GOLDEN TELECOM INC
Form 10-Q
November 08, 2005

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2005
(Commission file number: 0-27423)
Golden Telecom, Inc.
(Exact name of registrant as specified in its charter)

Delaware	**51-0391303**
(State of incorporation)	(I.R.S. Employer Identification No.)

Representative Office Golden TeleServices, Inc.
1 Kozhevnichesky Proezd
Moscow, Russia 115114
(Address of principal executive office)
(011-7-501) 797-9300
(Registrant s telephone number, including area code)

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

Indicate by checkmark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes þ No o

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

At November 8, 2005, there were 36,425,990 outstanding shares of common stock of the registrant.

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* Please refer to the special note regarding forward-looking statements in this section.

PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements of Golden Telecom, Inc.

GOLDEN TELECOM, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In Thousands of US$, Except Share Data)

	December 31, 2004 (audited)	September 30, 2005 (unaudited)
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 53,699	$ 85,950
Accounts receivable, net of allowance for doubtful accounts of $23,205 and $28,290 at December 31, 2004 and September 30, 2005, respectively	89,177	98,718
VAT receivable	19,022	19,384
Prepaid expenses and advances to suppliers	13,793	11,171
Deferred tax asset	7,863	8,827
Other current assets	16,738	14,607
TOTAL CURRENT ASSETS	200,292	238,657
Property and equipment, net of accumulated depreciation of $185,781 and $229,866 at December 31, 2004 and September 30, 2005, respectively	347,891	374,212
Goodwill and intangible assets:		
Goodwill	146,254	148,507
Intangible assets, net of accumulated amortization of $41,999 and $55,422 at December 31, 2004 and September 30, 2005, respectively	101,316	93,743
Net goodwill and intangible assets	247,570	242,250
Restricted cash	1,012	563
Other non-current assets	9,003	9,197
TOTAL ASSETS	$ 805,768	$ 864,879

See notes to condensed consolidated financial statements.

GOLDEN TELECOM, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In Thousands of US$, Except Share Data)

	December 31, 2004 (audited)	September 30, 2005 (unaudited)
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 81,474	$ 89,778
VAT payable	14,235	18,557
Current capital lease obligations	2,301	2,429
Deferred revenue	11,761	15,103
Due to affiliates and related parties	3,199	1,981
Other current liabilities	3,572	3,174
TOTAL CURRENT LIABILITIES	116,542	131,022
Long-term debt, less current portion	200	253
Long-term deferred tax liability	24,244	23,551
Long-term deferred revenue	23,124	28,928
Long-term capital lease obligations	1,538	2,812
Other non-current liabilities	2,001	
TOTAL LIABILITIES	167,649	186,566
Minority interest	11,738	14,329
SHAREHOLDERS EQUITY		
Preferred stock, $0.01 par value (10,000,000 shares authorized; none issued and outstanding at December 31, 2004 and September 30, 2005)		
Common stock, $0.01 par value (100,000,000 shares authorized; 36,322,490 and 36,425,990 shares issued and outstanding at December 31, 2004 and September 30, 2005, respectively)	363	364
Additional paid-in capital	669,777	671,018
Accumulated deficit	(43,759)	(7,398)
TOTAL SHAREHOLDERS EQUITY	626,381	663,984
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 805,768	$ 864,879

See notes to condensed consolidated financial statements.

GOLDEN TELECOM, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In Thousands of US$, Except Per Share Data)
(unaudited)

	Three Months Ended September 30, 2004	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2004	Nine Months Ended September 30, 2005
REVENUE:				
Telecommunication services	$ 152,213	$ 168,716	$ 423,129	$ 488,706
Revenue from affiliates and related parties	500	1,214	1,631	3,198
TOTAL REVENUE	152,713	169,930	424,760	491,904
OPERATING COSTS AND EXPENSES:				
Access and network services (excluding depreciation and amortization)	77,953	88,345	216,447	254,533
Selling, general and administrative (excluding depreciation and amortization)	29,518	30,967	81,029	87,381
Depreciation and amortization	19,504	20,594	55,184	60,465
TOTAL OPERATING COSTS AND EXPENSES	126,975	139,906	352,660	402,379
INCOME FROM OPERATIONS	25,738	30,024	72,100	89,525
OTHER INCOME (EXPENSE):				
Equity in earnings of ventures	7	669	250	501
Interest income	241	772	781	1,672
Interest expense	(123)	(94)	(473)	(531)
Foreign currency losses	(443)	(125)	(667)	(364)
TOTAL OTHER INCOME (EXPENSE)	(318)	1,222	(109)	1,278
Income before minority interest and income taxes	25,420	31,246	71,991	90,803
Minority interest	245	837	784	2,102
Income taxes	9,064	12,014	23,536	30,512
NET INCOME	$ 16,111	$ 18,395	$ 47,671	$ 58,189

Basic earnings per share of common stock:

Net income per share basic	$ 0.44	$ 0.51	$ 1.32	$ 1.60
Weighted average common shares basic	36,278	36,411	36,200	36,356
Diluted earnings per share of common stock:				
Net income per share diluted	$ 0.44	$ 0.50	$ 1.30	$ 1.59
Weighted average common shares diluted	36,551	36,637	36,544	36,595
Cash dividends per common share	$	$ 0.20	$ 0.40	$ 0.60

See notes to condensed consolidated financial statements.

GOLDEN TELECOM, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands of US$)
(unaudited)

	Nine Months Ended September 30, 2004	Nine Months Ended September 30, 2005
OPERATING ACTIVITIES		
Net income	$ 47,671	$ 58,189
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation	41,606	47,021
Amortization	13,578	13,444
Equity in earnings of ventures	(250)	(501)
Foreign currency losses	667	364
Other	(67)	232
Changes in assets and liabilities:		
Accounts receivable	(15,535)	(8,602)
Accounts payable and accrued expenses	22,079	10,071
VAT, net	2,984	3,849
Other changes in assets and liabilities	(2,895)	4,235
NET CASH PROVIDED BY OPERATING ACTIVITIES	109,838	128,302
INVESTING ACTIVITIES		
Purchases of property and equipment and intangible assets	(86,062)	(70,330)
Acquisitions, net of cash acquired	(15,022)	(4,791)
Restricted cash	(5)	449
Other investing	932	2,243
NET CASH USED IN INVESTING ACTIVITIES	(100,157)	(72,429)
FINANCING ACTIVITIES		
Repayments of debt	(525)	
Proceeds from exercise of employee stock options	4,220	1,003
Cash dividends paid	(14,478)	(21,828)
Other financing	(2,540)	(2,660)
NET CASH USED IN FINANCING ACTIVITIES	(13,323)	(23,485)
Effect of exchange rate changes on cash and cash equivalents	(249)	(137)
Net increase (decrease) in cash and cash equivalents	(3,891)	32,251
Cash and cash equivalents at beginning of period	65,180	53,699

CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 61,289	$ 85,950

See notes to condensed consolidated financial statements.

GOLDEN TELECOM, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1: Basis of Presentation

Golden Telecom, Inc. (the Company) is a provider of a broad range of telecommunications services to businesses, other telecommunications service providers and consumers. The Company provides these services through its operation of voice, Internet and data networks, international gateways, local access and various value-added services in the Commonwealth of Independent States (CIS), primarily in Russia, and through its fixed line and mobile operations in Ukraine.

The financial statements included herein are unaudited and have been prepared in accordance with generally accepted accounting principles in the United States of America (US GAAP) for interim financial reporting and United States Securities and Exchange Commission (SEC) regulations. Certain information and footnote disclosures normally included in complete financial statements prepared in accordance with US GAAP and SEC rules and regulations have been condensed or omitted pursuant to such US GAAP and SEC rules and regulations. In the opinion of management, the financial statements reflect all adjustments of a normal and recurring nature necessary to present fairly the Company s financial position, results of operations and cash flows for the interim periods. These financial statements should be read in conjunction with the Company s 2004 audited consolidated financial statements and the notes related thereto. The results of operations for the three and nine months ended September 30, 2005, may not be indicative of the operating results for the full year.

Note 2: Summary of Significant Accounting Policies and New Accounting Pronouncements

Summary of Significant Accounting Policies

Goodwill and Intangible Assets

The total gross carrying value and accumulated amortization of the Company s intangible assets by major intangible asset class is as follows:

	As of December 31, 2004 (in thousands)		As of September 30, 2005	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Amortized intangible assets:				
Telecommunications service contracts	$ 92,250	$ (21,917)	$ 96,164	$ (28,949)
Contract-based customer relationships	36,849	(10,883)	36,849	(16,478)
Licenses	4,358	(2,515)	5,348	(2,997)
Other intangible assets	9,858	(6,684)	10,804	(6,998)
Total	$ 143,315	$ (41,999)	$ 149,165	$ (55,422)

Other intangible assets include software, Internet software and related content, as well as other intangible assets.

Comprehensive Income

Comprehensive income is defined as the change in equity of a business enterprise during a period from non-owner sources. For the three and nine months ended September 30, 2004, and 2005, respectively, comprehensive income for the Company is equal to net income.

GOLDEN TELECOM, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Stock-Based Compensation

The Company follows the provisions of Statement of Financial Accounting Standard (SFAS) No. 123, Accounting for Stock-Based Compensation, for its Equity Participation Plan. SFAS No. 123 establishes a fair value method of accounting for employee stock options and similar equity instruments. The fair value method requires compensation cost to be measured at the grant date based on the value of the award and to be recognized over the service period. SFAS No. 123 generally allows companies to either account for stock-based compensation under the fair value method of SFAS No. 123 or under the intrinsic value method of Accounting Principles Board (APB) No. 25, Accounting for Stock Issued to Employees. The Company has elected to account for its stock-based compensation in accordance with the provisions of APB No. 25 and to present pro forma disclosures of results of operations as if the fair value method had been adopted.

The effect of applying SFAS No. 123 on the reported net income, as disclosed below is not representative of the effect on net income in future periods due to the vesting period of the stock options and the fair value of additional stock options in future periods.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2005	2004	2005
	(in thousands, except per share data)			
Net income, as reported	$ 16,111	$ 18,395	$ 47,671	$ 58,189
Deduct: total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	454	145	1,357	475
Pro forma net income	$ 15,657	$ 18,250	$ 46,314	$ 57,714
Net income per share:				
Basic as reported	$ 0.44	$ 0.51	$ 1.32	$ 1.60
Basic pro forma	0.43	0.50	1.28	1.59
Diluted as reported	0.44	0.50	1.30	1.59
Diluted pro forma	0.43	0.50	1.27	1.58

Income Taxes

The Company accounts for income taxes using the liability method required by SFAS No. 109, Accounting for Income Taxes. For interim reporting purposes, the Company also follows the provisions of APB No. 28, Interim Financial Reporting, which requires the Company to account for income taxes based on the Company s best estimate of the effective tax rate expected to be applicable for the full fiscal year on a current year-to-date basis. The rate so determined is based on the tax rates currently applicable to the Company in the United States and to the Company s subsidiaries in Russia and other CIS countries and includes the Company s best estimate of the annual tax effect of non-deductible expenses, primarily related to amortization of intangible assets, foreign exchange and other permanent differences as well as estimates as to the realization of certain deferred tax assets. Deferred income taxes result from temporary differences between the tax basis of assets and liabilities and the basis as reported in the consolidated financial statements. The Company does not provide for deferred taxes on the undistributed earnings of its foreign subsidiaries, as such earnings are generally intended to be reinvested in those operations permanently. In the case of non-consolidated entities, where our partner requests that a dividend be paid, the amounts are not expected to have a material impact on the Company s income tax liability. It is not practical to determine the amount of unrecognized deferred tax liability for such reinvested earnings.

Use of Estimates in Preparation of Financial Statements

The preparation of these consolidated financial statements, in conformity with US GAAP, requires management to make estimates and assumptions that affect amounts in the financial statements and accompanying notes and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

GOLDEN TELECOM, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Comparative Figures

Certain 2004 amounts have been reclassified to conform to the presentation adopted in the current year.

Recent Accounting Pronouncements

In December 2004, Financial Accounting Standards Board (FASB) issued SFAS No. 123R, Share Based Payment , which is a revision of SFAS No. 123, Accounting for Stock-Based Compensation SFAS No. 123R supersedes APB No. 25, Accounting for Stock Issued to Employees and amends SFAS No. 95, Statement of Cash Flows . Under SFAS No. 123R, companies must calculate and record the cost of equity instruments, such as stock options or restricted stock, awarded to employees for services received in the income statement; pro forma disclosure is no longer permitted. The cost of the equity instruments is to be measured based on the fair value of the instruments on the date they are granted (with certain exceptions) and is required to be recognized over the period during which the employees are required to provide services in exchange for the equity instruments. SFAS No. 123R is effective in the first annual reporting period beginning after June 15, 2005.

SFAS No. 123R provides two alternatives for adoption: (1) a modified prospective method in which compensation cost is recognized for all awards granted subsequent to the effective date of this statement as well as for the unvested portion of awards outstanding as of the effective date and (2) a modified retrospective method which follows the approach in the modified prospective method, but also permits entities to restate prior periods to reflect compensation cost calculated under SFAS No. 123 for pro forma amounts disclosure. The Company plans to adopt SFAS No. 123R using the modified prospective method. As the Company currently accounts for share based payments to employees in accordance with the intrinsic value method permitted under APB No. 25, no compensation expense is recognized. On March 30, 2005, the SEC released Staff Accounting Bulletin No. 107, Share Based Payments, (SAB 107), which expresses the views of the SEC staff regarding the application of SFAS No. 123R. The impact of adopting SFAS No. 123R and SAB 107 cannot be accurately estimated at this time, as it will depend on the amount of share based awards granted in future periods. However, had the Company adopted SFAS No. 123R and SAB 107 in a prior period, the impact would approximate the impact of SFAS No. 123 as described in the disclosure of pro forma net income and earnings per share. SFAS No. 123R also requires that tax benefits received in excess of compensation cost be reclassified from an operating cash flow to a financing cash flow in the Consolidated Statement of Cash Flows. This change in classification will reduce net operating cash flows and increase net financing cash flows in the periods after adoption.

In March 2005, the FASB issued FASB Interpretation No. 47 (FIN No. 47), Accounting for Conditional Assets Retirement Obligations . FIN No. 47 clarifies that an entity must record a liability for a conditional asset retirement obligation if the fair value of the obligation can be reasonably estimated. FIN No. 47 is effective no later than the end of the fiscal year ending after December 15, 2005. The Company does not expect that the adoption of FIN No. 47 will have a material effect on the financial position, results of operations, or cash flow.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections , which is a replacement of APB Opinion No. 20, Accounting Changes and SFAS No. 3, Reporting Changes in Interim Financial Statements . SFAS No. 154 applies to all voluntary changes in accounting principle and changes the accounting for and reporting of a change in accounting principle. SFAS No. 154 requires retrospective application to prior periods financial statements of a voluntary change in accounting principle unless it is impracticable. In addition, SFAS No. 154 requires that a change in method of depreciation, amortization, or depletion for long-lived, nonfinancial assets be accounted for as a change in accounting estimate that is effected by a change in accounting principle. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company does not expect that the adoption of SFAS No. 154 will have a material effect on the financial position, results of operations, or cash flow.

GOLDEN TELECOM, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 3: Net Earnings Per Share

Basic earnings per share at September 30, 2004, and 2005 are computed on the basis of the weighted average number of common shares outstanding. Diluted earnings per share at September 30, 2004, and 2005 are computed on the basis of the weighted average number of common shares outstanding plus the effect of outstanding employee stock options using the treasury stock method. The number of stock options excluded from the diluted earnings per share computation, because their effect was antidilutive for the three and nine months ended September 30, 2004, and 2005, was 10,000 stock options.

The components of basic and diluted earnings per share were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2005	2004	2005
	(in thousands, except per share data)			
Net income	$ 16,111	$ 18,395	$ 47,671	$ 58,189
Weighted average outstanding of:				
Common stock shares	36,278	36,411	36,200	36,356
Dilutive effect of:				
Employee stock options	273	226	344	239
Common stock and common stock equivalents	36,551	36,637	36,544	36,595
Earnings per share:				
Basic	$ 0.44	$ 0.51	$ 1.32	$ 1.60
Diluted	$ 0.44	$ 0.50	$ 1.30	$ 1.59

Note 4: Business Combinations

In March 2005, the Company completed the acquisition of 75% ownership interest in OOO Dicom (Dicom), an early stage wireless broadband enterprise, for approximately $0.5 million in cash. In conjunction with the acquisition, the Company entered into a participants agreement which provided the seller with a put option that, if exercised, would require the Company to purchase the seller s remaining 25% interest at fair market value. In addition, the participants agreement provided the Company with a call option that, if exercised, would require the seller to sell after February 1, 2008 the seller s 25% interest in Dicom at any time beginning after February 1, 2008, if Dicom s valuation exceeds targeted levels by February 1, 2008. The results of Dicom have been included in the Company s consolidated operations since March 31, 2005.

In September 2005, the Company completed the acquisition of 60% of OOO Joint Venture Sakhalin Telecom Limited (Sakhalin Telecom), a fixed line alternative operator in the Far East region of Russia for $5.0 million in cash from Open Joint Stock Company Vimpel Communications. As a result of this acquisition and combined with the Company s previous ownership in Sakhalin Telecom, the Company now owns 83% of Sakhalin Telecom. The results of Sakhalin Telecom have been included in the Company s consolidated operations since September 30, 2005.

In March 2005, the Company expensed approximately $1.0 million in exter