.

As described in greater detail below, we expect future growth in operations to be derived from a broad range of activities, including the acquisition of additional telephone and communications companies; providing service to new customers, primarily through CLEC operations; providing additional and expanded services to existing customers; upgrading existing customers to higher grades of service; and by new service offerings of our RLEC and CLEC operations.

The Company also continually evaluates acquisition opportunities. We typically seek companies with local management who will remain active with their company. Telephone holding companies and others often compete aggressively for the acquisition of such properties, and the acquisitions are subject to the consent or approval of regulatory agencies on the Federal and state level. In addition, any acquisition is subject to various risks, including the ability to find and complete the transaction at an attractive price, and to successfully integrate and operate the acquired entity. Although our evaluation of potential acquisitions is ongoing, there can be no assurance that we will be able to identify suitable transactions or to conclude them successfully.

All of our current telephone companies offer broadband internet access service, either directly or through affiliated companies. At December 31, 2016, internet access customers totaled well over 30,000, compared to 28,368 at December 31, 2015, a year-over-year increase of approximately 7%. Our companies have substantially increased their numbers of broadband customers, but this growth has been offset by a decrease in our traditional telephone service resulting from a number of factors, including competition from wireless and cable companies. Affiliates of all of our telephone companies offer long distance and CLEC services. Several of our subsidiaries are providing and expanding VoIP service.

Below we offer a state-by-state review of our subsidiaries' development of new products and services:

#### *Utah*

CentraCom, based in Fairview, Utah, is successfully providing high capacity Ethernet circuits over its extensive fiber network to schools, hospitals, government users, cell towers and private business facilities. In 2015, it installed a 100Gbps backbone covering the 4 major population locations along the Wasatch front. It also continued to aggressively expand its CLEC business operations in the Provo/Orem, UT area. With a new focus on additional network interconnection opportunities and the implementation of multiple Master Agent Agreements, CentraCom was able to accomplish aggressive CLEC Enterprise customer sales goals. In addition, during 2016 CentraCom installed Ethernet backhaul services to 17 T-Mobile towers pursuant to a contract signed in 2015. CentraCom is also expanding its residential offerings by upgrading its CATV plant to an all-digital format, taking fiber to the premise in multi-tenant condominiums, and also a new subdivision of high-value properties.

#### *New Mexico*

In 2016, WNM Communications, Inc. ("Western New Mexico") continued to expand its broadband facilities in Silver City through the installation four miles of fiber optic cable and associated electronic equipment. This construction project closed a SONET communications ring in Silver City, and six more buildings were added to our "on-net" footprint there. Western New Mexico's VoIP service continued to grow rapidly with a 100% increase in year-over-year VoIP revenues. It is continuing to focus on the non-regulated side of its business in 2017.

#### *Kansas*

Giant Communications, Inc., an affiliate of J.B.N. Telephone Company, provides traditional CLEC services in Holton and other areas of northeast Kansas, with approximately 600 landline phone or VoIP subscribers,



1,200 CATV customers, and approximately 1,400 cable modem broadband subscribers. Giant also provides fixed wireless broadband to some 500 subscribers in these areas. Giant has developed a substantial hosted voice service offering in Wichita, KS, leveraging its existing soft switch, billing platform and IP connectivity. It is currently serving approximately 2,400 seats there. In 2016, Giant expanded into the metro Topeka area, where it currently serves over 400 seats and continues to expand. In addition, Giant expects to reduce its cost of revenues in these markets in 2017 by locating equipment in major Wichita and Topeka switching centers.

#### *Iowa/Illinois*

CS Technologies, Inc. (“CST”) provides CLEC services, both voice and data, in the Quad Cities and Dubuque, IA areas, primarily through its own facilities but also through UNE-L facilities. CST has begun building a metro fiber network in Dubuque and has committed to the construction of 15.7 miles of plant. CST now serves a total of approximately 1,500 CLEC customers and 3,850 lines in the Quad Cities and Dubuque.

#### *California/Oregon*

Cal-Ore Communications Inc. (“Cal-Ore”) is based in Dorris CA, with offices in Klamath Falls OR. The Company owns approximately 40 miles of fiber optic cable serving broadband customer needs. At year-end 2016, Cal-Ore had 366 active business fiber customers and approximately 1,100 VoIP customer lines which are delivered through on-net broadband connections. Cal-Ore serves a number of remote non-regulated rural locations through WiMAX wireless service. In 2017, Cal-Ore will continue to expand into new California markets including Mt. Shasta, Weed and Dunsmuir with fiber products and services targeted principally at business markets.

#### *Michigan*

Michigan Broadband Services (“MBS”) in 2016 implemented multiple NNI (Network to Network Interfaces) with three telecommunication fiber networks. These NNIs drive non-regulated fiber broadband revenues and allow MBS to bundle new services with its existing Meta Switch technology. MBS added technology called Software Defined Wide Area Network, or “SD-WAN”, to its portfolio of services offered throughout Michigan to enhance its commercial revenue opportunities. It continues to offer fiber-based Ethernet services in its regulated telephone exchanges. The MBS website was also redesigned, and now includes the ability to place an order online as well as speak directly with a customer service representative. In early 2017, began CLEC operations in Traverse City, Michigan.

#### *Geographic Operational Efficiencies*

In addition to developing new and enhanced operations, we are also planning to reap cost efficiencies by integrating internal operating and administrative service functions wherever our geography permits. We have already done this with our Iowa/Wisconsin operations and within our Kansas operations. Additionally, we are particularly attentive to potential acquisitions in geographic areas where we are currently conducting or developing our operations.

### *LICT Corporation Cautionary Note*

There is no assurance that the Company can successfully acquire or develop new businesses or make acquired or expanded businesses profitable within a reasonable period of time. New businesses, and in particular any CLEC business, would be expected to operate at a loss initially and for a period of time. In addition, competition in the CLEC and other telecommunications businesses is substantial and may increase in the future.

**Regulatory Environment.** Our subsidiaries that provide telecommunications services are subject to varying degrees of Federal and state regulation. Our operating telephone companies are regulated by the FCC with respect to interstate telecommunications services and by state regulatory agencies with respect to intrastate telecommunications services. They are also subject to local government regulation in some instances, such as the use of local streets and rights of way. The FCC and the state authorities do not regulate all providers that come under their jurisdiction in the same way. ILECs, of which RLECs are a subset, remain more highly regulated than CLECs. While some regulation of ILECs has eased as competition has increased, in general ILEC (including RLEC) regulation remains more comprehensive than the regulation of CLECs. The extent and nature of regulation, by the FCC and by states, is evolving for various reasons, such as Congressional and judicial mandates, public policy decisions and other factors.

On March 30, 2016, the FCC released an Order (“Order”) and Further Notice of Proposed Rulemaking (“FNPRM”) reforming USF (“Universal Service Fund”) support for rate-of-return carriers, including two major elements of USF known as High Cost Loop Support (“HCLS”) and Interstate Common Line Support (“ICLS”). Rate-of-return companies (including most of LICT’s subsidiaries, see *A-CAM* discussion below) were permitted to voluntarily elect to receive a fixed amount of USF support based on the Order’s new Alternative - Connect America Model (“A-CAM”) program for a ten-year period, which would replace their existing HCLS and ICLS revenues. Alternatively, carriers that do not elect A-CAM will receive support under a new Connect America Fund - Broadband Loop Support (“CAF-BLS”) mechanism that will replace ICLS and continue HCLS with certain modifications. The Order adopted differing broadband deployment milestones, service performance requirements and reporting requirements for the A-CAM and CAF/BLS programs.

For both A-CAM and CAF/BLS, the Order also reduces the allowable rate-of-return from the current 11.25 percent to 9.75 percent. For CAF/BLS companies, the reduction occurs over a six-year phased transition of 25 basis points per year from July 1, 2016 through July 1, 2021. This rate-of-return transition scheme applies for both USF and rate-making. The A-CAM program uses the 9.75 percent rate-of-return immediately.

#### *A-CAM*

A-CAM support commenced as of January 1, 2017. All of LICT’s subsidiaries that were eligible to participate in A-CAM elected to do so. These companies were Cal-Ore Telephone Company, Inc.; Central Scott Telephone Company, Inc.; Central Utah Telephone Company, Inc.; Haviland Telephone Company, Inc.; J.B.N. Telephone Company, Inc.; and Western New Mexico Telephone Company, Inc. (Belmont Telephone Company, Inc., Bretton Woods Telephone Company, Inc. and Cuba City Telephone Exchange, Inc. were not eligible for A-CAM and are participating in CAF/BLS.)

The A-CAM companies will no longer be subject to rate-of-return regulation for common line (“CL”) services and will no longer participate in the National Exchange Carrier Association’s (“NECA’s”) CL revenue pool. The Order permits these companies to remain in NECA’s tariff for access rates, however. In year eight of the A-CAM program, the FCC stated that it shall conduct a rulemaking to determine how support will be determined after the end of the 10-year period.

Carriers electing A-CAM are required to maintain voice and existing broadband service. In addition, they are required to offer at least 10/1 Mbps to the statewide total of “fully funded” locations, and at least 25/3 Mbps to a certain percentage of the fully funded locations, by the end of the 10-year support term, with deployment milestones along the way for the 10/1 Mbps locations. The split between 25/3 Mbps and 10/1 Mbps obligations depends upon housing density on a statewide basis. Carriers will also be required to offer at least 4/1 Mbps to a certain number of locations on a statewide basis that are not fully funded under the A-CAM program, and to other such locations if they meet the FCC’s “reasonable request” standard.

Under the FCC based A-CAM funding mechanisms, LICT’s operations will receive a combined fixed payment of \$23.3 million annually over the next ten years. In addition, two of our companies will receive transitional payments beginning in 2017 and ending in 2021. The transitional amounts will total \$0.5 million in 2017 and reduce by \$0.1 million per year. LICT’s A-CAM companies received \$7.4 million of ICLS revenues in 2016 and \$5.6 million of HCLS revenue in 2016 for a combined total of \$12.9 million. The FCC is also currently considering whether to increase the A-CAM funding described above, but the timing and the outcome of the FCC’s deliberations are not possible to predict.

Some of our A-CAM recipients also receive access and USF from the states in which they operate, \$6.4 million in total in 2016. Although we expect that these states will continue to support broadband deployment, it is unclear if or to what extent the state support revenues may be affected by A-CAM.

#### *Connect America Fund – Broadband Loop Support*

Three of LICT’s subsidiaries will operate under the CAF-BLS program: Bretton Woods Telephone Company, located in New Hampshire; and Belmont Telephone Company and Cuba City Telephone Exchange Company, located in Wisconsin. CAF/BLS carriers are subject to operating expense and capital expenditures limitations as well as overall budget controls in order to meet the \$2 billion annual USF support budget. There is a short transition period for carriers impacted by the operating expense cap. For CAF-BLS, new carrier-specific allowed capital expenditure amounts and five-year deployment obligations are adopted in the Order. Allowed capital expenditures are based on the extent to which the carrier has already deployed broadband, its forecasted CAF-BLS, density, a cost per location metric, and the percent a carrier is above or below the national broadband deployment average. CAF/BLS support will be eliminated for any census blocks that are determined to be served 85% or more by an unsubsidized competitor, although there is a transition period for the carriers affected. Despite the limitations and restrictions of CAF/BLS, at least initially LICT does not believe that this program will significantly reduce the revenues of any of our companies.

#### *Further Notice of Proposed Rulemaking*

Under the FNPRM issued with the Order, the FCC is considering issues relating to allowed expenses, affiliated company transactions and cost allocations for ratemaking, and USF support purposes for rate-of-return companies. The proposed rules are intended to establish measures governing prudent or reasonable expense levels for certain expense categories in order to eliminate inefficiencies and cross-subsidization. The rulemaking process is expected to be concluded in late 2016 or early 2017.

#### *Intrastate Access Revenues*

Our subsidiaries are compensated for their intrastate costs through billing and keeping intrastate access charge revenues (i.e., there are no intrastate access revenue pools). Intrastate access charge revenues are based on intrastate access rates filed with the state regulatory agency. If an ILEC subsidiary’s intrastate access charge rates were above the interstate rates at July 1, 2012, the FCC required that the company

reduce the intrastate rates so that all intrastate rates were at or below interstate rates by July 1, 2013, and with each subsequent interstate tariff filing thereafter.

#### *National Exchange Carrier Association*

For interstate services, our telephone subsidiaries participate in NECA's Common Line ("CL") and traffic sensitive ("TS") tariffs and access revenue pools. Effective in 2012, the CL and TS costs allowed for recovery from the access revenue pools were changed by the FCC so that certain costs are capped or phased down. All of our telephone subsidiaries are rural, rate-of-return companies for interstate regulatory purposes. Rate-of-return companies receive support based on their costs or the costs of similarly situated companies through formulas developed by NECA referred to as "average schedules". We have four average schedule companies and nine cost-based companies. Cost companies determine interstate revenues through cost studies computed based on the Company's own interstate costs, subject to the FCC caps and phase-downs. Interstate access revenue for rate-of-return carriers is based on an FCC regulated rate-of-return on investment, which is being reduced from 11.25% to 9.75% as described on page 6 above, and recovery of operating expenses related to interstate access. The FCC rules mandate that the CL pool earn the authorized rate-of-return, after all true-ups are completed; however, the TS pool does not have that provision. The NECA TS pool earns whatever rate-of-return the tariff rates produce given the actual demand during the year and based on the actual costs of the RLECs participating in the TS pool.

#### *Intercarrier Compensation Reform*

In 2011, the FCC issues an Order that significantly revised intercarrier compensation. ("ICC"). Prior to this ICC reform Order, the rate for ICC depended on the type of traffic at issue, the types of carriers involved, and the end points of the communications; these rules created opportunities for regulatory arbitrage as well as incentives for inefficient investment and deployment decisions. The 2011 Order provided for a reduction over the subsequent few years in the charges we received from other carriers to transport and terminate calls that originate on those carriers' networks. As a general matter, the amount and timeframe for these reductions was dependent on the nature of the traffic at issue. The 2011 Order required the transition of all terminating ICC to a default bill-and-keep arrangement by 2020, and support for the deployment of broadband services by regulated telephone companies is now provided primarily as discussed above.

#### *Eligible Telecommunication Carrier*

The FCC requires all companies receiving federal USF support to obtain designation by their state regulator annually as an eligible telecommunications carrier, or "ETC", in order to continue to receive that support. All of our subsidiaries receiving federal USF are currently designated as ETCs and we expect that they will continue to be so designated.

#### *Voice over Internet Protocol*

VoIP services are continuing to increase across the nation, including in some of the areas served by LICT companies. Competition from VoIP services could have a detrimental impact on future revenues and create additional uncertainty for us. It is not possible to predict the extent to which these complementary or substitutable services might impact our revenues. Because of the rural nature of their operations and related low population densities, our RLEC subsidiaries are generally high cost operations which receive substantial federal and state support. In at least some areas, the regulatory environment for RLEC operations is becoming less supportive than has historically been the case, which may enhance the competitive impact

of VoIP. The FCC's regulations provide that all carriers originating and terminating VoIP calls will be on equal footing in their ability to obtain compensation for this traffic.

**Competitive Developments.** In addition to the VoIP competition described above, competition in the telecommunications industry is increasing across the board. Competition in the Company's wireline telecommunications markets is growing fastest in the areas close to larger towns or metropolitan areas. All of our telephone companies have historically been monopoly wireline providers in their respective areas for local telephone exchange service, but the competitive aspect of the regulatory landscape is continually evolving. We now experience competition in most locations from long distance carriers, from cable companies for voice, data and video, from internet service providers for internet access, or from wireless carriers. Competition is resulting in a continuing loss of access lines and minutes of use, and in the conversion of retail lines to wholesale lines, which negatively affects revenues and margins from those lines. Competition also puts pressure on the prices we are able to charge for some services, particularly for some non-residential services. The total number of competitors is difficult to estimate since many of the companies do not have a local presence, but instead compete for customers via the internet using VoIP or through wireless operations. It is difficult to estimate how much traffic is lost to VoIP or wireless competitors.

**Wireless and Other Interests.** The Company has other, less than 50% owned interests, which contribute significant value to the Company.

*Modoc RSA Limited Partnership ("Modoc").* A wholly-owned subsidiary owns a 25% limited partnership interest in Modoc, which provides wireless data and voice services to California RSA No. 2. In 2016, revenues of the partnership were approximately \$23.8 million, compared to \$23.9 million in the prior year; and 2016 EBITDA was approximately \$9.8 million compare to \$9.5 million in the prior year. As of December 31, 2016, Modoc had approximately 28,700 subscribers as compared to 28,300 in the prior year. During 2016, the Company's subsidiary received \$1.95 million of cash distributions from Modoc, compared to \$2.35 million received in 2015. The 2015 distribution was affected by a lease/lease back arrangement executed by the partnership

*DFT Communications ("DFT").* A wholly-owned subsidiary owns a 20% interest in DFT, which offers Local and Long Distance Telephone Service, Business Telephone Systems, Internet Service, Security Systems, Wireless Communications and Call Center Services to areas in Western New York and portions of Pennsylvania. In 2016, DFT revenues were approximately \$13.9 million and EBITDA was approximately \$2.9 million, as compared to \$15.1 million in revenues and \$2.8 million in EBITDA in 2015.

*Iowa Network Services, Inc. ("INS").* A wholly-owned subsidiary owns 1,115 shares of INS participating preferred stock and 172 shares of INS common stock – equating to a 2.45% economic interest. INS provides wireline telecommunications access and transport services, long distance services and internet equipment and services to the exchanges of participating telephone companies and others. INS had revenues of approximately \$834 million in 2016. INS owns a minority position in Iowa Wireless Services, LLC, a cellular network operator, covering larger metropolitan areas in Iowa except for the Des Moines Basic Trading Area.

*CVIN LLC ("CVIN").* A wholly-owned subsidiary owns an interest of approximately 2.3% in CVIN, which owns and operates a fiber optic network in the Central Valley and northern areas of California. CVIN provides certain telecommunication support services to its ownership affiliates and others. In 2016, it had revenues of approximately \$14.9 million and EBITDA of approximately \$4.4 million.

*Kansas Fiber Network (“KFN”).* Two wholly-owned subsidiaries jointly own an interest of approximately 3% in KFN, a statewide fiber network which was formed in early 2009 by approximately thirty Kansas RLECs. KFN is currently providing fiber optic transport and other services to both its RLEC owners and other customers. In 2016, KFN had \$16.7 million in revenue and \$3.2 in EBITDA.

*Personal Communications Services (“PCS”) Spectrum.* In February 2005, Lynch 3G participated in the FCC’s Auction 58 for PCS Spectrum and was high bidder for two licenses, Marquette, MI, and Klamath Falls, OR, for a total cost of \$0.5 million. The licenses cover populations of 74,496 and 80,646 respectively.

A wholly-owned LICT subsidiary holds a PCS license in Clinton County, Iowa. This license was acquired as part of the acquisition of Central Scott Telephone Company, and covers a population of 11,470.

Lynch PCS Corporation G, a wholly-owned subsidiary, holds a PCS license in Las Cruces, NM which covers a population of 249,902.

*Advanced Wireless Services (AWS) Spectrum.* In September 2006, Lynch AWS Corporation participated in the FCC’s Auction No. 66 and was high bidder for an AWS license in Topeka, KS, for a cost of \$0.5 million. The license covers a population of 454,539.

We are participating in the FCC’s current wireless spectrum auction for broadcast spectrum, Auction 1002. FCC rules restrict information that bidders may disclose about their participation in this Auction, including eligibility, bidding, and payment information until the FCC has release such information. We also expect to participate in the FCC’s future spectrum auctions in order to have the flexibility to accommodate present and developing needs of existing and future customers, as well as establish high-bandwidth opportunities.

There are many risks relating to FCC wireless licenses, including without limitation the generally high cost of the licenses; the start-up nature of these businesses; the FCC’s rules imposing build-out requirements on all spectrum licenses; the need to raise substantial funds to pay for the licenses and their build-out; the decisions on how best to develop the licenses and which technology to use; the small size and limited resources of our companies compared to other potential competitors; existing and changing regulatory requirements; additional auctions of wireless telecommunications spectrum; and the challenges of actually building out and operating new businesses profitably in a highly competitive environment featuring already-established cellular telephone operators and other new licensees. There are substantial restrictions on the transfer of control of licensed spectrum. There can be no assurance that any licenses granted to entities in which subsidiaries of LICT have interests can be successfully sold, financed or developed, thereby allowing LICT’s subsidiaries to recover their debt and equity investments.

**Other Patents, Licenses, Franchises.** The Company holds other licenses of various types but it does not believe they are material to the conduct or results of its basic business and ongoing operations, which are its RLEC companies complemented by its CLEC operations.

**Environmental Compliance.** Capital expenditures, earnings and the competitive position of the Company have not been materially affected by compliance with current federal, state and local laws and regulations relating to the protection of the environment. We cannot predict the effect of future laws and regulations on its environmental compliance or the costs thereof.

**Seasonality.** No significant portion of the Company’s business regarded as seasonal. While the Company’s New Hampshire and Michigan operations’ usage varies somewhat during the year due to tourism and the presence of vacation homes, this variation is not material to LICT’s operations or results as a whole.

**Dependence on Particular Customers.** The Company does not believe that its business is dependent on any single customer or group of customers. Most ILECs, including LICT’s RLECs, received a significant amount of revenues in the form of access fees from IXCs. Bankruptcy of a significant IXC, or of several IXCs in the same period, could have a material adverse effect. We cannot predict which, if any, IXCs or other significant customers may go bankrupt in the future.

**Government Contracts.** In some instances, the Company provides service to the government under tariff and/or special contracts. Government contracts are not material to our operations as a whole and the elimination of those contracts would not significantly impact operations or financial results.

**Employees.** The Company had a total of 293 employees at December 31, 2016, including 7 corporate employees, with the remainder responsible for providing telecommunications services and support. The Company had a total of 283 employees at December 31, 2015.

#### EXECUTIVE OFFICERS

The following list of the Company’s senior executive employees as of December 31, 2016 sets forth the positions and offices with the Company held by each such person, and the principal employment by, or other service of these persons during past years.

| <u>Name</u>      | <u>Officers and Positions Held</u>  | <u>Age</u> |
|------------------|---|------------|
| Mario J. Gabelli | President and Chief Executive Officer since December 2010, Chairman since December 2004 (and also served as Chairman from September 1999 to December 2002), Vice Chairman from December 2002 to December 2004, Chief Executive Officer from September 1999 to November 2005.                        | 74         |
| Robert E. Dolan  | Executive Vice President, from December 2010, and Chief Financial Officer, from September 1999; Chief Executive Officer (Interim) from May 2006 to December 2010, and Controller from September 1999 to January 2004.   | 65         |
| Evelyn C. Jerden | Senior Vice President – Regulatory Dynamics since December 2008, Senior Vice President - Operations from September 2003 to December 2008, Vice President-Regulatory Affairs from 2002 to 2003, Director of Revenue Requirements of Western New Mexico Telephone Company, Inc. from 1992 to present. | 59         |
| James DaBramo    | Chief Operating Officer since November 2015; prior to LICT served as Founding Partner at FDN Communications 2007-1998. Executive Management Team at various Telecom Companies including Metro Access Networks 1995-1998. Held Executive Positions at Airband, IBBS and UNSi 2009-2015.              | 58         |
| Stephen J. Moore | Vice President - Finance from April 2014; prior to LICT, served as Controller North America – Poyry Management Consulting (USA) Inc. from January 2008 to October 2013, Controller at Dorian Drake International Inc. from June 1997 to December 2007.  | 52         |

John M. Aoki

Corporate Controller from April 2014; prior to LICT, served as Senior Project Manager at Denovo Ventures, LLC from 2013 to 2014, Lead Area Controller at Dean Foods Company from 2007 to 2013, Chief Financial Officer at Prolexys Pharmaceuticals Inc. from 2001 to 2006.

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The executive officers of the Company are elected annually by the Board of Directors, and hold office until the organizational meeting in the next subsequent year and until their respective successors are chosen and qualified, or until their earlier resignation or removal.

### **REAL ESTATE PROPERTIES**

The Company leases approximately 3,334 square feet of office space on customary commercial terms from an affiliate of its Chairman for its executive offices in Rye, New York. Annual lease payments are \$93,352 or \$28.00 per square foot, plus \$3.00 per square in utilities per year. There is an annual escalation adjustment and the lease expires in December 2023. In September 2014, the Company sublet 485 square foot of its corporate office space to another affiliate of the Chairman. The sublet lease expires on December 5, 2023 and the base rental rate is \$19,764 per annum.

CentraCom and its subsidiaries and affiliates own a total of 9.8 acres at sixteen sites, with an additional 3.8 acres at twenty-three sites which are under leases, permits or easements. These sites are located in the central, northeastern and Midwestern areas of Utah. CentraCom's principal operating facilities are located in Fairview, Utah, where it owns a commercial office building containing 14,400 square feet, and a plant office and central office building containing 5,200 square feet. In addition, it has 1,604 square feet of office space, 2,795 square feet of warehouse space, 6,595 square feet of vehicle maintenance facilities, 4,952 square feet of protective cover and three rental homes. CentraCom owns smaller facilities used mainly for housing central office switching equipment with a total of 11,265 square feet in 26 various locations. In addition, the company owns 1,019 miles of copper cable, 463 miles of coaxial cable and 1,202 miles of fiber optic cable running through rights-of-way within its 10,483 square mile service area.

Western New Mexico Telephone Company ("Western") owns a total of 16.9 acres at 15 sites located in southwestern New Mexico. Its principal operating facilities are located in Silver City, where Western owns one building with a total of 6,480 square feet housing its administrative offices and certain storage facilities, and another building of 216 square feet which houses core network equipment. In Cliff, New Mexico, Western owns six buildings with a total of 16,238 square feet which contain additional offices and storage facilities, as well as a vehicle shop, a fabrication shop, and central office switching equipment. Smaller facilities, used mainly for storage and for housing central office switching equipment, with a total of 9,984 square feet, are located in Lordsburg, Reserve, Magdalena and five other localities in New Mexico. In addition, Western leases 1.28 acres. It also owns and operates 13 microwave towers and 11 associated equipment buildings. Western has the use of 59 other sites under permits or easements at which it has installed various types of equipment either in small company-owned buildings (totaling 2,403 square feet) or under protective cover. Western also owns 3,944 miles of copper cable and 696 miles of fiber optic cable within its 15,000 regulated service area of approximately 15,000 square miles. In Silver City, NM, where Western operates as a CLEC, it serves eleven buildings with its own fiber optic cable or by means of fixed wireless facilities.

J.B.N. Telephone Company ("JBN") owns or leases a total of approximately 2.25 acres located in northeast Kansas. Its administrative and commercial office consisting of 7,000 square feet is located in Holton,



Kansas and a 3,000 square-foot garage/warehouse facility is located in Wetmore, Kansas. In addition, JBN owns 15 smaller facilities housing central office switching equipment and over 1,200 miles of copper cable, and with its affiliate Giant Communications, Inc., a combined 550 miles of fiber optic cable. A portion of these properties are encumbered under mortgages held by the RUS.

Haviland Telephone Company (“Haviland”) owns a total of approximately 3.9 acres at 20 sites located in south central Kansas. Its administrative and commercial office consisting of 5,500 square feet is located in Haviland, Kansas. The company owns 19 smaller facilities housing garage and warehouse facilities, along with central office switching equipment. Haviland has approximately 1,200 miles of copper cable and 577 miles of fiber optic cable.

Michigan Broadband Services (“MBS”) operates nineteen regulated telephone exchanges within the Upper and Lower Peninsulas of Michigan. MBS owns approximately 100 acres within these 19 exchanges located in the Upper and Lower Peninsulas of Michigan. MBS leases property to American Tower and owns a tower structure which generates lease revenue from a mobile operator. At its Carney, MI location MBS owns 11,200 square feet of space which is used for administrative, technical and customer service purposes. In addition, MBS owns 23 smaller facilities housing garage, warehouse and central office switching equipment. It also owns and operates 2,039 miles of copper cable as well as 547 miles of fiber optic cable. In 2017, the company will lease additional office space in a Lower Peninsula expansion market while consolidating sales operations in the Upper Peninsula.

Central Scott Telephone Company (“Central Scott”) owns 4 acres of land at 6 sites. Its main office in Eldridge, Iowa, contains 3,104 square feet of office and 341 square feet of storage space. It also has 3,360 square feet of garage space and 2,183 square feet utilized for its switching facilities. Central Scott, including its subsidiary CS Technologies, has 373 miles of copper cable, 221 miles of fiber optic cable and 111 miles of coaxial cable. All of these properties are encumbered under mortgages held by CoBank.

Cuba City Telephone Exchange Company (“Cuba City”) and Belmont Telephone Company (“Belmont”) are located in two small communities in Wisconsin. Cuba City is located in a 3,800 square-foot brick building which it owns on 0.4 acre in Cuba City. The building serves as the central office, commercial office, and garage for vehicle storage. The company also owns a 0.1 acre site with a 1,400 square foot cement block building and a 600 square foot metal building for storage of materials and equipment. Belmont is located in a cement block building of 800 square feet on 0.5 acre of land in Belmont. The building houses its central office equipment. The companies own a combined total of 329 miles of copper cable and 107 miles of fiber optic cable.

Cal-Ore Telephone Company (“Cal-Ore”) owns a total of 35.4 acres at 8 sites located in north central California. Its principal operating facilities are located in Dorris, CA, where Cal-Ore owns three buildings comprising a total of 4,727 square feet housing its administrative offices and central office switching terminals, 11,500 square feet of maintenance shop with offices and truck bays, and another building which houses record storage. Cal-Ore owns two buildings in Tulelake, CA with a total of 1,913 square feet containing business offices, central office switching terminals and storage facilities, as well as a vehicle maintenance shop of 4,450 square feet. Smaller facilities, used mainly for storage and for housing central office switching equipment, with a total of 1,893 square feet, are located in Macdoel, Tennant and Newell, CA. Cal-Ore has the use of 5 other sites under permits or easements at which it has constructed four microwave towers and installed various items of equipment either in small company owned buildings (totaling 824 square feet) or under protective cover. One of these sites is in Klamath Falls, OR. Cal-Ore also owns a total of 700 miles of copper cable and over 380 miles of fiber optic cable in California and Oregon.

Bretton Woods Telephone Co., Inc. leases approximately 2,800 square feet of business office space and garage/storage space located in Bretton Woods, New Hampshire. The company also owns two central office buildings on leased land in Bretton Woods totaling 844 square feet. The company has 29 miles of copper cable and 35 miles of fiber optic cable.

It is the Company's opinion that all of the facilities referred to above are in good operating condition and are suitable and adequate for present uses.

## **LEGAL PROCEEDINGS**

See Footnote 12 to the Company's Audited Financial Statements.

## **RISK FACTORS**

In addition to the risks noted above, any of the following risks could materially adversely affect our business, consolidated financial condition, results of operations or liquidity, or the market price of our common stock. The risks described below are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also materially and adversely affect our business operations.

### ***Risks Related to Our Indebtedness***

**To operate and expand our business, service our indebtedness and complete future acquisitions, we will require a significant amount of cash. Our ability to generate cash will depend on many factors beyond our control. We may not generate sufficient funds from operations to repay or refinance our indebtedness at maturity or otherwise, to consummate future acquisitions or to fund our operations.**

A significant amount of our cash flow from operations will be dedicated to capital expenditures and debt service. As a result, there can be no assurance that the cash that we retain will be sufficient to finance growth opportunities, including acquisitions, and we may be required to devote additional cash to unanticipated capital expenditures or to fund our operations. Our ability to make payments on our indebtedness will depend on our ability to generate cash flow from operations in the future, as well as our ability to refinance existing debt. This ability, to a certain extent, will be subject to general economic, financial, competitive, legislative, regulatory and other factors that will be beyond our control. There can be no assurance that our business will generate sufficient cash flow from operations or that future borrowings will be available to us in an amount sufficient to enable us to service our indebtedness, to make payments of principal at maturity or to fund our other liquidity needs.

We may also be forced to raise additional capital or sell assets and, if we are forced to pursue any of these options under distressed conditions, our business and the value of our common stock could be adversely affected. In addition, these alternatives may not be available to us when needed or on satisfactory terms due to prevailing market conditions, a decline in our business, legislative and regulatory factors or restrictions contained in the agreements governing our indebtedness.

**Our indebtedness could restrict our ability to pay dividends on our common stock and have an adverse impact on our financing options and liquidity position.** This indebtedness could have important adverse consequences for the holders of our common stock, including:

- limiting our ability to pay dividends on our common stock or make payments in connection with our other obligations, including under our existing credit facilities;
- limiting our ability in the future to obtain additional financing for working capital, capital expenditures or acquisitions;
- causing us to be unable to refinance our indebtedness on terms acceptable to us or at all;

- limiting our flexibility in planning for, or reacting to, changes in our business and the communications industry generally;
- requiring a significant portion of our cash flow from operations to be dedicated to the payment of interest and principal on our indebtedness, thereby reducing funds available for future operations, dividends on our common stock, capital expenditures or acquisitions;
- making us more vulnerable to economic and industry downturns and conditions, including increases in interest rates; and
- placing us at a competitive disadvantage compared to those of our competitors that have less indebtedness.

**The Company and certain of its subsidiaries are holding companies and rely on dividends, and other payments, advances and transfers of funds from operating subsidiaries and investments to meet debt service and other obligations.** The Company and certain of its subsidiaries are holding companies and conduct all of their operations through operating subsidiaries. The Company and these holding subsidiaries currently have no significant assets other than equity interests in the operating subsidiaries. As a result, the Company and these holding subsidiaries rely on dividends and other payments or distributions from operating subsidiaries to meet their debt service obligations and all of their other financial needs or requirements generally. The ability of the Company's operating subsidiaries to pay dividends or make other payments or distributions to the Company and the non-operating subsidiaries will depend on their respective operating results and may be restricted by, among other things:

- the laws of their jurisdiction of organization;
- the rules, regulations and orders of state regulatory authorities;
- agreements of those subsidiaries; and
- the terms of agreements governing indebtedness of those operating subsidiaries.

The Company's operating subsidiaries generally have no obligation, contingent or otherwise, to make funds available to the Company or its other subsidiaries, whether in the form of loans, dividends or other distributions.

**Our existing credit facilities and other agreements governing our indebtedness contain covenants that limit our business flexibility through operating and financial restrictions, including on the payment of dividends.** Our existing credit facilities impose certain operating and financial restrictions on us. These restrictions prohibit, require prior lender approval of, and/or limit, among other things:

- incurrence of additional indebtedness and the issuance by our subsidiaries of preferred stock;
- payment of dividends on, and purchases or redemptions of, capital stock;
- a number of other types of payments, including investments;
- creation of liens;
- ability of each of our subsidiaries to guarantee indebtedness;
- specified sales of assets;
- creation of encumbrances or restrictions on the ability of our subsidiaries to distribute and advance funds or transfer assets to us or any other subsidiary;
- specified transactions with affiliates;
- sale and leaseback transactions;
- our ability to enter lines of business outside the communications business; and
- certain consolidations and mergers and sales and/or transfers of assets by or involving us.

Our existing credit facilities also require us to maintain specified financial ratios and satisfy financial condition tests, including, without limitation, a maximum total leverage ratio and a minimum interest coverage ratio. It is possible that a new credit facility, if we were successful in negotiating one, would contain similar provisions on some of these points. Our ability to comply with these covenants, ratios or

tests contained in the agreements governing our indebtedness may be affected by events beyond our control, including prevailing and evolving economic, financial and industry conditions. A breach or violation of any of these covenants, ratios or tests could result in a default under the agreements governing our indebtedness. In the current economic and financial circumstances, obtaining a waiver of such a breach or violation, or a modification of the covenant or other provision involved, has become more difficult and expensive.

Under certain conditions, covenants prohibit us from making dividend payments on our common stock. In addition, upon the occurrence of an event of default, the lenders under our existing credit facilities (or a new credit facility, following the consummation of such a transaction) could have the option to declare all amounts outstanding, together with accrued interest, to be immediately due and payable. If we were to be unable to repay those amounts, the lenders under our existing credit facilities (or a new credit facility, following the consummation of such a transaction) could proceed against the security granted to them to secure that indebtedness, or commence collection or bankruptcy proceedings against us.

If the lenders accelerate the payment of any outstanding indebtedness, our assets may not be sufficient to repay all of our indebtedness. Due to general economic conditions, conditions in the lending markets, the results of our business or for other reasons, we may elect or be required to amend or refinance our existing credit facilities (or a new credit facility, following the consummation of such a transaction), at or prior to maturity, or enter into additional agreements for indebtedness. Any such amendment, refinancing or additional agreement may contain covenants which could limit in a significant manner our operations, our competitiveness and/or our financial flexibility generally.

**The price of our common stock may fluctuate substantially, which could negatively affect holders of our common stock.** The market price of our common stock may fluctuate widely as a result of various factors, such as period-to-period fluctuations in our operating results, the volume of sales of our common stock, developments in the communications industry, the failure of securities analysts to cover our common stock or changes in financial estimates by analysts, competitive factors, regulatory developments, economic and other external factors, general market conditions and market conditions affecting the stock of communications companies in particular. Communications companies have in the past experienced extreme volatility in the trading prices and volumes of their securities, which has often been unrelated to operating performance. High levels of market volatility may have a significant adverse effect on the market price of our common stock, and may generate litigation which could result in substantial costs and divert management's attention and resources.

**Future sales or the possibility of future sales of a substantial amount of our common stock may depress the price of our common stock.** Our stock is thinly-traded, and future sales, or the availability for sale in the public market, of substantial amounts of it could adversely affect the prevailing market price of the stock. The market price of our common stock could decline as a result of the perception that a relatively high volume of sales could occur, whether or not such sales are actually made.

### ***Risks Related to Our Business***

**We provide services to customers over access lines, and if we lose access lines, our business, financial condition and results of operations may be adversely affected.** We generate revenue primarily by delivering voice and data services over access lines. We have experienced net access line losses in the past years. These losses resulted mainly from competition, the use of alternative technologies and, to a lesser degree, challenging economic conditions and the offering of DSL services, which has prompted most customers to cancel their second line service. In addition to line losses, the usage of our networks, generally measured in Minutes of Use ("MOUs"), has also been decreasing. It is reasonable to expect that we will

continue to experience net access line and MOU losses in our markets. Our inability to retain access lines and the declining usage of the lines we do retain could adversely affect our business, financial condition and results of operations.

**We are subject to competition that may adversely impact our business, financial condition and results of operations.** As the incumbent telephone company, we historically had experienced little competition in our RLEC markets. However, many of the competitive threats confronting large communications companies, such as competition from VoIP and cable providers, are becoming more widespread in the rural markets that we serve. Regulations and technology change quickly in the communications industry, and changes in these factors historically have had, and may in the future have, a significant impact on the competitive dynamics of our industry. In most of our rural markets, we are facing competition from wireless technology, which may increase as wireless technology improves. We are also likely to face increased competition from wireline and cable television operators. We may face additional competition from providers of wireless broadband, VoIP, satellite communications and electric utilities. The internet services market is also highly competitive, and we expect that this competition will intensify. Many of our competitors have brand recognition, offer online content services, and have financial, personnel, marketing and other resources that are significantly greater than ours. We believe that a growing percentage of our current and potential customers will have access to a cable modem offering, and the cable industry is continuing to greatly increase its broadband capacities.

In addition, consolidation and strategic alliances within the communications industry or the development of other new technologies could affect our competitive position. We cannot predict the number of competitors that will emerge from technological developments or as a result of existing or new federal and state regulatory or legislative actions. However, increased competition from existing and new entities could have a material adverse effect on our business, financial condition and results of operations. Competition may lead to loss of revenues and profitability as a result of numerous factors, including:

- loss of customers;
- reduced usage of our network by our existing customers, who may use alternative providers for long distance and data services;
- reductions in the prices for our services which may be necessary to meet competition; and/or
- increases in marketing expenditures and discount and promotional campaigns.

In addition, our provision of long distance service is subject to a highly-competitive market served by large nationwide carriers that enjoy brand name recognition and have other financial and operational advantages over us.

**We may not be able to successfully integrate new technologies, respond effectively to customer requirements or provide new services.** The communications industry is subject to rapid and far-reaching changes in technology, frequent new service introductions and evolving industry standards. We cannot predict the effect of these changes on our competitive position, profitability or financial condition. Technological developments may reduce the competitiveness of our networks and require unbudgeted upgrades or the procurement of additional products that could be expensive, technologically complex and time-consuming to implement. In addition, new products and services arising out of technological developments may reduce the attractiveness of our services. If we fail to adapt successfully to technological changes or obsolescence, or fail to obtain access to important new technologies, we could lose customers and be limited in our ability to attract new customers and/or sell new services to our existing customers.

**Our relationships with other communications companies are material to our operations and their financial difficulties may adversely affect our business, financial condition and results of operations.** We originate and terminate calls for interexchange and other carriers over our network. For those services, we receive payments for access charges. These payments represent a significant portion of our revenues

and are material to our business. If one or more of these carriers go bankrupt or experience substantial financial difficulties, our inability to collect access charges from them could have a negative effect on our business, financial condition and results of operations.

**We face risks associated with acquired businesses and potential acquisitions.** We have grown in the past, in part, by acquiring other businesses and a portion of our future growth may result from additional acquisitions. Growth through acquisitions entails numerous risks, including:

- strain on our financial, management and operational resources, including the distraction of our management team in identifying potential acquisition targets, conducting due diligence and negotiating acquisition agreements;
- the potential loss of key employees or customers of the acquired businesses;
- unanticipated liabilities or contingencies of the acquired businesses;
- unbudgeted costs which we may incur in connection with pursuing potential acquisitions, whether or not the acquisitions are consummated;
- failure to achieve projected cash flow from acquired businesses;
- fluctuations in our operating results caused by incurring expenses to acquire businesses before receiving the anticipated revenues expected to result from the acquisitions;
- difficulties in finding suitable acquisition candidates;
- difficulties in making acquisitions on attractive terms due to a potential increase in competitors; and
- difficulties in obtaining and maintaining any required regulatory authorizations in connection with acquisitions.

In the future, we may need additional capital to continue growing through acquisitions. This additional capital may be raised in the form of additional debt, which would increase our leverage and further limit our financial flexibility. We may not be able to raise sufficient capital on terms we consider acceptable, or at all. We may not be able to successfully complete the integration of other businesses that we have previously acquired or successfully integrate any businesses that we might acquire in the future. If we fail to do so, or if we do so but at greater cost than we anticipated, our business, financial condition and results of operations may be adversely affected.

**A network disruption could cause delays or interruptions of service, which could cause us to lose customers.** To be successful, we will need to continue to provide our customers reliable service over our network. Some of the risks to our network and infrastructure include:

- physical damage to access lines;
- widespread power surges or outages;
- software defects in critical systems; and
- disruptions beyond our control.

Disruptions may cause interruptions in service or reduced capacity for customers, either of which could cause us to lose customers and/or revenues, and incur expenses.

**Our billing systems or the billing systems of our third party vendors may not function properly.** The failure of any of our billing systems or the billing systems of any of our third party vendors could result in our inability to adequately bill and provide service to our customers. The failure of any of our billing systems could have a material adverse effect on our business, financial condition and results of operations.

**We depend on third parties for our provision of long distance and broadband services.** Our provision of long distance and broadband services is dependent on underlying agreements with other carriers that provide us with transport and termination services. If these carriers fail to meet their obligations, or if the provisions in our agreements with them prove unfavorable to us due to changes in market conditions or other factors, our business and operations may be adversely affected.

**We may not be able to maintain the necessary rights-of-way for our networks.** We are dependent on rights-of-way and other permits from railroads, utilities, state highway authorities, local governments, transit authorities and others to install and maintain conduit and related communications equipment for any expansion of our networks. We may need to renew current rights-of-way for our networks and there can be no assurance that we would be successful in renewing each of these agreements on acceptable terms or at all. Some of our agreements may be short-term, revocable at will, or subject to termination upon customary default provisions, and we may not have access to existing rights-of-way after they have expired or been terminated. If any of these agreements are terminated or not renewed, we could be required to remove or abandon our facilities. Similarly, we may not be able to obtain right-of-way agreements on favorable terms, or at all, in new service areas, and, if we are unable to do so, our ability to expand our networks could be impaired.

**Our success depends on our ability to attract and retain qualified management and other personnel.** Our success depends upon the talents and efforts of our all of our personnel. The loss of any member of our senior management team, and the inability to attract and retain highly qualified technical and management personnel in the future, could have an adverse effect on our business, financial condition and results of operations.

**We may face significant future liabilities or compliance costs in connection with environmental and worker health and safety matters.** Our operations and properties are subject to federal, state and local laws and regulations relating among other things to protection of the environment, natural resources, and worker health and safety, including laws and regulations governing the management, storage and disposal of hazardous substances, materials and wastes, and remediation of contaminated sites. Under certain environmental laws, we could be held liable, jointly and severally and without regard to fault, for the costs of investigating and remediating any contamination at owned or operated properties, or for contamination arising from the disposal by us or our predecessors of regulated materials at formerly owned or operated properties or at third-party waste disposal sites. In addition, we could be held responsible for third-party property or personal injury claims relating to any such contamination or relating to any violations of environmental laws. Changes in existing laws or regulations, future acquisitions of businesses or any newly discovered information could require us to incur substantial costs relating to these matters.

**We have a significant amount of goodwill and other intangible assets on our balance sheet. If our goodwill or other intangible assets become impaired, we may be required to record a significant non-cash charge to earnings and reduce our stockholders' equity.** Under generally accepted accounting principles, intangible assets are reviewed for impairment on an annual basis or more frequently whenever events or circumstances indicate that their carrying value may not be recoverable. The Company monitors relevant circumstances, including general economic conditions, enterprise value EBITDA multiples for RLEC properties, the Company's overall financial performance, and the potential that changes in such circumstances might have on the valuation of the Company's intangible assets, including goodwill. If our intangible assets are determined to be impaired in the future, we may be required to record a significant non-cash charge to earnings during the period in which the impairment is determined.

### ***Risks Related to Our Regulatory Environment***

**We are subject to significant regulations that could change in a manner adverse to us.** We operate in a heavily regulated industry, and substantial portions of our revenues are supported by regulations, including access revenue and USF support for the provision of telephone services in rural areas. As discussed above, the new A-CAM program substantially increases the support being provided to LICT's telephone company subsidiaries, but future rules and regulations issued by the FCC could ultimately effect fundamental changes in the financial structure and characteristics of the telecommunications industry. Moreover, existing laws and regulations applicable to us and our competitors may be, and have been,

challenged in the courts, and could be changed by Congress or regulators in a manner adverse to us. In addition, any of the following have the potential to have a significant impact on us:

***Risk of loss or reduction of network access revenues.*** A significant portion of our revenues comes from network access charges, a portion of which are paid to us by intrastate and interstate long distance carriers for originating and terminating calls and for providing special access services which connect carriers to their end users in our service areas. In past years, several long distance carriers have declared bankruptcy. Future declarations of bankruptcy by carriers that utilize our access services could negatively impact our business, financial condition and results of operations. In addition, the amount of access charge revenues that we currently receive is based on rates set by federal and state regulatory bodies, and those rates could change in the future. At the current time, several IXCs have filed lawsuits alleging that ILECs, including RLECs, have improperly collected access charges relating to a particular type of wireless traffic. To date, the Federal Court handling these cases has decided them in favor of the ILEC and RLEC defendants. However, these decisions may be appealed and the unfavorable resolution of these suits could have an adverse effect on our companies. In addition, from time to time, federal and state regulatory bodies conduct rate cases, earnings reviews, or make adjustments to average schedule formulas that may result in such rate changes. In addition, reforms of the federal and state access charge systems, combined with the development of competition, have caused the aggregate amount of access charges paid by long distance carriers to decrease. Significant changes in the access charge system, if not offset by a revenue replacement mechanism, could result in a significant decrease in our revenues. Decreases in or loss of access charges may or may not result in offsetting increases in local, or subscriber line, revenues. Regulatory developments of this type could adversely affect our business, financial condition and results of operations.

***Risk of loss or reduction of Universal Service Fund support.*** We receive USF revenues in addition to A-CAM from both the federal and, in some cases, state universal service support mechanisms to help fund our operations. Any changes to the existing rules could reduce the USF revenues we receive. Corresponding changes in state universal service support could likewise have a negative effect on the revenues we receive. If we raise prices for services to offset losses of USF payments, the increased pricing of our services may disadvantage us competitively in the marketplace, resulting in additional potential revenue loss. Furthermore, any changes in the rules and regulations governing the distribution of such support or the manner in which USF contributions are obtained or calculated could have a material adverse effect on our business, financial condition or results of operations.

***Risk of loss of statutory exemption from burdensome interconnection rules imposed on incumbent local exchange carriers.*** Our RLECs are exempt from some of the Telecom Act's more burdensome requirements governing the rights of competitors to interconnect to ILEC networks and to utilize discrete elements of the ILEC's network at favorable rates. To the extent that state regulators may decide that some or all of these requirements should be imposed upon our RLECs, we could be required to provide unbundled network elements to competitors in our service areas. As a result, more competitors could enter our traditional telephone markets than are currently active there, which could have a material adverse effect on our business, financial condition and results of operations.

***Risks posed by costs of regulatory compliance.*** Regulatory requirements create significant compliance costs for us, and are expected to continue to do so. Our subsidiaries that provide intrastate services may be subject to certification, tariff filing and other ongoing regulatory requirements imposed by state regulators. Our interstate access services are currently provided in accordance with tariffs filed with the FCC by NECA. Challenges in the future to NECA's tariffs by regulators or delays in the Company's obtaining certifications and regulatory approvals could adversely affect the rates that we are able to charge our customers. We are also subject to audits by both federal and state regulatory authorities, which may be costly and burdensome and may result in fines, penalties, refunds or other unfavorable and burdensome requirements.



Our business also may be impacted by legislation or regulations imposing new or greater obligations related to assisting law enforcement, bolstering homeland security, minimizing environmental impacts, protecting customer privacy or addressing other issues that impact our business. For example, existing provisions of the Communications Assistance for Law Enforcement Act (“CALEA”) and FCC regulations implementing that legislation require communications carriers to ensure that their equipment, facilities, and services are able to facilitate authorized electronic surveillance. We cannot predict whether or to what extent the FCC might modify its CALEA rules or any other rules, or what compliance with new rules might cost. Similarly, we cannot predict whether or to what extent federal or state legislators or regulators might impose new security, environmental or other obligations on our business, although it is possible that they may do so.

***Risk of loss from rate reduction.*** Most of our local exchange companies that operate pursuant to intrastate rate of return regulation are subject to state regulatory authority over their intrastate telecommunications service rates. State review of these rates could lead to rate reductions, which in turn could have a material adverse effect on our business, financial condition and results of operations.

**Regulatory changes in the communications industry could adversely affect our business by facilitating greater competition, reducing potential revenues or raising our costs.** Over the past several years, the FCC has made fundamental changes in its regulation of the telecommunications industry and this regulatory regime is continuing to evolve. In addition, the Telecom Act also provides for ongoing changes and increased competition in the telecommunications industry, including competition for local communications and long distance services. This statute and the FCC’s regulations may be subject to additional Congressional amendment, regulatory modification or judicial review. It is not possible to predict what effects future legislation, FCC regulatory actions or court decisions will have on our business, financial condition or results of operations. However such effects could be materially adverse to our business and financial results.

## **MANAGEMENT'S DISCUSSION OF OPERATIONS**

This discussion should be read together with the Consolidated Financial Statements of LICT Corporation and the notes thereto.

### **Forward-Looking Statements and Uncertainty of Financial Projections**

The following discussion contains certain forward-looking statements. Forward-looking statements are not based on historical information but relate to future operations, strategies, financial results or other developments. Forward-looking statements are based on estimates and assumptions that are inherently subject to significant business, financial, economic and competitive uncertainties and contingencies, many of which are beyond our control and all of which, with respect to future business decisions, are subject to change. These uncertainties and contingencies can affect actual results and could cause actual results to differ materially from those expressed in any forward-looking statements made by, or on behalf of, the Company.

## **RESULTS OF OPERATIONS**

### Overview

LICT provides an array of communications services, primarily in rural areas but with continuing expansions in adjacent urban communities, which are detailed in the Telecommunications Operations section of this report. Our history is principally as an operator of rural telephone service (known as Rural Local Exchange Carriers, or "RLECs"), with our principal operations in rural parts of California, Iowa, Kansas, Michigan, New Hampshire, New Mexico, Utah and Wisconsin. As the technologies, have evolved, so have our services. In addition, on December 24, 2014, we closed the sale of our DFT Communications Corporation ("DFT") subsidiary, which holds the telephone companies serving Dunkirk/Fredonia and Casadaga, New York, as well as a Competitive Local Exchange Carrier, or "CLEC" operation. In our financial statements, we are treating the results of the DFT companies as discontinued operations during 2015 and 2014. Accordingly, in the discussions below on our operating results the contributions of the DFT companies have been excluded from the 2014 amounts.

The broad array of communications services which we provide to residential, commercial and governmental customers include:

- Local and long-distance telephone service;
- Broadband services, principally Digital Subscriber Lines ("DSL") and cable modem services which are increasingly provided through fiber optic technologies;
- Video services, including cable television and Internet Protocol Television ("IPTV");
- Access for other telephone service providers to the intra-state and interstate networks;
- Private line connections between, for example, two branches of a business;
- Public access, including, for example, 911 service;
- Managed Hosting, where we host virtual switchboards for customers; and
- Wireless broadband service, primarily for very remote customers

The federal and state governments have long had a policy of encouraging and promoting telephone and other communication services in rural areas because it provided a benefit to all Americans and to the nation as a whole. RLECs, in particular, including those that form the core of our Company, often provide communications services in rural areas where such service would not be economically feasible without numerous federal and state support mechanisms, which are generally referred to as Universal Service Funds ("USF"). Such programs evolve constantly to take into consideration customer needs, as well as new

services and technologies, and to encourage RLECs to invest in and support the new technologies and provide new services to their customers. In addition, the rates we can charge for some of our services are regulated by the FCC and in many cases, the various state public utility commissions. We devote considerable management attention to understanding, utilizing and complying with these different governmental programs, incentives and regulatory structures. There is no certainty that such support programs will continue at the same levels as they have in the past, and some reductions have already occurred although the FCC's new A-CAM support program, discussed below, has significantly increased the amount of federal support we are receiving. Overall, we believe that the various governmental agencies will continue to encourage and support the provision of modern communications services for people living in high-cost, rural areas. People are communicating more, and in more ways, than ever before – and this includes the rural population as well as urban dwellers. We believe that this expansion of communications creates an opportunity for us to successfully develop the Company's business, as rural customers demand additional and better communications infrastructure.

The advent and spreading acceptance of high-speed internet has been a major growth area for our Company. In particular, the number of broadband subscribers has grown dramatically in recent years. This has been offset, in part, by reductions in the number of traditional voice telephone lines we serve, as consumers replace traditional telephone connections with new technologies. We expect such shifts in consumer behavior to continue and we, in turn, are continuing to develop our Company as a broad-based communications provider, whatever the technology, rather than simply a provider of rural voice telephone connections.

Effective January 1, 2017, the FCC instituted a revised, voluntary USF mechanism for eligible rate-of-return Incumbent Local Exchange Carriers ("ILECs"), called A-CAM, an acronym for "Alternative – Connect America Model." A-CAM replaces the prior Interstate Common Line Support ("ICLS") and High Cost Loop Support ("HCLS") cost-based USF programs, which were based on specific company actual expenditures for operations and capital or on average schedule algorithms derived based on industry averages. The A-CAM program was designed by the FCC to expedite the deployment of broadband capabilities throughout the nation's rural areas that are served by rate-of-return carriers. Eleven of LICT's fourteen operating RLEC study areas elected to adopt A-CAM, which will provide a fixed amount of annual funding for a period of ten years, effective January 1, 2017. As part of adopting the A-CAM model, our RLECs must meet certain service requirements over the ten-year period. The LICT RLECs participating in A-CAM are located in six states and will receive a combined fixed payment of \$23.3 million over the next ten years. In addition, the RLECs in two of these states will receive supplemental transitional payments of \$0.5 million in 2017 reduced by \$0.1 million per year through the end of 2021. LICT's A-CAM electors received \$7.4 million of ICLS revenues in 2016 and \$5.6 million of HCLS revenues in 2016 for a combined \$12.9 million. Some of our A-CAM recipients also receive USF from the states in which they operate, totaling \$6.4 million in 2016. Although we expect that these states will continue to support broadband deployment, it is unclear whether and if so by how much these state revenues may be affected by A-CAM.

## Year 2016 compared to 2015

The following is a breakdown of revenues and operating costs and expenses from continuing operations (in thousands):

|  | 2016            | 2015            |
|--|-----------------|-----------------|
| Revenues:                                      |                 |                 |
| Regulated revenues:                            |                 |                 |
| Local access                                   | \$7,881         | \$7,957         |
| Interstate access                              | 31,986          | 32,699          |
| Intrastate access                              | 7,480           | 7,183           |
| Other regulated                                | 1,435           | 1,463           |
| Total regulated revenues                       | <u>48,782</u>   | <u>49,302</u>   |
| Non-regulated revenues:                        |                 |                 |
| Broadband and related services                 | 27,638          | 24,697          |
| Video (including cable modem                   | 10,418          | 9,024           |
| Other  | 3,902           | 3,657           |
| Total non-regulated revenues                   | <u>41,958</u>   | <u>37,378</u>   |
| Total revenues                                 | <u>90,740</u>   | <u>86,680</u>   |
| Operating Costs and Expenses:                  |                 |                 |
| Cost of revenue, excluding depreciation        | 44,783          | 41,290          |
| General and administrative costs at operations | 11,167          | 11,332          |
| Charitable contributions                       | 1,064           | -               |
| Depreciation and amortization                  | 17,972          | 17,730          |
| Total operating costs and expenses             | <u>74,986</u>   | <u>70,352</u>   |
| Operating profit before corporate expenses     | 15,754          | 16,328          |
| Corporate office expenses:                     |                 |                 |
| Allocated corporate office expenses            | 1,499           | 1,148           |
| Un-allocated corporate office expenses         | 2,334           | 1,788           |
| Total Corporate office expenses                | <u>3,833</u>    | <u>2,936</u>    |
| Operating profit                               | <u>\$11,921</u> | <u>\$13,392</u> |

Total revenues in 2016 increased \$4.1 million, or 4.7%, to \$90.7 million. Our non-regulated revenues grew by \$4.6 million to \$42.0 million, a 12.3% increase as compared to 2015. Non-regulated revenues, revenues from broadband services and other non-regulated services increased, specifically from our Utah (\$2.0 million), Iowa (\$1.1 million), California (\$0.4 million), and New Mexico (\$0.4 million) operations, primarily due to the sale of additional broadband circuits outside of our regulated service territory (\$1.6 million), additional revenue from increased subscribers of broadband cable modems (\$1.4 million) and the sale of communications equipment. Non-regulated revenues have grown to currently represent over 46% of our revenue streams and are expected to continue this growth, although due to the A-CAM revenues the percent of the total will decline. Our regulated revenues decreased by \$0.5 million to \$48.8 million, a 1.1% decrease as compared to 2015. Local access revenue decreased \$0.1 million, or 1.0%, resulting from a 3.3% decrease in regulated telephone access lines. Interstate access revenue decreased \$0.7 million, or 2.2%, in 2016, as the net effect of various regulatory changes and adjustments. We continue to be affected by changes in the regulatory model of the FCC, and erosion of access lines and minutes of use. Intrastate access revenues increased by \$0.3 million, or 4.1% in 2016, primarily due to rulings by the New Mexico Public Regulation Commission that recovered some our reduced 2015 New Mexico Universal Fund("NMUSF") payments in 2016, offset by reductions of minutes of use at several of our companies.

NMUSF revenues are expected to increase in 2017 due to the continued true-up reimbursement for reduced 2015 NMUSF.

Total operating costs were \$78.8 million in 2016 and \$73.3 million in 2015, predominantly due to our growing non-regulated operations whose costs and expenses grew by \$2.8 million as compared to a \$4.7 million revenue growth. In total, costs of revenue increased \$3.5 million or 8.5%. General and administrative costs were \$11.2 million about the same as the previous year's \$11.3 million. Corporate office expenses increased by \$0.9 million due to additional personnel costs. Charitable contributions increased \$1.1 million. Depreciation and amortization increased by \$0.2 million from the previous year.

As a result of the above factors, Operating Profit in 2016 decreased by \$1.5 million to \$11.9 million.

### **EBITDA**

EBITDA is used by our management as a supplemental financial measure to evaluate the operating performance of our business. When viewed with our GAAP results and the accompanying reconciliations, we believe it provides a more complete understanding of the factors and trends affecting our business than the GAAP results alone. We also regularly communicate our EBITDA to the shareholders through our earnings releases because it is the financial measure commonly used by analysts that cover the telecommunications industry and by our investor base to evaluate our operating performance. In addition, we routinely use EBITDA as a metric for valuing potential acquisitions. We understand that analysts and investors regularly rely on non-GAAP financial measures, such as EBITDA, to provide a financial measure by which to compare a company's statement of its operating performance against that of other companies in the same industry. This non-GAAP financial measure is helpful in more clearly reflecting the sales of our products and services, as well as highlighting trends in our core business that may not otherwise be apparent when relying solely on GAAP financial measures, because this non-GAAP financial measure eliminates from earnings financial items that have less bearing on our performance.

LICT's management believes strongly in growing intrinsic value as a long-term prescription for managing an enterprise's health. Our local management teams run their respective businesses as stand-alone, entrepreneurial units although we attempt to use economies of scale and other efficiencies (such as joint purchasing) where feasible. We believe that EBITDA is the clearest indicator of the cash-flow-generating ability and long-term health of such units. We value potential acquisitions on the same basis.

EBITDA refers to, for any period, net income (loss) before all components of "Other income (expense)" (consisting of investment income, interest expense, equity in earnings of affiliates, gains and losses on disposition of or impairment of assets), income taxes, depreciation, amortization, minority interests and income or loss from discontinued operations. Our EBITDA has been modified to include the cash we received from the equity in earnings of affiliated companies. Although we do not have majority voting control of such companies, we may have the ability to significantly influence financial and accounting policies.

The following table provides the components of EBITDA and reconciles it to net income from continuing operations (in thousands):

|                                       | 2016           | 2015           |
|---------------------------------------|----------------|----------------|
| EBITDA from:                          |                |                |
| Operating units                       | \$34,790       | \$34,058       |
| Dividends from equity affiliates      | 1,950          | 2,350          |
|                                       | <hr/> 36,740   | <hr/> 36,408   |
| Corporate expense                     | 3,833          | 2,936          |
| Charitable contributions              | 1,064          | -              |
|                                       | <hr/> \$31,843 | <hr/> \$33,472 |
| <b>Reconciliation to net income:</b>  |                |                |
| EBITDA                                | \$31,843       | \$33,472       |
| Less Dividends from equity affiliates | (1,950)        | (2,350)        |
| Depreciation and amortization         | (17,972)       | (17,730)       |
| Investment income                     | 480            | 366            |
| Interest expense                      | (2,542)        | (2,923)        |
| Equity in income of affiliates        | 2,075          | 1,810          |
| Other gains (losses)                  | (27)           | 26             |
| Income tax provision                  | (4,634)        | (4,960)        |
| Net income from continuing operations | <hr/> \$7,273  | <hr/> \$7,711  |

### **Other Income (Expense)**

Investment income increased by \$0.1 million in 2016, primarily due to a patronage capital distribution from CoBank as a result of borrowings under our Brighton's Revolving Credit Facility.

Interest expense decreased by \$0.4 million in 2016, primarily due to reductions in debt.

Equity in earnings of affiliates in 2016 were \$2.1 million up from the \$1.8 million in 2015, and primarily represent our Modoc RSA wireless investment in California.

During 2016, the Company initiated a shareholder designated and an employee matching charitable contribution programs. Under these programs, the company donated \$1.1 million to local and national IRS authorized 501(c)3 organizations, \$1.0 million related to the shareholder designated program. The company may continue these programs in the future.

### **Income Tax Provision**

The income tax provision from continuing operations includes federal as well as state and local taxes. The tax provision for 2016 and 2015 represents effective tax rates of 38.9% and 39.1%, respectively. The difference between these effective rates and the federal statutory rate is principally due to state income taxes as well as other adjustments.

### **Net Income**

Net income from continuing operations was \$7.3 million, or \$340.11 per basic share and \$338.32 per diluted share in 2016, compared to net income from continuing operations in 2015 of \$7.7 million, or \$349.74 per basic share and \$348.34 per diluted share.

## Year 2015 compared to 2014

The following is a breakdown of revenues and operating costs and expenses from continuing operations (in thousands):

|  | 2015            | 2014            |
|--|-----------------|-----------------|
| Revenues:                                      |                 |                 |
| Regulated revenues:                            |                 |                 |
| Local access                                   | \$7,957         | \$8,197         |
| Interstate access                              | 32,699          | 34,892          |
| Intrastate access                              | 7,183           | 9,507           |
| Other regulated                                | 1,463           | 1,479           |
|  | <u>49,302</u>   | <u>54,075</u>   |
| Non-regulated revenues:                        |                 |                 |
| Broadband and related services                 | 24,697          | 20,837          |
| Video (including cable modem)                  | 9,024           | 7,708           |
| Other  | 3,657           | 3,236           |
| Total non-regulated revenues                   | <u>37,378</u>   | <u>31,781</u>   |
| Total revenues                                 | <u>86,680</u>   | <u>85,856</u>   |
| Operating Costs and Expenses:                  |                 |                 |
| Cost of revenue, excluding depreciation        | 41,290          | 38,064          |
| General and administrative costs at operations | 11,332          | 11,398          |
| Depreciation and amortization                  | 17,730          | 17,659          |
| Total operating costs and expenses             | <u>70,352</u>   | <u>67,121</u>   |
| Operating profit before corporate expenses     | 16,328          | 18,735          |
| Corporate office expenses:                     |                 |                 |
| Allocated corporate office expenses            | 1,148           | 1,025           |
| Un-allocated corporate office expenses         | 1,788           | 1,597           |
| Total corporate office expenses                | <u>2,936</u>    | <u>2,622</u>    |
| Operating profit                               | <u>\$13,392</u> | <u>\$16,113</u> |

Total revenues in 2015 increased \$0.8 million, or 0.1%, to \$86.7 million. Local access revenue decreased \$0.2 million, or 2.9%, resulting from a 1.1% decrease in access lines. Interstate access revenue decreased \$2.2 million, or 6.2%, in 2015, due lower regulated rate base at certain of our operations and changes in the revenue recovery rates of certain of our capital expenditures. We continue to be affected by changes in the regulatory model of the FCC, erosion of access lines and minutes of use, and the fact that the actual industry-wide rate-of-return on investment for the NECA Traffic Sensitive pool was lower than the authorized rate-of-return. Intrastate access revenues decreased by \$2.3 million, or 24.4%. In 2015 rulings by the New Mexico Public Service Commission reduced our New Mexico Universal Fund Payments by \$1.9 million. Broadband and other non-regulated services revenues increased \$5.6 million, or 17.6% in 2015 primarily due to the sale of additional broadband circuits inside and outside of our regulated service territory.

Total operating costs were \$73.3 million in 2015 and \$69.7 million in 2014. Costs of revenue increased \$3.2 million or 8.5%, primarily due to increased costs from the growing broadband data services. General and administrative costs decreased by \$0.1 million from the previous year operations. Corporate office expenses increased by \$0.3 million due to additional personnel costs. Depreciation and amortization increased by \$0.1 million from the previous year.

As a result of the above factors, Operating profit in 2015 decreased by \$2.7 million to \$13.4 million.

## EBITDA

EBITDA is used by our management as a supplemental financial measure to evaluate the operating performance of our business. When viewed with our GAAP results and the accompanying reconciliations, we believe it provides a more complete understanding of the factors and trends affecting our business than the GAAP results alone. We also regularly communicate our EBITDA to the shareholders through our earnings releases because it is the financial measure commonly used by analysts that cover the telecommunications industry and by our investor base to evaluate our operating performance. In addition, we routinely use EBITDA as a metric for valuing potential acquisitions. We understand that analysts and investors regularly rely on non-GAAP financial measures, such as EBITDA, to provide a financial measure by which to compare a company's assessment of its operating performance against that of other companies in the same industry. This non-GAAP financial measure is helpful in more clearly reflecting the sales of our products and services, as well as highlighting trends in our core business that may not otherwise be apparent when relying solely on GAAP financial measures, because this non-GAAP financial measure eliminates from earnings financial items that have less bearing on our performance.

LICT's management believes strongly in growing intrinsic value as a long-term prescription for managing an enterprise's health. Our local management teams run their respective businesses as stand-alone, entrepreneurial units although we attempt to use economies of scale and other efficiencies (such as joint purchasing) where feasible. We believe that EBITDA is the clearest indicator of the cash flow generating ability and long-term health of such units. We value potential acquisitions on the same basis.

EBITDA refers to, for any period, net income (loss) before all components of "Other income (expense)" (consisting of investment income, interest expense, equity in earnings of affiliates, gains and losses on disposition of or impairment of assets), income taxes, depreciation, amortization, minority interests and income or loss from discontinued operations. EBITDA has been modified to include the cash we received from the equity in earnings of affiliated companies. Although we do not have majority voting control of such companies, we may have the ability to significantly influence financial and accounting policies.

The following table provides the components of EBITDA and reconciles it to net income from continuing operations (in thousands):

|                                       | 2015            | 2014            |
|---------------------------------------|-----------------|-----------------|
| EBITDA from:                          |                 |                 |
| Operating units                       | \$34,058        | \$36,394        |
| Dividends from equity affiliates      | 2,350           | 2,313           |
|                                       | <u>36,408</u>   | <u>38,707</u>   |
| Corporate expense                     | 2,936           | 2,622           |
|                                       | <u>\$33,472</u> | <u>\$36,085</u> |
| <b>EBITDA</b>                         | <b>\$33,472</b> | <b>\$36,085</b> |
| <b>Reconciliation to net income:</b>  |                 |                 |
| EBITDA                                | \$33,472        | \$36,085        |
| Less Dividends from equity affiliates | (2,350)         | (2,313)         |
| Depreciation and amortization         | (17,730)        | (17,659)        |
| Investment income                     | 366             | 446             |
| Interest expense                      | (2,923)         | (3,783)         |
| Equity in income of affiliates        | 1,810           | 2,025           |
| Other gains (losses)                  | 26              | (73)            |
| Income tax (provision) benefit        | (4,960)         | (5,553)         |
| Net income from continuing operations | <u>\$7,711</u>  | <u>\$9,175</u>  |



### **Other Income (Expense)**

Investment income decreased by less than \$0.1 million in 2015, primarily due to additional interest from the note retained from the sale of our New York Operations offset by lower distributions from our investment in Iowa Network Services, Inc.

Interest expense decreased by \$0.9 million in 2015, primarily due to reductions in debt outstanding at higher average interest rates.

Equity in earnings of affiliates in 2015 decreased by \$0.2, million primarily due to the profitability of our Modoc RSA wireless investment in California.

### **Income Tax Provision**

The income tax provision from continuing operations includes federal as well as state and local taxes. The tax provision for 2015 and 2014 represents effective tax rates of 39.1% and 37.7%, respectively. The difference between these effective rates and the federal statutory rate is principally due to state income taxes as well as other adjustments. In 2015 and 2014, the federal statutory tax rate was 35%.

### **Net Income**

Net income from continuing operations was \$7.7 million, or \$349.74 per basic share and \$348.34 per diluted share in 2015, compared to a net income in 2014 of \$9.2 million, or \$410.18 per share (basic and diluted). The Company had no dilutive instruments outstanding in 2014.

## **LIQUIDITY AND CAPITAL RESOURCES**

### **Liquidity**

The debt at certain of LICT's subsidiary companies contains restrictions on the amount of funds that can be transferred to their respective parent companies. Over the past several years, LICT has repaid and restructured the debt at other subsidiaries, permitting free movement of cash from those operations. In 2014, it established its primary corporate liquidity facility at Brighton Communications Corporations ("Brighton"), a direct wholly-owned subsidiary of LICT. Brighton now receives the cash flow from the operating subsidiaries and can, subject to certain restrictions, distribute that cash flow to LICT. With regard to the operations that still are encumbered (located in California and Kansas), Brighton receives cash to meet its obligations primarily through management fees charged to its subsidiaries, dividends, and a tax sharing agreement with its subsidiaries. Additional liquidity is obtained through usage of a revolving credit facility. LICT and Brighton also have obtained liquidity by the sale of assets.

On December 30, 2014, Brighton closed on a \$30 million revolving credit facility from CoBank, ACB. The facility, which was to expire in December 2017, replaced line of credit facilities previously arranged by LICT. On April 12, 2017, this facility was extended until March 31, 2020, and at the same terms, except that the total facility was expanded from \$30 million to \$50 million. Brighton owns substantially all the subsidiaries within the LICT consolidated group of companies. As of December 31, 2016, and 2015, there was \$16.0 million and \$14.0 million, respectively outstanding under this facility, classified as long-term debt. The average balance outstanding under these facilities was \$14.8 million at an average interest rate of 3.0% in 2016, and the highest amount outstanding was \$18.0 million. Management believes that the current CoBank facility provides adequate liquidity for at least the next twelve months.

The Company is obligated under long-term debt provisions and lease agreements to make certain cash payments over the term of the agreements. The following table summarizes, as of December 31, 2016, and for the periods shown, these contractual obligations and certain other financing commitments from banks and other financial institutions that provide liquidity:

|  | Payments Due by Period<br>(In thousands) |                     |                 |                 |                  |
|--|--|---------------------|-----------------|-----------------|------------------|
|  | Total                                    | Less than<br>1 year | 1 – 3<br>years  | 4 – 5<br>years  | After 5<br>years |
| Long-term debt, principal only                     | \$26,084                                 | \$4,723             | \$12,100        | \$8,793         | \$468            |
| Operating leases                                   | 2,452                                    | 575                 | 868             | 678             | 331              |
| Notes payable to banks, principal only             | 16,000                                   | --                  | --              | 16,000          | --               |
| Interest on debt and notes                         | 6,563                                    | 2,608               | 2,653           | 1,123           | 179              |
| Total contractual cash obligations and commitments | <u>\$51,099</u>                          | <u>\$7,906</u>      | <u>\$15,621</u> | <u>\$26,594</u> | <u>\$978</u>     |

At December 31, 2016, total debt, excluding deferred financing, was \$42.1 million, a decrease of \$2.7 million from December 31, 2015. At December 31, 2016, there was \$24.2 million of fixed interest rate debt outstanding, averaging 6.99%, and \$18.0 million of variable interest rate debt, averaging 3.217%. The long-term debt facilities at certain subsidiaries, located in Iowa and Kansas, are secured by substantially all those subsidiaries' assets, at another subsidiary, located in California, it is secured by the subsidiary's common stock. In addition, the revolving credit facility at Brighton is secured by the assets and common stock of the subsidiaries that are not already pledged. The debt facilities contain certain covenants restricting distributions to Brighton and, in turn, to LICT. Certain assets including the New Hampshire operations and the investment in the Modoc RSA Partnership can be distributed to LICT without restriction.

In October 2014, the company received a \$15.0 million loan from its Chairman and CEO to fund its participation in FCC Auction No. 97. The Note bore interest at .38% per annum. Auction 97 ended on January 29, 2015 and the company did not acquire any licenses. On February 9, 2015, the \$15.0 million loan was repaid with interest of \$19,000.

As of December 31, 2016, the ratio of total debt (excluding the operating leases and future interest) to EBITDA was 1.36 to 1.

As of December 31, 2016, LICT had current assets of \$32.7 million and current liabilities of \$15.0 million resulting in working capital of \$17.7 million, compared to working capital of \$7.2 million at December 31, 2015.

LICT Wireless Broadband Company, LLC ("LICT Wireless"), a wholly owned subsidiary of the Company, is participating in FCC forward auction phase of the broadcast incentive auction - Auction 1002 ("Auction"). FCC rules restrict information that bidders may disclose about their participation in this Auction, including eligibility, bidding and payment information until after the auction has concluded. LICT Wireless has made an upfront deposit in this Auction which is included in Prepaid Expense and other current assets in the consolidated balance sheet. The company expects the majority of this deposit to be returned in 2016.

### **Sources and Uses of Cash**

As noted above, the company's cash position will be significantly impact by the receipt of the incremental revenues and the return of most of the Auction 1002 deposit.

Cash at December 31, 2016, was \$8.5 million, a decrease of \$6.3 million compared to 2015. In addition, not included in the cash was the upfront payment for Auction No. 1002, most which the company expects to be returned in 2017.

Net cash provided by operations of \$26.3 million in 2016, \$27.5 million in 2015 and \$25.9 million in 2014 was primarily used to invest in plant and equipment, repay debt and acquire treasury shares.

Capital expenditures, excluding stimulus grant and loan spending, were \$16.4 million in 2016, \$18.4 million in 2015 and \$16.5 million in 2014 of which 57%, 58% and 61%, respectively, were spent at the RLECs and, for our cost based companies will be included in their rate bases for rate-setting purposes.

From 2008 through 2016, the Company has taken bonus depreciation deductions for eligible property additions as allowed by the Internal Revenue Service of 50%, starting January 1, 2008; 100%, starting September 9, 2010 through December 31, 2011; and 50% starting January 1, 2012. Such deductions have the effect of reducing current taxes payable but will increase tax payments in future years.

The Company received cash distributions from a 25% interest in the Modoc RSA Partnership of \$2.0 million in 2016, \$2.3 million in 2015 and \$1.4 million in 2014. The 2015 distribution was effected by a sale/lease back arrangement executed by the partnership. A distribution of \$2.0 million is expected in 2017.

The company continues to evaluate significant refinancing initiatives which will enhance our ability to take the operational steps necessary to position the organization for future success.

The Company's Board of Directors has authorized the purchase of up to 5,800 shares of the Company's common stock, including 800 authorized on February 5, 2016. Through December 31, 2016, 5,358 shares had been purchased at an average investment of \$3,365 per share, including 4,912 shares purchased in 2016 at an average investment of \$5,245 per share. The Company has not paid any cash dividends since its spin-off from Lynch Corporation in 1999. The Company has spun-off three entities: Morgan Group Holding Co. (2002), CIBL, Inc. (2007), and ICTC Group, Inc. (2010). Since its spin-off from LICT, CIBL has made cash distributions to shareholders of \$170 per share.



# ***LICT Corporation***

*Consolidated Financial Statements as of December 31, 2016 and 2015, and  
for the years ended December 31, 2016, 2015 and 2014, and Independent  
Auditor's Report*

# LICT Corporation and Subsidiaries

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The Board of Directors  
LICT Corporation and Subsidiaries:

***Report on the Financial Statements***

We have audited the accompanying consolidated financial statements of LICT Corporation and subsidiaries (the “Company”), which comprise the consolidated balance sheets as of December 31, 2016, and 2015, and the related consolidated statements of income, shareholders’ equity, and cash flows for each of the three years in the three-year period ended December 31, 2016, and the related notes to the consolidated financial statements.

***Management’s Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

***Auditors’ Responsibility***

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors’ judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly in all material respects, the financial position of LICT Corporation and its subsidiaries as of December 31, 2016 and 2015 and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2016, in accordance with accounting principles generally accepted in the United States of America.

*BDO USA, LLP*

Woodbridge, NJ  
April 20, 2017

**LICT CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
*(in thousands, except share data)*

|  | <b>December 31,</b> |             |
|--|---------------------|-------------|
|  | <b>2016</b>         | <b>2015</b> |
| <b>ASSETS</b>  |                     |             |
| Current assets:  |                     |             |
| Cash and cash equivalents  | \$8,470             | \$14,748    |
| Receivables, less allowances of \$263 and \$255  | 7,405               | 6,870       |
| Materials and supplies   | 3,791               | 3,156       |
| Deposit with FCC   | 11,000              | --          |
| Deposits, prepaid expenses and other current assets  | 2,004               | 1,888       |
| Total current assets   | 32,670              | 26,662      |
| Property, plant and equipment, net   | 87,125              | 88,722      |
| Goodwill   | 48,764              | 48,764      |
| Other intangibles  | 1,967               | 1,952       |
| Investments in affiliated companies  | 4,834               | 4,603       |
| Other assets   | 9,483               | 9,613       |
| Total assets   | \$184,843           | \$180,316   |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                     |             |
| Current liabilities:   |                     |             |
| Accounts payable   | \$2,802             | \$2,530     |
| Accrued interest payable   | 165                 | 245         |
| Accrued liabilities  | 7,269               | 4,091       |
| Current maturities of long-term debt   | 4,723               | 12,610      |
| Total current liabilities  | 14,959              | 19,476      |
| Long-term debt   | 37,361              | 32,171      |
| Deferred income taxes  | 20,092              | 20,370      |
| Other liabilities  | 3,955               | 4,852       |
| Total liabilities  | 76,367              | 76,869      |
| Commitments and contingencies (Note 11)  |                     |             |
| Shareholders' equity:  |                     |             |
| Shareholders' equity attributable to LICT Corporation:   |                     |             |
| Common stock, \$0.01 par value-10,000,000 shares authorized;<br>26,637.50 issued; 21,282.37 and 21,739.37 outstanding,<br>respectively | --                  | --          |
| Additional paid-in capital   | 17,162              | 16,831      |
| Retained earnings  | 109,345             | 102,072     |
| Treasury stock, 5,478.13 and 4,987.13 shares, respectively, at<br>cost   | (18,031)            | (15,456)    |
| Total shareholders' equity   | 108,476             | 103,447     |
| Total liabilities and shareholders' equity   | \$184,843           | \$180,316   |

*See Accompanying Notes to Consolidated Financial Statements.*



**LICT CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**  
*(in thousands, except share data)*

|   | <b>Years Ended December 31,</b> |             |             |
|---|---------------------------------|-------------|-------------|
|   | <b>2016</b>                     | <b>2015</b> | <b>2014</b> |
| Revenues  | \$90,740                        | \$86,680    | \$85,856    |
| Operating costs:  |                                 |             |             |
| Cost of revenue, excluding depreciation and amortization                                      | 44,783                          | 41,290      | 38,064      |
| General and administrative costs at operations  | 11,167                          | 11,332      | 11,398      |
| Corporate office expense  | 3,833                           | 2,936       | 2,622       |
| Charitable contributions  | 1,064                           | -           | -           |
| Depreciation and amortization   | 17,972                          | 17,730      | 17,659      |
| Operating profit  | 11,921                          | 13,392      | 16,113      |
| Other income (expense):   |                                 |             |             |
| Investment income   | 480                             | 366         | 446         |
| Interest expense  | (2,542)                         | (2,923)     | (3,783)     |
| Equity in earnings of affiliated companies  | 2,075                           | 1,810       | 2,025       |
| Other   | (27)                            | 26          | (73)        |
|   | (14)                            | (721)       | (1,385)     |
| Income from continuing operations before income taxes   | 11,907                          | 12,671      | 14,728      |
| Income tax provision  | (4,634)                         | (4,960)     | (5,553)     |
| Net income from continuing operations   | 7,273                           | 7,711       | 9,175       |
| Income from discontinued operations before income taxes and non-controlling interest          | -                               | -           | 159         |
| Gain on sale of discontinued operations   | -                               | 195         | 1,107       |
| Income tax provision from discontinued operations and gain on sale of discontinued operations | -                               | (78)        | (428)       |
| Less: income attributable to noncontrolling interests   | -                               | -           | (74)        |
| Net income from discontinued operations   | --                              | 117         | 764         |
| Net income attributable to LICT Corporation   | \$7,273                         | \$7,828     | \$9,939     |

*See Accompanying Notes to Consolidated Financial Statements.*

*(continued)*

**LICT CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**  
*(in thousands, except share data)*

|   | <b>Years Ended December 31,</b> |             |             |
|---|---------------------------------|-------------|-------------|
|   | <b>2016</b>                     | <b>2015</b> | <b>2014</b> |
| Basic weighted average shares outstanding   | 21,384.48                       | 22,047.59   | 22,368.47   |
| Effect of dilutive shares:                  |                                 |             |             |
| Restricted stock awards                     | 113.16                          | 89.00       | --          |
| Diluted weighted average shares outstanding | 21,497.64                       | 22,136.59   | 22,368.47   |
| <br>  |                                 |             |             |
| Basic earnings per share:                   |                                 |             |             |
| Net income from continuing operations       | \$340.11                        | \$349.74    | \$410.18    |
| Net income from discontinued operations     | --                              | 5.31        | 34.16       |
| Net income attributable to LICT Corporation | \$340.11                        | \$355.05    | \$444.34    |
| <br>  |                                 |             |             |
| Diluted earnings per share:                 |                                 |             |             |
| Net income from continuing operations       | \$338.32                        | \$348.34    | \$410.18    |
| Net income from discontinued operations     | --                              | 5.29        | 34.16       |
| Net income attributable to LICT Corporation | \$338.32                        | \$353.63    | \$444.34    |

*See Accompanying Notes to Consolidated Financial Statements.*

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**LICT CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
*(in thousands, except share data)*

| <b>LICT Corporation</b>                 |   |                                  |                      |                   |                                  |                  |
|---|---|----------------------------------|----------------------|-------------------|----------------------------------|------------------|
|   | Shares of<br>Common<br>Stock Out-<br>standing | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Treasury<br>Stock | Non -<br>Controlling<br>Interest | Total            |
| <b>Balance at January 1, 2014</b>       | <b>22,486.37</b>                              | <b>\$16,637</b>                  | <b>\$84,305</b>      | <b>(\$11,379)</b> | <b>496</b>                       | <b>\$90,059</b>  |
| Net income from continuing operations   | --  | --                               | 9,175                | --                | --                               | 9,175            |
| Net income from discontinued operations | --  | --                               | 764                  | --                | --                               | 764              |
| Sub-total                               |   |                                  | 9,939                |                   | --                               | 9,939            |
| Disposal of Discontinued Operations     | --  | --                               | --                   | --                | (496)                            | (496)            |
| Purchase of treasury stock              | (214.00)                                      | --                               | --                   | (775)             | --                               | (775)            |
| <b>Balance at December 31, 2014</b>     | <b>22,272.37</b>                              | <b>16,637</b>                    | <b>94,244</b>        | <b>(12,154)</b>   | <b>--</b>                        | <b>98,727</b>    |
| Net income from continuing operations   | --  | --                               | 7,711                | --                | --                               | 7,711            |
| Net income from discontinued operations | --  | --                               | 117                  | --                | --                               | 117              |
| Sub-total                               |   |                                  | 7,828                |                   | --                               | 7,828            |
| Purchase of treasury stock              | (622.00)                                      | --                               | --                   | (3,302)           | --                               | (3,302)          |
| Restricted stock awards                 | 89.00   | 194                              | -                    | -                 | -                                | 194              |
| <b>Balance at December 31, 2015</b>     | <b>21,739.37</b>                              | <b>16,831</b>                    | <b>102,072</b>       | <b>(15,456)</b>   | <b>--</b>                        | <b>103,447</b>   |
| Net income                              | --  | --                               | 7,273                | --                | --                               | 7,273            |
| Purchase of treasury stock              | (491.00)                                      | --                               | --                   | (2,575)           | --                               | (2,575)          |
| Restricted stock awards                 | 34.00   | 331                              | --                   | --                | --                               | 331              |
| <b>Balance at December 31, 2016</b>     | <b>21,282.37</b>                              | <b>\$17,162</b>                  | <b>\$109,345</b>     | <b>(\$18,031)</b> | <b>\$ --</b>                     | <b>\$108,476</b> |

*See Accompanying Notes to Consolidated Financial Statements.*

**LICT CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
*(in thousands)*

|   | <b>Years Ended December 31</b> |             |             |
|---|--------------------------------|-------------|-------------|
|   | <b>2016</b>                    | <b>2015</b> | <b>2014</b> |
| <b>OPERATING ACTIVITIES</b>   |                                |             |             |
| Net income attributable to LICT Corporation   | \$7,273                        | \$7,828     | \$9,939     |
| Net income from discontinued operations   | --                             | --          | (56)        |
| Net gain on sale of discontinued operations   | --                             | (117)       | (708)       |
| Net income from continuing operations   | 7,273                          | 7,711       | 9,175       |
| Adjustments to reconcile net income from continuing operations to net cash provided by operating activities from continuing operations: |                                |             |             |
| Depreciation and amortization   | 18,086                         | 17,844      | 17,659      |
| Equity in earnings of affiliated companies  | (2,075)                        | (1,810)     | (2,025)     |
| Distributions received from affiliated companies  | 1,950                          | 2,350       | 2,313       |
| Deferred income tax provision   | (278)                          | 2,078       | 1,037       |
| Restricted stock award expense  | 331                            | 194         | --          |
| Changes in operating assets and liabilities, net of effects of acquisitions:  |                                |             |             |
| Trade accounts receivable   | (536)                          | 121         | 133         |
| Income taxes payable/ receivable  | 2,056                          | 668         | (699)       |
| Trade accounts payable and accrued liabilities  | 1,317                          | (1,383)     | (1,301)     |
| Other assets and liabilities  | (1,822)                        | (128)       | (171)       |
| Other   | (51)                           | (160)       | (216)       |
| Net cash provided by operating activities from continuing operations  | 26,251                         | 27,485      | 25,905      |
| Net cash provided by operating activities from discontinued operations  | --                             | --          | 3,981       |
| Gain on sale of discontinued operations, net of tax   | --                             | 117         | 708         |
| Net cash provided by operating activities from discontinued operations  | --                             | 117         | 3,273       |
| Net cash provided by operating activities   | 26,251                         | 27,602      | 29,178      |
| <b>INVESTING ACTIVITIES</b>   |                                |             |             |
| Capital expenditures  | (16,409)                       | (18,441)    | (16,536)    |
| Acquisition of Dixon Telephone Company  | --                             | (360)       | --          |
| Stimulus grant spending   | --                             | --          | (356)       |
| Stimulus grant recoveries   | --                             | --          | 773         |
| Cash proceeds from sale of discontinued operations, net of cash disposed of   | --                             | --          | 7,129       |
| Deposit with FCC for Auctions   | (11,000)                       | --          | (19,000)    |
| Return of deposit from FCC  | --                             | 19,000      | 11,000      |
| Other   | 171                            | 581         | 756         |
| Net cash provided by (used in) investing activities from continuing operations  | (27,238)                       | 780         | (16,234)    |
| Net cash (used in) investing activities from discontinued operations  | --                             | --          | (2,320)     |
| Net cash provided by (used in) investing activities   | (27,238)                       | 780         | (18,554)    |

*(continued)*

**LICT CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
*(in thousands)*

|  | <b>Year Ended December 31</b> |             |             |
|--|-------------------------------|-------------|-------------|
|  | <b>2016</b>                   | <b>2015</b> | <b>2014</b> |
| <b>FINANCING ACTIVITIES</b>  |                               |             |             |
| Payments to reduce long-term debt                                  | (4,716)                       | (5,033)     | (8,701)     |
| Borrowings related to lines of credit                              | 7,000                         | --          | 45,042      |
| Payments to reduce lines of credit                                 | (5,000)                       | --          | --          |
| Repayments related to lines of credit                              | --                            | (8,442)     | (39,800)    |
| Repayment of FCC Auction Loan to affiliate                         | --                            | (15,000)    | (11,000)    |
| Purchase of treasury stock   | (2,575)                       | (3,302)     | (775)       |
| Payments of debt issue cost  | --                            | (12)        | (280)       |
| Short term loan from affiliate for FCC Deposit                     | --                            | --          | 15,000      |
| Net cash used in financing activities from continuing operations   | (5,291)                       | (31,789)    | (514)       |
| Net cash used in financing activities from discontinued operations | --                            | --          | (1,227)     |
| Net cash used in financing activities                              | (5,291)                       | (31,789)    | (1,741)     |
| Net increase (decrease) in cash and cash equivalents               | (6,278)                       | (3,407)     | 8,883       |
| Cash and cash equivalents at beginning of year                     | 14,748                        | 18,155      | 9,272       |
| Cash and cash equivalents at end of year                           | \$8,470                       | \$14,748    | \$18,155    |
| Cash paid during the year for:                                     |                               |             |             |
| Interest   | \$2,511                       | \$2,676     | \$3,716     |
| Income tax payments, net of refunds                                | \$2,885                       | \$1,986     | \$4,672     |
| Non-cash transactions:   |                               |             |             |
| Sale of DFT  |                               |             |             |
| Subordinated note issued from Brick Skirt                          | \$--                          | \$--        | \$3,250     |
| Brighton Debt to DFT forgiven by Brick Skirt                       | --                            | --          | 1,116       |
| Minority Interest in DFT   | --                            | --          | 306         |
|  | \$--                          | \$--        | \$4,672     |

*See Accompanying Notes to Consolidated Financial Statements.*

## **LICT CORPORATION AND SUBSIDIARIES**

### **Notes to Consolidated Financial Statements**

#### **1. Accounting and Reporting Policies**

##### **Organization**

LICT Corporation, (the “Company” or “LICT”) is an integrated communications company that trades on the OTC Pink Sheets under the symbol LICT and has not paid cash dividends since its inception in 1990.

LICT’s telecommunications subsidiaries operate in rural communities in nine states, providing regulated and unregulated communications services including local telephone service, network access, transport, high speed internet access, long-distance service, cable television, and competitive local exchange carrier (“CLEC”) services. LICT’s operating telephone companies include Western New Mexico Telephone Company in New Mexico; Cuba City Telephone Exchange Company and Belmont Telephone Company in Wisconsin; Bretton Woods Telephone Company in New Hampshire; J.B.N. Telephone Company and Haviland Telephone Company, in Kansas; Upper Peninsula Telephone Company and Michigan Central Broadband Company in Michigan; Central Scott Telephone Company in Iowa; Central Utah Telephone, Skyline Telecom and Bear Lake Communications in Utah; and California-Oregon Telephone Company in California.

##### **Basis of Presentation**

The accompanying consolidated financial statements represent the accounts of LICT and its wholly owned subsidiaries, which consist of communications (voice and data), cable television, and internet services. All significant inter-company transactions and balances have been eliminated in consolidation. Investments in affiliates in which the Company does not have majority voting control but has the ability to significantly influence financial and operating policies are accounted for in accordance with the equity method of accounting. The Company accounts for the following affiliated companies on the equity method of accounting: cellular partnership in California (25% owned), and telecommunications operations in California, Kansas, New York and Utah (2% to 14% owned through partnerships), and the previously sold rural communication and alarm system subsidiary in New York, in which we own 20% through common stock warrants that were exercised in July 2015. All other investments are measured at cost.

The Company’s telephone subsidiaries are public utilities that are regulated by both the Federal Communications Commission (FCC) and various state commissions. The subsidiaries follow the accounting prescribed by the Uniform System of Accounts of the FCC, the state commissions, and regulated accounting practices. Where applicable, this regulated accounting recognizes the economic effects of rate regulation by recording costs and a return on investment as such amounts are recovered through rates authorized by regulatory authorities. Accordingly, the Company is required to depreciate telephone plant over useful lives prescribed by regulators that would otherwise be determined by management. Criteria that would give rise to the discontinuance of regulatory accounting practices include (1) increasing competition restricting the Company’s wireline businesses’ ability to establish prices to recover specific costs and (2) significant changes in the manner in which rates are set by regulators from cost-based regulation to another form of regulation. The Company periodically reviews the applicability of regulatory accounting guidelines based on the developments in its current regulatory and competitive environments.

## **Subsequent Events**

The Company has evaluated events subsequent to the balance sheet date and prior to issuance of the financial statements for the year ended December 31, 2016 through April 20, 2017, the issuance date of the financial statements.

## **Use of Estimates**

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include the useful lives of fixed assets; allowances for doubtful accounts; the valuation of deferred tax assets, goodwill and other intangible assets, marketable securities; liabilities for income tax uncertainties; the application of regulated accounting practices; reserves for National Exchange Carrier Association (NECA) revenues, and other contingencies. The current economic environment has increased the degree of uncertainty inherent in those estimates and assumptions.

## **Cash and Cash Equivalents**

Cash equivalents consist of highly liquid investments with original maturities of three months or less when purchased.

## **Concentration of Risks**

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of cash and cash equivalents. Management believes the financial risks associated with these financial instruments are minimal.

Cash equivalents held in United States Treasury money market funds totaled \$4.6 million and \$10.7 million at December 31, 2016 and 2015, respectively, and are insured by Securities Investor Protection Corporation ("SIPC") up to \$500,000 per separate capacity account. The Company maintains its cash balance in accounts which, at times, may exceed the \$250,000 Federal Deposit Insurance Corporation (FDIC) limits per financial institution.

In 2016, the Company received \$31.3 million, or 34% of its revenue, from the Federal Universal Service Fund, various state funds and the National Exchange Carrier Association (NECA). In 2015 and 2014, respectively, the Company received \$28.3 million, or 33% and \$33.2 million, or 39% from such sources.

## **Investment income - Patronage**

The Company has loans with CoBank, a cooperative owned and controlled by its members that requires each customer to own a restricted share of CoBank. Each customer borrowing from the bank shares in the bank's net income through receipt of patronage refunds. In 2016, 2015 and 2014, 75% of patronage refunds were received in cash, with the balance in CoBank stock. Total patronage refunds were \$0.2 million, \$0.1 million and \$0.1 million in 2016, 2015 and 2014, respectively, and were included as investment income in the Company's consolidated statement of operations. Patronage stock is redeemable at its face value for cash ten years after the related debt is paid off. Patronage redemptions were \$0.4 million in each of 2016, 2015 and 2014.

## **Accounts Receivable**

Accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company establishes an allowance for doubtful

accounts based upon factors surrounding the credit risk of specific customers, historical trends, and other information. Receivable balances are reviewed on an aged basis and account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is doubtful. Due to the dispersed geographic nature of the Company's operations and the residential nature of its customers, no single customer or identifiable group of customers' accounts for a significant amount of the Company's receivable balances, other than from NECA as discussed in "Revenue Recognition" below.

### **Materials and Supplies**

Inventories, consisting of materials and supplies, are stated at cost and are not held for sale, but rather for purposes of supporting the Company's business.

### **Property, Plant and Equipment**

Property, plant and equipment are recorded at cost and include expenditures for additions and major improvements and, for our regulated telephone companies, include an allowance for funds used during construction (AFUDC). Maintenance and repairs are charged to operations as incurred. Depreciation of telephone plant is computed on the straight-line method using class or overall group rates acceptable to regulatory authorities. This accounting recognizes the economic effects of rate regulation by recording costs and a return on investment, and as such, amounts are recovered through rates authorized by regulatory authorities. Accordingly, the Company is required to depreciate plant and equipment over the useful lives that would otherwise be determined by management. Depreciation of non-telephone property is computed on the straight-line method over the estimated useful lives of the assets.

Depreciable lives for the Company's telephone and non-telephone properties, excluding land, range from 15 to 40 years for buildings, 3 to 50 years for machinery and equipment and 3 to 25 years for other assets. Regulated telecommunication assets acquired from other regulated entities are capitalized using the pre-existing entity's gross cost and associated accumulated depreciation.

When a portion of the Company's depreciable property, plant and equipment relating to its telephone operations business is retired, the gross carrying value of the assets, including cost of disposal and net of any salvage value, is charged to accumulated depreciation, in accordance with regulated accounting procedures.

### **Goodwill and Other Intangible Assets**

The Company evaluates the recoverability of goodwill and other intangible assets with indefinite lives for impairment annually, or more often, whenever events or circumstances indicate that such assets may be impaired. In September 2011, the FASB issued ASU 2011-08, *Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment*. This ASU permits an entity to make a qualitative assessment of whether it is more likely than not that a reporting unit's fair value is less than its carrying amount before applying the two-step goodwill impairment test. If an entity concludes it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, it need not perform the two-step impairment test as required in FASB ASC Topic 350, *Intangibles- Goodwill and Other*. The Company utilized the two-step goodwill impairment test in 2016 and 2015 for all reporting units. In 2016, goodwill impairment is determined using the two-step process prescribed in FASB ASC Topic 350, *Intangibles - Goodwill and Other*. The first step is to screen for potential impairment, in which the Company determines the fair value for each reporting unit. The Company estimates the fair value of each reporting unit based on a number of subjective factors, including: (a) appropriate weighting of valuation approaches (income approach and market approaches), (b) estimates of our future cost structure, (c) discount rates for our estimated cash flows, (d) selection of peer group companies for the market approach, (e) required level of working capital, (f) assumed terminal value and (g) time horizon of cash flow forecasts.



If such tests indicate potential impairment, then a second step measures the amount of impairment, if any. Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation and the residual fair value after this allocation is the implied fair value of the reporting unit goodwill. The Company estimates the fair value using Level 3 inputs, as defined by the fair value hierarchy (see Note 9).

The impairment test for other intangible assets not subject to amortization consists of a comparison of the fair value of the intangible asset with its carrying value. If the carrying value of the intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess. The Company estimates the fair value using Level 3 inputs.

The Company performed its annual impairment tests of goodwill as of September 30, 2016, 2015 and 2014 and no impairment charge was required.

In addition to goodwill, intangible assets with indefinite lives, including cellular licenses and spectrum, had a carrying value of \$2.0 million at December 31, 2016 and \$1.9 million at December 31, 2015, respectively.

The Company's subscriber lists and related rights are generally amortized over a 10 to 15-year life. Such intangible assets had a gross value of \$5.3 million at December 31, 2016 and \$5.2 million at December 31, 2015, and accumulated amortization of \$5.2 million and \$5.1 million at December 31, 2016 and 2015, respectively. Amortization expense was \$48,000 in 2016, \$129,000 for 2015 and \$130,000 for 2014, respectively, and is estimated to be \$16,000 per year in years 2017 to 2019 and \$4,000 in year 2020.

### **Impairment of Long-lived Assets**

Long-lived assets, such as property, plant, and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset (or asset group) to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell, and depreciation ceases. There were no asset impairments recorded during the years ended December 31, 2016, 2015 and 2014.

### **Deferred Financing Costs**

Expenses incurred in connection with the issuance of long-term debt are deferred and are amortized over the life of the respective debt issued. Amortization amounted to \$114,000 for 2016 and 2015, and \$134,000 for 2014, and was recorded as interest expense.

Retrospectively, on January 1, 2016, the Company amended the presentation of debt issuance for its Term Loan Facility. As a result, the deferred financing costs of \$46,000 at December 31, 2016 and \$65,000 at December 31, 2015 are netted against debt on the consolidated balance sheets. The 2015 amounts were previously disclosed in other assets.

### **Commitments and Contingencies**

Liabilities for loss contingencies arising from claims, assessments, litigation, fines, and penalties and other sources, are recorded when it is probable that a liability has been incurred and the amount

can be reasonably estimated. Legal costs incurred in connection with loss contingencies are expensed as incurred.

### **Revenue Recognition**

Telephone service revenue is primarily derived from regulated local, intrastate and interstate access services and is recognized as services are provided. Revenues for our cost-based companies are generally derived from the Company's cost for providing services.

Local access revenue comes from providing local telephone exchange services and is billed to end users in accordance with tariffs filed with each state's Public Utilities Commission. Local access revenue is predominantly billed in advance and recognized as revenue when earned.

Revenue that is billed in arrears includes most intrastate and interstate network access services, nonrecurring local services and long distance services. The earned but unbilled portion of this revenue is recognized as revenue in the period that the services are provided.

Revenue from intrastate access is based on tariffs approved by each state's Public Utilities Commission. Revenue from interstate access is derived from settlements with NECA. NECA was created by the FCC to administer interstate access rates and revenue pooling on behalf of small local exchange carriers who elect to participate in a pooling environment. LICT's RLEC subsidiaries include nine cost based companies and five average schedule companies. Interstate settlements for cost based companies, including amounts received from the federal Universal Service Fund ("USF"), are determined based on the Company's cost of providing interstate telecommunications service, including investments in specific types of infrastructure and operating expenses and taxes. Interstate settlements for average schedule companies, including amounts received from Universal Service Funds, are determined based on formula based costs using industry averages, which are intended to represent a surrogate for company specific costs.

The FCC still has an ongoing proceeding considering whether to make other changes to switched and special access services. Accordingly, the Company cannot predict the long term impact at this time but believes the Order provides a stable regulatory framework to facilitate its ongoing focus on the deployment of broadband into its rural markets.

Other businesses from which revenues are derived include the Company's internet, CLEC, wireless, long-distance and cable, all for which revenues are recognized as services are provided. Additionally, deferred revenue resulting from installation or other services are included in other liabilities.

### **Stock Based Compensation**

The Company has granted restricted stock awards ("RSAs") to five employees as of December 31, 2016. The Company used a fair value based method of accounting for stock-based compensation provided to our employees. The estimated fair value of RSAs is determined by using the closing price of Common Stock ("Common Stock") on the day prior to the grant date. The total expense, which would be reduced by estimated forfeitures, is recognized over the vesting period for these shares from the date of grant to the vesting date. During the vesting period, dividends to RSA holders are held for them until the RSA vesting dates and are forfeited if the grantee is no longer employed by the Company on the vesting dates. Dividends declared on these RSAs, less estimated forfeitures, are charged to retained earnings on the declaration date. Due to the limited number of employees currently participating in the program, the current forfeiture rate is estimated to be zero.

|                                  | <b>Weighted Average<br/>Grant Date</b> |                             |
|----------------------------------|--|-----------------------------|
|                                  | <b>Shares</b>                          | <b>Fair Value per Share</b> |
| 2015 Grants                      | 89                                     | \$5,100                     |
| Outstanding at December 31, 2015 | 89                                     | \$5,100                     |
| 2016 Grants                      | 34                                     | 5,175                       |
| Outstanding at December 31, 2016 | 123                                    | \$5,121                     |

The 2015 awards includes 29 shares vested on January 1, 2017, and 60 shares, which were to originally scheduled to vest on January 1, 2017, were amended to vest on July 1, 2017. The accounting impact of the amendment was immaterial. The 2016 awards vest on January 1, 2018.

On January 31, 2017, the Company awarded 35 shares of its stock to two members of executive management.

### **Broadband Stimulus Grants**

In 2010, four of the Company's subsidiaries were awarded a total of \$6.5 million of grant and \$1.0 million of loan stimulus funds from the Department of Agriculture's Rural Utilities Service ("RUS") Broadband Initiatives Program. In addition, the Company is obligated to spend an additional \$1.1 million of its own funds to complete such projects. This funding is aimed at expanding broadband access in unserved and underserved portions of the nation. LICT will expand and upgrade broadband service at four of our Telephone Companies, in New Hampshire, Kansas, California and Utah, with this stimulus funding. Through December 31, 2015, LICT spent \$7.4 million on such stimulus projects. We did not spend any stimulus funds in 2016 and 2015.

Capital expenditures related to the broadband stimulus grants are initially recorded in property, plant and equipment. In the same period, an offsetting credit is recorded in property, plant and equipment and a receivable representing the expected reimbursement from the RUS is recorded. Cash received from the grant in excess of capital spending is recorded in a restricted cash account included in other current assets. In the cash flow statement, grant spending, grant recoveries and recoveries in excess of spending (restricted cash) are shown as separate inflows and outflows within investing activities.

### **Income Taxes**

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax effects attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Accounting guidance concerning uncertain income tax positions requires the Company to recognize the effect of income tax positions only if those positions are more likely than not to be sustained. There were no uncertain tax positions to report in 2016 and 2015. Recognized income tax positions are measured at the largest amount that is greater than 50% likely to be realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs.

### **Earnings Per Share**

Basic and diluted earnings per common share amounts are based on the weighted average number of common shares outstanding during each period. The restricted stock awards are dilutive and the weighted average outstanding is included in the diluted weighted average number of common shares.

### **Noncontrolling Interest**

Prior to January 1, 2015 the Company consolidated certain subsidiaries that were less than 100% owned. The portion of such subsidiaries not owned by the Company was shown as Noncontrolling Interests in the Consolidated Statements of Income and Comprehensive Income, Balance Sheets, Cash Flows and Shareholders' Equity.

### **Business Acquisitions**

The Company accounts for business acquisitions using the purchase method of accounting and, accordingly, the financial statements reflect the allocations of the total purchase price to the net tangible and intangible assets acquired, based on their respective fair values at the date of acquisition. The results of operations of acquired businesses are reflected by the Company from the date of acquisition. Transaction costs related to the business acquisitions are expensed as incurred and included in general and administrative costs in the Consolidated Statements of Income. On November 16, 2015, Dixon Acquisition, LLC, a wholly-owned subsidiary of Central Scott Telephone Company, acquired the assets and operations of Dixon Telephone Company in eastern Iowa.

## **2. Dispositions and Discontinued Operations**

On December 24, 2014, the Company sold its subsidiary, DFT Communications Corporation ("DFT") to Brick Skirt Holdings, Inc. ("Brick Skirt"), an entity owned by DFT's management and former owners of DFT. DFT provides broadband, voice and other telecommunications services in areas of western New York State, principally the Dunkirk/Fredonia, Cassadaga and Jamestown areas. Effective as of the date of sale and as disclosed in Note 12, LICT elected to early adopt the guidance of ASU 2014-08: Presentation of Financial Statements (Topic 205) and Property, Plant and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, and has concluded that the disposal of DFT meets the criteria to be treated as a discontinued operation.

LICT received \$7.4 million in cash, a promissory note of \$3.3 million and \$1.1 million of debt to the former shareholders of DFT was forgiven. The net result is that the Company recognized a pre-tax gain on the sale of approximately \$1.1 million and \$399,000 of taxes in 2014. The sale of DFT enables the Company to focus on its core geographic area, the central and western parts of the United States. The Company maintains a 20% equity position in DFT through common stock warrants granted as part of the transaction, which were valued at \$306,000 as of December 24, 2014, and which were exercised on July 1, 2015. In 2016, the Company made a capital contribution to Brick Skirt's equity in the amount of \$107,000. This was done with other shareholders of Brick Skirt on a pro rata basis. The Company has the right to two seats on the Brick Skirt board, as long as the note remains outstanding. The Company recognized a loss of \$24,000 for its portion of the DFT net loss for the period of December 24, 2014 through December 31, 2014. The equity method is utilized to recognize the results of DFT operations in the Company results. The terms of the sale included a working capital adjustment that resulted in an additional after-tax gain of \$117,000 which was recognized in 2015. During 2016 and 2015, LICT recorded interest income totaling \$165,000 related to the promissory note with Brick Skirt.

The following is a summary of DFT's directly attributable operating results, which are included in income from discontinued operations for the period ended December 24, 2014:

|                                     | <b>2014</b>           |
|-------------------------------------|-----------------------|
|                                     | <i>(in thousands)</i> |
| Revenues                            | \$15,240              |
| Cost of revenues                    | 14,571                |
| Operating profit                    | 669                   |
| Other expense                       | (510)                 |
| Income tax expense                  | (29)                  |
| Noncontrolling interest             | (74)                  |
| Income from discontinued operations | \$56                  |

### 3. Investments in Affiliated Companies

A subsidiary of LICT owns a 25% partnership interest in a cellular telephone provider in Northern California, California RSA #2. As of December 31, 2016 and 2015, the carrying value of the equity ownership in the partnership was \$3.8 million and \$3.7 million, respectively.

In April 2014, WAPSI Wireless, LLC, in which a subsidiary of LICT owned a 14.29% interest, sold substantially all of its assets and distributed the cash proceeds to its shareholders. The LICT subsidiary received \$875,000 and recognized a pre-tax gain of approximately \$188,000. In 2015, the LICT subsidiary received approximately \$124,000 as the final distribution from WAPSI Wireless.

Undistributed earnings of companies accounted for using the equity method that are included in consolidated retained earnings are \$3.1 million and \$3.4 million as of December 31, 2016 and 2015.

### 4. Property, Plant and Equipment

Components of the Company's property, plant and equipment and accumulated depreciation are as follows:

|  | <b>Year Ended December 31,</b> |             |
|--|--------------------------------|-------------|
|  | <b>2016</b>                    | <b>2015</b> |
|  | <i>(in thousands)</i>          |             |
| Property, plant and equipment:                             |                                |             |
| Land   | \$955                          | \$938       |
| Buildings and improvements                                 | 17,438                         | 17,171      |
| Machinery, vehicles, equipment and construction in process | 320,295                        | 307,284     |
|  | 338,688                        | 325,393     |
| Accumulated depreciation                                   | (251,563)                      | (236,671)   |
|  | \$87,125                       | \$88,722    |

Depreciation and amortization expense for 2016, 2015 and 2014 was approximately \$17.9 million, \$17.6 million and \$17.5 million, respectively.

## 5. Line of Credit and Debt

The Company's long term debt facilities contain covenants that restrict the distribution of cash and other net assets between subsidiaries or to the parent company. Long-term debt represents borrowings by various subsidiaries of LICT.

|  | <u>Year Ended December 31.</u> |                 |
|--|--------------------------------|-----------------|
|  | <u>2016</u>                    | <u>2015</u>     |
|  | <i>(in thousands)</i>          |                 |
| Long-term debt consists of:  |                                |                 |
| Rural Utilities Service (RUS) and Rural Utilities Service broadband initiatives program (BIP), and Rural Telephone Bank (RTB) notes payable in equal monthly or quarterly installments through 2031 at fixed interest rates ranging from 2.1% to 7.2% (4.3% weighted average), secured by assets of the J.B.N. Telephone Company | \$1,479                        | \$3,472         |
| Revolving Credit Facility from CoBank, ACB through 2020 at a weighted average variable interest rate of 3.24%  | 16,000                         | 14,000          |
| Term loan through 2019 at variable interest rates averaging 3.06%  | 1,975                          | 3,092           |
| Unsecured notes issued to sellers in connection with acquisitions at fixed interest rates of either 6.0% or 8.0% (7.2% weighted average)   | 22,676                         | 24,282          |
| Deferred financing costs   | (46)                           | (65)            |
|  | <u>42,084</u>                  | <u>44,781</u>   |
| Current maturities   | (4,723)                        | (12,610)        |
|  | <u>\$37,361</u>                | <u>\$32,171</u> |

In December 2014, the Company secured a \$30 million Revolving Credit Facility agreement with CoBank, which was to expire in December, 2017 with an interest rate of LIBOR plus 2.5%. This Line of Credit replaced the Company's previous \$25.0 million line of credit agreement with an affiliate of its Chairman, who is also the Chief Executive Officer, expiring on June 30, 2016 with an interest rate of LIBOR plus 4.0%. On April 12, 2017, the due date was extended until March 31, 2020, and at the same terms, except that the total Facility was expanded from \$30 million to \$50 million. Accordingly, in the Company's Consolidated Balance Sheet the outstanding balance at December 31, 2016 was classified as long-term. The outstanding balance under the line of credit facility with CoBank, included as bank credit facility in the table above, was \$16.0 million at December 31, 2016 and \$14.0 million at December 31, 2015. The average balance of notes payable outstanding was \$14.8 million in 2016 and \$17.9 million in 2015; the highest amount outstanding was \$18.0 million in 2016 and \$22.4 million in 2015; and the average interest rate was 3.0% in 2016 and 3.4% in 2015.

A subsidiary has a \$13.0 million term loan from CoBank. Principal payments are due quarterly based on a calculated commitment reduction through the loan's maturity in September 2019. The term loan contains various restrictive covenants, including maintaining debt service coverage and interest coverage to earnings ratios, total leverage ratio, and limitations on capital expenditures. The interest rate on the loan is equal to LIBOR plus 2.25%. As of December 31, 2016, and 2015, the interest rate was 3.1% and 2.7% respectively. All assets of the Company, excluding the investment INS, are held as collateral for the loan with CoBank. The term loan balance was \$2.0 million and \$3.1 million as of December 31, 2016, and 2015, respectively. Deferred financing costs of \$46,000, and \$65,000, at December 31, 2016 and 2015, respectively, are related to this loan and are shown as an offset to long term debt on the accompanying balance sheet.

In October 2014, the Company received a \$15.0 million loan from its Chairman to assist in funding the \$19.0 million deposit with the FCC, to enable its participation in FCC Auction No 97. The Note bore interest at .38% per annum and was due with the principal payment four months after the closing of the Auction 97. The auction ended on January 29, 2015 and the Company did not acquire any licenses. On February 6, 2015, the FCC refunded the Company's \$19.0 million deposit for Auction 97, and on February 9, 2015, the \$15 million loan from our Chairman was repaid with interest of approximately \$19,000.

In December 2013, the Company received an \$11.0 million loan from an affiliate of its Chairman to fund its participation in FCC Auction No 96. The Note bore interest at 6% per annum and was due with the principal payment four months after the closing of the Auction 96. The auction ended on February 27, 2014 and the company did not acquire any licenses. On March 7, 2014, the \$11.0 million loan was repaid with interest of approximately \$143,000.

Aggregate principal maturities of long-term debt at December 31, 2016 for each of the next five years are as follows: 2017- \$4.7 million, 2018- \$10.2 million, 2019- \$1.9 million, 2020- \$17.0 million, 2021 - \$7.8 million and thereafter- \$0.5 million.

## **6. Related Party Transactions**

Since 1998, LICT leases its corporate headquarters from an affiliate of its Chairman. The lease expires in 2023 and rent expense, including utilities and escalation, was \$120,000, \$124,000 and \$120,000 in 2016, 2015 and 2014, respectively. In September 2014, the Company sublet 485 square feet of its corporate office space to another affiliate of the Chairman. The sublet lease expires on December 5, 2023 and the base rental rate is \$20,000 per annum. In addition, expenses relating to administrative support, transportation, and communications paid to the same affiliate were \$163,000, \$165,000 and \$136,000 for 2016, 2015 and 2014, respectively.

At December 31, 2016 and 2015, assets of \$4.6 million and \$10.7 million, which are classified as cash and cash equivalents, are invested in United States Treasury money market funds for which affiliates of the Company's Chairman serve as investment managers to the respective funds.

Shares of CIBL Inc. ("CIBL") were distributed to LICT shareholders in 2007. LICT is party to a Transitional Administrative and Management Services Agreement (TAMSA) under which LICT provides management and administrative services to CIBL, extended annually by the parties. Payments under these agreements were \$125,000 in 2016, \$125,000 in 2015 and \$300,000 in 2014. In addition, in 2016 and 2015, LICT received \$100,000 from a subsidiary of CIBL for management services.

During 2014, the Company executed a \$25 million line of credit agreement with an affiliate of its Chairman. This line of credit was replaced by a new line of credit with CoBank in December 2014. During 2014 the Company paid interest of \$667,000 on the line of credit with the affiliate of its Chairman.

The Company has subordinated notes payable to former owners of certain of its telephone companies in connection with acquisitions (see Note 5).

## **7. Shareholder's Equity**

LICT's Board of Directors has authorized the purchase of up to 5,800 shares of its common stock. Through December 31, 2016, 5,358 shares allowed under the bank covenants have been purchased on the open market, at an average investment of \$3,365 per share.

## 8. Income Taxes

LICT files a consolidated income tax return with its subsidiaries for federal income tax purposes. Certain entities file separate state and local income tax returns, while others file on a combined or consolidated basis.

The provision benefit for income taxes from continuing operations is summarized as follows:

|                                  | <b>Year Ended December 31,</b> |                |                |
|----------------------------------|--------------------------------|----------------|----------------|
|                                  | <b>2016</b>                    | <b>2015</b>    | <b>2014</b>    |
|                                  | <i>(in thousands)</i>          |                |                |
| Current taxes:                   |                                |                |                |
| Federal                          | \$3,936                        | \$2,227        | \$3,408        |
| State and local                  | 976                            | 655            | 1,108          |
|                                  | <u>4,912</u>                   | <u>2,882</u>   | <u>4,516</u>   |
| Deferred taxes:                  |                                |                |                |
| Federal                          | (170)                          | 1,838          | 920            |
| State and local                  | (108)                          | 240            | 117            |
|                                  | <u>(278)</u>                   | <u>2,078</u>   | <u>1,037</u>   |
| Total provision for income taxes | <u>\$4,634</u>                 | <u>\$4,960</u> | <u>\$5,553</u> |

A reconciliation of the provision for income taxes from continuing operations and the amount computed by applying the statutory federal income tax rate to income before income taxes and minority interest:

|   | <b>Year Ended December 31,</b> |                |                |
|---|--------------------------------|----------------|----------------|
|   | <b>2016</b>                    | <b>2015</b>    | <b>2014</b>    |
|   | <i>(in thousands)</i>          |                |                |
| Tax at statutory rate                         | \$4,167                        | \$4,348        | \$ 5,008       |
| Increases (decreases):                        |                                |                |                |
| State and local taxes, net of federal benefit | 565                            | 591            | 800            |
| Other   | (98)                           | 21             | (255)          |
| Total provision for income taxes              | <u>\$4,634</u>                 | <u>\$4,960</u> | <u>\$5,553</u> |

Deferred income taxes for 2016 and 2015 are provided for the temporary differences between the financial reporting bases and the tax bases of the Company's assets and liabilities. Cumulative temporary differences at December 31, 2016 and 2015 are as follows:

|   | <b>Year Ended</b>     |                 |
|---|-----------------------|-----------------|
|   | <b>2016</b>           | <b>2015</b>     |
|   | <i>(in thousands)</i> |                 |
| Fixed assets and depreciation                   | \$13,816              | \$14,692        |
| Unrealized gains on investments                 | 1,129                 | 1,129           |
| Partnership tax losses in excess of book losses | 257                   | 307             |
| Other reserves and accruals                     | 4,890                 | 4,242           |
| Total deferred tax liabilities                  | <u>\$20,092</u>       | <u>\$20,370</u> |

The Company recognizes tax liabilities in accordance with guidance for uncertain tax positions and adjusts these liabilities when its judgment changes as a result of the evaluation of new information not previously available. Due to the complexity of some of these uncertainties, the ultimate resolution may result in a payment that is materially different from our current estimate of the tax



liabilities. These differences will be reflected as increases or decreases to income tax expense in the period in which they are determined.

The Company remains subject to examination for tax years 2013 through 2016 by the Internal Revenue Service and with few exceptions, is subject to state examinations by tax authorities for the same three years.

## **9. Fair Value Measurement**

The Company follows the authoritative guidance for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the financial statements on a recurring basis, and of nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis, or are presented only in disclosures. Authoritative guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date and establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three levels. Level 1 inputs are quoted prices in active markets for identical assets or liabilities. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, or quoted prices for identical assets and liabilities in inactive markets. Level 3 inputs are unobservable.

The Company has two types of assets that are measured at fair value: U.S. Treasury money market funds, included in cash and cash equivalents in the accompanying Balance Sheet, and marketable securities, included in other assets, which are both classified as Level 1 inputs because they are valued using quoted market prices. US Treasury money market funds had a value of \$4.6 million and \$10.7 million at December 31, 2016 and 2015, respectively. The Company had no marketable securities as of December 31, 2016 and 2015.

Cash in banks, trade accounts receivable, short-term borrowings, trade accounts payable and accrued liabilities are carried at cost, which approximates fair value due to the short-term maturity of these instruments. The fair value of the Company's borrowings under its long-term debt obligations is approximately \$0.3 million higher than its carrying value based on borrowing rates for similar instruments. The fair value of the Company's revolving line of credit approximates carrying amount, as the obligations bear interest at a floating rate.

## **10. Employee Benefit Plans**

LICT maintains several defined contribution plans at its telephone subsidiaries and corporate office. LICIT's contributions under these plans, which vary by subsidiary, are based primarily on the financial performance of the business units and employee compensation. Total discretionary employer contribution expense related to these plans was \$1.6 million in 2016, \$1.5 million in 2015 and \$1.4 million in 2014.

The Company has a Principal Executive Bonus Plan that has been approved by the shareholders, for which \$0.5 million, \$0.3 million and \$0.3 million was recorded in 2016, 2015 and 2014, respectively.

## **11. Charitable Contribution Programs**

During 2016, the Company established a Shareholder Designated Charitable Contribution program. Under the program, each shareholder is eligible to designate a charity to which the Company would make a donation based upon the actual number of shares registered in the shareholder's name. Shares held in nominee or street name were not eligible to participate. The Board of Directors approved one contribution during 2016 of \$100 per registered share. During 2016, the Company recorded a charge of \$1.0 million before tax benefit, or \$30.42 per diluted

share, net of tax benefit related to the contributions which were included in Operating Costs in the Consolidated Statements of Income.

In addition, also during 2016, Company established an Employee Matching Charitable Contribution program in which the Company recorded a charge of \$0.1 million before tax benefit, or \$3.05 per diluted share, net of tax benefit related to the contributions which were also included in Operating Costs in the Consolidated Statements of Income.

## **12. Commitments and Contingencies**

### *Leases.*

The Company leases certain land, office space, computer equipment, computer software, and network services equipment under non-cancelable operating leases that expire in various years through 2028. Terms of the leases, including renewal options and escalation clauses, vary by lease. When determining the term of a lease, the Company includes renewal options that are reasonably assured. Rental expense under operating leases was \$0.6 million in each of 2016, 2015 and 2014. Minimum lease payments due under non-cancelable operating leases at December 31, 2016 are as follows: \$0.6 million in 2017; \$0.5 million in 2018; \$0.4 million in 2019, \$0.3 million in 2020; \$0.2 in 2021 and \$0.3 million thereafter.

The Company is involved from time to time in various legal proceedings, regulatory investigations, and claims arising in the normal conduct of business, which may include proceedings that are specific to us and others generally applicable to business practices within the industries in which we operate. A substantial legal liability or a significant regulatory action against us could have an adverse effect on our business, financial condition, and on the results of operations in a particular year. LICT was not involved in any legal proceedings in 2016, which had any significant effect on its financial results, and is not involved in any ongoing legal proceedings which would be expected to have any such effect in 2017.

## **13. New Accounting Pronouncements**

**Revenue from Contracts with Customers** - In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers," which supersedes the revenue recognition requirements in the Accounting Standards Codification ("Codification") Topic 605, Revenue Recognition, and most industry-specific guidance throughout the industry topics of the Codification. The core principle of the new ASU No. 2014-09 is for companies to recognize revenue from the transfer of goods or services to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. The new standard provides a five-step approach to be applied to all contracts with customers and also requires expanded disclosures about revenue recognition. ASU No. 2016-08 "Principal versus Agent Considerations" amends ASU No. 2014-09 to clarify if an entity is considered a principal, an agent, or both in the contract. In addition, ASU No. 2016-20 "Technical Corrections and Improvements in Topic 606 Revenue from Contracts with Customers" provides additional clarification to a number of topics addressed in ASU No. 2014-09. The three ASUs are effective for annual reporting periods beginning after December 15, 2017, including interim periods and is either applied on a retrospective or modified retrospective basis. The Company is currently evaluating this guidance and the impact it will have on its consolidated financial statements.

**Deferred Financing Costs** - In April 2015, the FASB issued ASU 2015-03, which amends the presentation of debt issuance costs in financial statements. This amended guidance requires entities to present the cost of debt issuances as a reduction of the related debt rather than as an asset. This guidance is effective for the Company beginning January 1, 2016. The Company adopted this guidance retrospectively on January 1, 2016. As a result, the debt issuance costs related to the Term Loan totaling \$46,000 at December 31, 2016 and \$65,000 at December 31, 2015 are netted against

debt on the consolidated balance sheets. The 2015 amounts were previously disclosed in other assets on the consolidated balance sheets.

**Deferred Taxes** – In November 2015, the FASB issued ASU 2015-17 to simplify the presentation of deferred income tax assets and liabilities. Current GAAP requires an entity to separate deferred income tax assets and liabilities into current and non-current classifications. This guidance requires that all deferred tax liabilities be classified as non-current. The Company adopted this guidance on January 1, 2016, and adoption did not have a material effect on our consolidated financial statements.

**Leases** - In February, 2016, the FASB issued Accounting Standard Update No. 2016-02, Leases for lease accounting under GAAP. The new standards, which were developed in coordination with new international accounting standards, are intended to eliminate off-balance-sheet recording of lease obligations in an effort to cause financial statements to more accurately reflect a company's leasing activities. This guidance is effective for fiscal years beginning after December 15, 2018. We expect to adopt this guidance when effective and adoption is not expected to have a material effect on our consolidated financial statements.

**Compensation—Stock Compensation** - In March 2016, the FASB issued ASU 2016-09, which simplifies several aspects of the accounting for employee share-based payment transactions for both public and nonpublic entities, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The ASU is effective for annual reporting periods beginning after December 15, 2016, including interim periods within those annual reporting periods. Early adoption is permitted. The Company has adopted this ASU effective January 1, 2017 without a material impact on its consolidated financial statements.

**Presentation of Financial Statements – Going Concern** - In August 2014, the FASB issued ASU No. 2014-15, “Presentation of Financial Statements – Going Concern,” which provides guidance on determining when and how reporting entities must disclose going-concern uncertainties in their financial statements. The new standard requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date of issuance of the entity's financial statements. Further, an entity must provide certain disclosures if there is “substantial doubt about the entity's ability to continue as a going concern.” The FASB believes that requiring management to perform the assessment will enhance the timeliness, clarity, and consistency of related disclosures. The ASU is effective for annual periods ending after December 15, 2016, and for annual and interim periods thereafter. The Company has adopted this ASU effective December 31, 2016. No additional disclosures were required in these consolidated financial statements based on management's assessment that it does not have substantial doubt about the Company's ability to continue as a going concern.

**Statement of Cash Flows: Classification of Certain Cash Receipts and Payments** - In August 2016, the FASB issued ASU 2016-15, which adds and clarifies guidance on the classification of certain cash receipts and payments in the consolidated statements of cash flows. The ASU is effective for annual reporting periods beginning after December 15, 2017, including interim periods within those annual reporting periods. Early adoption is permitted. The Company is currently evaluating this guidance and the impact it will have on its consolidated financial statements.

**Income Taxes: Intra-Entity Transfers of Assets Other than Inventory** - In October 2016, the FASB issued ASU 2016-16, which removes the prohibition in ASC 740 against the immediate recognition of the current and deferred income tax effects of intra-entity transfers of assets other than inventory. The ASU is intended to reduce the complexity of U.S. GAAP and diversity in practice related to the tax consequences of certain types of intra-entity transfers, particularly those

involving intellectual property. The ASU is effective for annual periods beginning after December 15, 2017. Early adoption is permitted. The Company is currently evaluating this guidance and the impact it will have on its consolidated financial statements.

**Intangibles-Goodwill and Other: Simplifying the Test for Goodwill Impairment** - In January 2017, the FASB issued ASU 2017-04 to simplify the process used to test for goodwill. Under the new standard, if “the carrying amount of a reporting unit exceeds its fair value, an impairment loss shall be recognized in an amount equal to that excess, limited to the total amount of goodwill allocated to that reporting unit.” The ASU is effective for annual and any interim impairment tests for periods beginning after December 15, 2019. Early adoption is permitted for impairment tests that occur after January 1, 2017. The Company is currently evaluating this guidance and the impact it will have on its consolidated financial statements.