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# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-K

**(Mark One)**

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

**For the fiscal year ended December 31, 2003.**

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

**For the transition period from to**

**Commission File Number 333-56365**

# FairPoint Communications, Inc.

(Exact Name of Registrant as Specified in its Charter)

| | |
|---|---|
| **Delaware**<br>(State or Other Jurisdiction of Incorporation or Organization) | **13-3725229**<br>(I.R.S. Employer Identification No.) |
| **521 East Morehead Street, Suite 250**<br>**Charlotte, North Carolina**<br>(Address of Principal Executive Offices) | **28202**<br>(Zip code) |

Registrant's Telephone Number, Including Area Code: **(704) 344-8150.**

Securities registered pursuant to Section 12(b) of the Act: **NONE**

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b 2 of the Securities Exchange Act of 1934). Yes ☐ No ☒

As of March 22, 2004, the registrant had outstanding 45,697,566 shares of class A common stock and 4,269,440 shares of class C common stock. There is no public market for our class A common stock or class C common stock.

Documents incorporated by reference: None

**FAIRPOINT COMMUNICATIONS, INC. ANNUAL REPORT ON FORM 10-K**
**FOR THE FISCAL YEAR ENDED DECEMBER 31, 2003**

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## PART I

Except as otherwise required by the context, references in this Annual Report on Form 10-K to FairPoint, our company, we, us or our refer to the combined businesses of FairPoint Communications, Inc. and all of its subsidiaries. All references to the Company refer to FairPoint Communications, Inc., excluding its subsidiaries.

### ITEM 1. BUSINESS

**Our Business**

We are a leading provider of communications services in rural communities, offering an array of services, including local voice, long distance, data, Internet and broadband product offerings. We are one of the largest rural telephone companies, and we believe that we are the 16th largest local telephone company, in the United States. We operate in 17 states with approximately 264,300 access line equivalents (including voice access lines and digital subscriber lines, or DSL) in service as of December 31, 2003.

We were incorporated in February 1991 for the purpose of operating and acquiring incumbent telephone companies in rural markets. We have acquired 30 such businesses, 26 of which we continue to own and operate. Many of our telephone companies have served their respective communities for over 75 years. The majority of the rural communities we serve have fewer than 2,500 residents. All of our telephone company subsidiaries qualify as rural local exchange carriers, or RLECs, under the Telecommunications Act of 1996, or the Telecommunications Act.

RLECs generally are characterized by stable operating results and strong cash flow margins and operate in supportive regulatory environments. In particular, existing state and federal regulations permit us to charge rates that enable us to recover our operating costs, plus a reasonable rate of return on our invested capital (as determined by relevant regulatory authorities). Competition is typically limited because RLECs primarily serve sparsely populated rural communities with predominantly residential customers, and the cost of operations and capital investment requirements for new entrants is high. As a result, in our markets, we have experienced virtually no wireline competition and limited competition from cable providers. While most of our markets are served by wireless service providers, their impact on our business has been limited.

**Our Competitive Strengths**

We believe we are distinguished by the following competitive strengths:

- **Consistent and predictable cash flows and strong margins.** We have the leading market position in the rural communities we serve, with limited competition. Demand for telephone services from our residential and local business customers has historically been very stable despite changing economic conditions. As a result, we have experienced a relatively stable access line count during the last two years compared to regional bell operating companies, or RBOCs. Additionally, our telephone companies operate in generally supportive regulatory environments. These factors have permitted us to generate consistent cash flows and strong margins.

- **Geographically diversified markets**. We currently operate 26 RLECs in 17 states clustered in five regions, enabling us to capitalize on economies of scale and operating efficiencies. Our geographic diversity significantly enhances our cash flow stability by limiting our exposure to competition, local economic downturns and state regulatory changes. In addition, we believe that we have achieved significant scale efficiencies by centralizing many functions, such as marketing, network planning, accounting and customer service.

- **Technologically advanced infrastructure.** Our advanced network infrastructure enables us to provide a wide array of communications services. Our network consists of central office hosts and remote sites with all digital switches, primarily manufactured by Nortel and Siemens, operating with current software. As of December 31, 2003, we maintained over 24,000 miles of copper plant and approximately 2,800 miles of fiber optic plant in order to service our 264,300 access line equivalents. As a result of our historic capital investments, our network infrastructure requires predictable capital expenditures and allows us to implement certain broadband enabled services with minimal incremental cost. As of December 31, 2003, approximately 86% of our exchanges are capable of providing DSL services.

- **Broadest service offerings in our markets.** We believe that, as a result of our advanced network and switching infrastructure, we offer the only comprehensive suite of communications services in our markets, including local voice, long distance, data and Internet services. In addition, we offer enhanced features such as caller identification, call waiting, call forwarding, teleconferencing, video conferencing and voicemail. We also offer broadband communications solutions to most of our customers primarily through DSL technology.

- **Management team with proven track record.** We have an experienced management team that has demonstrated its ability to grow our rural telephone business over the past decade. Our senior management team has an average of 21 years of experience working with a variety of telephone companies. Our regional presidents have an average of 29 years of experience in the telecommunications industry. Our management team has successfully integrated 30 business acquisitions since 1993, improving revenues and cash flow significantly while enhancing service quality and broadening service offerings.

**Our Strategy**

The key elements of our strategy are to:

- **Continue to improve operating efficiencies and profitability.** We have achieved significant operating efficiencies by applying our operational, regulatory, marketing and management expertise to our acquired businesses. We intend to continue to increase our operating efficiencies by consolidating various administrative functions and implementing best practices across all of our regions. For example, we have begun to integrate all billing systems into a single, outsourced billing platform, which will allow us to improve our customer service and enhance sales and marketing efforts. When completed, we plan to use this platform to develop regional customer service and call centers and to create a significantly improved customer data base. These call centers and customer data base will allow us to enhance our operating efficiency and optimize our marketing initiatives. The billing platform will also enable our customers to directly access, via the Internet, their accounts and will allow us to provide virtual call centers.

- **Increase revenue per customer.** We are focused on increasing our revenues by introducing innovative product offerings and marketing strategies for enhanced and ancillary services to meet the growing needs of our customers. Our long standing relationships with our customers have helped us to successfully cross-sell broadband and value-added services, such as DSL, long distance, Internet dial-up, voicemail and other services. We will continue to evaluate and implement technologies that will allow us to offer new products and services.

- **Enhance customer loyalty.** We believe that our service driven customer relationships and long-standing local presence lead to high levels of customer satisfaction and increased demand for enhanced and ancillary services. We continue to build long-term relationships with our customers by actively participating in the communities we serve and by offering an array of communications services and quality customer care.



- **Pursue selective acquisitions.** We believe that our acquisition strategy has been successful because of our ability to integrate acquisitions and improve operating efficiencies in the businesses we acquire. Our management team has consistently produced strong operating cash flow improvements in our acquired businesses. We continue to evaluate and pursue acquisitions which provide the opportunity to enhance revenues and cash flows. Given these objectives, we believe that such acquisitions will be primarily in regions where we already operate.

**Our Services**

We offer a broad portfolio of high-quality communications services for residential and business customers in each of the markets in which we operate. We have a long history of operating in our markets and a recognized and respected brand identity within each of our service areas. Our companies are locally managed and staffed, which enables us to efficiently and reliably provide an array of communications services to meet our customer needs. These include services traditionally associated with local telephone companies, as well as other services such as long distance, Internet and broadband enabled services. Based on our understanding of our local customers' needs, we have attempted to be proactive by offering bundled services designed to simplify the customer's purchasing and management process.

We operate in an industry that is subject to rapid and significant 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 industry. Technological developments may reduce the competitiveness of our networks and require unbudgeted upgrades or the procurement of additional products that could be expensive and time consuming. 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.

We primarily generate revenue through: (i) the provision of our basic local telephone service to customers within our service areas; (ii) the provision of network access to interexchange carriers, or IXCs, for origination and termination of interstate and intrastate long distance phone calls; (iii) Universal Service Fund—high cost loop payments; and (iv) the provision of other services such as long distance resale, data and Internet and broadband enabled services, enhanced services, such as caller name and number identification, and billing and collection for IXCs.

The following chart summarizes our revenue sources for the year ended December 31, 2003:

| Revenue Source | % Revenue | Description |
|---|---|---|
| Local Calling Services | 24% | Enables the local customer to originate and receive an unlimited number of calls within a defined "exchange" area. The customer is charged a flat monthly fee for basic service and service charges for special calling features. |
| Network Access Charges | 48% | Enables long distance companies to utilize our local network to originate or terminate intrastate and interstate calls. The network access charges are paid by the IXC to us and are regulated by state regulatory agencies and the Federal Communications Commission, or FCC, respectively. This also includes universal service fund, or USF, payments for local switching support, long term support and interstate common line support. |
| Universal Service Fund—high cost loop | 8% | We receive payments from the USF to support the high cost of our operations in rural markets. This support fluctuates based upon the historical costs of our operating companies. |
| Long Distance Services | 7% | We receive revenues for intrastate and interstate long distance services provided to our retail customers and our wholesale long distance customers. |
| Data and Internet Services | 6% | We receive revenues from monthly recurring charges for services, including broadband, DSL, special access, private lines, Internet and other services. |
| Other Services | 7% | We generate revenues from other services, including enhanced services and billing and collection. |

See Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" for more information regarding our revenue sources.

### Local Calling Services

Local calling services include basic local lines, private lines and switched data services. We provide local calling services to residential and business customers, generally for a fixed monthly charge. In an RLEC's territory, the amount that we can charge a customer for local service is determined by rate proceedings involving the appropriate state regulatory authorities.

### Network Access Charges

Network access charges relate to long distance, or toll calls, that typically involve more than one company in the provision of telephone service. Since toll calls are generally billed to the customer originating the call, a mechanism is required to compensate each company providing services relating to the call. We bill access charges to long distance companies and other customers for the use of our facilities to access the customer, as described below.

*Intrastate Access Charges.* We generate intrastate access revenue when an intrastate long distance call involving an IXC is originated by a customer in our RLEC exchange to a customer in another of our exchanges in the same state. The IXC pays us an intrastate access payment for either terminating or originating the call. We record the details of the call through our carrier access billing system, or



CABS, and receive the access payment from the IXC. The access charge for intrastate services is regulated and approved by the state regulatory authority.

*Interstate Access Charges.* We generate interstate access revenue when an interstate long distance call is originated by a customer calling from one state to a customer in another state. We bill interstate access charges in the same manner as we bill intrastate access charges; however, the interstate access charge is regulated and approved by the FCC instead of the state regulatory authority.

### Universal Service Fund—High Cost Loop

The USF supplements the amount of local service revenue received by us to ensure that basic local service rates for customers in high cost rural areas are consistent with rates charged in lower cost urban and suburban areas. The USF, which is funded by monthly fees charged to IXCs and local exchange carriers, or LECs, distributes funds to us on a monthly basis based upon our costs for providing local service.

### Long Distance Services

We offer switched and dedicated long distance services throughout our service areas through resale agreements with national IXCs. In addition, through our subsidiary FairPoint Carrier Services, Inc., or Carrier Services, we offer wholesale long distance services to our RLECs and other non-affiliated communications providers.

### Data and Internet Services

We offer Internet access via DSL technology, dedicated T-1 connections, Internet dial-up, high speed cable modem and wireless broadband. Customers can utilize this access in combination with customer owned equipment and software to establish a presence on the web. In addition, we offer enhanced Internet services, which include obtaining Internet protocol addresses, basic web site design and hosting, domain name services, content feeds and web-based e-mail services. Our services include access to 24-hour, 7-day a week customer support.

**Other Services**

We seek to capitalize on our RLECs' local presence and network infrastructure by offering enhanced services to customers, as well as billing and collection services for IXCs.

*Enhanced Services.* Our advanced digital switch and voicemail platforms allows us to offer enhanced services such as call waiting, call forwarding and transferring, call hunting, three-way calling, automatic callback, call hold, caller name and number identification, voice mail, teleconferencing, video conferencing, store-and-forward fax, follow-me numbers, Centrex services and direct inward dial, or DID.

*Billing and Collection.* Many IXCs provide long distance services to our RLEC customers and may elect to use our billing and collection services. Our RLECs charge IXCs a billing and collection fee for each call record generated by the IXC's customer.

*Directory Services.* Through our local telephone companies, we publish telephone directories in the majority of our locations. These directories provide white page listings, yellow page listings and community information listings. These directories generate revenues and operating cash flow from the sale of yellow page and related advertising to businesses. We contract out with leading industry providers to assist in the sale of advertising, compilation of information, as well as the production, publication and distribution of these directories.



**Our Markets**

Our 26 RLECs operate as the incumbent local exchange carrier in each of their respective markets. Our RLECs serve an average of approximately 13 access lines per square mile versus the non-rural carrier average of approximately 128 access lines per square mile. Approximately 80% of these access lines serve residential customers. Our business customers account for approximately 20% of our access lines. Our business customers are predominantly in the agriculture, light manufacturing and service industries.

The following chart identifies the number of access line equivalents in each of our 17 states as of December 31, 2003:

| State | Access Line Equivalents |
|---|---|
| Maine | 66,206 |
| Florida | 53,041 |
| Washington | 44,613 |
| New York | 43,219 |
| Ohio | 9,487 |
| Virginia | 7,945 |
| Illinois | 7,787 |
| Vermont | 6,599 |
| Kansas | 6,008 |
| Idaho | 5,951 |
| Oklahoma | 3,731 |
| Colorado | 3,068 |
| Pennsylvania | 3,000 |
| Other States(1) | 3,653 |
| Total: | 264,308 |

(1) Includes Massachusetts, New Hampshire, Georgia and Alabama.

**Sales and Marketing**

Our marketing approach emphasizes locally-managed, customer-oriented sales, marketing and service. We believe most telecommunications companies devote their resources and attention primarily toward customers in more densely populated markets. We seek to differentiate ourself from our competitors by providing a superior level of service to each of our customers.

Each of our RLECs has a long history in the communities it serves. It is our policy to maintain and enhance the strong brand identity and reputation that each RLEC enjoys in its markets, as we believe this is a significant competitive advantage. As we market new services, we will seek to continue to utilize our brand identity in order to attain higher recognition with potential customers.

To demonstrate our commitment to the markets we serve, we maintain local offices in most of the population centers within our service territories. These offices are typically staffed by local residents and provide sales and customer support services in the community. We believe that local offices facilitate a direct connection to the community, which improves customer satisfaction and loyalty.

In addition, our strategy is to enhance our telecommunications services by offering comprehensive bundling of services and deploying new technologies to build upon the strong reputation we enjoy in our markets and to further promote rural economic development in the rural communities we serve.

Many of the RLECs acquired by us traditionally have not devoted a substantial amount of their operating budget to sales and marketing activities. After acquiring the RLECs, we typically change this practice to provide additional support for existing products and services as well as to support the introduction of new services. As of December 31, 2003, we had 235 employees engaged in sales, marketing and customer service.

We have two basic tiers of customers: (i) local customers located in our local access and transport areas, or LATAs, who pay for local phone service and (ii) the IXCs which pay us for access to customers located within our LATAs. In general, the vast majority of our local customers are residential, as opposed to business, which is typical for rural telephone companies.

**Information Technology and Support Systems**

Our approach to billing and operational support systems focuses on implementing best-of-class applications that allow consistent communication and coordination throughout our entire organization. Our objective is to improve profitability by reducing individual company costs through the sharing of best practices, centralization or standardization of functions and processes, and deployment of technologies and systems that provide for greater efficiencies and profitability.

We have begun to integrate all billing systems into a single, outsourced billing platform. When completed, we plan to use this platform to develop regional customer service and call centers and to create a significantly improved customer data base. These call centers and customer data base will allow us to enhance our operating efficiency and optimize our marketing initiatives. The billing platform will also enable our customers to directly access, via the Internet, their accounts and will allow us to provide virtual call centers.

**Network Architecture and Technology**

Our RLEC networks consist of central office hosts and remote sites with advanced digital switches, primarily manufactured by Nortel and Siemens, operating with current software. The outside plant consists of transport and distribution delivery networks connecting our host central office with remote central offices and ultimately with our customers. As of December 31, 2003, we maintained over 24,000 miles of copper plant and 2,800 miles of fiber optic plant. We own fiber optic cable, which has been deployed throughout our current network and is the primary transport technology between our host and remote central offices and interconnection points with other incumbent carriers.

Our fiber optic transport system is primarily a synchronous optical network capable of supporting increasing customer demand for high bandwidth transport services. This system supports advanced services including Asynchronous Transfer Mode, Frame Relay and/or Internet Protocol Transport, facilitating delivery of advanced services as demand warrants.

In our RLEC markets, DSL-enabled integrated access technology is being deployed to provide significant broadband capacity to our customers. As of December 31, 2003, we had invested approximately $13.3 million and deployed this technology in all 26 of our RLECs, reaching 123 of our 143 exchanges.

To be successful, we will need to continue to provide our customers with reliable service over our network. Some of the risks to our network and infrastructure include: physical damage to access lines; power surges or outages; software defects; 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 incur expenses. In addition, rapid and significant changes in technology are expected in the communications industry. Our future success will depend, in part, on our ability to anticipate and adapt to technological changes. We believe that our network architecture enables us to efficiently



respond to these technological changes. An element of our business strategy is to deliver enhanced and ancillary services to customers. The successful delivery of new services is uncertain and dependent on many factors, and we may not generate anticipated revenues from such services.

**Acquisitions**

On December 1, 2003, the Company purchased all of the capital stock of Community Service Telephone Co., or CST, and Commtel Communications, Inc., or CCI. CST and CCI serve approximately 13,280 access line equivalents in central Maine. This acquisition is referred to herein as the Maine acquisition.

On June 18, 2003, the Company, MJD Ventures, Inc. and FairPoint Berkshire Corporation, or FairPoint Berkshire, executed an agreement and plan of merger with Berkshire Telephone Corporation, or Berkshire, to merge FairPoint Berkshire with Berkshire, pending required state regulatory approvals. Shareholders of Berkshire would receive approximately $19.2 million in the merger, subject to adjustment. Berkshire is an independent local exchange carrier, or ILEC, that provides voice communication services to over 7,200 access line equivalents serving five communities in New York State. Berkshire's communities of service are adjacent to Taconic Telephone Corp., one of the Company's subsidiaries. This acquisition is expected to close during the third quarter of 2004, pending regulatory approval. The acquisition of Berkshire is referred to herein as the Berkshire acquisition.

**Discontinued Operations**

On September 30, 2003, MJD Services Corp., or MJD Services, a wholly-owned subsidiary of the Company, completed the sale of all of the capital stock owned by MJD Services of Union Telephone Company of Hartford, or Union, Armour Independent Telephone Co., or Armour, WMW Cable TV Co., or WMW, and Kadoka Telephone Co., or Kadoka, to Golden West Telephone Properties, Inc., or Golden West. The sale was completed in accordance with the terms of the purchase agreement, dated as of May 9, 2003, between MJD Services and Golden West, which we refer to as the South Dakota purchase agreement. The divestiture is referred to herein as the South Dakota disposition. MJD Services received approximately $24.2 million in proceeds from the South Dakota disposition, subject to certain escrow obligations as set forth in the South Dakota purchase agreement. The companies sold to Golden West served approximately 4,150 voice access lines located in South Dakota. The operations of these companies were presented as discontinued operations beginning in the second quarter of 2003. Therefore, the balances associated with these activities were reclassified as "held for sale." All prior period financial statements have been restated accordingly. We recorded a gain on disposal of the South Dakota companies of $7.7 million during the third quarter of 2003.

In early 1998, we launched our competitive local exchange carrier, or CLEC, enterprise through our wholly-owned subsidiary, Carrier Services. In November 2001, we decided to discontinue such CLEC operations. This decision was a proactive response to the deterioration in the capital markets, the general slow-down of the economy and the slower-than-expected growth in Carrier Services' CLEC operations. Carrier Services completed the termination or sale of its CLEC operations in the second quarter of 2002.



Carrier Services provides wholesale long distance service and support to our RLECs and to other non-affiliated communications providers. These services allow such companies to operate their own long distance communication services and sell such services to their respective customers.

**Regulatory Environment**

Our communications services are subject to extensive federal, state and local regulation. We hold various regulatory authorizations for our service offerings. At the federal level, the FCC generally exercises jurisdiction over all facilities and services of telecommunications common carriers, such as us, to the extent those facilities are used to provide, originate, or terminate interstate or international communications. State regulatory commissions generally exercise jurisdiction over such facilities and services to the extent those facilities are used to provide, originate or terminate intrastate communications. In addition, pursuant to the Telecommunications Act, state and federal regulators share responsibility for implementing and enforcing the domestic pro-competitive policies introduced by that legislation. In particular, state regulatory agencies have substantial oversight over the provision by incumbent telephone companies of interconnection and non-discriminatory network access to competitive communications providers. Local governments often regulate the public rights-of-way necessary to install and operate networks, and may require communications services providers to obtain licenses or franchises regulating their use of public rights-of-way. Additionally, municipalities and other local government agencies may regulate limited aspects of our business, including our use of public rights of way, and by requiring us to obtain construction permits and abide by building codes.

We believe that competition in our telephone service areas will increase in the future as a result of the Telecommunications Act, although the ultimate form and degree of competition cannot be ascertained at this time. To date, we do not believe that we have encountered significant competition in our traditional telephone markets.

**Federal Regulation**

We must comply with the Communications Act of 1934, as amended, which requires, among other things, that communications carriers offer services at just and reasonable rates and on non-discriminatory terms and conditions. The amendments to the Communications Act contained in the Telecommunications Act dramatically changed and are expected to continue to change the landscape of the telecommunications industry. The central aim of the Telecommunications Act was to open local telecommunications marketplaces to competition while enhancing universal service. Most significantly, the Telecommunications Act governs the removal of barriers to market entry into local telephone services, requires incumbent local exchange carriers to interconnect with competitors, establishes procedures pursuant to which incumbent local exchange carriers may provide other services, such as the provision of long distance services by RBOCs, and imposes on incumbent local exchange carriers duties to negotiate interconnection arrangements in good faith.

*Removal of Entry Barriers.* Prior to the enactment of the Telecommunications Act, many states limited the services that could be offered by a company competing with an incumbent local exchange carrier. The Telecommunications Act preempts state and local laws that prevent competitive entry into the provision of any communications service. However, states can modify conditions of entry into areas served by RLECs where the state regulatory commission determines that competitive entry is in the public interest. Since the passage of the Telecommunications Act, we have experienced only limited competition from cable and wireless service providers.

*Interconnection with Local Telephone Companies and Access to Other Facilities.* In order to create an environment in which local competition is a practical possibility, the Telecommunications Act imposes a number of access and interconnection requirements on all local communications providers. All local carriers must interconnect with other carriers, permit resale of their services, provide local



telephone number portability and dialing parity, provide access to poles, ducts, conduits, and rights-of-way, and complete calls originated by competing carriers under reciprocal compensation or mutual termination arrangements.

All of our 26 subsidiaries qualify as RLECs under the Telecommunications Act. Accordingly, they have an exemption from the incumbent local telephone company interconnection requirements until they receive a bona fide request for interconnection and the applicable state regulatory commission lifts the exemption.

*Access Charges.* The FCC regulates the prices that incumbent local telephone companies charge for the use of their local telephone facilities in originating or terminating interstate transmissions. The FCC has structured these prices, also referred to as "access charges," as a combination of flat monthly charges paid by the end-users and usage sensitive charges paid by long distance carriers. State regulatory commissions regulate intrastate access charges. Many states generally mirror the FCC price structure. A significant amount of our revenues come from network access charges, which are paid to us by intrastate carriers and interstate long distance carriers for originating and terminating calls in the regions served by our RLECs. The amount of access charge revenues that we receive is subject to change at any time.

The FCC regulates the levels of interstate access charges by imposing price caps on larger incumbent local telephone companies. These price caps can be adjusted based on various formulae, such as inflation and productivity, and otherwise through regulatory proceedings. Smaller incumbents may elect to base access charges on price caps, but are not required to do so unless they elected to use price caps in the past or their affiliated incumbent local telephone companies base their access charges on price caps. Each of our 26 incumbent local telephone subsidiaries elected not to apply the FCC's price caps. Instead, our subsidiaries employ rate-of-return regulation for their interstate access charges.

The FCC has made, and is continuing to consider, various reforms to the existing rate structure for charges assessed on long distance carriers for connection to local networks. States often mirror federal rules in establishing intrastate access charges. In 2001, the FCC adopted an order implementing the beginning phases of the Multi-Association Group, or MAG, plan to reform the access charge system for rural carriers. The MAG plan is revenue neutral to our operating companies. Among other things, the MAG plan reduces access charges and shifts a portion of cost recovery, which historically have been based on minutes-of-use, to flat-rate, monthly per line charges on end-user customers rather than long distance carriers. As a result, the aggregate amount of access charges paid by long distance carriers to access providers, such as our RLECs, has decreased and may continue to decrease. In adopting the MAG plan, the FCC also determined that rate-of-return carriers will continue to be permitted to set rates based on the authorized rate of return of 11.25%. Additionally, the FCC initiated a rulemaking proceeding to investigate the MAG's proposed incentive regulation plan and other means of allowing rate-of-return carriers to increase their efficiency and competitiveness. The MAG plan expires in 2006 and will need to be renewed or replaced at such time. In addition, to the extent our RLECs become subject to competition in their own local exchange areas, such access charges could be paid to competing local exchange carriers rather than to us. Additionally, the access charges we receive may be reduced as a result of wireless competition. Such a circumstance could have a material adverse effect on our financial condition and results of operations. In addition, the FCC has sought comment on broad policy changes that could harmonize the rate structure and levels of all forms of intercarrier compensation, and could, as a result, substantially modify the current forms of carrier-to-carrier payments for interconnected traffic. Furthermore, in the notice of proposed rulemaking on voice over internet protocol services the FCC adopted in February 2004, the FCC has sought comment on whether access charges should apply to voice over internet protocol or other internet protocol-based services. It is unknown at this time what additional changes, if any, the FCC may eventually adopt and the effect of any such changes on our business.



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*RLEC Services Regulation.* Our RLEC services segment revenue is subject to regulation including regulation by the FCC and incentive regulation by various state regulatory commissions. We believe that state lawmakers will continue to review the statutes governing the level and type of regulation for telecommunications services. It is expected that over the next few years, legislative and regulatory actions will provide opportunities to restructure rates, introduce more flexible incentive regulation programs and possibly reduce the overall level of regulation. We expect the election of incentive regulation plans and the expected reduction in the overall level of regulation to allow us to introduce new services more expeditiously than in the past.

The FCC generally must approve in advance most transfers of control and assignments of operating authorizations by FCC-regulated entities. Therefore, if we seek to acquire companies that hold FCC authorizations, in most instances we will be required to seek approval from the FCC prior to completing those acquisitions. The FCC has the authority to condition, modify, cancel, terminate or revoke operating authority for failure to comply with applicable federal laws or rules, regulations and policies of the FCC. Fines or other penalties also may be imposed for such violations. Our interstate common carrier services are also subject to nondiscrimination requirements and requirements that rates be just and reasonable.

The FCC has required that incumbent independent local exchange carriers that provide interstate long distance services originating from their local exchange service territories must do so in accordance with "structural separation" rules. These rules require that our long distance affiliates (i) maintain separate books of account, (ii) not own transmission or switching facilities jointly with the local exchange affiliate, and (iii) acquire any services from its affiliated local exchange telephone company at tariffed rates, terms and conditions. The FCC has initiated a rulemaking proceeding to examine whether there is a continuing need for such requirements; however, we cannot predict the outcome of that proceeding.

The Telecommunications Act required all carriers to offer local number portability, or LNP. This requirement allows telephone customers to change service providers but keep their existing telephone numbers. Initially, the FCC set November 24, 2003 as the LNP deadline for carriers within the Top 100 Metropolitan Statistical Areas, or MSAs, and May 24, 2004 for carriers outside the Top 100 MSAs. On January 16, 2004, the FCC granted an extension of time, to May 24, 2004, to LECs with fewer than two percent of the nation's subscriber lines, regardless of whether the companies operate in a Top 100 MSA. All LECs with *bona fide* LNP requests must be prepared to port numbers from wireline to wireless carriers on or before May 24, 2004. We will file for state waivers to extend the time for implementation beyond the May $24^{th}$ date in certain states where technical limitations hinder compliance by this date.

**State Regulation**

Most states have some form of certification requirement that requires providers of telecommunications services to obtain authority from the state regulatory commission prior to offering common carrier services. Each of our 26 RLECs operates as the incumbent local telephone company in the states in which it operates and is certified in those states to provide local telephone services. State regulatory commissions generally regulate the rates incumbent local exchange carriers charge for intrastate services, including rates for intrastate access services paid by providers of intrastate long distance services. Although the FCC has preempted certain state regulations pursuant to the Telecommunications Act, states have retained authority to impose requirements on carriers necessary to preserve universal service, protect public safety and welfare, ensure quality of service and protect consumers. For instance, incumbent local exchange carriers must file tariffs setting forth the terms, conditions and prices for their intrastate services, and such tariffs may be challenged by third parties. From time to time, states conduct rate cases or "earnings" reviews. Such reviews may result in the disallowance of certain investments or expenses for rate making purposes. Subsidiaries of the Company



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recently completed rate cases in Vermont, Illinois, Kansas and Maine. We currently have "earnings" reviews of our rates being conducted in Idaho, New York and Vermont.

Under the Telecommunications Act, state regulatory commissions have jurisdiction to arbitrate and review interconnection disputes and agreements between incumbent local exchange carriers and competitive local exchange carriers, in accordance with rules set by the FCC. However, because all of our 26 subsidiaries qualify as RLECs under the Telecommunications Act, they have an exemption from the incumbent local telephone company interconnection requirements until they receive a bona fide request for interconnection and the applicable state regulatory commission lifts the exemption. State regulatory commissions may also formulate rules regarding taxes and fees imposed on providers of telecommunications services within their respective states to support state universal service programs. States often require prior approvals or notifications for certain acquisitions and transfers of assets, customers, or ownership of regulated entities. Therefore, in most instances we will be required to seek state approval prior to completing new acquisitions of RLECs. States generally retain the right to sanction a carrier or to revoke certifications if a carrier materially violates relevant laws and/or regulations.

**Local Government Authorizations**

We may be required to obtain from municipal authorities permits for street opening and construction or operating franchises to install and expand facilities in certain rural communities. Some of these franchises may require the payment of franchise fees. We have obtained such municipal franchises as were required. In some rural areas, we do not need to obtain such permits or franchises because the subcontractors or electric utilities with which we have contracts already possess the requisite authorizations to construct or expand our networks.

**The Promotion of Local Service Competition and Traditional Telephone Companies**

As discussed above, the Telecommunications Act provides, in general, for the removal of barriers to entry into the telecommunications industry in order to promote competition for the provision of local service. Congress, however, has recognized that states should not be prohibited from taking actions necessary to preserve and advance universal service, and has further recognized that special consideration should be given to the appropriate conditions for competitive entry in areas served by rural telephone companies.

Pursuant to the Telecommunications Act, all local exchange carriers, including both incumbents and new competitive carriers, are required to: (i) allow others to resell their services at retail rates; (ii) ensure that customers can keep their telephone numbers when changing carriers; (iii) ensure that competitors' customers can use the same number of digits when dialing and receive nondiscriminatory access to telephone numbers, operator service, directory assistance and directory listing; (iv) ensure access to telephone poles, ducts, conduits and rights of way; and (v) compensate competitors for the competitors' costs of completing calls to competitors' customers. Competitors are required to compensate the incumbent telephone company for the cost of providing these interconnection services. Under the Telecommunications Act, our RLECs may request from state regulatory commissions exemption, suspension or modification of any or all of the requirements described above. A state regulatory commission may grant such a request if it determines that such exemption, suspension or modification is consistent with the public interest and necessary to avoid a significant adverse economic impact on communications users and generally avoid imposing a requirement that is technically unfeasible or unduly economically burdensome. If a state regulatory commission denies some or all of any such request made by one of our RLECs, or does not allow us adequate compensation for the costs of providing interconnection, our costs could increase. In addition, with such a denial, competitors could enjoy benefits that would make their services more attractive than if they did not receive such interconnection rights. We have not filed any such requests.



The Telecommunications Act, with certain exceptions, imposes the following additional duties on incumbent telephone companies by requiring them to: (i) interconnect their facilities and equipment with any requesting telecommunications carrier at any technically feasible point; (ii) unbundle and provide nondiscriminatory access to network elements such as local loops, switches and transport facilities, at nondiscriminatory rates and on nondiscriminatory terms and conditions; (iii) offer their retail services for resale at wholesale rates; (iv) provide reasonable notice of changes in the information necessary for transmission and routing of services over the incumbent telephone company's facilities or in the information necessary for interoperability; and (v) provide, at rates, terms and conditions that are just, reasonable and nondiscriminatory, for the physical co-location of equipment necessary for interconnection or access to unbundled network elements at the premises of the incumbent telephone company. Competitors are required to compensate the incumbent local exchange carrier for the cost of providing these interconnection services. However, pursuant to the Telecommunications Act, our RLECs are automatically exempt from these additional incumbent telephone company requirements, except in Florida where the legislature has determined that all local exchange carriers are required to provide interconnection services as prescribed in the Telecommunications Act. This exemption can be rescinded or modified by a state regulatory commission if a competing carrier files a bona fide request for interconnection services or access to network elements. If such a request is filed by a potential competitor with respect to one of our operating territories, we are likely to ask the relevant state regulatory commission to retain the exemption. A state regulatory commission may grant such a potential competitor's request if it determines such interconnection request is not unduly economically burdensome, is technically feasible and is consistent with universal service obligations. If a state regulatory commission rescinds such exemption in whole or in part and if the state regulatory commission does not allow us adequate compensation for the costs of providing the interconnection, our costs would significantly increase, we would face new competitors in that state and we could suffer a significant loss of customers. In addition, we could incur additional administrative and regulatory expenses as a result of the interconnection requirements.

**Promotion of Universal Service**

The USF payments received by our RLECs from the USF fund are intended to support the high cost of our operations in rural markets. Such USF payments related to the high cost loop represented 8% of our revenues for the year ended December 31, 2003. If our RLECs were unable to receive USF payments, or if such payments were reduced, many of our RLECs would be unable to operate as profitably as they have historically. Furthermore, under the current regulatory scheme, as the number of access lines that we have in any given state increases, the per access line rate at which we can recover certain payments decreases.

Universal service rules have been adopted by both the FCC and some state regulatory commissions. USF funds may be distributed only to carriers that are designated as eligible telecommunications carriers, or ETCs, by a state regulatory commission. All of our RLECs have been designated as ETCs pursuant to the Telecommunications Act. However, under the Telecommunications Act, competitors could obtain the same support payments as we do if a state regulatory commission determined that granting such support payments to competitors would be in the public interest.

Two notable regulatory changes enacted by the FCC in the last three years are the adoption, with certain modifications, of the Rural Task Force, or RTF, proposed framework for rural high-cost universal service support and the implementation of the beginning phases of the MAG plan. The FCC's RTF order modifies the existing universal service support mechanism for RLECs and adopts an interim embedded, or historical, cost mechanism for a five-year period that provides predictable levels of support to rural carriers. The FCC has stated its intention to develop a long-term plan based on forward-looking costs when the five-year period expires in 2006. The MAG plan created a new universal service support mechanism, Interstate Common Line Support, to replace carrier common line access charges. In a recent order, the FCC added Long Term Support, previously part of access charges, to USF.

The Federal State Joint Board, or the Joint Board, is currently considering recommendations on the question of which carriers can obtain USF support in a market. The Joint Board recommended that:

- a set of permissive federal guidelines be developed to ensure that the public interest is served before ETCs are designated;
- support be limited to a single connection that provides access to the public telephone network; and
- the basis for providing support be considered and further clarified during the comprehensive review of the USF to be completed in 2006.

The FCC statutorily must act on these recommendations by February 27, 2005. Also, the FCC is considering resolution of the method by which contributions to the USF are determined.

In addition, there are a number of judicial appeals challenging several aspects of the FCC's universal service rules. It is not possible to predict at this time whether the FCC or Congress will order modification to those rules, or the ultimate impact any such modification might have on us.

**Potential Internet Regulatory Obligations**

In connection with our Internet access offerings, we could become subject to laws and regulations as they are adopted or applied to the Internet. There is currently only a small body of laws and regulations applicable to access to or commerce on the Internet. As the significance of the Internet expands, federal, state and local governments may adopt rules and regulations, or apply existing laws and regulations to the Internet. The FCC is currently reviewing the appropriate regulatory framework governing broadband access to the Internet through telephone and cable operators' communications networks. The outcome of these proceedings may affect our regulatory obligations and the form of competition for these services. In February 2004, the FCC initiated a proceeding to examine the regulatory implications of voice over Internet protocol technology. We cannot predict the results of these proceedings, the nature of these regulations or their impact on our business.

**Other Regulations**

Our operations and properties are subject to federal, state and local laws and regulations relating 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. 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 hazardous wastes at formerly owned 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 violations of environmental laws. Changes in existing laws or regulations or future acquisitions of businesses could require us to incur substantial costs in the future relating to such matters.

**Competition**

We believe that the Telecommunications Act and other recent actions taken by the FCC and state regulatory authorities promote competition in the provision of telecommunications services; however, many of the competitive threats now confronting the large telephone companies do not currently exist



in the RLEC marketplace. Our RLECs historically have experienced little competition as the incumbent carrier because the demographic characteristics of rural telecommunications markets generally will not support the high cost of operations and significant capital investment required for new entrants to offer competitive services. For instance, the per minute cost of operating both telephone switches and interoffice facilities is higher in rural areas, as RLECs typically have fewer, more geographically dispersed customers and lower calling volumes. Also, the distance from the telephone switch to the customer is typically longer in rural areas, which results in increased distribution facilities costs. These relatively high costs tend to discourage competitors from entering territories serviced by RLECs. As a result, RLECs generally are not faced with the threat of significant competition. In fact, we have virtually no wireline competition in any of our RLEC markets.

In most of our rural markets, we face competition from wireless technology. We do not expect this technology to represent a significant competitive threat to us in the near term, but as technology and economies of scale improve, we may experience increased competition from wireless carriers. We also face competition from new market entrants, such as cable television and electric utility companies. Cable television companies are entering the telecommunications market by upgrading their networks with fiber optics and installing facilities to provide fully interactive transmission of broadband voice, video and data communications. However, we believe that the unfavorable economics of constructing and operating competitive systems in our sparsely populated areas and the difficulties inherent in selling such services to a predominantly residential customer base has resulted in limited competition from cable service providers. Electric utilities have existing assets and access to low cost capital that could allow them to enter a market rapidly and accelerate network development. In addition, in the future, we may face additional competition from new market entrants, such as providers of wireless broadband and voice over internet protocol.

The Internet services market is also highly competitive, and we expect that competition to continue to intensify. Internet services, meaning both Internet access (wired and wireless) and on-line content services, are provided by Internet service providers, satellite-based companies, long distance carriers and cable television companies. Many of these companies provide direct access to the Internet and a variety of supporting services to businesses and individuals. In addition, many of these companies, such as America Online, Inc., Microsoft Network and Yahoo, offer on-line content services consisting of access to closed, proprietary information networks. Long distance companies and cable television operators, among others, are aggressively entering the Internet access markets. Long distance carriers have substantial transmission capabilities, traditionally carry data to large numbers of customers and have an established billing system infrastructure that permits them to add new services. Satellite companies are offering broadband access to the Internet from desktop PCs. Many of these competitors have substantially greater financial, technological, marketing, personnel, name-brand recognition and other resources than those available to us.

In addition, we could face increased competition from CLECs, particularly in offering services to Internet service providers.

**Employees**

As of December 31, 2003, we employed a total of 831 full-time employees. 126 employees of our RLECs are represented by four unions. We believe the state of our relationship with our union and non-union employees is good. Within our Company, 33 employees are employed at our corporate office, 790 employees are employed at our RLECs and 8 employees are employed by Carrier Services.

## ITEM 2. PROPERTIES

We own all of the properties material to our business. Our headquarters is located in Charlotte, North Carolina. We also have administrative offices, maintenance facilities, rolling stock, central office



and remote switching platforms and transport and distribution network facilities in each of the 17 states in which we operate our RLEC business. Our administrative and maintenance facilities are generally located in or near the rural communities served by our RLECs and our central offices are often within the administrative building and outlying customer service centers. Auxiliary battery or other non-utility power sources are at each central office to provide uninterrupted service in the event of an electrical power failure. Transport and distribution network facilities include fiber optic backbone and copper wire distribution facilities, which connect customers to remote switch locations or to the central office and to points of presence or interconnection with the long distance carriers These facilities are located on land pursuant to permits, easements or other agreements. Our rolling stock includes service vehicles, construction equipment and other required maintenance equipment.

We believe each of our respective properties is suitable and adequate for the business conducted therein, is being appropriately used consistent with past practice and has sufficient capacity for the present intended purposes.

## ITEM 3. LEGAL PROCEEDINGS

We currently and from time to time are involved in litigation and regulatory proceedings incidental to the conduct of our business, but currently we are not a party to any lawsuit or proceeding which, in our opinion, is likely to have a material adverse effect on us.

## ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of our security holders during the fourth quarter of the fiscal year.



# PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

There is no established public market for the common equity securities of the Company. Substantially all of the Company's outstanding common equity securities are owned by affiliates of Kelso & Company, or Kelso, Thomas H. Lee Equity Fund IV, L.P., or THL, certain institutional investors and the Company's executive officers and directors.

As of December 31, 2003, there were approximately 69 record holders of the Company's class A common stock and 6 record holders of the Company's class C common stock.

There were 6,737,674 options to purchase shares of class A common stock outstanding as of December 31, 2003, of which 5,429,514 were fully vested. These were 144,506 restricted stock units representing our class A common stock outstanding as of December 31, 2003, none of which were vested.

Other than 2,065,134 stock options and 144,506 restricted stock units issued pursuant to the 1998 plan and 2000 plan, the Company did not sell unregistered equity securities during the past three years. We believe that the issuance of the stock options and restricted stock units were exempt from the registration requirements of the Securities Act of 1933, or the Securities Act, under Rule 701 or Section 4(2) of the Securities Act.

Our ability to pay dividends is governed by restrictive covenants contained in the indentures governing our senior notes and senior subordinated notes as well as restrictive covenants in our bank lending arrangements. We have never paid cash dividends on our common equity securities and currently have no intention of paying cash dividends on our common equity securities for the foreseeable future. For a description of certain restrictions on our ability to pay dividends, see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations-Description of Certain Indebtedness."

For a description of our equity compensation plans, see "Item 11. Executive Compensation."

## ITEM 6. SELECTED FINANCIAL DATA

Certain of the selected financial data presented below under the captions "Statement of Operations," "Operating Data," "Summary Cash Flow Data" and "Balance Sheet Data" as of December 31, 2002 and 2003, and for each of the years in the three-year period ended December 31, 2003, are derived from the consolidated financial statements of the Company and its subsidiaries, which financial statements have been audited by KPMG LLP, independent auditors. The consolidated financial statements as of December 31, 2002 and 2003, and of each of the years in the three-year period ended December 31, 2003, and the report thereon, are included elsewhere in this annual Report. The following financial information should be read in conjunction with "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Item 8. Independent Auditor's Report and Consolidated Financial Statements." Amounts in thousands, except access lines and ratios.



| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 1999 | 2000 | 2001 | 2002 | 2003 |
| **Statement of Operations:** | | | | | |
| Revenues | $ 133,475 | $ 190,786 | $ 230,176 | $ 230,819 | $ 231,432 |
| Operating expenses: | | | | | |
| Operating costs | 71,214 | 95,540 | 115,763 | 110,265 | 111,188 |
| Depreciation and amortization(1) | 29,964 | 46,146 | 55,081 | 46,310 | 48,089 |
| Stock based compensation expense | 3,386 | 12,323 | 1,337 | 924 | 15 |
| Total operating expenses | 104,564 | 154,009 | 172,181 | 157,499 | 159,292 |
| Income from operations | 28,911 | 36,777 | 57,995 | 73,320 | 72,140 |
| Interest expense(2) | (50,464) | (59,556) | (76,314) | (69,520) | (90,224) |
| Other income (expense), net(3) | 4,877 | 13,198 | (6,670) | (11,974) | 9,600 |
| Loss from continuing operations before income taxes | (16,676) | (9,581) | (24,989) | (8,174) | (8,484) |
| Income tax (expense) benefit(3) | (2,179) | (5,607) | (431) | (518) | 236 |
| Minority interest in income of subsidiaries | (100) | (3) | (2) | (2) | (2) |
| Loss from continuing operations | (18,955) | (15,191) | (25,422) | (8,694) | (8,250) |
| Income (loss) from discontinued operations | (10,085) | (73,926) | (186,178) | 21,933 | 9,921 |
| Net income (loss) | (29,040) | (89,117) | (211,600) | 13,239 | 1,671 |
| Redeemable preferred stock dividends and accretion(2) | — | — | — | (11,918) | (8,892) |
| Gain on repurchase of redeemable preferred stock | — | — | — | — | 2,905 |
| Net income (loss) attributable to common shareholders | $ (29,040) | $ (89,117) | $ (211,600) | $ 1,321 | $ (4,316) |
| **Operating Data:** | | | | | |
| EBITDA(4) | 63,652 | 96,118 | 106,404 | 107,654 | 129,827 |
| Capital expenditures | 27,773 | 49,601 | 43,175 | 38,803 | 33,595 |
| Access line equivalents(5) | 150,612 | 237,294 | 247,862 | 248,581 | 264,308 |
| Residential access lines | 120,387 | 184,798 | 191,570 | 189,803 | 196,145 |
| Business access lines | 30,225 | 51,025 | 53,056 | 51,810 | 50,226 |
| DSL lines | — | 1,471 | 3,236 | 6,968 | 17,937 |
| Ratio of earnings to fixed charges(6) | — | — | — | — | — |
| **Summary Cash Flow Data:** | | | | | |
| Net cash provided by operating activities of continuing operations | $ 26,411 | $ 44,706 | $ 35,717 | $ 55,632 | $ 32,834 |
| Net cash used in investing activities of continuing operations | (59,986) | (284,953) | (57,161) | (30,258) | (54,010) |
| Net cash provided by (used in) financing activities of continuing operations | 46,979 | 300,088 | 101,234 | (12,546) | (1,976) |
| Net cash contributed (from) to continuing operations (to) from discontinued operations | (17,862) | (64,466) | (80,862) | (10,353) | 23,361 |
| **Balance Sheet Data (at period end):** | | | | | |
| Cash | $ 8,616 | $ 3,991 | $ 2,919 | $ 5,394 | $ 5,603 |
| Property, plant and equipment | 357,444 | 552,776 | 599,592 | 624,091 | 674,554 |
| Property, plant and equipment, net | 157,236 | 272,228 | 278,277 | 271,690 | 266,706 |
| Total assets | 517,356 | 863,547 | 875,015 | 829,253 | 843,068 |
| Total long term debt | 462,395 | 756,812 | 907,602 | 804,190 | 825,560 |
| Preferred shares subject to mandatory redemption | — | — | — | 90,307 | 96,699 |
| Total stockholders' equity (deficit) | (11,581) | 64,378 | (149,510) | (146,150) | (147,953) |

(1) On January 1, 2002, we adopted SFAS No. 142, "Goodwill and Other Intangible Assets." Pursuant to the requirements of SFAS No. 142, we ceased amortizing goodwill beginning January 1, 2002, and instead test for goodwill impairment annually. Amortization expense for goodwill and equity method goodwill was $5,335, $9,762 and $11,962 in fiscal 1999, 2000 and 2001, respectively. Depreciation and amortization excludes amortization of debt issue costs.

(2) Interest expense includes amortization of debt issue costs aggregating $1,575, $2,362, $4,018, $3,664 and $4,171 for the fiscal years ended December 31, 1999, 2000, 2001, 2002 and 2003, respectively. In 1999, interest expense includes $13,331 related to the retirement of put warrants of one of our subsidiaries. We prospectively adopted the provisions of SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Liabilities and Equity," effective July 1, 2003. SFAS 150 requires us to classify as a long-term liability our series A preferred stock and to reclassify dividends and accretion from the series A preferred stock as interest expense. Such stock is now described as "Preferred Shares Subject to Mandatory Redemption" in the balance sheet and dividends and accretion on these shares are now included in pre-tax income whereas previously they were presented as a reduction to equity (a dividend), and, therefore, a reduction of net income available to common stockholders. In 2003, interest expense includes $9,049 related to dividends and accretion on shares subject to mandatory redemption.

(3) On January 1, 2001, we adopted the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Certain Hedging Activities," as amended by SFAS No. 138. On the date of adoption, the Company recorded a cumulative adjustment of $4,664 in accumulated other comprehensive income for the fair value of interest rate swaps. Because the interest rate swaps do not qualify as accounting hedges under SFAS No. 133, the change in fair value of the interest rate swaps are recorded as non operating gains or losses, which the Company classifies in other income (expense). We also recorded other

income (expense) in 2001, 2002 and 2003 for the amortization of the transition adjustment of the swaps initially recognized in accumulated other comprehensive income. In the second quarter of 2002, we adopted SFAS No. 145 "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13 and Technical Corrections." This statement eliminates the requirement that gains and losses from the extinguishment of debt be required to be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. In 2003, other income (expense) includes a $3,465 gain on the extinguishment of debt and a $4,967 loss for the write-off of debt issue costs related to this extinguishment of debt.

(4) EBITDA means net income (loss) before income (loss) from discontinued operations, interest expense, income taxes, and depreciation and amortization. We believe EBITDA is useful to investors because EBITDA is commonly used in the communications industry to analyze companies on the basis of operating performance and leverage. We believe EBITDA allows a standardized comparison between companies in the industry, while minimizing the differences from depreciation policies, financial leverage and tax strategies. EBITDA is also used in covenants in credit facilities and high yield debt indentures to measure a borrower's ability to incur debt and for other purposes, and may be the preferred measure for these purposes. Covenants in our credit facility and the indentures governing our senior subordinated notes and senior notes that limit our ability to incur debt are based on EBITDA. While providing useful information, EBITDA should not be considered in isolation or as a substitute for consolidated statement of operations and cash flows data prepared in accordance with generally accepted accounting principles. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources."

A reconciliation of net income (loss) to EBITDA follows (in thousands):

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 1999 | 2000 | 2001 | 2002 | 2003 |
| Net income (loss) | $ (29,040) | $ (89,117) | $ (211,600) | $ 13,239 | $ 1,671 |
| (Income) loss from discontinued operations | 10,085 | 73,926 | 186,178 | (21,933) | (9,921) |
| Loss from continuing operations | (18,955) | (15,191) | (25,422) | (8,694) | (8,250) |
| Adjustments: | | | | | |
| Interest expense(2)(3) | 50,464 | 59,556 | 76,314 | 69,520 | 90,224 |
| Provision (benefit) for income tax expense | 2,179 | 5,607 | 431 | 518 | (236) |
| Depreciation and amortization | 29,964 | 46,146 | 55,081 | 46,310 | 48,089 |
| EBITDA | $ 63,652 | $ 96,118 | $ 106,404 | $ 107,654 | $ 129,827 |

(5) Total access line equivalents includes voice access lines and DSL.

(6) For purposes of determining the ratio of earnings to fixed charges, earnings are defined as earnings (losses) from continuing operations before income taxes, minority interest and income or loss from equity investments, plus distributed income of equity investments, amortization of capitalized interest, and fixed charges. Fixed charges include interest expense on indebtedness, capitalized interest and rental expense on operating leases representing that portion of rental expense deemed to be attributable to interest. We had a deficiency to cover fixed charges of $16,583, $11,232, $24,906, $6,954 and $7,801 for the years ended December 31, 1999, 2000, 2001, 2002 and 2003, respectively.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Overview

We are a leading provider of communications services in rural communities, offering an array of services, including local voice, long distance, data, Internet and broadband product offerings. We are one of the largest rural telephone companies, and we believe that we are the 16th largest local telephone company, in the United States. We operate in 17 states with approximately 264,300 access line equivalents in service as of December 31, 2003.

Since 1993, we have acquired 30 such businesses, 26 of which we continue to own and operate. Many of our telephone companies have served their respective communities for over 75 years. The majority of the rural communities we serve have fewer than 2,500 residents. All of our telephone company subsidiaries qualify as RLECs under the Telecommunications Act.

RLECs generally are characterized by stable operating results and strong cash flow margins and operate in supportive regulatory environments. In particular, existing state and federal regulations permit us to charge rates that enable us to recover our operating costs, plus a reasonable rate of return on our invested capital (as determined by relevant regulatory authorities). Competition is typically limited because RLECs primarily serve sparsely populated rural communities with predominantly



residential customers, and the cost of operations and capital investment requirements for new entrants is high. As a result, in our markets, we have experienced virtually no wireline competition and limited competition from cable providers. While most of our markets are served by wireless service providers, their impact on our business has been limited.

### Revenues

We derive our revenues from:

- *Local calling services*. We receive revenues from providing local exchange telephone services, including monthly recurring charges for basic service, usage charges for local calls and service charges for special calling features.

- *Universal Service Fund—high cost loop support*. We receive payments from the USF to support the high cost of our operations in rural markets. This revenue stream is based upon our average cost per loop compared to the national average cost per loop. This support fluctuates based upon the historical costs of our operating companies.

- *Interstate access revenues*. These revenues are primarily based on a regulated return on rate base and recovery of allowable expenses associated with the origination and termination of toll calls both to and from our customers. Interstate access charges to long distance carriers and other customers are based on access rates filed with the FCC. These revenues also include USF payments for local switching support, long term support and interstate common line support.

- *Intrastate access revenues*. These revenues consist primarily of charges paid by long distance companies and other customers for access to our networks in connection with the origination and termination of long distance telephone calls both to and from our customers. Intrastate access charges to long distance carriers and other customers are based on access rates filed with the state regulatory agencies.

- *Long distance services*. We receive revenues from long distance services we provide to our residential and business customers. In addition, our subsidiary Carrier Services provides our RLECs and other non-affiliated communications providers with wholesale long distance services.

- *Data and Internet services*. We receive revenues from monthly recurring charges for services, including digital subscriber line, special access, private lines, Internet and other services.

- *Other services*. We receive revenues from other services, including billing and collection, directory services and sale and maintenance of customer premise equipment.

The following summarizes our revenues and percentage of revenues from continuing operations from these sources:

| | Years ended December 31, Revenues (in thousands) | | | Years ended December 31, % of Revenues | | |
|---|---|---|---|---|---|---|
| **Revenue Source** | **2001** | **2002** | **2003** | **2001** | **2002** | **2003** |
| Local calling services | $ 50,629 | $ 54,000 | $ 56,078 | 22% | 23% | 24% |
| Universal service fund—high cost loop support | 19,019 | 22,429 | 18,903 | 8 | 10 | 8 |
| Interstate access revenues | 66,002 | 65,769 | 66,564 | 29 | 29 | 29 |
| Intrastate access revenues | 48,671 | 43,848 | 43,969 | 21 | 19 | 19 |
| Long distance services | 19,459 | 16,763 | 15,440 | 9 | 7 | 7 |
| Data and Internet services | 7,684 | 10,257 | 13,431 | 3 | 4 | 6 |
| Other services | 18,712 | 17,753 | 17,047 | 8 | 8 | 7 |
| Total | $ 230,176 | $ 230,819 | $ 231,432 | 100% | 100% | 100% |



**Operating Expenses**

Our operating expenses are categorized as operating expenses; depreciation and amortization; and stock based compensation.

- Operating expenses include cash costs incurred in connection with the operation of our central offices and outside plant facilities and related operations. In addition to the operational costs of owning and operating our own facilities, we also purchase long distance services from RBOCs, large independent telephone companies and third party long distance providers. In addition, our operating expenses include expenses relating to sales and marketing, customer service and administration and corporate and personnel administration.

- Depreciation and amortization includes depreciation of our communications network and equipment. Prior to January 1, 2002, and the implementation of SFAS No. 142, this category also included amortization of goodwill relating to our acquisitions.

- Stock based compensation consists of non-cash compensation charges incurred in connection with the employee stock options granted to our executive officers, and stockholder appreciation rights agreements granted to two of our executive officers.

**Acquisitions**

We intend to continue to pursue selective acquisitions:

- On December 1, 2003, we purchased all of the capital stock of CST and CCI. CST and CCI serve approximately 13,280 access line equivalents in central Maine.

- On June 18, 2003, we executed an agreement and plan of merger with Berkshire to merge FairPoint Berkshire Corporation with Berkshire, pending required state regulatory approvals. Shareholders of Berkshire would receive approximately $19.2 million in the merger, subject to adjustment. Berkshire is an ILEC that provides voice communication services to over 7,200 access line equivalents serving five communities in New York State. Berkshire's communities of service are adjacent to Taconic Telephone Corp., one of the Company's subsidiaries. This acquisition is expected to close during the third quarter of 2004.

- During 2002, we made no acquisitions.

- During 2001, we acquired one RLEC and certain assets of additional telephone exchanges for an aggregate purchase price of $24.2 million, which included $0.7 million of acquired debt. At the respective dates of acquisition, these businesses served an aggregate of approximately 5,600 access lines.

We expect that a portion of our future growth will result from additional acquisitions, some of which may be material. We may not be able to successfully complete the integration of the businesses we have already acquired or successfully integrate any businesses we might acquire in the future. If we fail to do so, or if we do so at a greater cost than anticipated, or if our acquired businesses do not experience significant growth, there will be a risk that our business may be adversely affected. In addition, we may need additional financing to continue growing through acquisitions and such financing may be in the form of additional debt, which would increase our leverage. We may not be able to raise sufficient additional capital at all or on terms that we consider acceptable.

Our acquisitions likely will be subject to federal, state and local regulatory approvals. We cannot assure you that we will be able to obtain any necessary approvals, in which case a potential acquisition could be delayed or not consummated. For example, in June 2003, we executed an agreement and plan of merger with respect to the Berkshire acquisition and we have not yet received the regulatory approvals required to consummate that transaction.



**Stock Based Compensation**

In 2003, we did not recognize any material non-cash compensation charges, primarily due to the fact that the fair market value per share of our common stock remained relatively stable.

In March 2002, we recognized a non-cash compensation benefit of $0.2 million associated with the reduction in estimated fair market value of the stockholder appreciation rights agreements. In December 2002, an additional benefit of $0.1 million was recognized in connection with these agreements. This benefit was offset by a non-cash compensation charge of $1.2 million in connection with the modification of employee stock options by one of our executive officers.

In December 2001, we recognized a non-cash compensation charge of $2.2 million in connection with the modification of employee stock options by one of our executive officers. This charge was offset by a non-cash compensation benefit of $0.9 million associated with the reduction in estimated fair market value of the stockholder appreciation rights agreements.

**Discontinued Operations**

On September 30, 2003, MJD Services completed the sale of all of the capital stock owned by Union, Armour, WMW and Kadoka to Golden West. The sale was completed in accordance with the terms of the South Dakota purchase agreement. MJD Services received approximately $24.2 million in proceeds from the South Dakota disposition, subject to certain escrow obligations as set forth in the South Dakota purchase agreement. The companies sold to Golden West served approximately 4,150 voice access lines located in South Dakota. The operations of these companies were presented as discontinued operations beginning in the second quarter of 2003. Therefore, the balances associated with these activities were reclassified as "held for sale." All prior period financial statements have been restated accordingly. We recorded a gain on disposal of the South Dakota companies of $7.7 million during the third quarter of 2003.

In November 2001, we decided to discontinue the CLEC operations of Carrier Services. This decision was a proactive response to the deterioration in the capital markets, the general slow-down of the economy and the slower-than-expected growth in Carrier Services CLEC operations.

Carrier Services provides wholesale long distance services and support to our RLECs and other non-affiliated communications providers. These services allow such companies to operate their own long distance communication services and sell such services to their respective customers. Our long distance business is included as part of continuing operations in the accompanying financial statements.

The information in our year to year comparisons below represents only our results from continuing operations.



**Results of Operations**

The following table sets forth the percentages of revenues represented by selected items reflected in our consolidated statements of operations. The year-to-year comparison of financial results are not necessarily indicative of future results:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2001 | 2002 | 2003 |
| Revenues | 100.0% | 100% | 100% |
| Operating expenses | 50.3 | 47.8 | 48.0 |
| Depreciation and amortization | 23.9 | 20.1 | 20.8 |
| Stock based compensation | 0.6 | 0.4 | 0.0 |
| Total operating expenses | 74.8 | 68.3 | 68.8 |
| Income from operations | 25.2 | 31.7 | 31.2 |

| | | | |
|---|---|---|---|
| Net gain (loss) on sale of investments and other assets | (0.3) | 0.0 | 0.3 |
| Interest and dividend income | 0.9 | 0.8 | 0.8 |
| Interest expense | (33.2) | (30.1) | (39.0) |
| Impairment of investments | 0.0 | (5.4) | 0.0 |
| Equity in net earnings of investees | 2.1 | 3.4 | 4.4 |
| Realized and unrealized losses on interest rate swaps | (5.6) | (4.1) | (0.6) |
| Other non-operating, net | 0.0 | 0.2 | (0.7) |
| Total other expenses | (36.1) | (35.3) | (34.8) |
| Loss from continuing operations before income taxes | (10.9) | (3.5) | (3.7) |
| Income tax benefit (expense) | (0.2) | (0.2) | 0.1 |
| Minority interest in income of subsidiaries | 0.0 | 0.0 | 0.0 |
| Loss from continuing operations | (11.0)% | (3.8)% | (3.6)% |

***Year Ended December 31, 2003 Compared with Year Ended December 31, 2002***

***Revenues***

*Revenues.* Revenues increased $0.6 million to $231.4 million in 2003 compared to $230.8 million in 2002. Of this increase, $0.7 million was attributable to the Maine acquisition and $1.5 million to revenues from our existing operations. This was offset by a decrease in revenues of $1.6 million from our wholesale long distance company. We derived our revenues from the following sources:

*Local calling services.* Local calling service revenues increased $2.1 million from $54.0 million in 2002 to $56.1 million in 2003. Despite a slight decline in access lines, revenues from our existing operations increased $1.8 million due to increases in local calling features and local interconnection revenues. The remaining increase of $0.3 million was attributable to the Maine acquisition.

*Universal service fund—high cost loop.* Universal service fund—high cost loop receipts decreased $3.5 million to $18.9 million in 2003 from $22.4 million in 2002. Our existing operations accounted for all of this decrease. The support from the high cost loop fund is associated with historical expense levels of our companies that exceed the national average cost per loop. The historical expenses occur two years prior to the receipt of the USF revenues. Historical expenses related to a performance share plan paid in 2000 by an acquired company resulted in USF receipts in 2002 which did not recur in 2003. In addition to this decrease, the USF receipts declined due to increases in the national average cost per loop.



*Interstate access revenues.* Interstate access revenues increased $0.8 million from $65.8 million in 2002 to $66.6 million in 2003. Our existing operations accounted for $0.5 million of this increase due to operating expense increases that resulted in higher interstate revenue requirements and $0.3 million was attributable to the Maine acquisition.

*Intrastate access revenues.* Intrastate access revenues increased slightly from $43.8 million in 2002 to $44.0 million in 2003. This slight increase was attributable to the Maine acquisition. While consolidated access revenues were relatively flat, lower access rates in a few of the states in which we operate were generally offset by higher minutes of use in other states in which we operate.

*Long distance services.* Long distance services revenues decreased $1.4 million from $16.8 million in 2002 to $15.4 million in 2003. An approximately $0.2 million increase was attributable to our existing RLEC operations. Carrier Services revenues decreased by $1.6 million as a result of rate increases from its underlying toll carriers, which resulted in the loss of wholesale customers by Carrier Services.

*Data and Internet services.* Data and Internet services revenues increased $3.1 million from $10.3 million in 2002 to $13.4 million in 2003. This increase is primarily from an increase of DSL customers from 6,659 to 17,937, an increase of 169%.

*Other services.* Other revenues decreased by $0.8 million from $17.8 million in 2002 to $17.0 million in 2003 at our existing operations. This decrease is mainly associated with reductions in billing and collections revenues, as interexchange carriers, or IXCs, continue to take back the billing function for their more significant long distance customers. We expect this trend to continue.

***Operating Expenses***

*Operating expenses.* Operating expenses increased $0.9 million to $111.2 million in 2003 from $110.3 million in 2002. Expenses of our wholesale long distance company decreased $0.7 million as a result of lower minutes of use from our wholesale customers. This decrease was offset by an increase of $1.3 million related to our existing operations and $0.3 million related to expenses of the companies we acquired in 2003 in the Maine acquisition. Several items contributed to the expense increase, including network operations expense, transport and network costs associated with our broadband initiatives. Expenses also increased because of an increase in the USF life line fund contribution expense which is directly assigned to the interstate revenue requirement and is fully recovered via our interstate revenues. Marketing and promotion expenses increased due to higher levels of activity related to the promotion of custom calling features, data services and other performance products. The increased expenses in 2003 would have been larger except for lower compensation costs in 2003 as a result of employee termination costs incurred in 2002, as well as a $1.9 million bad debt expense incurred in 2002 when a carrier declared bankruptcy and a $0.6 million recovery of this write-off received in 2003 resulting in a year over year decrease in bad debt expense of $2.5 million.

*Depreciation and Amortization.* Depreciation and amortization from continuing operations increased $1.8 million to $48.1 million in 2003 from $46.3 million in 2002. An increase of $1.7 million was attributable to the increased investment in our communications network by existing operations we acquired prior to 2003 and $0.1 million was attributable to the Maine acquisition.

*Stock Based Compensation.* For the year ended December 31, 2002, stock based compensation of $0.9 million was incurred, including $1.2 million resulting from a modification of an employee stock option agreement with an executive officer, offset by the decrease in the estimated value of fully vested stockholder appreciation rights agreements of $0.3 million. Stock based compensation for the year ended December 31, 2003 was not material.

*Income from Operations.* Income from continuing operations decreased $1.1 million to $72.2 million in 2003 from $73.3 million in 2002. A $0.5 million decrease attributable to our existing



operations and a decrease of $0.9 million from our wholesale long distance company was offset by a $0.3 million increase attributable to the Maine acquisition.

*Other Income (Expense).* Total other expense from continuing operations decreased $0.9 million to $80.6 million in 2003 from $81.5 million in 2002. The expense consisted primarily of interest expense on long-term debt. Interest expense increased $20.7 million to $90.2 million in 2003 from $69.5 million in 2002, mainly attributable to our March 2003 debt refinancing and our early adoption of SFAS 150, as of July 1, 2003, the latter of which resulted in our recording $9.0 million in interest expense related to dividends and accretion on preferred shares subject to mandatory redemption. During 2002, we recorded non-cash impairment of investments of $12.6 million which is associated with other than temporary declines in fair value of approximately $8.2 million of Choice One stock and a write-down of $4.4 million for certain investments accounted for under the equity method. There were no similar impairment losses recorded in 2003. Earnings in equity investments increased $2.3 million to $10.1 million in 2003 from $7.8 million in 2002. Other non-operating income (expense) includes net gain (loss) on the extinguishment of debt and expenses related to the loss on the write off of loan origination costs. As a result of the issuance of $225.0 million in senior notes during the first quarter of 2003, we recorded $2.8 million and $0.7 million of non-operating gains on the extinguishment of the senior subordinated notes and the Carrier Services loans, respectively. Additionally, we recorded a non-operating loss of $5.0 million for the write-off of debt issue costs related to this extinguishment of debt in 2003.

The following is a summary of amounts included in realized and unrealized gains (losses) on interest rate swaps (dollars in thousands):

| | 2002 | 2003 |
|---|---|---|
| Change in fair value of interest rate swaps | $ 2,135 | $ 7,693 |
| Reclassification of transition adjustment included in other comprehensive income (loss) | (1,437) | (1,029) |
| Realized gains (losses) | (10,275) | (8,051) |
| Total | $ (9,577) | $ (1,387) |

*Income Tax Benefit.* Income tax benefit from continuing operations increased $0.7 million to $0.2 million in 2003 from an expense of $0.5 million in 2002. The income tax benefit related primarily to income taxes owed in certain states offset by investment tax credits in certain states.

*Discontinued Operations.* In November 2001, we decided to discontinue the CLEC operations of Carrier Services. Net income from discontinued operations of our CLEC operations was $0.3 million and $19.5 million for 2003 and 2002, respectively. The income in 2002 was a result of a gain on extinguishment of debt attributable to Carrier Services. Net income from discontinued operations of our existing operations sold in the South Dakota disposition was $1.9 million and $2.4 million for 2003 and 2002, respectively. The Company recorded a gain on disposal in connection with the South Dakota disposition of $7.7 million in 2003.

*Net Income (Loss).* Our 2003 net loss attributable to common shareholders was $4.3 million after giving effect to $8.9 million in dividends and accretion related to our series A preferred stock and the repurchase of series A preferred stock at a discount of $2.9 million. Additionally, as a result of the adoption of SFAS 150 on July 1, 2003, the dividends and accretion of $9.0 million related to these instruments is included as a reduction of net income for the third and fourth quarters of 2003. Our 2002 net income attributable to common shareholders was $1.3 million after giving effect to $11.9 million in dividends and accretion related to our series A preferred stock. The differences between the 2003 and 2002 net income (loss) are a result of the factors discussed above.



### *Year Ended December 31, 2002 Compared with Year Ended December 31, 2001*

#### *Revenues*

*Revenues.* Revenues increased $0.6 million to $230.8 million in 2002 compared to $230.2 million in 2001. Of this increase, $4.2 million was attributable to revenues from companies we acquired in 2001. This was offset by a reduction of $0.7 million in revenues from our existing operations and a decrease in revenues of $2.9 million attributable to revenues from our wholesale long distance company. We derived our revenues from the following sources.

*Local calling services.* Local calling service revenues increased $3.4 million from $50.6 million in 2001 to $54.0 million in 2002, including an increase of $2.2 million from an increase in the number of access lines and local services provided in our existing operations, as well as an increase of $1.2 million from the companies we acquired in 2001.

*Universal service fund—high cost loop.* Universal service fund—high cost loop receipts increased $3.4 million to $22.4 million in 2002 from

$19.0 million in 2001. Our existing operations accounted for $3.2 million of the increase with the balance obtained from companies we acquired in 2001. The support from the high cost loop fund is associated with historical expense levels of our companies that exceed the national average cost per loop.

*Interstate access revenues.* Interstate access revenues were relatively flat from year to year, decreasing $0.2 million from $66.0 million in 2001 to $65.8 in 2002. A reduction of $1.2 million from our existing operations was offset by $1.0 million associated with companies we acquired in 2001. The $1.2 million revenue reductions are due mainly to our cost reductions at acquired entities, which correspondingly lower our revenue requirement.

*Intrastate access revenues.* Intrastate access revenues decreased $4.9 million from $48.7 million in 2001 to $43.8 in 2002. An increase of $1.6 million from companies we acquired in 2001 was offset by a reduction of $6.5 million from our existing operations. The decrease was mainly due to rate and state support reductions in Maine, Kansas, Vermont and Illinois. We continue to expect downward pressure on our intrastate access rates. To the extent these pressures reduce our earnings levels below authorized rates of return, our companies are allowed to file and seek approval from the state public utility commissions for recovery of these reductions through increases in local rates and, where they exist, state universal service funds.

*Long distance services.* Long distance services revenues decreased $2.7 million from $19.5 million in 2001 to $16.8 million in 2002, all attributed to a reduction in Carrier Services' long distance wholesale operations. Wholesale customers were lost when one of our underlying wholesale carriers declared bankruptcy.

*Data and Internet services.* Data and Internet services revenues increased $2.6 million from $7.7 million in 2001 to $10.3 million in 2002, including an increase of $0.1 million from acquisitions and an increase of $2.5 million as a result of increased service offerings to our customers of our existing operations.

*Other services.* Other revenues decreased by $0.9 million from $18.7 million in 2001 to $17.8 million in 2002 as other revenue contributed by the companies we acquired in 2001 of $0.1 million was offset by a reduction in other revenues of $1.0 million from our existing operations. This decrease is mainly associated with reductions in billing and collections revenues, as interexchange carriers, or IXCs, "take back" the billing function for their long distance customers. This trend is expected to continue.



***Operating Expenses***

*Operating expenses.* Operating expenses decreased $5.5 million, or 4.7%, to $110.3 million in 2002 from $115.8 million in 2001. Expenses of our wholesale long distance company decreased $2.5 million as a result of lower minutes of use from our wholesale customers. In addition, expenses of our existing operations decreased by $4.4 million, mainly attributable to overall cost reduction efforts throughout the company. This decrease was offset by an increase of $1.4 million attributable to expenses of the RLECs we acquired in 2001.

*Depreciation and Amortization.* Depreciation and amortization from continuing operations decreased $8.8 million to $46.3 million in 2002 from $55.1 million in 2001. The decrease of $12.0 million attributable to the discontinuance of amortizing goodwill upon the implementation of SFAS No. 142 was offset by increases in depreciation of property, plant and equipment consisting of $2.5 million attributable to the increased investment in our communications network by existing operations we acquired prior to 2001 and $0.7 million related to the companies we acquired in 2001.

*Stock Based Compensation.* For the year ended December 31, 2002, stock based compensation of $0.9 million was incurred, including $1.2 million related to a modification of an employee stock option agreement with an executive officer, offset by the decrease in the estimated value of fully vested stockholder appreciation rights agreements of $0.3 million. For the year ended December 31, 2001, stock based compensation of $0.9 million was related to the decrease in the estimated value of fully vested stockholder appreciation rights agreements. This is offset by a $2.2 million non-cash stock based compensation charge related to a modification of an employee stock option agreement with an executive officer. The net charge for the year ended December 31, 2001 was $1.3 million.

*Income from Operations.* Income from continuing operations increased $15.3 million to $73.3 million in 2002 from $58.0 million in 2001. Of this increase, $13.2 million was attributable to our existing operations and $2.1 million was attributable to the RLECs we acquired in 2001. Income from our wholesale long distance company decreased $0.4 million, and stock based compensation expense decreased $0.4 million.

*Other Income (Expense).* Total other expense from continuing operations decreased $1.5 million to $81.5 million in 2002 from $83.0 million in 2001. The expense consists primarily of interest expense on long-term debt. Interest expense decreased $6.8 million to $69.5 million in 2002 from $76.3 million in 2001. During 2002, we recorded non-cash impairment of investments of $12.6 million which is associated with other than temporary declines in fair value of approximately $8.2 million of Choice One stock and a write-down of $4.4 million for certain investments accounted for under the equity method. Earnings in equity investments increased $2.9 million to $7.8 million in 2002 from $4.9 million in 2001.

The following is a summary of amounts included in realized and unrealized gains (losses) on interest rate swaps (dollars in thousands):

| | 2001 | 2002 |
|---|---|---|
| Change in fair value of interest rate swaps | $ (6,896) | $ 2,135 |
| Reclassification of transition adjustment included in other comprehensive income (loss) | (1,238) | (1,437) |
| Realized gains (losses) | (4,739) | (10,275) |
| Total | $ (12,873) | $ (9,577) |

*Income Tax Expense.* Income tax expense from continuing operations increased $0.1 million to $0.5 million in 2002 from $0.4 million in 2001. The income tax expense relates primarily to income taxes owed in certain states.

*Discontinued Operations.* Income from discontinued operations was $21.9 million in 2002. $2.4 million was a result of the South Dakota disposition and $17.5 million was a result of a gain on extinguishment of debt at Carrier Services. Losses from discontinued operations for 2001 were $186.2 million. This loss was associated with a loss on the disposition of the CLEC operations of $95.3 million, losses from the discontinued operations of the CLEC operations of $93.0 million, offset with income from the South Dakota disposition of $2.1 million.

*Net Income (Loss).* Our 2002 net income attributable to common shareholders was $1.3 million after giving effect to $11.9 million in dividends and accretion related to the series A preferred stock. Our net loss was $211.6 million for 2001, as a result of the factors discussed above and mainly associated with the loss from discontinued operations.

**Liquidity and Capital Resources**

We intend to fund our operations, capital expenditures, interest expense and working capital requirements from internal cash from operations. To fund future acquisitions, we intend to use borrowings under our revolving credit facility, or we will need to secure additional funding through the sale of public or private debt and/or equity securities or enter into another bank credit facility. Our ability to make principal payments on our indebtedness will depend on our ability to generate cash in the future. We will need to refinance all or a portion of our indebtedness on or before maturity. We may not be able to refinance our indebtedness on commercially reasonable terms or at all. For the years ended December 31, 2003, 2002 and 2001, cash provided by operating activities of continuing operations was $32.8 million, $55.6 million and $35.7 million, respectively.

Net cash used in investing activities from continuing operations was $54.0 million, $30.3 million and $57.2 million for the years ended December 31, 2003, 2002 and 2001, respectively. These cash flows primarily reflect capital expenditures of $33.6 million, $38.8 million and $43.2 million for the years ended December 31, 2003, 2002 and 2001, respectively and acquisitions of telephone properties, net of cash acquired of $33.1 million, $0 million and $18.9 million for the years ended December 31, 2003, 2002 and 2001, respectively. There were no acquisitions of telephone properties for the year ended December 31, 2002. Offsetting capital expenditures were distributions from investments of $10.8 million, $9.0 million and $5.0 million for the years ended December 31, 2003, 2002 and 2001, respectively. These distributions represent passive ownership interests in partnership investments. We do not control the timing or amount of distributions from such investments.

Net cash provided by (used in) financing activities from continuing operations was $(2.0) million, $(12.5) million and $101.2 million for the years ended December 31, 2003, 2002 and 2001, respectively. These cash flows primarily represent net proceeds of long term debt of $23.3 million and $104.2 million for the years ended December 31, 2003 and 2001, respectively. For the year ended December 31, 2002, net repayments were $11.5 million.

Our annual capital expenditures for our rural telephone operations have historically been significant. Because existing regulations allow us to recover our operating and capital costs, plus a reasonable return on our invested capital in regulated telephone assets, capital expenditures constitute an attractive use of our cash flow. Net capital expenditures were approximately $33.6 million for the year ended December 31, 2003 and are expected to be approximately $36.6 million in 2004 (which includes a $3.8 million non-recurring capital expenditure relating to our billing platform and DSL related investments) and approximately $32.5 million in 2005.

Our credit facility was amended and restated as part of a refinancing completed on March 6, 2003. Our credit facility was further amended on December 17, 2003, which amendment became effective on January 30, 2004, to increase the credit facility's revolving loan facility from $70 million to $85 million and tranche A term loan facility from $30 million to $40 million. On January 30, 2004, the Company used additional borrowings under the tranche A term loan facility and a portion of the borrowings



under the revolving loan facility to repay in full all indebtedness under the Carrier Services credit facility.

We intend to use borrowings under our credit facility's revolving loan facility to fund the Berkshire acquisition.

In 1998, the Company issued $125.0 million aggregate principal amount of $9\frac{1}{2}\%$ senior subordinated notes, or the $9\frac{1}{2}\%$ notes, and $75.0 million aggregate principal amount of floating rate notes. Both series of these notes mature on May 1, 2008. These notes are general unsecured obligations of the Company, subordinated in right of payment to all of the Company's senior debt. In March 2003 the Company used a portion of the proceeds from the offering of its $11\frac{7}{8}\%$ senior notes due 2010, or the $11\frac{7}{8}\%$ notes, and borrowings under the credit facility's tranche A term loan facility to repurchase $9.8 million aggregate principal amount of the $9\frac{1}{2}\%$ notes (together with accrued and unpaid interest thereon) for approximately $7.9 million.

In 2000, the Company issued $200.0 million aggregate principal amount of $12\frac{1}{2}\%$ senior subordinated notes, or the $12\frac{1}{2}\%$ notes. These notes mature on May 10, 2010. These notes are general unsecured obligations of the Company, subordinated in right of payment to all of the Company's senior debt. In March 2003, the Company used a portion of the proceeds from the offering of the $11\frac{7}{8}\%$ notes and borrowings under the credit facility's tranche A term loan facility to repurchase $7.0 million aggregate principal amount of the $12\frac{1}{2}\%$ notes (together with accrued and unpaid interest thereon) for approximately $6.1 million.

In 2003, the Company issued $225.0 million aggregate principal amount of $11\frac{7}{8}\%$ notes. These notes mature on March 1, 2010. These notes are general unsecured obligations of the Company, ranking *pari passu* in right of payment with all existing and future senior debt of the Company, including all obligations under our credit facility, and senior in right of payment to all existing and future subordinated indebtedness of the Company. The proceeds from the offering of the $11\frac{7}{8}\%$ notes and borrowings under the credit facility's tranche A term loan facility were used to: (i) repay the entire amount of all loans outstanding under the Company's then outstanding credit facility's revolving facility, acquisition facility and tranche B term loan facility; (ii) repurchase $13.3 million aggregate liquidation preference of our series A preferred stock (together with accrued and unpaid dividends thereon) at 65% of its liquidation preference; (iii) repurchase $9.8 million aggregate principal amount of the Company's outstanding $9\frac{1}{2}\%$ notes (together with accrued and unpaid interest thereon) for approximately $7.9 million; (iv) repurchase $7.0 million aggregate principal amount of the Company's outstanding 12 1/2% notes (together with accrued and unpaid interest thereon) for approximately $6.1 million; (v) make a capital contribution of approximately $1.5 million to Carrier Services, which used these proceeds to retire a portion of its debt; and (vi) pay transaction fees.

For a summary description of our debt, see "—Description of Certain Indebtedness."

In May 2002, Carrier Services entered into an amended and restated credit facility with its lenders to restructure its obligations under its credit facility. In the restructuring, (i) Carrier Services paid certain of its lenders $5.0 million to satisfy $7.0 million of obligations under the credit facility, (ii) the lenders converted approximately $93.9 million of the loans under the credit facility into shares of the Company's series A preferred stock and (iii) the remaining loans under the credit facility and certain swap obligations were converted into $27.9 million of new term loans. In March 2003, the Company used a portion of the proceeds from the offering of the 11 7/8% notes and borrowings under the credit facility's tranche A term loan facility to repay $2.2 million principal amount of loans under the Carrier Services credit facility, at approximately a 30% discount to par. On January 30, 2004, the Company used additional borrowings under its credit facility's tranche A term loan facility and a portion of the borrowings under its credit facility's revolving loan facility to repay in full all indebtedness under the Carrier Services credit facility.



The Company's series A preferred stock is non-voting, except as required by applicable law, and is not convertible into common stock of the Company. The series A preferred stock provides for the payment of dividends at a rate equal to 17.428% per annum. Dividends on the series A preferred stock are payable, at the option of the Company, either in cash or in additional shares of series A preferred stock. The Company has the option to redeem the series A preferred stock at any time. The redemption price for such shares is payable in cash in an amount equal to $1,000 per share plus any accrued but unpaid dividends thereon, which we refer to as the preference amount. Under certain circumstances, the Company would be required to pay a premium of up to 6% of the preference amount in connection with the redemption of the series A preferred stock. In addition, upon the occurrence of certain events, such as (i) a merger, consolidation, sale, transfer or disposition of at least 50% of the assets or business of the Company and its subsidiaries, (ii) a public offering of the Company's common stock which yields in the aggregate at least $175.0 million, or (iii) the first anniversary of the maturity of the 12 1/2% notes (which first anniversary will occur in May 2011), unless prohibited by its credit facility or by the indentures governing its 9 1/2% notes, floating rate notes and 12 1/2% notes, the Company would be required to redeem all outstanding shares of the series A preferred stock at a price per share equal to the preference amount. Certain holders of the series A preferred stock have agreed with the Company to reduce the dividend rate payable on the shares they hold for a period of two years. In March 2003, the Company used a portion of the proceeds from the offering of the 11 7/8% notes and borrowings under the credit facility's tranche A term loan facility to repurchase $13.3 million aggregate liquidation preference of the series A preferred stock.

**Summary of Contractual Obligations**

The tables set forth below contain information with regard to disclosures about contractual obligations and commercial commitments.



The following table discloses aggregate information about our contractual obligations as of December 31, 2003 and the periods in which payments are due:

| | Payments due by period | | | | |
|---|---|---|---|---|---|
| | Total | Less than 1 year | 1-3 years | 3-5 years | More than 5 years |
| | (Dollars in thousands) | | | | |
| Contractual obligations: | | | | | |
| Debt maturing within one year | $ 21,982 | $ 21,982 | — | — | — |
| Long term debt | 803,578 | — | 69,710 | 312,319 | 421,549 |
| Preferred shares subject to mandatory redemption(1) | 96,699 | — | — | — | 96,699 |
| Capital leases | — | — | — | — | — |
| Operating leases(2) | 12,863 | 5,428 | 5,073 | 1,749 | 613 |
| Deferred transaction fee(3) | 8,445 | — | — | — | 8,445 |
| Common stock subject to put options | 2,136 | 1,000 | 1,136 | — | — |
| Non-compete agreements | 245 | 145 | 100 | — | — |
| Minimum purchase contract | 4,027 | 2,833 | 1,194 | — | — |
| Total contractual cash obligations | $ 949,975 | $ 31,388 | $ 77,213 | $ 314,068 | $ 527,306 |

(1) The Company has the option to redeem the series A preferred stock at any time. Under certain circumstances, the Company would be required to pay a premium of up to 6% in connection with a redemption. The Company is required to redeem the series A preferred stock upon the occurrence of one of the following events: (i) a merger, consolidation, sale, transfer or disposition of at least 50% of the assets or business of the Company and its subsidiaries, (ii) a public offering of the Company's common stock which yields in the aggregate at least $175.0 million, or (iii) the first anniversary of the maturity of the 12 1/2% notes (which first anniversary will occur in May 2011), unless prohibited by its credit facility or the indentures governing its 9 1/2% notes, floating rate notes and 12 1/2% notes.

(2) Real property lease obligations of $9.9 million associated with the discontinued operations discussed in note (12) to our consolidated financial statements which are stated in this table at total contractual amounts. However, we have negotiated lease terminations or subleases on these properties to reduce the total obligation. Operating leases from continuing operations of $3.0 million are also included.

(3) Payable to affiliates of Kelso upon the occurrence of certain events. See "Item 13. Certain Relationships and Related Party Transactions—Financial Advisory Agreements."

The following table discloses aggregate information about our commercial commitments as of December 31, 2003. Commercial commitments are items that we could be obligated to pay in the future. They are not included in our condensed consolidated balance sheets.

| | Amount of Commitment Expiration Per Period | | | | |
|---|---|---|---|---|---|
| | Total Amounts Committed | Less than 1 year | 1-3 years | 3-5 years | More than 5 years |
| | (Dollars in thousands) | | | | |
| Source of fair value: | | | | | |
| Financial guarantee | $ 1,511 | $ 617 | $ 894 | $ — | $ — |



The following table discloses aggregate information about our derivative financial instruments as of December 31, 2003, the source of fair value of these instruments and their maturities.

| | Fair Value of Contracts at Period End | | | | |
|---|---|---|---|---|---|
| | Total | Less than 1 year | 1-3 years | 3-5 years | More than 5 years |
| | (Dollars in thousands) | | | | |
| Source of fair value: | | | | | |
| Derivative financial instruments(1) | $ 874 | $ 874 | $ — | $ — | $ — |

(1) Fair value of interest rate swaps at December 31, 2003 was provided by the counterparties to the underlying contracts using consistent methodologies.

**Description of Certain Indebtedness**

We have utilized a variety of debt instruments to fund our business and we have a significant amount of debt outstanding. Our high level of debt could significantly affect our business by: making it more difficult for us to satisfy our obligations, including making scheduled interest payments under our debt obligations; limiting our ability to obtain additional financing; increasing our vulnerability to generally adverse economic and communications industry conditions, including changes in interest rates; requiring us to dedicate a substantial portion of our cash flow from operations to payments on our debt, thereby reducing the availability of our cash flow for other purposes; limiting our flexibility in planning for, or reacting to, changes in our business and the communications industry; and placing us at a competitive disadvantage compared to those of our competitors that have less debt.

In addition, our credit facility and the indentures governing our senior subordinated notes and our senior notes contain covenants that limit our operating flexibility and restrict our ability to take specific actions, even if we believe such actions are in our best interest. These include restrictions on our ability to: incur additional debt; pay dividends or distributions on, or redeem or repurchase, capital stock; create liens or negative pledges with respect to our assets; make investments, loans or advances; make capital expenditures; issue, sell or allow distributions on capital stock of specified subsidiaries; enter into sale and leaseback transactions; prepay or defease specified indebtedness; enter into transactions with affiliates; enter into specified hedging arrangements; merge, consolidate or sell our assets; or engage in any business other than communications. We also are required to maintain specified financial ratios and/or meet financial tests prescribed by our amended and restated credit facility. We may not be able to meet these requirements or satisfy these covenants in the future. If we fail to do so, our debts could become immediately payable at a time when we are unable to pay them, which could have an adverse effect on our business.

***Our credit facility***

We have a credit facility with various lenders, Wachovia Bank, National Association, as documentation agent, Deutsche Bank Trust Company Americas, as administrative agent, and Bank of America, N.A., as syndication agent. Our credit facility was amended and restated as part of a refinancing completed on March 6, 2003 to provide for, among other things, rescheduled amortization and an excess cash flow sweep with respect to the tranche C facility. Our credit facility was further amended on December 17, 2003, which amendment became effective on January 30, 2004, to increase the credit facility's revolving loan facility from $70 million to $85 million and tranche A term loan facility from $30 million to $40 million. All of our obligations under our credit facility are unconditionally and irrevocably guaranteed jointly and severally by four of our first-tier subsidiaries. Outstanding debt under our credit facility is secured by a first priority perfected security interest in all of the capital stock of certain of our subsidiaries.

Our amended and restated credit agreement is comprised of the following facilities:

*Revolving loan facility*. A revolving loan facility of up to $70 million, of which $14.7 million was outstanding as of December 31, 2003. These loans mature on March 31, 2007 and bear interest per annum at either a base rate plus 3.00% or LIBOR plus 4.00%. On January 30, 2004, the Company increased the revolving loan facility to $85 million.

*Tranche A term loan facility*. A tranche A term loan facility of $30 million. As of December 31, 2003, $30.0 million of tranche A term loans were outstanding. These loans mature on March 31, 2007 and bear interest per annum at either a base rate plus 3.00% or LIBOR plus 4.00%. On January 30, 2004, the Company increased the tranche A term loan facility to $40 million.

*Tranche C term loan facility*. As of December 31, 2003, approximately $126.4 million of tranche C term loans remained outstanding. These loans mature on March 31, 2007. Mandatory repayments under the tranche C term loan facility are scheduled to be $20.0 million, $20.0 million $30.0 million and a final $56.4 million in 2004, 2005, 2006 and on March 31, 2007, respectively. Tranche C term loans bear interest per annum at either a base rate plus 3.50% or LIBOR plus 4.50%.

*Covenants and events of default*

Our amended and restated credit facility contains certain customary covenants and other credit requirements of the Company and its subsidiaries and certain customary events of default.

*Prepayments*

Net cash proceeds from asset sales are required to be applied as mandatory prepayments of principal on outstanding loans unless such proceeds are used by us to finance acquisitions permitted under our amended and restated credit facility within 180 days of our receipt of such proceeds. Change of control transactions trigger a mandatory prepayment obligation. Voluntary prepayments of loans, including interim prepayments of revolving loans with proceeds of asset sales that are not used to prepay term loans in anticipation of being subsequently applied to fund a permitted acquisition or acquisitions within 180 days of the asset sale may be made at any time without premium or penalty, provided that voluntary prepayments of eurodollar loans made on a date other than the last day of an interest period applicable thereto shall be subject to customary breakage costs.

In addition, our credit facility provides that on the date occurring ninety days after the last day of each of our fiscal years, commencing December 31, 2003, 50% of excess cash flow (as defined in our credit facility) for the immediately preceding fiscal year shall be applied as a mandatory repayment of the then outstanding tranche C term loan facility; provided, however, that such requirement shall terminate at such time as (i) we first meet a senior secured leverage ratio (as defined in our credit facility) of less than or equal to 1.00 to 1.00 and (ii) no default or event of default exists under our amended and restated credit facility.

***$9^{1}/2$% notes and floating rate notes issued in 1998***

The Company issued $125.0 million of the $9^{1}/2$% notes and $75.0 million of the floating rate notes in 1998. The $9^{1}/2$% notes bear interest at the rate of $9^{1}/2$% per annum and the floating rate notes bear interest at a rate per annum equal to LIBOR plus 418.75 basis points, in each case payable semi-annually in arrears. The LIBOR rate on the floating rate notes is determined semi-annually.

The $9^{1}/2$% notes and floating rate notes mature on May 1, 2008. The Company may redeem the $9^{1}/2$% notes and the floating rate notes at any time, in each case, at the redemption prices stated in the indenture under which those notes were issued, together with accrued and unpaid interest, if any, to the redemption date. In the event of a change of control, the Company must offer to repurchase the



outstanding $9^{1}/2$% notes and floating rate notes for cash at a purchase price of 101% of the principal amount of such notes, together with all accrued and unpaid interest, if any, to the date of repurchase.

The $9^{1}/2$% notes and floating rate notes are general unsecured obligations of the Company, subordinated in right of payment to all existing and future senior indebtedness of the Company, including all obligations under our credit facility.

The indenture governing the Company's $9^{1}/2$% notes and floating rate notes contains certain customary covenants and events of default.

***$12^{1}/2$% notes issued in 2000***

The Company issued $200.0 million of the $12^{1}/2$% notes in 2000. The $12^{1}/2$% notes bear interest at the rate of $12^{1}/2$% per annum payable semi-annually in arrears.

The $12^{1}/2$% notes mature on May 1, 2010. The Company may redeem the $12^{1}/2$% notes at any time on or after May 1, 2005 at the redemption prices stated in the indenture under which the $12^{1}/2$% notes were issued, together with accrued and unpaid interest, if any, to the redemption date. In the event of a change of control, the Company must offer to repurchase the outstanding $12^{1}/2$% notes for cash at a purchase price of 101% of the principal amount of such notes, together with all accrued and unpaid interest, if any, to the date of repurchase.

The $12^{1}/2$% notes are general unsecured obligations of the Company, subordinated in right of payment to all existing and future senior indebtedness of the Company, including all obligations under our credit facility.

The indenture governing the $12^{1}/2$% notes contains certain customary covenants and events of default.

***$11^{7}/8$% notes issued in 2003***

The Company issued $225.0 million of the $11^{7}/8$% notes in 2003. The $11^{7}/8$% notes bear interest at the rate of $11^{7}/8$% per annum payable semi-annually in arrears.

The $11^{7}/8$% notes mature on March 1, 2010. The Company may redeem the $11^{7}/8$% notes at any time on or after March 1, 2007 at the redemption prices stated in the indenture under which the $11^{7}/8$% notes were issued, together with accrued and unpaid interest, if any, to the redemption date. In the event of a change of control, the Company must offer to repurchase the outstanding senior notes for cash at a purchase price of 101% of the principal amount of such notes, together with all accrued and unpaid interest, if any, to the date of repurchase.

The $11^{7}/8$% notes are general unsecured obligations of the Company, ranking pari passu in right of payment with all existing and future senior debt of the Company, including all obligations under our credit facility, and senior in right of payment to all existing and future subordinated indebtedness of the Company.

The indenture governing the $11^{7}/8$% notes contains certain customary covenants and events of default.

**Critical Accounting Policies**

Our critical accounting policies are as follows:

- Accounting for income taxes; and

- Valuation of long-lived assets, including goodwill



***Accounting for income taxes.*** As part of the process of preparing our consolidated financial statements we were required to estimate our income taxes. This process involves estimating our actual current tax exposure and assessing temporary differences resulting from different treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheets. We must then assess the realizability of our deferred tax assets. In performing the assessment, management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies.

We had $250.8 million in federal and state net operating loss carryforwards as of December 31, 2003. In order to fully utilize the deferred tax assets, mainly generated by the net operating losses, we will need to generate future taxable income of approximately $176.4 million prior to the expiration of the net operating loss carryforwards beginning in 2019 through 2022. Based upon the level of projections for future taxable income over the periods in which the deferred tax assets are deductible, we believe we will realize the benefits of these deductible differences, net of the valuation allowance of $64.4 million at December 31, 2003. The amount of the deferred tax assets considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carry forward period are reduced.

***Valuation of long-lived assets, including goodwill.*** We review our long-lived assets, including goodwill for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Several factors could trigger an impairment review such as (1) significant underperformance relative to expected historical or projected future operating results, (2) significant regulatory changes that would impact future operating revenues, (3) significant negative industry or economic trends and (4) significant changes in the overall strategy in which we operate our overall business. Net goodwill was $468.8 million at December 31, 2003.

We are required to perform an annual impairment review of goodwill as required by Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*. No impairment of goodwill or other long-lived assets resulted from the annual valuation of goodwill.

**New Accounting Standards**

The Financial Accounting Standards Board (FASB) issued SFAS No. 143, *Accounting for Asset Retirement Obligations*, which was effective January 1, 2003. This statement requires, among other things, the accounting and reporting of legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development or normal operation of a long-lived asset. The FCC has ordered that companies subject to regulatory accounting rules not adopt SFAS No. 143 and accordingly, the Company will not adopt this standard for its regulated operations. The adoption of this pronouncement, effective January 1, 2003, did not have a material effect on the financial statements of our non-regulated entities.

In July 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* (SFAS No. 146). SFAS No. 146 will apply to exit ("restructuring") plans initiated after December 31, 2002. Under SFAS No. 146, restructuring costs associated with a plan to exit an activity are required to be recognized when incurred. The Company's previously recorded restructuring liabilities were recognized when the Company committed to an exit plan, consistent with the guidance in EITF 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)*. In the event the Company initiates new exit plans after December 31, 2002, the liability recognition of SFAS No. 146 will apply.

In November 2002, the FASB issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, an interpretation of SFAS No. 5, 57 and 107 and rescission of FASB Interpretation No. 34. This interpretation requires additional disclosures to be made by a guarantor in its interim and annual financial statements about its



obligations under certain guarantees that it has issued. It also specifies the requirements for liability recognition (at fair value) for obligations undertaken in issuing the guarantee. The disclosure requirements were effective in 2002. The initial recognition and measurement provisions are effective for all guarantees within the scope of Interpretation 45 issued or modified after December 31, 2002. The adoption of this pronouncement did not have a material effect on our financial statements.

In December 2002, the FASB issued SFAS No. 148, *Accounting for Stock Based Compensation—Transition and Disclosure, an amendment to FASB Statement 123*. This Statement amends SFAS No. 123, *Accounting for Stock Based Compensation*, to provide alternative methods of transition for a voluntary change to the fair value method of accounting for stock based employee compensation. In addition, this Statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements. Although we have adopted the disclosure provisions required by SFAS No. 148, we do not expect to voluntarily adopt the fair value based method of accounting for our stock based compensation plans. The adoption of SFAS No. 148 did not impact our financial position or results of operations.

In January 2003, the FASB issued FASB Interpretation No. 46, *Consolidation of Variable Interest Entities, an interpretation of ARB No. 51*. In December 2003, the FASB revised Interpretation No. 46, which clarifies the application of Accounting Research Bulletin (ARB) No. 51, *Consolidated Financial Statements.* As per ARB No. 51, a general rule for preparation of consolidated financial statements of a parent and its subsidiary is ownership by the parent, either directly or indirectly, of over fifty percent of the outstanding voting shares of a subsidiary. However, application of the majority voting interest requirement of ARB No. 51 to certain types of entities may not identify the party with a controlling financial interest because the controlling financial interest may be achieved through arrangements that do not involve voting interest. Interpretation No. 46 clarifies applicability of ARB No. 51 to entities in which the equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. Interpretation No. 46 requires an entity to consolidate a variable interest entity even though the entity does not, either directly or indirectly, own over fifty percent of the outstanding voting shares. Interpretation No. 46 is applicable for financial statements issued for reporting periods that end after March 15, 2004. We are in the process of reviewing the recent provisions of Interpretation No. 46. Any potential changes, as a result of implementation of Interpretation No. 46, are not expected to have a significant impact on our financial statements.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity.* SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 applies specifically to a number of financial instruments that companies have historically presented within their financial statements either as equity or between the liabilities section and the equity section, rather than as liabilities. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatorily redeemable financial instruments of a non-public entity, in which case this statement shall be effective for fiscal periods beginning after December 15, 2003. For purposes of SFAS No. 150, we meet the definition of a nonpublic entity. As described in note 7 to our consolidated financial statements contained elsewhere in this Annual Report on Form 10-K, we adopted SFAS No. 150 early, as of July 1, 2003.

In March 2003, the Emerging Issues Task Force, or EITF, reached consensus on EITF 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables*, or EITF 00-21. This guidance addresses the determination of whether an arrangement involving multiple deliverables contains more than one unit of accounting. EITF 00-21 is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The implementation of EITF 00-21 did not have a material impact on our financial statements.



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In November 2003, the EITF reached consensus on EITF 03-1, *The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments,* that certain quantitative and qualitative disclosures are required for equity and fixed maturity securities that are impaired at the balance sheet date but for which an other-than-temporary impairment has not been recognized. The guidance requires companies to disclose the aggregate amount of unrealized losses and the related fair value of investments with unrealized losses for securities that have been in an unrealized loss position for less than 12 months and separately for those that have been in an unrealized loss position for over 12 months, by investment category. We have adopted the disclosure requirements in these financial statements. Further discussion on the meaning of other-than-temporary impairments for EITF 03-1 is expected at a future EITF meeting.

**Inflation**

We do not believe inflation has a significant effect on our operations.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

At December 31, 2003, we recorded our marketable available-for-sale equity securities at a fair value of $1.9 million. These securities have exposure to price risk. A hypothetical ten percent adverse change in quoted market prices would decrease the recorded value by approximately $0.2 million.

Approximately 75% of our debt bears interest at fixed rates or effectively at fixed rates. We have limited our exposure to material future earnings or cash flow changes due to changes in interest rates on our floating rate long-term debt through the use of interest rate swaps. However, our earnings are affected by changes in interest rates as our long-term debt under our credit facilities have variable interest based on either the prime rate or LIBOR. If interest rates on our variable rate debt averaged 10% more, our interest expense would have increased, and our loss from continuing operations before taxes would have increased by approximately $1.4 million for the year ended December 31, 2003.

We have entered into interest rate swaps to manage our exposure to fluctuations in interest rates on our variable rate debt. Our liability for the fair value of these swaps was approximately $0.9 million at December 31, 2003. The fair value indicates an estimated amount we would have to pay to cancel the contracts or transfer them to other parties. In connection with our credit facility, we used two interest rate swap agreements, with notional amounts of $25.0 million each, to effectively convert a portion of our variable interest rate exposure to fixed rates ranging from 8.07% to 10.34%. The swap agreements expire in May 2004.



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## ITEM 8. INDEPENDENT AUDITORS' REPORT AND CONSOLIDATED FINANCIAL STATEMENTS

**INDEX TO FINANCIAL STATEMENTS**





**Independent Auditors' Report**

The Board of Directors
FairPoint Communications, Inc.:

We have audited the accompanying consolidated balance sheets of FairPoint Communications, Inc. and subsidiaries (the Company) as of December 31, 2002 and 2003, and the related consolidated statements of operations, stockholders' equity (deficit), comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2003. These consolidated financial statements are the responsibility of FairPoint Communications, Inc.'s management. 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2002 and 2003, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

As described in note 1 to the consolidated financial statements, the Company adopted the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets*, as required for goodwill and intangible assets effective January 1, 2002.

As described in notes 1 and 7 to the consolidated financial statements, the Company adopted the provisions of SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* effective July 1, 2003.

/s/ KPMG LLP
Omaha, Nebraska
March 12, 2004



**FAIRPOINT COMMUNICATIONS, INC. AND SUBSIDIARIES**

**Consolidated Balance Sheets**

**December 31, 2002 and 2003**

**(Amounts in thousands, except per share data)**

| | 2002 | 2003 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash | $ 5,394 | 5,603 |
| Accounts receivable, net | 25,024 | 28,845 |
| Materials and supplies | 3,355 | 4,139 |
| Prepaid and other | 1,548 | 1,517 |
| Investments available-for-sale | 560 | 1,889 |

| | | |
|---|---|---|
| Assets of discontinued operations | 806 | 105 |
| Assets held for sale | 16,647 | — |
| Total current assets | 53,334 | 42,098 |
| Property, plant, and equipment, net | 271,690 | 266,706 |
| Other assets: | | |
| Goodwill, net of accumulated amortization | 443,781 | 468,845 |
| Investments | 43,627 | 41,792 |
| Debt issue costs, net of accumulated amortization | 15,157 | 21,614 |
| Notes receivable—related party | — | 1,000 |
| Covenants not to compete, net of accumulated amortization | 806 | 151 |
| Other | 858 | 862 |
| Total other assets | 504,229 | 534,264 |
| Total assets | $ 829,253 | 843,068 |



| Liabilities and Stockholders' Deficit | | |
|---|---|---|
| Current liabilities: | | |
| Accounts payable | $ 20,664 | 14,671 |
| Other accrued liabilities | 18,797 | 13,116 |
| Accrued interest payable | 10,501 | 16,739 |
| Current portion of long-term debt | 5,704 | 21,982 |
| Accrued property taxes | 2,192 | 1,968 |
| Current portion of obligation for covenants not to compete | 536 | 145 |
| Demand notes payable | 427 | 407 |
| Income taxes payable | 219 | 70 |
| Liabilities of discontinued operations | 5,065 | 4,461 |
| Liabilities held for sale | 639 | — |
| Total current liabilities | 64,744 | 73,559 |
| Long-term liabilities: | | |
| Long-term debt, net of current portion | 798,486 | 803,578 |
| Preferred shares subject to mandatory redemption | — | 96,699 |
| Other liabilities | 13,070 | 12,278 |
| Liabilities of discontinued operations | 5,265 | 2,571 |
| Obligation for covenants not to compete, net of current portion | 245 | 100 |
| Unamortized investment tax credits | 134 | 85 |
| Total long-term liabilities | 817,200 | 915,311 |
| Minority interest | 16 | 15 |
| Common stock subject to put options, 239 shares at December 31, 2002 and 163 shares at December 31, 2003 | 3,136 | 2,136 |
| Redeemable preferred stock, Series A nonvoting, nonconvertible, par value $0.01 per share. Authorized 1,000 shares; issued and outstanding 105 shares; redemption value of $104,779 | 90,307 | — |
| Commitments and contingencies | | |
| Stockholders' deficit: | | |
| Common stock: | | |
| Class A voting, par value $0.01 per share. Authorized 236,200 shares; issued and outstanding 45,611 shares at December 31, 2002 and 2003 | 456 | 456 |
| Class B nonvoting, convertible, par value $0.01 per share. Authorized 150,000 shares | — | — |
| Class C nonvoting, convertible, par value $0.01 per share. Authorized 13,800 shares; issued and outstanding 4,269 shares at December 31, 2002 and 2003 | 43 | 43 |
| Additional paid-in capital | 206,942 | 198,065 |
| Accumulated other comprehensive loss | (1,132) | 1,366 |

| | | |
|---|---|---|
| Accumulated deficit | (352,459) | (347,883) |
| Total stockholders' deficit | (146,150) | (147,953) |
| Total liabilities and stockholders' deficit | $ 829,253 | 843,068 |

See accompanying notes to consolidated financial statements.



**FAIRPOINT COMMUNICATIONS, INC. AND SUBSIDIARIES**

**Consolidated Statements of Operations**

**Years ended December 31, 2001, 2002, and 2003**

**(Dollars in thousands)**

| | 2001 | 2002 | 2003 |
|---|---|---|---|
| Revenues | $ 230,176 | 230,819 | 231,432 |
| Operating expenses: | | | |
| Operating expenses, excluding depreciation and amortization and stock-based compensation | 115,763 | 110,265 | 111,188 |
| Depreciation and amortization | 55,081 | 46,310 | 48,089 |
| Stock-based compensation | 1,337 | 924 | 15 |
| Total operating expenses | 172,181 | 157,499 | 159,292 |
| Income from operations | 57,995 | 73,320 | 72,140 |
| Other income (expense): | | | |
| Net gain (loss) on sale of investments and other assets | (648) | 34 | 608 |
| Interest and dividend income | 1,998 | 1,898 | 1,792 |
| Interest expense | (76,314) | (69,520) | (90,224) |
| Impairment on investments | — | (12,568) | — |
| Equity in net earnings of investees | 4,930 | 7,798 | 10,092 |
| Realized and unrealized gains (losses) on interest rate swaps | (12,873) | (9,577) | (1,387) |
| Other nonoperating, net | (77) | 441 | (1,505) |
| Total other expense | (82,984) | (81,494) | (80,624) |
| Loss from continuing operations before income taxes | (24,989) | (8,174) | (8,484) |
| Income tax benefit (expense) | (431) | (518) | 236 |
| Minority interest in income of subsidiaries | (2) | (2) | (2) |
| Loss from continuing operations | (25,422) | (8,694) | (8,250) |
| Discontinued operations: | | | |
| Income (loss) from discontinued operations | (90,894) | 2,433 | 1,929 |
| Income (loss) on disposal of assets of discontinued operations | (95,284) | 19,500 | 7,992 |
| Income (loss) from discontinued operations | (186,178) | 21,933 | 9,921 |
| Net income (loss) | (211,600) | 13,239 | 1,671 |
| Redeemable preferred stock dividends and accretion | — | (11,918) | (8,892) |
| Gain on repurchase of redeemable preferred stock | — | — | 2,905 |
| Net income (loss) attributed to common shareholders | $ (211,600) | 1,321 | (4,316) |

See accompanying notes to consolidated financial statements.

## FAIRPOINT COMMUNICATIONS, INC. AND SUBSIDIARIES

### Consolidated Statements of Stockholders' Equity (Deficit)

### Years ended December 31, 2001, 2002, and 2003

### (Amounts in thousands)

| | Class A Common | | Class B Common | | Class C Common | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | Shares | Amount | Additional paid-in capital | Unearned compensation | Accumulated other comprehensive income (loss) | Accumulated deficit | Total stockholders' equity (deficit) |
| Balance at December 31, 2000 | 45,527 | $ 455 | — | $ — | 4,269 | $ 43 | 227,245 | (9,707) | 440 | (154,098) | 64,378 |
| Net loss | — | — | — | — | — | — | — | — | — | (211,600) | (211,600) |
| Compensation expense for stock-based awards | — | — | — | — | — | — | 1,337 | (1,138) | — | — | 199 |
| Forfeit of unvested stock options | — | — | — | — | — | — | (10,845) | 10,845 | — | — | — |
| Other comprehensive loss from available-for-sale securities | — | — | — | — | — | — | — | — | (118) | — | (118) |
| Exercise of stock options | 92 | 1 | — | — | — | — | 299 | — | — | — | 300 |
| Other comprehensive loss from cash flow hedges | — | — | — | — | — | — | — | — | (2,569) | — | (2,569) |
| Repurchase and cancellation of shares of common stock | (8) | — | — | — | — | — | (100) | — | — | — | (100) |
| Balance at December 31, 2001 | 45,611 | 456 | — | — | 4,269 | 43 | 217,936 | — | (2,247) | (365,698) | (149,510) |
| Net income | — | — | — | — | — | — | — | — | — | 13,239 | 13,239 |
| Compensation expense for stock-based awards | — | — | — | — | — | — | 924 | — | — | — | 924 |
| Other comprehensive loss from available-for-sale securities | — | — | — | — | — | — | — | — | (322) | — | (322) |
| Other comprehensive income from cash flow hedges | — | — | — | — | — | — | — | — | 1,437 | — | 1,437 |
| Preferred stock accretion | — | — | — | — | — | — | (1,000) | — | — | — | (1,000) |
| Preferred stock dividends | — | — | — | — | — | — | (10,918) | — | — | — | (10,918) |
| Balance at December 31, 2002 | 45,611 | 456 | — | — | 4,269 | 43 | 206,942 | — | (1,132) | (352,459) | (146,150) |
| Net income | — | — | — | — | — | — | — | — | — | 1,671 | 1,671 |
| Compensation expense for stock-based awards | — | — | — | — | — | — | 15 | — | — | — | 15 |
| Other comprehensive loss from available-for-sale securities | — | — | — | — | — | — | — | — | 1,469 | — | 1,469 |
| Other comprehensive income from cash flow hedges | — | — | — | — | — | — | — | — | 1,029 | — | 1,029 |
| Repurchase redeemable preferred stock | — | — | — | — | — | — | — | — | — | 2,905 | 2,905 |
| Preferred stock accretion | — | — | — | — | — | — | (729) | — | — | — | (729) |
| Preferred stock dividends | — | — | — | — | — | — | (8,163) | — | — | — | (8,163) |
| Balance at December 31, 2003 | 45,611 | $ 456 | — | $ — | 4,269 | $ 43 | 198,065 | — | 1,366 | (347,883) | (147,953) |

See accompanying notes to consolidated financial statements.



## FAIRPOINT COMMUNICATIONS, INC. AND SUBSIDIARIES

### Consolidated Statements of Comprehensive Income (Loss)

### Years ended December 31, 2001 2002, and 2003

### (Dollars in thousands)

| | 2001 | 2002 | 2003 |
|---|---|---|---|
| Net income (loss) | $ (211,600) | 13,239 | 1,671 |
| Other comprehensive income (loss): | | | |
| Available-for-sale securities: | | | |
| Unrealized holding gains (losses) | $ 833 | (8,491) | 1,618 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Less reclassification adjustment for gain realized in net income (loss) | (951) | | (7) | | (149) | |
| Reclassification for other than temporary loss included in net income | — | (118) | 8,176 | (322) | — | 1,469 |
| Cash flow hedges: | | | | | | |
| Cumulative effect of a change in accounting principle | (4,664) | | — | | — | |
| Reclassification adjustment | 2,095 | (2,569) | 1,437 | 1,437 | 1,029 | 1,029 |
| Other comprehensive income (loss) | | (2,687) | | 1,115 | | 2,498 |
| Comprehensive income (loss) | | $ (214,287) | | 14,354 | | 4,169 |

See accompanying notes to consolidated financial statements.



**FAIRPOINT COMMUNICATIONS, INC. AND SUBSIDIARIES**

**Consolidated Statements of Cash Flows**

**Years ended December 31, 2001, 2002, and 2003**

**(Dollars in thousands)**

| | 2001 | 2002 | 2003 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Net income (loss) | $ (211,600) | 13,239 | 1,671 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities of continuing operations: | | | |
| (Income) loss from discontinued operations | 186,178 | (21,933) | (9,921) |
| Dividends and accretion on shares subject to mandatory redemption | — | — | 9,049 |
| Depreciation and amortization | 55,081 | 46,310 | 48,089 |
| Amortization of debt issue costs | 4,018 | 3,664 | 4,171 |
| Provision for uncollectible revenue | 1,035 | 2,997 | 1,028 |
| Income from equity method investments | (4,930) | (7,798) | (10,092) |
| Deferred patronage dividends | (394) | (253) | (233) |
| Minority interest in income of subsidiaries | 2 | 2 | 2 |
| Loss on early retirement of debt | — | — | 1,503 |
| Net loss (gain) on sale of investments and other assets | 648 | (34) | (608) |
| Impairment on investments | — | 12,568 | — |
| Amortization of investment tax credits | (138) | (85) | (37) |
| Stock-based compensation | 1,337 | 924 | 15 |
| Change in fair value of interest rate swaps and reclassification of transition adjustment recorded in comprehensive income (loss) | 8,134 | (698) | (6,664) |
| Changes in assets and liabilities arising from continuing operations, net of acquisitions: | | | |
| Accounts receivable | 707 | 2,534 | (3,801) |
| Prepaid and other assets | (939) | 1,266 | (771) |
| Accounts payable | (175) | 900 | (7,185) |
| Accrued interest payable | 233 | 506 | 7,786 |
| Other accrued liabilities | (4,009) | 1,640 | 418 |
| Income taxes | 306 | 379 | (149) |
| Other assets/liabilities | 223 | (496) | (1,437) |
| Total adjustments | 247,317 | 42,393 | 31,163 |
| Net cash provided by operating activities of continuing operations | 35,717 | 55,632 | 32,834 |
| Cash flows from investing activities of continuing operations: | | | |
| Acquisition of telephone properties, net of cash acquired | (18,862) | — | (33,114) |
| Acquisition of property, plant, and equipment | (43,175) | (38,803) | (33,595) |

| | | | |
|---|---|---|---|
| Proceeds from sale of property, plant, and equipment | 131 | 377 | 377 |
| Distributions from investments | 5,013 | 9,018 | 10,775 |
| Payment on covenants not to compete | (945) | (805) | (536) |
| Acquisition of investments | (652) | (493) | (17) |
| Proceeds from sale of investments and other assets | 1,329 | 448 | 2,100 |
| Net cash used in investing activities of continuing operations | (57,161) | (30,258) | (54,010) |
| Cash flows from financing activities of continuing operations: | | | |
| Proceeds from issuance of long-term debt | 316,215 | 129,080 | 317,680 |
| Repayment of long-term debt | (211,973) | (140,560) | (294,414) |
| Repurchase of shares of common stock subject to put options | (975) | (1,000) | (1,000) |
| Repurchase of redeemable preferred stock | — | — | (8,645) |
| Loan origination costs | (2,322) | (63) | (15,593) |
| Dividends paid to minority stockholders | — | (3) | (4) |
| Proceeds from exercise of stock options | 300 | — | — |
| Repayment of capital lease obligation | (11) | — | — |
| Net cash provided by (used in) financing activities of continuing operations | 101,234 | (12,546) | (1,976) |
| Net cash contributed (from) to continuing operations (to) from discontinued operations | (80,862) | (10,353) | 23,361 |
| Net increase (decrease) in cash | (1,072) | 2,475 | 209 |
| Cash, beginning of year | 3,991 | 2,919 | 5,394 |
| Cash, end of year | $ 2,919 | 5,394 | 5,603 |



| | | | |
|---|---|---|---|
| Supplemental disclosures of cash flow information: | | | |
| Interest paid | $ 91,807 | 76,611 | 77,351 |
| Income taxes paid, net of refunds | $ 111 | 252 | 701 |
| Supplemental disclosures of noncash financing activities: | | | |
| Redeemable preferred stock issued in connection with long-term debt settlement | $ — | 93,861 | — |
| Long-term debt forgiveness in connection with Carrier Services' debt settlement | $ — | 2,000 | — |
| Redeemable preferred stock dividends paid in-kind | $ — | 10,918 | 8,163 |
| Gain on repurchase of redemmable preferred stock | $ — | — | 2,905 |
| Accretion of redeemable preferred stock | $ — | 1,000 | 729 |
| Long-term debt issued in connection with Carrier Services' interest rate swap settlement | $ — | 3,003 | — |
| Long-term debt issued in connection with Carrier Services' Tranche B interest payment | $ — | 887 | 1,548 |

See accompanying notes to consolidated financial statements.



**FAIRPOINT COMMUNICATIONS, INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

**December 31, 2001, 2002, and 2003**

### (1) Organization and Summary of Significant Accounting Policies

#### *(a) Organization*

FairPoint Communications, Inc. (FairPoint) provides management services to its wholly owned subsidiaries: ST Enterprises, Ltd. (STE); MJD Ventures, Inc. (Ventures); MJD Services Corp. (Services); FairPoint Carrier Services, Inc. (Carrier Services) (formerly known as FairPoint Communications Solutions Corp.); FairPoint Broadband, Inc. (Broadband); and MJD Capital Corp. STE, Ventures, and Services also provide management services to their wholly owned subsidiaries.

Collectively, the wholly owned subsidiaries of STE, Ventures, and Services primarily provide telephone local exchange services in various states. Operations also include resale of long distance services, internet services, cable services, equipment sales, and installation and repair services. MJD Capital Corp. leases equipment to other subsidiaries of FairPoint. Carrier Services provides wholesale long distance services. Broadband provides wireless broadband services and wholesale data products.

STE's wholly owned subsidiaries include Sunflower Telephone Company, Inc. (Sunflower); Northland Telephone Company of Maine, Inc. and Northland Telephone Company of Vermont (Collectively, the Northland Companies); and ST Long Distance, Inc. (ST Long Distance). Ventures' wholly owned subsidiaries include Sidney Telephone Company (Sidney); C-R Communications, Inc. (C-R); Taconic Telephone Corp. (Taconic); Ellensburg Telephone Company (Ellensburg); Chouteau Telephone Company (Chouteau); Utilities, Inc. (Utilities); Chautauqua and Erie Telephone Corporation (C&E); The Columbus Grove Telephone Company (Columbus Grove); The Orwell Telephone Company (Orwell); GTC Communications, Inc. (GT Com); Peoples Mutual Telephone Company (Peoples); Fremont Telcom Co. (Fremont); Fretel Communications, LLC (Fretel); Comerco, Inc. (Comerco); Marianna and Scenery Hill Telephone Company (Marianna); Community Service Telephone Co. (CST); and Commtel Communications Inc. (Commtel). Services' wholly owned subsidiaries include Bluestem Telephone Company (Bluestem); Big Sandy Telecom, Inc. (Big Sandy); Columbine Telecom Company (Columbine); Odin Telephone Exchange, Inc. (Odin); Ravenswood Communications, Inc. (Ravenswood); and Yates City Telephone Company (Yates).

#### *(b) Principles of Consolidation and Basis of Presentation*

The consolidated financial statements include the accounts of FairPoint and its subsidiaries (the Company). All intercompany transactions and accounts have been eliminated in consolidation.

On November 7, 2001, the Company announced Carrier Services' plan to sell certain of its assets and to discontinue competitive communications operations. As a result of the adoption of this plan, the financial results have been reclassified in the accompanying consolidated financial statements to present these operations as discontinued (see note 12).

On September 30, 2003, the Company completed the sale of all of the capital stock owned by Services of Kadoka Telephone Co., Union Telephone Company of Hartford, Armour Independent Telephone Co. and WMW Cable TV Co. As a result of this sale, the financial results have been reclassified in the accompanying consolidated financial statements to present these operations as discontinued and the assets and liabilities of these operations were reclassified as held for sale at December 31, 2002 (see note 2). This divestiture is referred to herein as the South Dakota Divestiture.

The Company's telephone subsidiaries follow the accounting for regulated enterprises prescribed by Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain*



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*Types of Regulation* (SFAS No. 71). This 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, SFAS No. 71 requires the Company's telephone subsidiaries to depreciate telephone plant over useful lives that would otherwise be determined by management. SFAS No. 71 also requires deferral of certain costs and obligations based upon approvals received from regulators to permit recovery of such amounts in future years. The Company's telephone subsidiaries periodically review the applicability of SFAS No. 71 based on the developments in their current regulatory and competitive environments.

#### *(c) Use of Estimates*

The Company's management has made a number of estimates and assumptions relating to the reporting of assets and liabilities, the reported amounts of revenues and expenses, and the disclosure of contingent assets and liabilities to prepare these consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. Actual results could differ from those estimates.

#### *(d) Revenue Recognition*

Revenues are recognized as services are rendered and are primarily derived from the usage of the Company's networks and facilities or under revenue sharing arrangements with other communications carriers. Revenues are primarily derived from: access, pooling, long distance services, internet and data services, and other miscellaneous services. Local access charges are billed to local end users under tariffs approved by each state's Public Utilities Commission. Access revenues are derived for the intrastate jurisdiction by billing access charges to interexchange carriers and to regional Bell operating companies. These charges are billed based on toll or access tariffs approved by the local state's Public Utilities Commission. Access charges for the interstate jurisdiction are billed in accordance with tariffs filed by the National Exchange Carrier Association (NECA) or by the individual company and approved by the Federal Communications Commission.

Revenues are determined on a bill and keep basis or a pooling basis. If on a bill and keep basis, the Company bills the charges to either the access provider or the end user and keeps the revenue. If the Company participates in a pooling environment (interstate or intrastate), the toll or access billed are contributed to a revenue pool. The revenue is then distributed to individual companies based on their company-specific revenue requirement. This distribution is based on individual state Public Utilities Commission (intrastate) or Federal Communications Commission's (interstate) approved separation rules and rates of return. Distribution from these pools can change relative to changes made to expenses, plant investment, or rate of return. Some companies participate in federal and certain state universal service programs that are pooling in nature but are regulated by rules separate from those described above. These rules vary by state.

Long distance retail and wholesale services are usage sensitive and are billed in arrears and recognized when earned. Internet and data services revenues are substantially all recurring revenues and billed are one month in advance and deferred until earned. The majority of the Company's miscellaneous revenue is provided from billing and collection and directory services. The Company earns revenue from billing and collecting charges for toll calls on behalf of interexchange carriers. The interexchange carrier pays a certain rate per each message billed by the Company. The Company recognizes revenue from billing and collection services when the services are provided. The Company



recognizes directory services revenue over the subscription period of the corresponding directory. Billing and collection is normally billed under contract or tariff supervision. Directory services are normally billed under contract.

***(e) 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 considered remote.

The following is activity in the Company's allowance for doubtful accounts receivable for the years ended December 31 (dollars in thousands):

| | | 2001 | 2002 | 2003 |
|---|---|---|---|---|
| Balance, beginning of period | $ | 1,434 | 1,355 | 1,235 |
| Additions due to acquisitions | | 4 | — | 202 |
| Provision charged to expense | | 1,035 | 2,997 | 292 |
| Amounts written off, net of recoveries | | (1,118) | (3,117) | (701) |
| Balance, end of period | $ | 1,355 | 1,235 | 1,028 |

***(f) Credit Risk***

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of cash and trade receivables. The Company places its cash with high-quality financial institutions. Concentrations of credit risk with respect to trade receivables are principally related to receivables from other interexchange carriers and are otherwise limited to the Company's large number of customers in several states.

The Company is also exposed to credit losses in the event of nonperformance by the counterparties to its interest rate swap agreements. The Company anticipates, however, that the counter parties will be able to fully satisfy their obligations under the contracts.

***(g) Investments***

Investments consist of stock in CoBank, ACB (CoBank), Rural Telephone Bank (RTB), the Rural Telephone Finance Cooperative (RTFC), Choice One Communications Inc. (Choice One), various cellular companies and partnerships and other minority equity investments, and Non-Qualified Deferred Compensation Plan assets. The stock in CoBank, RTB, and the RTFC is nonmarketable and stated at cost. For investments in partnerships, the equity method of accounting is used.

The investment in Choice One stock is a marketable security classified as available for sale. Non-Qualified Deferred Compensation Plan assets are classified as trading. The Company uses fair value reporting for marketable investments in debt and equity securities classified as either available-for-sale or trading. For available-for-sale securities, the unrealized holding gains and losses,



net of the related tax effect, are excluded from earnings and are reported as a separate component of comprehensive income until realized. Unrealized holding gains and losses on trading securities are included in other income.

To determine if an impairment of an investment exists, the Company monitors and evaluates the financial performance of the business in which it invests and compares the carrying value of the investee to quoted market prices (if available), or the fair values of similar investments, which in certain instances, is based on traditional valuation models utilizing multiples of cash flows. When circumstances indicate that a decline in the fair value of the investment has occurred and the decline is other than temporary, the Company records the decline in value as a realized impairment loss and a reduction in the cost of the investment.

The Company currently receives patronage dividends from its investments in businesses organized as cooperatives for Federal income tax purposes (CoBank and RTFC stock). Patronage dividends represent cash distributions of the cooperative's earnings and notices of allocations of earnings to the Company. Deferred and uncollected patronage dividends are included as part of the basis of the investment until collected. The RTB investment pays dividends annually at the discretion of its board of directors.

***(h) Property, Plant, and Equipment***

Property, plant, and equipment are carried at cost. Repairs and maintenance are charged to expense as incurred and major renewals and improvements are capitalized. For traditional telephone companies, the original cost of depreciable property retired, together with removal cost, less any salvage realized, is charged to accumulated depreciation. For all other companies, the original cost and accumulated depreciation are removed from the accounts and any gain or loss is included in the results of operations. Depreciation is determined using the straight-line method for financial reporting purposes.

***(i) Debt Issue Costs***

Debt issue costs are being amortized over the life of the related debt, ranging from 3 to 10 years. During 2003, $5.0 million in net book value of debt issue costs were written off in association with refinancing activity classified as other nonoperating expense in the statements of operations. Accumulated amortization of loan origination costs from continuing operations was $13.0 million and $10.3 million at December 31, 2002 and 2003, respectively.

***(j) Goodwill and Other Intangible Assets***

Goodwill consists of the difference between the purchase price incurred in acquisitions using the purchase method of accounting and the fair value of net assets acquired.

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets,* which the Company adopted effective January 1, 2002, goodwill is no longer amortized, but instead is assessed for impairment at least annually. During this assessment, management relies on a number of factors, including operating results, business plans, and anticipated future cash flows. In fiscal year 2001, goodwill was amortized using the straight-line method over an estimated useful life of 40 years. Accumulated amortization of goodwill at December 31, 2003 and 2002 is $33.7 million.



***(k) 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 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.

Goodwill and intangible assets not subject to amortization are tested annually for impairment following the adoption of SFAS No. 142. Prior to the adoption of SFAS No. 142, the Company evaluated the recoverability of goodwill pursuant to Accounting Principles Board Opinion No. 17, *Intangible Assets*, and used estimates of future cash flows in periodically evaluating goodwill for impairment. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's estimated fair value.

***(l) Income Taxes***

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences 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.

FairPoint files a consolidated income tax return with its subsidiaries. FairPoint has a tax sharing agreement in which all of its subsidiaries are participants. All intercompany tax transactions and accounts have been eliminated in consolidation.

***(m) Interest Rate Swap Agreements***

The Company assesses interest rate cash flow risk by continually identifying and monitoring changes in interest rate exposures that may adversely impact expected future cash flows and by evaluating hedging opportunities. The Company maintains risk management control systems to monitor interest rate cash flow risk attributable to both the Company's outstanding or forecasted debt obligations. The risk management control systems involve the use of analytical techniques, including cash flow sensitivity analysis, to estimate the expected impact of changes in interest rates on the Company's future cash flows.

The Company uses variable and fixed-rate debt to finance its operations, capital expenditures, and acquisitions. The variable-rate debt obligations expose the Company to variability in interest payments due to changes in interest rates. The Company believes it is prudent to limit the variability of a portion of its interest payments. To meet this objective, the Company enters into interest rate swap agreements to manage fluctuations in cash flows resulting from interest rate risk. These swaps change the variable-rate cash flow exposure on the debt obligations to fixed cash flows. Under the terms of the interest rate swaps, the Company receives variable interest rate payments and makes fixed interest rate



payments, thereby creating the equivalent of fixed-rate debt. As of December 31, 2003, the Company had two interest rate swap agreements with a combined notional amount of $50.0 million and expiration dates of May 2004.

In June 1998, the Financial Accounting Standards Board (FASB) issued SFAS No. 133, *Accounting for Derivative Instruments and Certain Hedging Activities* (SFAS No. 133). In June 2000, the FASB issued SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities, an Amendment to SFAS No. 133* (SFAS No. 138). SFAS No. 133 and SFAS No. 138 require that all derivative instruments be recorded on the balance sheet at their respective fair values. The Company adopted SFAS No. 133 and SFAS No. 138 on January 1, 2001. In accordance with the transition provisions of SFAS No. 133, the Company recorded a cumulative-effect-type loss adjustment (the "transition adjustment") of $(4.7) million in other comprehensive income (loss) to recognize at fair value all interest rate swap agreements. The fair value of the Company's interest rate swap agreements is determined from valuations received from financial institutions. The fair value indicates an estimated amount the Company would pay if the contracts were cancelled or transferred to other parties. At December 31, 2003, the Company expects to reclassify to nonoperating income (expense) during the next 12 months $0.1 million from the transition adjustment that was recorded in other comprehensive income (loss).

Effective January 1, 2001, the Company discontinued hedge accounting prospectively on its existing interest rate swap agreements because the agreements do not qualify as accounting hedges under SFAS No. 133. As of December 31, 2002 and 2003, the fair value of all outstanding interest rate swap agreements used in continuing operations was $8.6 million and $0.9 million, respectively.

On May 1, 2001, the Company entered into an interest swap with a notional amount of $25 million that was being accounted for as a cash flow hedge under the provisions of SFAS No. 133. The effective portion of the loss on this interest rate swap ($0.6 million) was being recorded in other comprehensive income (loss) through the third quarter of 2001. In association with the discontinued operations of the competitive communications business at Carrier Services and the bank negotiations in relation to Carrier Services' Credit Facility, as of December 31, 2001, the Company discontinued hedge accounting on this swap. As of December 31, 2001, the fair value of this interest rate swap was $0.6 million, and was recorded in the statements of operations as a charge to discontinued operations. In addition, the Company reclassified $0.6 million from other comprehensive income (loss) to discontinued operations from the translation adjustment recorded on January 1, 2001 for the other remaining interest rate swap (notional amount of $50 million) used by the Company for Carrier Services' Credit Facility. The fair market value of this swap was $2.6 million at December 31, 2001. At December 31, 2001, these interest rate swaps were classified as current liabilities of discontinued operations on the consolidated balance sheet at their respective fair values. These interest rate swaps were settled in May 2002 in conjunction with the restructuring of Carrier Services' Credit Facility.

Amounts receivable or payable under interest rate swap agreements are accrued at each balance sheet date and included as adjustments to realized and unrealized gains (losses) on interest rate swaps.



The following is a summary of amounts included in realized and unrealized gains (losses) on interest rate swaps (dollars in thousands):

| | | 2001 | 2002 | 2003 |
|---|---|---|---|---|
| Change in fair value of interest rate swaps | $ | (6,896) | 2,135 | 7,693 |
| Reclassification of transition adjustment included in other comprehensive income (loss) | | (1,238) | (1,437) | (1,029) |
| Realized gains (losses) | | (4,739) | (10,275) | (8,051) |
| Total | $ | (12,873) | (9,577) | (1,387) |

***(n) Stock Appreciation Rights***

Stock appreciation rights have been granted to certain members of management by principal shareholders of the Company. The Company accounts for stock appreciation rights in accordance with FASB Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans.* The Company measures compensation as the amount by which the market value of the shares of the Company's stock covered by the grant exceeds the option price or value specified, by reference to a market price or otherwise, subject to any appreciation limitations under the plan and a corresponding credit to additional paid-in capital. Changes, either increases or decreases, in the market value of those shares between the date of the grant and the measurement date result in a change in the measure of compensation for the right. Valuation of stock appreciation rights is typically based on traditional valuation models utilizing multiples of cash flows, unless there is a current market value for the Company's stock.

***(o) Stock Option Plans***

At December 31, 2003, the Company has three stock-based employee compensation plans. The Company accounts for its stock option plans using the intrinsic value-based method prescribed by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB No. 25), and related interpretations. As such, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeds the exercise price. SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123), permits entities to recognize as expense over the vesting period the fair value of all stock-based awards on the date of grant. SFAS No. 123 allows entities to continue to apply the provisions of APB No. 25 and provide pro forma net income disclosures as if the fair-value method defined in SFAS No. 123 had been applied. The Company has elected to continue to apply the intrinsic value-based method of accounting under APB No. 25 and has adopted the disclosure requirements of SFAS No. 123.

The Company calculates stock-based compensation pursuant to the disclosure provisions of SFAS No. 123 using the straight-line method over the vesting period of the option. Had the Company



determined compensation cost based on the fair value at the grant date for its stock options under SFAS No. 123, the Company's net income (loss) would have been:

| | December 31, 2001 | December 31, 2002 | December 31, 2003 |
|---|---|---|---|

| | | (Dollars in thousands) | |
|---|---|---|---|
| Net income (loss), as reported | $ (211,600) | 13,239 | 1,671 |
| Stock-based compensation expense included in reported net income (loss) | 2,203 | 1,260 | 15 |
| Stock-based compensation determined under fair value based method | 40 | (1,387) | (658) |
| Pro forma net income (loss) | $ (209,357) | 13,112 | 1,028 |

The pro forma impact on income for the year ended December 31, 2001 assumes estimated forfeitures for those employees subject to termination due to the discontinued competitive communications operations. The pro forma impact on income for the year ended December 31, 2002 assumes estimated forfeitures for an employee who retired in January 2003. The pro forma impact on income for the year ended December 31, 2003 assumes estimated forfeitures for an employee who retired in December 2003. The stock-based compensation expense does not agree to the consolidated statements of operations due to the credit adjustments related to the stock appreciation rights of $(0.9) million and $(0.3) million for the years ended December 31, 2001 and 2002, respectively. There were no adjustments to the stock appreciation rights in the year ended December 31, 2003, as the fair market value per share of the Company's common stock remained flat during the year. The pro forma effects are not representative of the effects on reported net income for future years.

### *(p) Certain Financial Instruments with Characteristics of Liabilities and Equity*

The Company prospectively adopted SFAS No. 150, effective July 1, 2003. The SFAS No. 150 adoption had no impact on net income (loss) attributed to common shareholders for any of the periods presented. SFAS No. 150 requires the Company to classify as a long-term liability its Series A Preferred Stock and to reclassify dividends and accretion from the Series A Preferred Stock as interest expense. Such stock is now described as "Preferred Shares Subject to Mandatory Redemption" in the Consolidated Balance Sheet as of December 31, 2003 and dividends and accretion on these shares are now included in pre-tax income whereas previously they were presented as a reduction to equity (a dividend) and, therefore, a reduction of net income available to common shareholders.

### *(q) Business Segments*

Under the provisions of SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information,* the Company's only separately reportable business segment is its traditional telephone operations. The Company's traditional telephone operations are conducted in rural, suburban and small urban communities in various states. The operating income of this segment is reviewed by the chief operating decision maker to assess performance and make business decisions. Due to the sale of the Company's competitive communications operations, such operations (which were previously reported as a separate segment) are classified as discontinued operations.



### *(r) Reclassifications*

Certain amounts previously reported have been reclassified to conform to current year presentation.

## (2) Acquisitions

On September 4, 2001, the Company acquired 100% of the capital stock of Marianna. This acquisition is not deductible for tax purposes. On September 28, 2001, the Company acquired certain assets of Illinois Consolidated Telephone Company. This acquisition is deductible for tax purposes. The aggregate purchase price for these acquisitions was $23.5 million.

On December 1, 2003, the Company acquired 100% of the capital stock of CST and Commtel. The purchase for this acquisition was $32.6 million. The Company believes the entire amount of goodwill will be deductible for income tax purposes.

Acquisition costs were $0.3 million and $0.3 million in 2001 and 2003, respectively. The Company's 2001 and 2003 acquisitions have been accounted for using the purchase method and, accordingly, the results of their operations have been included in the Company's consolidated financial statements from the date of acquisition. The excess of the purchase price and acquisition costs over the fair value of the net identifiable assets acquired was $14.4 million and $25.1 million and has been recognized as goodwill in 2001 and 2003, respectively.

The allocation of the total net purchase price for the 2001 and 2003 acquisitions are shown in the table below:

| | 2001 | 2003 |
|---|---|---|
| | (Dollars in thousands) | |
| Current assets | $ 5,659 | 1,027 |
| Property, plant, and equipment | 4,953 | 8,301 |
| Excess cost over fair value of net assets acquired | 14,358 | 25,064 |
| Other assets | 6 | — |
| Current liabilities | (111) | (1,182) |
| Other liabilities | (1,098) | (268) |
| Total net purchase price | $ 23,767 | 32,942 |

The following unaudited pro forma information presents the combined results of operations of the Company as though the acquisitions made in each of the following years occurred at the beginning of the preceding year. These results include certain adjustments, including increased interest expense on debt related to the acquisitions, certain preacquisition transaction costs, and related income tax effects. The pro forma financial information does not necessarily reflect the results of operations if the acquisitions had been in effect at the beginning of the period or which may be attained in the future.

| | Pro forma year ended December 31, | | |
|---|---|---|---|
| | 2001 | 2002 | 2003 |
| | (Dollars in thousands) (Unaudited) | | |
| Revenues | $ 233,640 | $ 238,466 | $ 238,663 |
| Loss from continuing operations | (25,182) | (8,321) | (8,190) |
| Net income (loss) | (211,360) | 13,612 | 1,731 |

**(3) Goodwill and Other Intangible Assets**

Changes in the carrying amount of goodwill were as follows (dollars in thousands):

| | |
|---|---|
| Balance, December 31, 2001 and 2002 | $ 454,306 |
| Disposal of South Dakota Divestiture | (10,525) |
| Balance, December 31, 2002, adjusted for discontinued operations | 443,781 |
| Acquisition of CST and Commtel | 25,064 |
| Balance, December 31, 2003 | $ 468,845 |

In connection with the transitional goodwill impairment evaluation performed as of January 1, 2002, SFAS No. 142 required the Company to perform an assessment of whether there was an indication that goodwill was impaired as of the date of adoption. To accomplish this, the Company was required to identify its reporting units and determine the carrying value of each reporting unit by assigning the assets and liabilities, including the existing goodwill and intangible assets, to those reporting units as of January 1, 2002. The Company was required to determine the fair value of each reporting unit and compare it to the carrying amount of the reporting unit within six months of January 1, 2002. In performing the initial transitional impairment test, the Company determined that the carrying amount of its reporting unit did not exceed its estimated fair value and, therefore, the Company did not record an impairment loss upon adoption of SFAS No. 142. The Company updated its annual impairment testing of goodwill as of October 1, 2002 and 2003, and determined that no impairment loss was required to be recognized.

As of the date of adoption of SFAS No. 142, the Company had unamortized goodwill of $443.8 million and equity method goodwill of $10.3 million. The loss from continuing operation as of



December 31, 2001. adjusted as if SFAS No. 142 had been effective as of January 1, 2001, compared to actual results for the years ended 2002 and 2003 (dollars in thousands) is as follows:

| | 2001 | 2002 | 2003 |
|---|---|---|---|
| Reported loss from continuing operations | $ (25,422) | $ (8,694) | $ (8,250) |
| Amortization of goodwill | 11,680 | — | — |
| Amortization of equity method goodwill | 282 | — | — |
| Adjusted loss from continuing operations | $ (13,460) | $ (8,694) | $ (8,250) |

As of the date of adoption, the Company had $1.7 million in covenants not to compete that are intangible assets subject to amortization under SFAS No. 142. The covenants not to compete are being amortized over their useful lives of three to five years. Accumulated amortization of covenants not to compete was $3.9 million and $4.6 million at December 31, 2002 and 2003, respectively. The Company recorded amortization of $0.9 million, $0.9 million, and $0.7 million for the years ended December 31, 2001, 2002, and 2003, respectively. The Company will continue to amortize the covenants over their remaining estimated useful lives and will record amortization of $0.1 million during 2004.

**(4) Property, Plant, and Equipment**

A summary of property, plant, and equipment from continuing operations is shown below:

| Estimated life (in years) | 2002 | 2003 |
|---|---|---|
| | (Dollars in thousands) | |

| | | | |
|---|---|---|---|
| Land | — | $ 3,667 | $ 3,861 |
| Buildings and leasehold improvements | 2 - 40 | 34,122 | 36,331 |
| Telephone equipment | 3 - 50 | 548,152 | 591,621 |
| Cable equipment | 3 - 20 | 1,456 | 1,568 |
| Furniture and equipment | 3 - 34 | 15,448 | 18,184 |
| Vehicles and equipment | 3 - 20 | 19,200 | 20,712 |
| Computer software | 3 - 5 | 2,046 | 2,277 |
| Total property, plant, and equipment | | 624,091 | 674,554 |
| Accumulated depreciation | | (352,401) | (407,848) |
| Net property, plant, and equipment | | $ 271,690 | $ 266,706 |

The telephone company composite depreciation rate for property and equipment was 7.61%, 7.62%, and 7.46% in 2001, 2002, and 2003, respectively. Depreciation expense from continuing operations for the years ended December 31, 2001, 2002, and 2003 was $41.9 million, $45.3 million, and $47.1 million, respectively.



**(5) Investments**

The cost, unrealized holding gains and losses, and fair value of the Company's marketable equity investments classified as available-for-sale, at December 31, 2002 and 2003 are summarized below (dollars in thousands):

| | Cost | Unrealized holding gains | Unrealized holding loss | Fair value |
|---|---|---|---|---|
| December 31, 2002 | $ 560 | — | — | 560 |
| December 31, 2003 | 420 | 1,469 | — | 1,889 |

Proceeds from sales of available-for-sale securities were $1.1 million, $0.4 million, and $0.3 million in 2001, 2002, and 2003, respectively. Gross gains of $1.0 million, approximately $7,000 and $0.1 million in 2001, 2002, and 2003, respectively, were realized on those sales.

The Company's noncurrent investments at December 31, 2002 and 2003 consist of the following:

| | 2002 | 2003 |
|---|---|---|
| | (Dollars in thousands) | |
| Investment in cellular companies and partnerships | $ 16,341 | 14,399 |
| RTB stock | 20,125 | 20,125 |
| CoBank stock and unpaid deferred CoBank patronage | 4,903 | 5,136 |
| RTFC secured certificates and unpaid deferred RTFC patronage | 534 | 478 |
| Other nonmarketable minority equity investments and Non-Qualified Deferred Compensation Plan assets | 1,724 | 1,654 |
| Total investments | $ 43,627 | 41,792 |

The Company records its share of the earnings or losses of the investments accounted for under the equity method on a three-month lag. The investments accounted for under the equity method and the Company's ownership percentage as of December 31, 2002 and 2003 are summarized below:

| | 2002 | 2003 |
|---|---|---|
| Chouteau Cellular Telephone Company | 33.7% | 33.7% |
| Illinois Valley Cellular RSA 2—I Ptnrs | 13.3% | — |
| Illinois Valley Cellular RSA 2—II Ptnrs | 13.3% | — |
| Illinois Valley Cellular RSA 2—III Ptnrs | 13.3% | — |
| ILLINET Communications, LLC | 9.1% | 9.1% |
| Orange County-Poughkeepsie Limited Partnership | 7.5% | 7.5% |
| ILLINET Communications of Central IL LLC | 5.2% | 5.2% |
| Syringa Networks, LLC | 13.9% | 13.9% |

Proceeds from sales of investments accounted for under the equity method were $0.2 million and $1.8 million in 2001 and 2003, respectively. Gross gains of approximately $43,000 and $0.5 million, respectively, were realized on those sales. There were no sales of investments accounted for under the equity method during 2002.

Chouteau Cellular Telephone Company (a limited partnership in which the Company holds a 1.0% general partner interest and a 32.67% limited partner interest) (Chouteau) is an investment vehicle which holds a 25% member interest in Independent Cellular Telephone, LLC (ICT). ICT in turn is an investment vehicle which holds a 44.45% member interest in United States Cellular Telephone of Greater Tulsa, LLC (Tulsa, LLC). Because Tulsa, LLC is the actual operating entity within the overall investment structure, its summary financial information is presented below, rather than summary information for the Chouteau Cellular Telephone Company, which is the actual entity accounted for under the equity method on the books of the Company:

| | September 30 | |
|---|---|---|
| | 2002 | 2003 |
| | (Dollars in thousands) | |
| Current assets | $ 12,346 | 10,060 |
| Property, plant, and equipment, net | 65,394 | 90,060 |
| Other | 20,648 | 20,834 |
| Total assets | $ 98,388 | 120,954 |
| Current liabilities | $ 55,070 | 70,718 |
| Noncurrent liabilities | 2,878 | 1,165 |
| Members' equity | 40,440 | 49,071 |
| Total liabilities and members' equity | $ 98,388 | 120,954 |

| | Twelve months ended September 30 | | |
|---|---|---|---|
| | 2001 | 2002 | 2003 |
| | (Dollars in thousands) | | |
| Revenues | $ 95,852 | 96,361 | 98,747 |
| Operating income | 7,338 | 12,407 | 12,482 |
| Net income before cumulative effect of a change in accounting principle | 4,950 | 10,402 | 13,232 |
| Cumulative effect of a change in accounting principle | (963) | — | — |
| Net income | 3,987 | 10,402 | 13,232 |

In addition to holding the 44.45% member interest in Tulsa, LLC, ICT has long-term debt consisting of variable rate borrowings (5.50% at December 31, 2003) under a loan agreement with RTFC, due in quarterly installments of $0.7 million including interest through 2006. The note is collateralized by the assets of ICT, including its investment in Tulsa, LLC. The RTFC debt balance at December 31, 2003 was $6.0 million. The Company has issued an unsecured guarantee of the RTFC debt. As of December 31, 2003, the amount of the unsecured guarantee was $1.5 million.

During 2003, the Company sold its ownership percentages of Illinois Valley Cellular RSA 2-I Partnership, Illinois Valley Cellular RSA 2-II Partnership and Illinois Valley Cellular RSA 2-III Partnership. Proceeds from the sales of these investments were $1.8 million and gross gains of approximately $0.4 million were realized on these sales.

The Company continually evaluates its investment holdings for evidence of impairment. During 2002, the Company determined that the decline in market value of its Choice One common stock was



"other than temporary." As such, the Company recorded a noncash charge of $8.2 million. This charge is classified with the impairment on investments in the consolidated statements of operations.

During 2002, the Company determined that the carrying amount exceeded the estimated fair value of some investments accounted for under the equity method, and such declines were "other than temporary." As such, the Company recorded a noncash charge of $1.7 million and $2.7 million, respectively, for the Chouteau and the Illinois Valley Cellular RSA 2—I, II, and III partnership investments. These charges are classified with the impairment on investments in the consolidated statements of operations.

**(6) Long-term Debt**

Long-term debt at December 31, 2002 and 2003 is shown below:

| | 2002 | 2003 |
|---|---|---|
| | (Dollars in thousands) | |

| | | | |
|---|---|---|---|
| Senior secured notes, variable rates ranging from 4.25% to 10.57% at December 31, 2003, due 2004 to 2007 | $ | 351,778 | 171,091 |
| Senior subordinated notes due 2008: | | | |
| Fixed Rate Notes, 9.50% | | 125,000 | 115,207 |
| Variable Rate Notes, 5.81% at December 31, 2003 | | 75,000 | 75,000 |
| Senior subordinated notes, 12.50%, due 2010 | | 200,000 | 193,000 |
| Senior subordinated notes, 11.78% due 2010 | | — | 225,000 |
| Carrier Services' senior secured notes, 8.00%, due 2007 | | 28,829 | 24,570 |
| Senior notes to RTFC: | | | |
| Fixed rate, 9.20%, due 2009 | | 3,250 | 2,776 |
| Variable rate, 5.50% at December 31, 2003, due 2009 | | 4,871 | 4,162 |
| Subordinated promissory notes, 7.00%, due 2005 | | 7,000 | 7,000 |
| First mortgage notes to Rural Utilities Service, fixed rates ranging from 2.00% to 10.78%, due 2003 to 2016 | | 7,090 | 6,492 |
| Senior notes to RTB, fixed rates ranging from 7.50% to 8.00%, due 2008 to 2014 | | 1,372 | 1,262 |
| Total outstanding long-term debt | | 804,190 | 825,560 |
| Less current portion | | (5,704) | (21,982) |
| Total long-term debt, net of current portion | $ | 798,486 | 803,578 |



The approximate aggregate maturities of long-term debt for each of the five years subsequent to December 31, 2003 are as follows (dollars in thousands):

| | | |
|---|---|---|
| Fiscal year: | | |
| 2004 | $ | 21,982 |
| 2005 | | 32,119 |
| 2006 | | 37,591 |
| 2007 | | 119,619 |
| 2008 | | 192,700 |
| Thereafter | | 421,549 |
| | $ | 825,560 |

***Senior Secured Notes***

On March 30, 1998, the Company closed a $315 million senior secured credit facility (the Credit Facility) which committed $75 million of term debt (tranche C) amortized over nine years, $155 million of term debt (tranche B) amortized over eight years, and $85 million of reducing revolving credit facility debt (revolving facility) with a term of 6.5 years. On March 14, 2000, an additional $165 million of reducing revolving credit facility debt (acquisition facility) with a term of 4.5 years was committed and made available to the Company under the Credit Facility. The Credit Facility requires that the Company maintain certain financial covenants.

The Credit Facility was amended and restated as part of a refinancing completed on March 6, 2003. Our amended and restated credit facility provides for, among other things, rescheduled amortization and an excess cash flow sweep with respect to the tranche C term facility. Our amended and restated credit facility consists of term loan facilities (consisting of tranche A loans and tranche C loans) in an aggregate principal amount of $156.4 million and a revolving credit facility in an aggregate principal amount of $70.0 million. All of our obligations under our amended and restated credit facility are unconditionally and irrevocably guaranteed jointly and severally by four of our mid-tier subsidiaries. Outstanding debt under our amended and restated credit facility is secured by a first priority perfected security interest in all of the capital stock of certain of our subsidiaries.

Our amended and restated credit facility is comprised of the following facilities:

*Revolving loan facility.* A revolving loan facility of $70 million. As of December 31, 2003, $14.7 million was outstanding under the revolving loan facility. These loans mature on March 31, 2007 and bear interest per annum at either a base rate plus 3.00% or LIBOR plus 4.00%.

*Tranche A term loan facility.* A tranche A term loan facility of $30 million. As of December 31, 2003, $30.0 million of tranche A term loans were outstanding. These loans mature on March 31, 2007 and bear interest per annum at either a base rate plus 3.00% or LIBOR plus 4.00%.

*Tranche C term loan facility.* As of December 31, 2003, approximately $126.4 million of tranche C term loans remained outstanding. These loans mature on March 31, 2007. Mandatory repayments under the tranche C term loan facility are scheduled to be $20.0 million, $20.0 million, $30.0 million and a final $56.4 million in years 2004, 2005, 2006, and on March 31, 2007, respectively. Tranche C term loans bear interest per annum at either a base rate plus 3.50% or LIBOR plus 4.50%.

Our amended and restated credit facility contains certain customary covenants and other credit requirements of the Company and its subsidiaries and certain customary events of default. Our amended and restated credit facility limits our ability to make investments in Carrier Services and its subsidiaries.

Net cash proceeds from asset sales are required to be applied as mandatory prepayments of principal on outstanding loans unless such proceeds are used by us to finance acquisitions permitted under our amended and restated credit facility within 180 days (270 days with respect to a Special Asset Sale, as defined in the credit facility) of our receipt of such proceeds. Change of control transactions trigger a mandatory prepayment obligation. Voluntary prepayments of loans, including interim prepayments of revolving loans with proceeds of asset sales that are not used to prepay term loans in anticipation of being subsequently applied to fund a permitted acquisition or acquisitions within 180 days (270 days in the event described above) of the asset sale, may be made at any time without premium or penalty, provided that voluntary prepayments of Eurodollar loans made on a date other than the last day of an interest period applicable thereto shall be subject to customary breakage costs.

In addition, our amended and restated credit facility provides that on the date occurring 90 days after the last day of each of our fiscal years, commencing December 31, 2003, 50% of excess cash flow (as defined in our amended and restated credit facility) for the immediately preceding fiscal year shall be applied as a mandatory repayment of the then outstanding tranche C term loan facility; provided, however, that such requirement shall terminate at such time as (i) we first meet a senior secured leverage ratio (as defined in our credit facility) of less than or equal to 1.00 to 1.00 and (ii) no default or event of default exists under our amended and restated credit facility.

On January 30, 2004, the Company amended its amended and restated credit facility to increase its revolving loan facility from $70.0 million to $85.0 million and its tranche A term loan facility from $30.0 million to $40.0 million. The Company used all of the additional borrowing under the Tranche A term loan facility and a portion of the borrowings under the revolving loan facility to repay in full all of the indebtedness under Carrier Services' Senior Secured Notes. There was no gain or loss on the extinguishment of this indebtedness.

The Company used two interest rate swap agreements, with notional amounts of $25 million each, to effectively convert a portion of its variable interest rate exposure under the Credit Facility to fixed rates ranging from 8.07% to 10.34%. The expiration date of the swap agreements is May 2004.

The Company's amended and restated credit facility allows the Company to request letters of credit to support obligations of the Company incurred in the ordinary course of business in an aggregate principal amount not to exceed $5.0 million and subject to limitations on the aggregate amount outstanding under the amended and restated credit facility. As of December 31, 2003, $1.0 million had been issued under this letter of credit.

***Fixed Rate and Floating Rate Senior Subordinated Notes issued in 1998***

FairPoint issued $125.0 million aggregate principal amount of Senior Subordinated Notes (the 1998 Fixed Rate Notes) and $75.0 million of Floating Rate Notes (the 1998 Floating Rate Notes) in 1998. The 1998 Fixed Rate Notes bear interest at the rate of $9^{1}/_{2}$% per annum and the 1998 Floating Rate Notes bear interest at a rate per annum equal to LIBOR plus 418.75 basis points, in each case payable semi-annually in arrears. The LIBOR rate on the 1998 Floating Rate Notes is determined semi-annually.



The 1998 Fixed Rate Notes and 1998 Floating Rate Notes mature on May 1, 2008. FairPoint may redeem the 1998 Fixed Rate Notes and the 1998 Floating Rate Notes at any time, in each case, at the redemption prices stated in the indenture under which those notes were issued, together with accrued and unpaid interest, if any, to the redemption date. In the event of a change of control, FairPoint must offer to repurchase the outstanding 1998 Fixed Rate Notes and 1998 Floating Rate Notes for cash at a purchase price of 101% of the principal amount of such notes, together with all accrued and unpaid interest, if any, to the date of repurchase.

The 1998 Fixed Rate Notes and 1998 Floating Rate Notes are general unsecured obligations of FairPoint, subordinated in right of payment to all existing and future senior indebtedness of FairPoint, including all obligations under the Company's amended and restated credit facility.

The indenture governing the 1998 Fixed Rate Notes and 1998 Floating Rate Notes contains certain customary covenants and events of default.

At December 31, 2003 the Company's restricted covenants do not allow the Company to make any dividend payments.

***Senior Subordinated Notes issued in 2000***

FairPoint issued $200.0 million aggregate principal amount of Senior Subordinated Notes (the 2000 Notes) in 2000. The 2000 Notes bear interest at the rate of $12^{1}/_{2}$% per annum, payable semi-annually in arrears.

The 2000 Notes mature on May 1, 2010. FairPoint may redeem the 2000 Notes at any time on or after May 1, 2005 at the redemption prices stated in the indenture under which the 2000 Notes were issued, together with accrued and unpaid interest, if any, to the redemption date. In the event of a change of control, FairPoint must offer to repurchase the outstanding 2000 Notes for cash at a purchase price of 101% of the principal amount of such notes, together with all accrued and unpaid interest, if any, to the date of repurchase.

The 2000 Notes are general unsecured obligations of FairPoint, subordinated in right of payment to all existing and future senior indebtedness of FairPoint, including all obligations under the Company's amended and restated credit facility.

The indenture governing the 2000 Notes contains certain customary covenants and events of default.

*Senior Notes issued in 2003*

FairPoint issued $225.0 million aggregate principal amount of Senior Notes in 2003 (the 2003 Notes). The 2003 Notes bear interest at the rate of $11^{7}/_{8}$% per annum, payable semi-annually in arrears.

The 2003 Notes mature on March 1, 2010. FairPoint may redeem the 2003 Notes at any time on or after March 1, 2007 at the redemption prices stated in the indenture under which the 2003 Notes were issued, together with accrued and unpaid interest, if any, to the redemption date. In the event of a change of control, FairPoint must offer to repurchase the outstanding 2003 Notes for cash at a purchase price of 101% of the principal amount of such notes, together with all accrued and unpaid interest, if any, to the date of repurchase.

The 2003 Notes are general unsecured obligations of FairPoint, ranking *pari passu* in right of payment with all existing and future senior debt of FairPoint, including all obligations under the Company's amended and restated credit facility, and senior in right of payment to all existing and future subordinated indebtedness of FairPoint.



The indenture governing the 2003 Notes contains certain customary covenants and events of default.

The proceeds from the offering of the 2003 Notes and borrowings under the Company's amended and restated credit facility's tranche A term loan facility were used to: (i) repay the entire amount of all loans outstanding under FairPoint's then outstanding credit facility's revolving facility, acquisition facility and tranche B term loan facility; (ii) repurchase $13.3 million aggregate liquidation preference of the Company's Series A Preferred Stock (together with accrued and unpaid dividends thereon) at 65% of its liquidation preference; (iii) repurchase $9.8 million aggregate principal amount of the 1998 Fixed Rate Notes (together with accrued and unpaid interest thereon) for approximately $7.9 million; (iv) repurchase $7.0 million aggregate principal amount of the 2000 Notes (together with accrued and unpaid interest thereon) for approximately $6.1 million; (v) make a capital contribution of approximately $1.5 million to Carrier Services, which used these proceeds to retire $2.2 million of its debt; and (vi) pay transaction fees.

As a result of the issuance of the 2003 Notes, the Company recorded $2.8 million and $0.7 million of non-operating gains on the extinguishment of the 1998 Fixed Rate Notes and 2000 Notes and the Carrier Services debt, respectively. The Company also repurchased some Series A Preferred Stock at a discount of $2.9 million. Additionally, the Company recorded a non-operating loss of $5.0 million for the write-off of debt issue costs related to this extinguishment of debt in 2003.

*Carrier Services' Senior Secured Notes*

On May 10, 2002, Carrier Services entered into an Amended and Restated Credit Agreement with its lenders to restructure the obligations of Carrier Services and its subsidiaries under Carrier Services' Credit Facility. In connection with such restructuring, (i) Carrier Services paid certain of its lenders $5.0 million to satisfy $7.0 million of the obligations under Carrier Services' Credit Facility, (ii) the lenders converted $93.9 million of the loans and obligations under Carrier Services' Credit Facility into shares of the Company's Series A Preferred Stock having a liquidation preference equal to the amount of the loans and obligations under Carrier Services' Credit Facility, and (iii) the remaining loans under Carrier Services' Credit Facility and Carrier Services' obligations under its swap arrangements were converted into $27.9 million aggregate principal amount of new term loans.

As a result of this restructuring, in 2002, the Company recorded a gain classified within discontinued operations of $17.5 million for the extinguishment of debt and settlement of its interest rate swap agreements. The gain represents the difference between the May 10, 2002 carrying value of $128.8 million of retired debt ($125.8 million) and related swap obligations ($3.0 million) and the sum of the aggregate value of the cash paid ($5.0 million) plus principal amount of new term loans ($27.9 million) plus the estimated fair value of the Company's Series A Preferred Stock issued ($78.4 million).

The converted loans under the new Carrier Services' Amended and Restated Credit Agreement consist of two term loan facilities: (i) Tranche A Loans in the aggregate principal amount of $8.7 million and (ii) Tranche B Loans in the aggregate principal amount of $19.2 million, each of which matures in May 2007. Interest on the new loans is payable monthly and accrues at a rate of 8% per annum; provided, however, that upon an event of default the interest rate shall increase to 10% per annum. Interest on the Tranche A Loans must be paid in cash and interest on Tranche B Loans may be paid, at the option of Carrier Services, either in cash or in kind. For the years ended December 31,



2002 and 2003, $0.9 million and $1.5 million, respectively, in additional debt was issued to satisfy the accrued in kind interest on the Tranche B loans. The principal of the Tranche A Loans is due at maturity and the principal of the Tranche B Loans is payable as follows: (a) $3,026,000 is due on September 30, 2005; (b) $5,372,000 is due on September 30, 2006; and (c) the remaining principal balance is due at maturity. On May 6, 2003, Carrier Services extinguished $2.2 million of the tranche A and tranche B loans. Carrier Services has made mandatory prepayments on the tranche B loans utilizing payments received under its tax sharing agreement with the Parent and proceeds from asset sales. As of December 31, 2003, approximately $7.9 million tranche A and $16.7 million of tranche B loans remained outstanding. On January 30, 2004, these loans were paid in full utilizing borrowings under the Company's amended and restated credit facility.

*Other*

In conjunction with the senior notes payable to the RTFC and the RTB and the first mortgage notes payable to the Rural Utilities Service, certain of the Company's subsidiaries are subject to restrictive covenants limiting the amounts of dividends that may be paid.

The Company also has $0.4 million of unsecured demand notes payable to various individuals and entities with interest payable at 5.25% at December 31, 2003.

**(7) Redeemable Preferred Stock**

The Series A Preferred Stock was issued to the lenders in connection with the Carrier Services debt restructuring. The Series A Preferred Stock is nonvoting and is not convertible into common stock of the Company. The Series A Preferred Stock provides for the payment of dividends at a rate equal to 17.428% per annum. Dividends on the Series A Preferred Stock are payable, at the option of the Company, either in cash or in additional shares of Series A Preferred Stock. The Company has the option to redeem any outstanding Series A Preferred Stock at any time. The redemption price for such shares is payable in cash in an amount equal to $1,000 per share plus any accrued but unpaid dividends thereon (the Preference Amount). Under certain circumstances, the Company would be required to pay a premium of up to 6% of the Preference Amount in connection with the redemption of the Series A Preferred Stock. In addition, upon the occurrence of certain events, such as (i) a merger, consolidation, sale, transfer or disposition of at least 50% of the assets or business of the Company and its subsidiaries, (ii) a public offering of the Company's common stock which yields in the aggregate at least $175.0 million, or (iii) the first anniversary of the maturity of the Company's senior subordinated notes (which first anniversary will occur in May 2011), the Company would be required to redeem all outstanding shares of the Series A Preferred Stock at a price per share equal to the Preference Amount, unless prohibited by the Company's credit facility or by the indentures governing its senior subordinated notes. In connection with the March refinancing, certain holders of the Series A Preferred Stock agreed to reduce the dividend rate payable on the shares they hold from 17.428% to 15% for the period from March 6, 2003 to March 6, 2005.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Liabilities and Equity.* SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 applies specifically to financial instruments that companies have historically presented within their financial statements either as equity or between the liabilities section and the equity section, rather than as liabilities. SFAS No. 150 is effective for financial instruments entered into or modified



after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatorily redeemable financial instruments of a nonpublic entity, in which this statement shall be effective for fiscal periods beginning after December 15, 2003. For purposes of SFAS No. 150, the Company meets the definition of a nonpublic entity. The Company prospectively adopted SFAS No. 150, effective July 1, 2003. The SFAS No. 150 adoption had no impact on net income (loss) attributed to common shareholders for any of the periods presented.

SFAS No. 150 requires the Company to classify as a long-term liability its Series A Preferred Stock and to classify dividends and accretion from the Series A Preferred Stock as interest expense. Such stock is now described as "Preferred Shares Subject to Mandatory Redemption" in the Balance Sheets as of December 31, 2003 and dividends and accretion on these shares are now included in pre-tax income whereas previously they were presented as a reduction to equity (a dividend) and, therefore, a reduction of net income available to common shareholders.

The initial carrying amount of the Series A Preferred Stock has been recorded at its fair value at the date of issuance ($78.4 million). The carrying amount is being increased by periodic accretions, using the interest method, so that the carrying amount will equal the mandatory redemption amount ($82.3 million) at the mandatory redemption date (May 2011). On March 6, 2003, in connection with the Company's issuance of the 2003 Notes, the Company used a portion of these proceeds to repurchase $13.3 million aggregate liquidation preference of its Series A Preferred Stock at a 35% discount (together with accrued and unpaid dividends thereon). For the years ended December 31, 2002 and 2003, the Series A Preferred Stock has been increased by $1.0 million and $1.4 million, respectively, to reflect the periodic accretions. The carrying amount of the Series A Preferred Stock has been further increased by $10.9 million and $16.5 million in connection with dividends paid in-kind on the outstanding shares of the Series A Preferred Stock for the years ended December 31, 2002 and 2003, respectively. Prior to the adoption of SFAS No. 150, additional paid-in capital has been decreased $11.9 million and $8.9 million for the increases in the carrying balance of the Series A Preferred Stock for the year ended December 31, 2002 and the period ended June 30, 2003, respectively. Upon the adoption of SFAS No. 150, pre-tax income has been decreased $9.0 million for the increases in the carrying balance of the Series A Preferred Stock for the period July 1, 2003 through December 31, 2003.

**(8) Employee Benefit Plans**

The Company sponsors a voluntary 401(k) savings plan (the 401(k) Plan) that covers substantially all eligible employees. Each 401(k) Plan year, the Company contributes to the 401(k) Plan an amount of matching contributions determined by the Company at its discretion. For the 401(k) Plan years ended December 31, 2001, 2002, and 2003, the Company matched 100% of each employee's contribution up to 3% of compensation and 50% of additional contributions up to 6%. The 401(k) Plan also allows for a profit sharing contribution that is made based upon management discretion. Total Company contributions to the 401(k) Plan were $1.8 million, $1.4 million, and $2.7 million for the years ended December 31, 2001, 2002, and 2003, respectively.

In 1999, the Company began a Non-Qualified Deferred Compensation Plan (the NQDC Plan) that covers certain employees. The NQDC Plan allows highly compensated individuals to defer additional compensation beyond the limitations of the 401(k) Plan. Company matching contributions are subject to the same percentage as the 401(k) Plan. Total Company contributions to the NQDC Plan were approximately $16,000, $1,000, and $7,000 for the years ended December 31, 2001, 2002, and 2003,



respectively. At December 31, 2002 and 2003, the NQDC Plan assets were $0.5 million. The related deferred compensation obligation is included in other liabilities in the accompanying consolidated balance sheets.

C&E, Taconic, and GT Com also sponsor defined contribution 401(k) retirement savings plans for union employees. C&E, Taconic, and GT Com match contributions to these plans based upon a percentage of pay of all qualified personnel and make certain profit sharing contributions. Contributions to the plans were $0.2 million, $0.3 million, and $0.2 million for the years ended December 31, 2001, 2002, and 2003, respectively.

**(9) Income Taxes**

Income tax benefit (expense) from continuing operations for the years ended December 31, 2001, 2002, and 2003 consists of the following components:

| | 2001 | 2002 | 2003 |
|---|---|---|---|
| | (Dollars in thousands) | | |
| Current: | | | |
| Federal | $ — | — | — |
| State | (569) | (603) | 199 |
| Total current income tax benefit (expense) from continuing operations | (569) | (603) | 199 |
| Investment tax credits | 138 | 85 | 37 |
| Deferred: | | | |
| Federal | — | — | — |
| State | — | — | — |
| Total deferred income tax benefit (expense) from continuing operations | — | — | — |
| Total income tax benefit (expense) from continuing operations | $ (431) | (518) | 236 |



Total income tax benefit (expense) from continuing operations was different than that computed by applying U.S. Federal income tax rates to losses from continuing operations before income taxes for the years ended December 31, 2001, 2002, and 2003. The reasons for the differences are presented below:

| | 2001 | 2002 | 2003 |
|---|---|---|---|
| | (Dollars in thousands) | | |
| Computed "expected" tax benefit from continuing operations | $ 7,791 | 1,952 | 2,880 |
| State income tax benefit (expense), net of Federal income tax expense | (376) | (398) | 131 |
| Amortization of investment tax credits | 138 | 85 | 37 |
| Goodwill amortization | (3,339) | — | — |
| Dividends on preferred stock | — | — | (3,077) |
| Dividends received deduction | — | — | 94 |
| Stock-based compensation | (749) | (428) | — |
| Valuation allowance | (4,067) | (1,851) | — |
| Disallowed expenses and other | 171 | 122 | 171 |
| Total income tax benefit (expense) from continuing operations | $ (431) | (518) | 236 |

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities as of December 31, 2002 and 2003 are presented below:

| | 2002 | 2003 |
|---|---|---|
| | (Dollars in thousands) | |
| Deferred tax assets: | | |
| Federal and state tax loss carryforwards | $ 94,223 | 91,527 |
| Employee benefits | 632 | 784 |
| Restructure charges and exit liabilities | 2,873 | 1,917 |
| Allowance for doubtful accounts | 451 | 375 |
| Alternative minimum tax and other state credits | 2,861 | 2,209 |
| Total gross deferred tax assets | 101,040 | 96,812 |
| Valuation allowance | (71,733) | (64,392) |
| Net deferred tax assets | 29,307 | 32,420 |

| | | |
|---|---|---|
| Deferred tax liabilities: | | |
| Property, plant, and equipment, principally due to depreciation differences | 16,716 | 17,244 |
| Goodwill, due to amortization differences | 8,906 | 10,654 |
| Basis in investments | 3,685 | 4,522 |
| Total gross deferred tax liabilities | 29,307 | 32,420 |
| Net deferred tax assets | $ — | — |

The valuation allowance for deferred tax assets as of December 31, 2002 and 2003 was $71.7 million and $64.4 million, respectively. The change in the valuation allowance was $(4.9) million and $(7.3) million of which $1.9 million and $0.0 million was allocated to continuing operations and



$(6.8) million and $(7.3) million to discontinued operations for the years ended December 31, 2002 and 2003, respectively. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. In order to fully realize the deferred tax asset, the Company will need to generate future taxable income of $176.4 million prior to the expiration of the net operating loss carryforwards in 2022. Taxable income (loss) for the years ended December 31, 2002 and 2003 was $(11.2) million and $7.6 million, respectively. Based upon the level of projections for future taxable income over the periods which the deferred tax assets are deductible, management believes it is more likely than not the Company will realize the benefits of these deductible differences, net of the existing valuation allowance at December 31, 2003. The amount of the deferred tax assets considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carry forward period are reduced.

At December 31, 2003, federal and state net operating loss carryforwards of $250.8 million expire in 2019 to 2022. At December 31, 2003, the Company has alternative minimum tax credits of $1.7 million which may be carried forward indefinitely.

**(10) Stockholders' Equity**

The following summarizes the authorized share capital of the Company:

**Class A common stock**—authorized 236,200,000 voting common shares at a par value of $0.01 per share. Class A common shares carry one vote per share.

**Class B common stock**—authorized 150,000,000 nonvoting, convertible common shares at a par value of $0.01 per share.

**Class C common stock**—authorized 13,800,000 nonvoting, convertible common shares at a par value of $0.01 per share. The Class C common shares are automatically convertible into Class A common shares upon either the completion of an initial public offering of at least $150 million of the Company's Class A common stock or the occurrence of certain conversion events, as defined in the articles of incorporation. The conversion rate for the Class C common shares to Class A common shares is one-for-one.

**Series A preferred stock**—authorized 1,000,000 nonvoting, nonconvertible, redeemable preferred shares at a par value of $0.01 per share (see note 7).

**Series D preferred stock**—authorized 100,000,000 nonvoting, convertible, cumulative participating preferred shares at a par value of $0.01 per share.

In May 2002, the Company amended and restated its certificate of incorporation to eliminate its Series D preferred stock and to designate and authorize the issuance of up to 1,000,000 shares of Series A preferred stock.

***Issuance of Common Stock Subject to Put Obligations***

In connection with the acquisition of Fremont, the Company issued 457,318 shares of Class A common stock to certain of the former owners of Fremont. Under the terms of the agreements, these



shares can be put back to the Company at any time. The purchase price for such stock is the higher of the current fair market value or the fair market value of the Company's common stock on the date of the acquisition of Fremont. Such former owners of Fremont exercised their put options on 75,418 shares in December 2000 and on 66,676 shares in March 2001. The Company has recorded the common stock subject to put options as temporary equity in the accompanying consolidated balance sheets. In May 2001, the Company loaned $999,980 to such former owners of Fremont. In January 2002, these loans were paid with 76,218 shares subject to the put options. In January 2003, put options on 76,218 shares were exercised for $999,980. In July 2003, the Company loaned $999,980 to such former owners of Fremont; these loans mature on January 2, 2005. In January 2004, put options on 76,218 shares were exercised for $999,980.

**(11) Stock Option Plans**

*Compensation expense*

In April 2000, the Company issued stock options under the 1998 Plan to employee participants in the FairPoint Communications Corp. Stock Incentive Plan (Carrier Services' Plan) in consideration of the cancellation of all options previously granted under the Carrier Services' Plan. The Company issued 1,620,465 and 73,200 options to purchase Class A common stock of the Company at an exercise price of $3.28 per share and $13.12 per share, respectively. The Company was recognizing a compensation charge on these Carrier Services' options for the amount the market value of the Company's common stock exceeded the exercise price on the date of grant. In order to maintain the same economic benefits as previously existed under the Carrier Services' Plan, Carrier Services also intended to provide a cash bonus to its employees for each option exercised. The Company was amortizing the compensation charge related to the Carrier Services' option grant and the cash bonus over the vesting period of five years up to the settlement of these options in 2001.

On December 31, 2001, the Company extended the exercise period on 284,200 1995 Plan stock options. The Company recognized a compensation charge of $2.2 million related to the modification of these options during 2001. On December 31, 2002, the Company extended the exercise period on 213,200 1995 Plan Stock Options. The Company recognized a compensation charge of $1.2 million related to the modification of these options during 2002.

Certain principal shareholders of the Company granted stock appreciation rights to certain members of management. The stock appreciation rights are fully vested. The stock appreciation rights may be settled in cash or stock, at the option of the granting shareholders. In connection with the stock appreciation rights, the Company recognized a benefit of $0.9 million and $0.3 million in 2001 and 2002, respectively, as the value associated with the stock appreciation rights declined. There were no adjustments to the stock appreciation rights in the year ended December 31, 2003, as the fair market value per share of the Company's common stock remained flat during the year.

*1995 Stock Option Plan*

In February 1995, the Company adopted the 1995 Plan. The 1995 Plan covers officers, directors, and employees of the Company. The Company may issue qualified or nonqualified stock options to purchase up to 1,136,800 shares of the Company's Class A common stock to employees that will vest equally over 5 years from the date of employment of the recipient and are exercisable during years 5 through 10. In 1995, the Company granted options to purchase 852,800 shares at $0.25 per share. There were no options granted since 1995.



The per share weighted average fair value of stock options granted during 1995 was $0.13 on the date of grant using the Black Scholes option-pricing model. Input variables used in the model included no expected dividend yields, a risk-free interest rate of 6.41%, and an estimated option life of five years. Because the Company was nonpublic on the date of the grant, no assumption as to the volatility of the stock price was made.

Stock option activity under the 1995 Plan is summarized as follows:

| | 2001 | 2002 | 2003 |
|---|---|---|---|
| Outstanding at January 1 | 592,460 | 592,460 | 592,460 |
| Granted | — | — | — |
| Exercised | — | — | — |
| Forfeited | — | — | — |
| Outstanding at December 31 | 592,460 | 592,460 | 592,460 |
| Exercisable at December 31 | 592,460 | 592,460 | 592,460 |
| Stock options available to grant at December 31, 2003 | | | 284,000 |

*MJD Communications, Inc. Stock Incentive Plan*

In August 1998, the Company adopted the 1998 Plan. The 1998 Plan provides for grants of up to 6,952,540 nonqualified stock options to executives and members of management, at the discretion of the compensation committee of the board of directors. Options vest in 25% increments on the second, third, fourth, and fifth anniversaries of an individual grant. In the event of a change in control, outstanding options will vest immediately.

Pursuant to the terms of the grant, options granted in 1998 and 1999 become exercisable only in the event that the Company is sold, an initial public offering of the Company's common stock results in the principal shareholders holding less than 10% of their original ownership, or other changes in control, as defined, occur. The number of options that may become ultimately exercisable also depends upon the extent to which the price per share obtained in the sale of the Company would exceed a minimum selling price of $4.28 per share. All options have a term of 10 years from date of grant. For those options granted in 1998 and 1999, the Company will record compensation expense for the excess of the estimated market value of its common stock over the exercise price of the options when and if a sale of the Company, at the prices necessary to result in exercisable options under the grant, becomes imminent or likely.

Pursuant to the terms of the grant, options granted in 2000 become exercisable immediately upon vesting. The per share weighted average fair value of stock options granted under the 1998 Plan during 2000 was $11.17 on the date of grant using the Black Scholes option-pricing model. Input variables used in the model included no expected dividend yields, a risk-free interest rate of 6.52%, and an estimated option life of 10 years. Because the Company was nonpublic on the date of the grant, no assumption as to the volatility of the stock price was made.

Stock option activity under the 1998 Plan is summarized as follows:

| | Options outstanding | Weighted average exercise price |
|---|---|---|
| Outstanding at January 1, 2001 | 6,088,315 | $ 2.22 |
| Granted | — | — |
| Exercised | (91,500) | 3.28 |
| Forfeited | (1,590,525) | 3.21 |
| Outstanding at December 31, 2001 | 4,406,290 | 1.84 |
| Granted | 250,000 | 7.00 |
| Exercised | — | — |
| Forfeited | (225,090) | 3.28 |
| Outstanding at December 31, 2002 | 4,431,200 | 2.06 |
| Granted | — | — |
| Exercised | — | — |
| Forfeited | (17,500) | 1.71 |
| Outstanding at December 31, 2003 | 4,413,700 | 2.06 |
| Stock options available to grant at December 31, 2003 | 2,538,840 | |

| | Options outstanding | | Options exercisable | |
|---|---|---|---|---|
| Exercise price | Number outstanding at December 31, 2003 | Remaining contractual life (years) | Number exercisable at December 31, 2003 | Weighted average exercise price |
| $1.71 | 3,961,400 | 4.60 | — | $ — |
| 2.74 | 184,000 | 5.50 | — | — |
| 3.28 | 18,300 | 6.30 | 13,725 | 3.28 |
| 7.00 | 250,000 | 8.00 | — | — |
| | 4,413,700 | | 13,725 | $ 3.28 |

The weighted average remaining contractual life for the options outstanding at December 31, 2003 is 4.8 years.

***FairPoint Communications, Inc. 2000 Employee Stock Incentive Plan***

In May 2000, the Company adopted the 2000 Plan. The 2000 Plan provided for grants to members of management of up to 10,019,200 options to purchase Class A common stock, at the discretion of the compensation committee. During 2002, the Company amended the 2000 Plan to limit the number of shares available for grant to 2,365,510. In December 2003, the Company amended the 2000 Plan to allow for the grant to members of management of up to 10,019,200 shares of restricted stock in addition to shares available for stock options. Options granted under the 2000 Plan may be of two types: (i) incentive stock options and (ii) nonstatutory stock options. Unless the compensation



committee shall otherwise specify at the time of grant, any option granted under the 2000 Plan shall be a nonstatutory stock option.

Under the 2000 Plan, unless otherwise determined by the compensation committee at the time of grant, participating employees are granted options to purchase Class A common stock at exercise prices not less than the market value of the Company's Class A common stock at the date of grant. Options have a term of 10 years from date of grant. Options vest in increments of 10% on the first anniversary, 15% on the second anniversary, and 25% on the third, fourth, and fifth anniversaries of an individual grant. Subject to certain provisions, in the event of a change of control, the Company will cancel each option in exchange for a payment in cash of an amount equal to the excess, if any, of the highest price per share of Class A common stock offered in conjunction with any transaction resulting in a change of control over the exercise price for such option.

On August 3, 2001, the Company made an offer to its employees to cancel their existing options issued under the 2000 Plan in exchange for new options to be granted on the date that is on or after six months and one day following the expiration date of the offer. As a result of this offer, 3,274,935 options were canceled. The remaining shares outstanding under this plan were forfeited during 2001. On March 13, 2002, 880,819 stock options were issued under this exchange offer.

Restricted stock units vest in increments of 33% on each of the third, fourth, and fifth anniversaries of the award. In December 2003, 144,506 restricted stock units were awarded with an aggregate value of $890,000. The Company has recognized a compensation charge of $15,000 during 2003 related to these awards and will recognize the balance of compensation expense over the remaining vesting period.

Stock option activity under the 2000 Plan is summarized as follows:

| | Options outstanding | Weighted average exercise price |
|---|---|---|
| Outstanding at January 1, 2001 | 3,997,141 | $ 13.12 |
| Granted | — | — |
| Exercised | — | — |
| Canceled or forfeited | (3,997,141) | 13.12 |
| Outstanding at December 31, 2001 | — | — |
| Granted | 1,337,109 | 7.00 |
| Exercised | — | — |
| Canceled or forfeited | (116,368) | 7.00 |
| Outstanding at December 31, 2002 | 1,220,741 | 7.00 |
| Granted | 478,025 | 7.00 |
| Exercised | — | — |
| Canceled or forfeited | (111,758) | 7.00 |
| Outstanding at December 31, 2003 | 1,587,008 | 7.00 |
| Stock options available to grant at December 31, 2003 | 778,502 | |

The remaining contractual life for the options outstanding at December 31, 2003 was 8.75 years, and 422,715 options were exercisable.



The per share weighted average fair value of stock options granted under the 2000 Plan during 2000, 2002, and 2003 were $1.85, $2.84, and $1.59, respectively, on the date of grant using the Black Scholes option-pricing model. Input variables used in the model included no expected dividend yields, a weighted average risk free interest rate of 6.49%, 5.28%, and 4.26% in 2000, 2002, and 2003 respectively, and an estimated option life of 10 years. Because the Company was nonpublic on the date of grant, no assumption as to the volatility of the stock price was made.

**(12) Discontinued Operations and Restructure Charges**

**Competitive Communications Business Operations.** In October and November of 2001, Carrier Services sold certain assets of its competitive communications operations to Advanced TelCom, Inc., a wholly owned subsidiary of Advance Telcom Group, Inc. and Choice One. Total proceeds from these sales of assets were $9.0 million in cash and 2,500,000 restricted shares of Choice One common stock (valued at $7.9 million). The Company recorded a net loss of $31.1 million from the sale of these assets. In April 2002, Carrier Services earned an additional 1,000,000 restricted shares of Choice One Common Stock based on the number of access lines converted to the Choice One operating platform within 120 days after closing. The value of these additional shares, $0.8 million, was recognized as a gain within discontinued operations in 2002.

In November 2001, in connection with the sale of certain of its assets as previously discussed, the Company announced its plan to discontinue the competitive communications business operations of its wholly owned subsidiary, Carrier Services. As a result of the adoption of the plan to discontinue the competitive communications operations, these results are presented as discontinued operations. The Company recognized a total charge of $95.3 million on the disposal of its competitive communications operations, including the $31.1 million loss on the sale of assets, $36.1 million for the write-off of the remaining operating assets, including property, plant and equipment, and $28.1 million for expenses the Company estimated it would incur during the phase-out period, net of estimated revenue to be received from customers until they were transitioned to other carriers. Estimated expense for the phase-out period included interest expense. Interest expense was allocated to discontinued operations based on the interest incurred by the Company under Carrier Services' Credit Facility and the two interest rate swaps related to this facility.

In May 2002, Carrier Services entered into an amended and restated credit facility with its lenders to restructure its obligations under its credit facility. In the restructuring, (i) Carrier Services paid certain of its lenders $5.0 million to satisfy $7.0 million of obligations under the credit facility, (ii) the lenders converted approximately $93.9 million of the loans under the credit facility into shares of FairPoint's Series A Preferred Stock having a liquidation preference equal to the amount of such loans and (iii) the remaining loans under the credit facility and certain swap obligations were converted into $27.9 million of new term loans.

As a result of this restructuring, in 2002, the Company recorded a gain in discontinued operations of $17.5 million for the extinguishment of debt and settlement of its interest rate swap agreements. The gain represents the difference between the May 10, 2002 carrying value of $128.8 million of retired debt ($125.8 million) and related swap obligations ($3.0 million) and the sum of the aggregate value of the cash paid ($5.0 million) plus principal amount of new term loans ($27.9 million) plus the estimated fair value of the Company's Series A Preferred Stock issued ($78.4 million).

Selected information from discontinued operations of Carrier Services for the year ended December 31, 2001 (dollars in thousands):

| | | |
|---|---|---|
| Revenue | $ | 57,080 |
| Operating loss | | 44,943 |
| Loss before income taxes | | 93,952 |
| Income tax benefit | | 985 |
| Loss from discontinued operations | $ | 92,967 |
| Capital expenditures | $ | 37,426 |

Assets and liabilities of discontinued operations of Carrier Services as of December 31, 2002 and 2003 follows:

| | | 2002 | 2003 |
|---|---|---|---|
| | | (Dollars in thousands) | |
| Cash | $ | 25 | — |
| Accounts receivable | | 781 | 105 |
| Current assets of discontinued operations | $ | 806 | 105 |
| Accounts payable | $ | (35) | — |
| Accrued liabilities | | (2,743) | (1,516) |
| Restructuring accrual | | (1,968) | (2,682) |
| Accrued property taxes | | (319) | (263) |
| Current liabilities of discontinued operations | $ | (5,065) | (4,461) |
| Restructuring accrual | $ | (5,214) | (2,571) |
| Other liabilities | | (51) | — |
| Long-term liabilities of discontinued operations | $ | (5,265) | (2,571) |

In connection with Carrier Services' debt restructuring, as of May 10, 2002, the converted loans of $27.9 million are classified as long-term debt as these loans will be serviced through continuing operations. Investments in marketable securities (consisting of Choice One stock) were also reclassified from discontinued operations to other current assets as these investments upon liquidation will fund the debt service requirements of Carrier Services' debt.

The 2000 restructure charges include provisions of $3.3 million for the termination benefits for 360 employees, losses from abandoned leased facilities, equipment, and other obligations of $10.3 million, and $0.1 million of other costs associated with the plan of restructuring. Accrued liabilities of the discontinued operations of Carrier Services included $13.3 million for amounts unpaid at December 31, 2000 for this plan of restructuring.

In the first quarter of 2001, the Company completed additional plans for the restructuring of operations at Carrier Services, which resulted in recording a charge of $33.6 million. Of the total 2001 restructuring charge, $3.4 million related to employee termination benefits and other employee termination related costs. The Company terminated 365 positions in January 2001. Certain positions were eliminated at the central operating facility in Albany, New York, and at the corporate office in



Charlotte, North Carolina. In addition, another 11 sales offices were closed and staff at the remaining sales offices were reduced.

The restructure charge in the first quarter of 2001 included $12.2 million in contractual obligations for equipment, occupancy, and other lease terminations and other facility exit costs incurred as a direct result of the plan. The restructuring charge also included $17.9 million, net of salvage value, for the write-down of property, plant, and equipment. There were also $0.1 million of other incremental costs incurred as a direct result of the restructuring plan.

Except for the remaining liabilities associated with equipment and lease terminations, all liabilities for employee termination benefits and other liabilities were settled or paid by December 31, 2001, for the 2000 and 2001 plans of restructuring. These remaining liabilities were re-evaluated and increased by $1.9 million in 2001. During 2002 and 2003, the Company entered into arrangements related to certain leases and revised its assumptions on certain other remaining leases. For these reasons, there was a reduction to the remaining restructure obligation of $1.2 million in 2002 and $0.2 million in 2003. These reductions have been recognized as a gain and classified within discontinued operations for the year ended December 31, 2002 and 2003, respectively.

Selected information relating to the restructuring charge follows:

| | Employee termination benefits | Equipment, occupancy, and other lease terminations | Write-down of property, plant, and equipment | Other | Total |
|---|---|---|---|---|---|
| | (Dollars in thousands) | | | | |
| Restructuring accrual as of December 31, 2000 | $ 3,028 | 10,207 | — | 108 | 13,343 |
| Restructure charge | 3,416 | 12,180 | 17,916 | 95 | 33,607 |
| Write-down of assets to net realizable value | — | — | (16,696) | — | (16,696) |
| Adjustments from initial estimated charges | (91) | 1,916 | (1,220) | 59 | 664 |
| Cash payments | (6,353) | (11,993) | — | (262) | (18,608) |
| Restructuring accrual as of December 31, 2001 | — | 12,310 | — | — | 12,310 |
| Adjustments from initial estimated charges | — | (1,192) | — | — | (1,192) |
| Cash payments | — | (3,936) | — | — | (3,936) |
| Restructuring accrual as of December 31, 2002 | — | 7,182 | — | — | 7,182 |
| Adjustments from initial estimated charges | — | (246) | | | (246) |
| Cash payments | — | (1,683) | | | (1,683) |
| Restructuring accrual as of December 31, 2003 | $ — | 5,253 | — | — | 5,253 |

**Rural Local Exchange Carrier Operations.** On September 30, 2003, the Company completed the sale of all of the capital stock owned by Services of Union Telephone Company of Hartford, Armour Independent Telephone Co., WMW Cable TV Co. and Kadoka Telephone Co. to Golden West Telephone Properties, Inc. ("Golden West"). The sale was completed in accordance with the terms of the Purchase Agreement, dated as of May 9, 2003 (the "Purchase Agreement"), with Golden West. The Company received $24,156,000 in sales proceeds, subject to certain escrow obligations as set forth in the Purchase Agreement. The South Dakota properties were geographically isolated from other Company properties making it increasingly difficult to realize additional operating efficiencies. These properties were adjacent to Golden West's operations and offered Golden West numerous operational



synergies. The proceeds from this divestiture were used to fund acquisitions completed in 2003. The operations of these companies are presented as discontinued operations. Therefore, the balances associated with these activities were reclassified as "held for sale." All prior period financial statements have been restated accordingly.

Income from the South Dakota Divestiture operations consists of the following (dollars in thousands):

| | Twelve months ended December 31, 2001 | Twelve months ended December 31, 2002 | Nine months ended September 30, 2003 |
|---|---|---|---|
| Revenue | $ 5,037 | 5,299 | 4,028 |
| Income from discontinued operations | $ 2,073 | 2,433 | 1,929 |

Assets and liabilities of the South Dakota Divestiture as of December 31, 2002 follow (dollars in thousands):

| | |
|---|---|
| Cash | $ 178 |
| Accounts receivable | 430 |
| Property, plant and equipment, net | 5,027 |
| Investments | 395 |
| Goodwill, net of accumulated amortization | 10,526 |
| Other | 91 |
| Current assets held for sale | $ 16,647 |
| Accounts payable | $ 342 |
| Accrued liabilities | 297 |
| Current liabilities held for sale | $ 639 |

The Company recorded a gain on disposal of the South Dakota companies of $7.7 million.

**(13) Related Party Transactions**

The Company has entered into financial advisory agreements with certain equity investors, pursuant to which the equity investors provide certain consulting and advisory services related but not limited to equity financings and strategic planning. The Company paid $1.0 million for each of the years ended December 31, 2001, 2002, and 2003 in such fees to the equity investors and this expense is classified within operating expenses. The agreements also provide that the Company will reimburse the equity investors for travel relating to the Company's boards of directors meetings. The Company reimbursed the equity investors $0.1 million, $43,000, and $21,000 for the years ended December 31, 2001, 2002, and 2003, respectively, for travel and related expenses. Per the financial advisory agreements, the advisory and consulting fees to be paid to each of the principal shareholders through December 31, 2006 is $0.5 million per annum. In January 2000, the Company entered into an agreement whereby the Company must obtain consent from its two principal shareholders in order to incur debt in excess of $5.0 million.



In 2001, a law firm in which a partner of such law firm is a director of the Company, was paid $0.8 million, of which $0.3 million was for general counsel services, $0.1 million was for services related to financings, and $0.4 million was for services related to the restructure and discontinuance of the competitive communications operations. In 2002, this same law firm was paid $0.8 million, of which $0.3 million was for general counsel services, $0.3 million was for services related to the discontinuance of the competitive communications operations, and $0.2 million was for services related to acquisitions. In 2003, this same law firm was paid $1.3 million, of which $0.4 million was for general counsel services and $0.9 million was for services related to financings. All payments made by the Company for general counsel services and unsuccessful acquisition bids are classified within operating expenses on the statements of operations. All payments made for services related to financings have been recorded as debt or equity issue costs. All payments made for services related to successful acquisition bids have been capitalized as direct costs of the acquisitions. All services related to the restructure and discontinuance of the competitive communications operations have been classified in discontinued operations.

On July 31, 2003, the Company loaned $990,980 to two employees that are the former owners of Fremont. These loans mature on January 2, 2005.

**(14) Quarterly Financial Information (Unaudited)**

| | | First quarter | Second quarter | Third quarter | Fourth quarter |
|---|---|---|---|---|---|
| | | (Dollars in thousands) | | | |
| 2002: | | | | | |
| Revenue | $ | 57,156 | 55,570 | 57,778 | 60,315 |
| Income (loss) from continuing operations | | 4,927 | (7,826) | (1,442) | (4,353) |
| Net income (loss) | | 5,501 | 11,083 | 933 | (4,278) |
| 2003: | | | | | |
| Revenue | $ | 55,812 | 57,285 | 58,566 | 59,769 |
| Income (loss) from continuing operations | | 668 | (1,112) | (4,209) | (3,597) |
| Net income (loss) | | 1,294 | (504) | 4,283 | (3,402) |

In the second quarter of 2002, the Company recorded a gain in discontinued operations of $17.5 million related to the extinguishment of debt and settlement of its interest rate swap agreements. In the second, third, and fourth quarters of 2002, the Company recorded a noncash charge of $5.6 million, $1.8 million and $0.8 million, respectively, related to the other than temporary decline in market value of its Choice One common stock. In the fourth quarter of 2002, the Company recorded a noncash charge of $4.4 million related to the other than temporary decline in market value of investments accounted for under the equity method. During the fourth quarter of 2002, the Company identified errors in the fair value calculations of the interest rate swaps and recorded an adjustment of $0.9 million to increase expense that related to prior periods. The effect of this entry was not material to previously reported results.

In the first quarter of 2003, the Company recognized a $3.5 million nonoperating gain on the extinguishment of the Senior Subordinated Notes and the Carrier Services' loans, offset by a loss of $5.0 million for the write-off of debt issue costs related to this extinguishment of debt. In the third quarter of 2003, the Company recognized a gain of $7.7 million on the South Dakota Divestiture.



**(15) Disclosures About the Fair Value of Financial Instruments**

***Cash, Accounts Receivable, Accounts Payable, and Demand Notes Payable***

The carrying amount approximates fair value because of the short maturity of these instruments.

***Investments***

Investments classified as available for sale and trading are carried at their fair value which approximates $0.6 million and $0.5 million, respectively, at December 31, 2002 and $1.9 million and $0.5 million, respectively, at December 31, 2003 (see note 5 and note 8).

***Long-term Debt***

The fair value of the Company's publically registered long-term debt is stated at quoted market prices. The fair value of the Company's remaining long-term debt is estimated by discounting the future cash flows of each instrument at rates currently offered to the Company for similar debt instruments of comparable maturities. At December 31, 2002 and 2003, the Company had long-term debt with a carrying value of

$804.2 million and $825.6 million, respectively, and estimated fair values of $683.6 million and $870.7 million, respectively.

***Redeemable Preferred Stock***

The fair value of the Company's redeemable preferred stock is estimated utilizing a cash flow analysis at a discount rate equal to rates available for debt with terms similar to the preferred stock. At December 31, 2002 and 2003, the Company's carrying value of its redeemable preferred stock was $90.3 million and $96.7 million, respectively, and estimated fair value was $68.1 million and $97.3, respectively.

***Limitations***

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

**(16) Revenue Concentrations**

Revenues for interstate access services are based on reimbursement of costs and an allowed rate of return. Revenues of this nature are received from NECA in the form of monthly settlements. Such revenues amounted to 26.5%, 26.3%, and 26.3% of the Company's total revenues from continuing operations for the years ended December 31, 2001, 2002, and 2003, respectively.

**(17) Revenue Settlements**

Certain of the Company's telephone subsidiaries participate in revenue sharing arrangements with other telephone companies for interstate revenue sharing arrangements and for certain intrastate revenue. Such sharing arrangements are funded by toll revenue and/or access charges within state jurisdiction and by access charges in the interstate market. Revenues earned through the various sharing arrangements are initially recorded based on the Company's estimates. The Company



recognized $7.2 million, $3.1 million and $3.0 million of revenue for settlements and adjustments related to prior years during 2001, 2002, and 2003, respectively.

**(18) Commitments and Contingencies**

***Operating Leases***

Future minimum lease payments under noncancellable operating leases as of December 31, 2003 are as follows:

| | Continuing operations | Discontinued operations |
|---|---|---|
| | (Dollars in thousands) | |
| Year ending December 31: | | |
| 2004 | $ 1,256 | 4,172 |
| 2005 | 593 | 2,424 |
| 2006 | 266 | 1,790 |
| 2007 | 160 | 1,491 |
| 2008 | 98 | — |
| Thereafter | 613 | — |
| Total minimum lease payments | $ 2,986 | 9,877 |
| Less estimated rentals to be received under subleases | | (4,556) |
| Estimated minimum lease payments included in liabilities of discontinued operations | | $ 5,321 |

Total rent expense from continuing operations was $3.4 million, $3.1 million, and $3.1 million in 2001, 2002, and 2003, respectively.

***Legal Proceedings***

From time to time, the Company is involved in litigation and regulatory proceedings arising out of its operations. The Company is not currently a party to any legal proceedings, the adverse outcome of which, individually or in the aggregate, that management believes would have a material adverse effect on the Company's financial position or results of operations.



**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

Not applicable.

## ITEM 9A. CONTROLS AND PROCEDURES

### (a) Evaluation of disclosure controls and procedures.

Within 90 days prior to the filing date of this report, we carried out an evaluation, under the supervision and with the participation of our management, including the Company's chief executive officer and chief financial officer, of the effectiveness of our disclosure controls and procedures (as defined in rule 15d-14(c) of the Securities Exchange Act of 1934).

Based upon that evaluation, the Company's chief executive officer and chief financial officer have concluded that our disclosure controls and procedures (a) are effective to ensure that information required to be disclosed by us in this report has been timely recorded, processed, summarized and reported and (b) include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in this report has been accumulated and communicated to the Company's management, including its chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

### (b) Changes in internal controls.

There have been no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of our evaluation.



# PART III

## ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The following table sets forth information with respect to our directors, executive officers and other key personnel. Executive officers are generally appointed annually by the board of directors to serve, subject to the discretion of the board of directors, until their successors are appointed.

| Name | Age | Position |
|---|---|---|
| Eugene B. Johnson | 56 | Co-Founder, Chairman of the Board of Directors and Chief Executive Officer |
| Peter G. Nixon | 51 | Chief Operating Officer |
| Walter E. Leach, Jr. | 52 | Senior Vice President and Chief Financial Officer |
| John P. Duda | 56 | President |
| Shirley J. Linn | 53 | Vice President, General Counsel and Secretary |
| Timothy W. Henry | 48 | Vice President of Finance and Treasurer |
| Lisa R. Hood | 38 | Vice President and Controller |
| Daniel G. Bergstein | 60 | Co-Founder and Director |
| Frank K. Bynum, Jr. | 41 | Director |
| Anthony J. DiNovi | 41 | Director |
| George E. Matelich | 47 | Director |
| Kent R. Weldon | 36 | Director |

*Eugene B. Johnson.* Mr. Johnson has served as our Chairman since January 1, 2003 and as our Chief Executive Officer since January 1, 2002. Prior to his current responsibilities, Mr. Johnson was Chief Development Officer from May 1993 to December 2002 and Vice Chairman from August 1998 to December 2002. Mr. Johnson is a co-founder and has been a director of our company since 1991. From 1997 to 2002, Mr. Johnson served as a director of the Organization for the Promotion and Advancement of Small Telecommunications Companies, or OPASTCO, the primary industry organization for small independent telephone companies. From 1987 to 1993, Mr. Johnson served as President and principal shareholder of JC&A, Inc., an investment banking and brokerage firm providing services to the cable television, telephone and related industries. From 1985 to 1987, Mr. Johnson served as the director of the mergers and acquisitions department of Cable Investments, Inc., an investment banking firm. Mr. Johnson currently is chairman of OPASTCO's USF committee.

*Peter G. Nixon.* Mr. Nixon has served as our Chief Operating Officer since November 2002. Previously, Mr. Nixon was our Senior Vice President of Corporate Development from February 2002 to November 2002 and President of our Telecom Group from April 2001 to February 2002. Prior to this, Mr. Nixon served as President of our Eastern Region Telecom Group from June 1999 to April 2001 and President of Chautauqua & Erie Telephone Corporation, or C&E, from July 1997, when we acquired C&E, to June 1999. From April 1, 1989 to June 1997, Mr. Nixon served as Executive Vice President of C&E. From April 1, 1978 to March 31, 1989, Mr. Nixon served as Vice President of Operations for C&E. Mr. Nixon has served as the past Chairman of the New York State Telephone Association, in addition to his involvement in several community and regional organizations.

*Walter E. Leach, Jr.* Mr. Leach has served as our Chief Financial Officer since October 1994 and our Senior Vice President since February of 1998. From October 1994 to December 2000, Mr. Leach was our Secretary. From 1984 through September 1994, Mr. Leach served as Executive Vice President of Independent Hydro Developers, where he had responsibility for all project acquisition, financing and development activities.

*John P. Duda.* Mr. Duda has served as our President since April 2001. Mr. Duda is primarily responsible for industry relations, public policy and regulatory and legislative affairs. Prior to his current responsibilities, Mr. Duda was our Chief Operating Officer from April 2001 to November 2002. Mr. Duda also served as President of our Telecom Group and was responsible for all aspects of our RLEC operations from January 1994 to April 2001. Prior to 1994, Mr. Duda served as Vice President, Operations and Engineering of Rochester Tel Mobile Communications, State Vice President Minnesota, Nebraska and Wyoming and Director of Network Planning and Operations for Pennsylvania and New Jersey for Sprint and served in various management positions with C&P Telephone and Bell Atlantic. Mr. Duda is currently a member of the United States Telecom Association's Board of Directors. Mr. Duda is also currently a member of the OPASTCO Board of Directors.

*Shirley J. Linn.* Ms. Linn has served as our Vice President and General Counsel since October 2000 and our Secretary since December 2000. Prior to joining us, Ms. Linn was a partner, from 1984 to 2000, in the Charlotte, North Carolina law firm of Underwood Kinsey Warren & Tucker, P.A., where she specialized in general business matters, particularly mergers and acquisitions.

*Timothy W. Henry.* Mr. Henry has served as our Vice President of Finance and Treasurer since December 1997. From 1992 to December 1997, Mr. Henry served as Vice President/Portfolio Manager at CoBank, ACB, and managed a $225 million telecommunications loan portfolio, which included responsibility for CoBank's relationship with us.

*Lisa R. Hood.* Ms. Hood has served as our Vice President and Controller since December 1993. Prior to joining our company, Ms. Hood served as manager of a local public accounting firm in Kansas. Ms. Hood is a certified public accountant.

*Daniel G. Bergstein.* Mr. Bergstein is a co-founder and has been a director of our company since 1991. Mr. Bergstein served as Chairman of our board of directors from 1991 until August 1998. Since 1988, Mr. Bergstein has been a senior partner in the New York office of the international law firm Paul, Hastings, Janofsky & Walker LLP, where he is the Chairman of the Firm's National Telecommunications Practice.

*Frank K. Bynum, Jr.* Mr. Bynum has served as a director of our company since July 1997. He is also a Managing Director of Kelso. Mr. Bynum joined Kelso in 1987 and has held positions of increasing responsibility at Kelso prior to becoming a Managing Director. Mr. Bynum is a director of CDT Holdings, plc, Citation Corporation, Endurance Business Media, Inc., eMarkets, Inc. and 21st Century Newspapers, Inc. He is also a Trustee of Prep for Prep and a member of the Board of Trustees of the College Foundation of the University of Virginia.

*Anthony J. DiNovi.* Mr. DiNovi has served as a director of our company since January 2000. He is currently a Managing Director of Thomas H. Lee Partners, L.P., where he has been employed since 1988. Mr. DiNovi is a director of American Media, Inc., Endurance Specialty Holdings Ltd., Eye Care Centers of America Inc., Fisher Scientific International, Inc., Michael Foods, Inc., National Waterworks, Inc., US LEC Corp., Vertis, Inc. and various private corporations.

*George E. Matelich.* Mr. Matelich has served as a director of our company since July 1997. Mr. Matelich is currently a Managing Director of Kelso, with which he has been associated since 1985. Mr. Matelich is a director of Capital Environmental Resource, Inc. Mr. Matelich is also a Trustee of the University of Puget Sound.

*Kent R. Weldon.* Mr. Weldon has served as a director of our company since January 2000. He is currently a Managing Director of Thomas H. Lee Partners, L.P. Mr. Weldon worked at the firm from 1991 to 1993 and rejoined it in 1995. Prior to 1991, Mr. Weldon worked at Morgan Stanley & Co. Incorporated in the Corporate Finance Department. Mr. Weldon is a director of Michael Foods, Inc. and Syratech Corporation.

**Committees of the Board of Directors**

Our board of directors has standing audit and compensation committees.



*Audit Committee*

Our audit committee currently consists of Frank K. Bynum, Jr., George E. Matelich and Kent R. Weldon. Among other functions, our audit committee:

- makes recommendations to our board of directors regarding the selection of independent auditors;
- reviews the results and scope of the audit and other services provided by our independent auditors;
- reviews our financial statements; and
- reviews and evaluates our internal control functions.

George E. Matelich has been designated as the audit committee financial expert for purposes of the Securities Exchange Act of 1934, and is not independent.

*Compensation Committee*

Our compensation committee currently consists of Anthony J. DiNovi and George E. Matelich. The compensation committee makes recommendations to our board of directors regarding the following matters:

- executive compensation;
- salaries and incentive compensation for our employees; and
- the administration of our stock option plans and defined contribution plans.

*Compensation Committee Interlocks and Insider Participation*

For the fiscal year ended December 31, 2003, our compensation committee consisted of Anthony J. DiNovi and George E. Matelich. Mr. DiNovi has served as a director of our company since January 2000. Mr. Matelich has served as a director of our company since July 1997. None of our executive officers has served as a member of the compensation committee (or other committee serving an equivalent function) of any other entity, whose executive officers served as a director of our company or member of our compensation committee.

**Director Compensation**

Currently, we reimburse non-employee directors for any expenses incurred in attending meetings of our board of directors and committees of our board of directors.

**Code of Ethics for Financial Professionals**

We have adopted a code of ethics for financial professionals, or code, as required by the United States Securities and Exchange Commission, or SEC, under Section 406 of the Sarbanes-Oxley Act of 2002. The code sets forth written standards that are designed to deter wrongdoing and to promote honest and ethical conduct by the Company's senior financial officers, including its chief executive officer, and is a supplement to our Code of Conduct and the other policies and procedures that govern the conduct of our employees. In addition to applying to the our chief executive officer, chief financial officer, vice president of finance and treasurer, controller and regional controllers, this Code applies to all of the other persons employed by us who have significant responsibility for preparing or overseeing the preparation of the Company's financial statements and the other financial data included in our periodic reports to the SEC and in other public communications made by us that are designated from time to time by the chief financial officer as senior financial professionals.



**ITEM 11. EXECUTIVE COMPENSATION**

The following table sets forth information concerning compensation paid to our chief executive officer and our other four most highly compensated executive officers in the years indicated.

**Summary Compensation Table**

| | Annual Compensation | | | | Long-term Compensation Awards | |
|---|---|---|---|---|---|---|
| **Name and Principal Position** | **Year** | **Salary** | **Bonus** | **Other Annual Compensation(1)** | **Number of Securities Underlying Options/ SARS** | **All Other Compensation(2)** |
| Eugene B. Johnson | 2003 | $ 341,923 | $ 166,450 | $ 45,353 | — | $13,252 |
| Chairman and Chief Executive Officer | 2002 | 256,500 | 69,543 | 46,093 | 358,131 | 11,038 |
| | 2001 | 285,000 | — | 37,511 | — | 10,540 |
| Peter G. Nixon | 2003 | $ 198,789 | $ 95,200 | — | 156,906 | $ 9,690 |
| Chief Operating Officer | 2002 | 155,000 | 47,024 | — | 44,426 | 9,690 |
| | 2001 | 151,827 | 60,014 | — | — | 8,243 |
| Walter E. Leach, Jr. | 2003 | $ 199,219 | $ 95,200 | $ 36,130 | 25,000 | $11,661 |
| Senior Vice President and Chief | 2002 | 171,074 | 45,752 | 20,077 | 408,278 | 9,822 |
| Financial Officer | 2001 | 186,250 | 33,000 | 21,191 | — | 8,100 |
| John P. Duda | 2003 | $ 189,000 | $ 61,625 | $ 31,127 | — | $10,435 |
| President | 2002 | 189,081 | 50,568 | 37,431 | 285,640 | 10,435 |
| | 2001 | 200,000 | — | 29,701 | — | 10,839 |
| Shirley J. Linn | 2003 | $ 188,758 | $ 76,700 | — | 93,750 | $11,379 |
| Vice President, General Counsel and | 2002 | 180,000 | 40,157 | — | 48,594 | 9,898 |
| Secretary | 2001 | 168,294 | 64,782 | — | — | 9,378 |

(1) Reflects the value of certain benefits provided pursuant to employment arrangements.

(2) Reflects matching contributions made under our 401(k) plan and the value of group term life insurance coverage.

**1995 Stock Option Plan**

Our 1995 Stock Option Plan, or 1995 plan, was adopted on February 22, 1995. The 1995 plan provides for the grant of options to purchase up to an aggregate of 1,136,800 shares of our class A common stock. The 1995 plan is administered by our compensation committee, which makes discretionary grants of options to our officers, directors and employees.

Options granted under the 1995 plan may be incentive stock options, which qualify for favorable Federal income tax treatment under Section 422A of the Internal Revenue Code, or nonstatutory stock options.

The selection of participants, allotment of shares, determination of price and other conditions of purchase of such options is determined by our compensation committee, in its sole discretion. Each option grant is evidenced by a written incentive stock option agreement or nonstatutory stock option agreement dated as of the date of grant and executed by us and the optionee. Such agreement also sets forth the number of options granted, the option price, the option term and such other terms and conditions as may be determined by the board of directors. As of March 15, 2004, a total of 592,460



options to purchase shares of our class A common stock were outstanding under the 1995 plan. Such options are exercisable at a price of $.25 per share.

Options granted under the 1995 plan are nontransferable, other than by will or by the laws of descent and distribution.

**1998 Stock Incentive Plan**

In August 1998, we adopted our 1998 Stock Incentive Plan, or 1998 plan. The 1998 plan provides for grants to members of management of up to 6,952,540 nonqualified options to purchase our class A common stock, at the discretion of our compensation committee. These options generally vest in 25% increments on the second, third, fourth, and fifth anniversaries of an individual grant. In the event of a change in control (as defined in the 1998 plan), outstanding options will vest immediately. As of March 15, 2004, a total of 4,413,700 options were outstanding under the 1998 plan.

Pursuant to the terms of the grant, 4,395,400 options become exercisable only in the event that we are sold, an initial public offering of our common stock occurs, or other changes in control (as defined in the 1998 plan) occur. The number of options that may ultimately become exercisable also depends upon the extent to which the price per share obtained in a sale of the Company would exceed a minimum selling price of $4.28 per share. These options have a term of ten years from date of grant. We will accrue as compensation expense the excess of the estimated fair value of our common stock over the exercise price of the options when and if a sale of the Company, at the prices necessary to result in exercisable options under the grant, becomes imminent or likely.

On December 31, 2001, 450,000 options were forfeited and the vesting schedule of 200,000 options was modified. These options were rescheduled to vest equally over the ensuing 24 months on a monthly vesting schedule of 8,333.34 options per month such that all 200,000 options were fully vested in December 2003.

On January 1, 2002, an additional 250,000 shares were issued at $7.00 per option. At issuance, 41,667 options were vested immediately. The remaining 208,333 options vested equally over 15 months at a rate of 13,888.87 options per month such that all 250,000 options were fully vested in March 2003.

In April 2000, all of the options outstanding under Carrier Services' stock option plan were converted to options to purchase our class A common stock under the 1998 plan. As a result, 925,500 options to purchase common stock of Carrier Services were converted into an aggregate of 1,693,665 options to purchase our class A common stock, which become immediately exercisable upon vesting. As of March 15, 2004, 18,300 options to purchase our class A common stock at an exercise price of $3.28 per share were outstanding under this grant. Upon completion of the conversion, the Carrier Services stock option plan was terminated.

**2000 Employee Stock Incentive Plan**

In May 2000, we adopted the 2000 Employee Stock Incentive Plan, or 2000 plan. The 2000 plan provides for grants to members of management of up to 10,019,200 options to purchase our class A common stock, at the discretion of our compensation committee. During 2002, we amended the 2000 plan to limit the number of shares available for grant to 2,365,510. In December 2003, we amended the 2000 plan to allow for the grant to members of management of shares of restricted stock in addition to stock options. As of March 15, 2004, 144,506 restricted stock units were outstanding. Options granted under the 2000 plan may be of two types: (i) incentive stock options and (ii) nonstatutory stock options. Unless the compensation committee shall otherwise specify at the time of grant, any option granted under the 2000 plan shall be a nonstatutory stock option.

Under the 2000 plan, unless otherwise determined by our compensation committee at the time of grant, participating employees are granted options to purchase our class A common stock at exercise prices not less than the market value of our class A common stock at the date of grant. Options have a term of 10 years from date of grant. Options vest in increments of 10% on the first anniversary, 15%



on the second anniversary, and 25% on the third, fourth, and fifth anniversaries of an individual grant. Subject to certain provisions, in the event of a change of control, we will cancel each option in exchange for a payment in cash of an amount equal to the excess, if any, of the highest price per share of class A common stock offered in conjunction with any transaction resulting in a change of control over the exercise price for such option.

On August 3, 2001, the Company made an offer to its employees to cancel their existing options issued under the 2000 plan in exchange for new options to be granted on the date that is on or after six months and one day following the expiration date of the offer. As a result of this offer, 3,274,935 options were cancelled. The remaining options outstanding under this plan were forfeited during 2001. In March 2002, an additional 1,337,109 shares were issued at $7.00 per option. During 2003, 111,758 options were forfeited and 478,025 options were issued at $7.00 per option. As of March 15, 2004, 1,585,729 options were outstanding under the 2000 plan.

**Aggregated Option/SAR Exercises in Last Fiscal Year and Fiscal Year End Option/SAR Values**

The following table sets forth the information with respect to the named executive officers set forth in the Summary Compensation Table concerning the exercise of options during fiscal year 2003, the number of securities underlying options as of December 31, 2003 and the year-end value of all unexercised in-the-money options held by such individuals.

| Name | Shares Acquired on Exercise (#) | Value Realized ($) | Numbers of Securities Underlying Unexercised Options/SARs At Fiscal Year End (#) Exercisable/Unexercisable | Value of Unexercised In The Money Options/SARs at Fiscal Year End ($) Exercisable/Unexercisable(1) |
|---|---|---|---|---|
| Eugene B. Johnson | 0 | 0 | 267,266/1,499,065 | $1,260,012/$5,314,763 |
| Peter G. Nixon | 0 | 0 | 12,627/288,705 | — /$627,807 |
| Walter E. Leach, Jr. | 0 | 0 | 204,139/838,539 | — /$3,210,410 |
| John P. Duda | 0 | 0 | 157,880/632,820 | $561,805/$2,169,578 |
| Shirley J. Linn | 0 | 0 | 19,182/123,162 | — /$115,500 |

(1) Represents the difference between the exercise price and the fair market value of our common stock at December 31, 2003.

**Employment Agreements**

*Eugene B. Johnson*

In December 2002, we entered into an employment agreement with Mr. Johnson, pursuant to which we named Mr. Johnson Chief Executive Officer of the Company and/or Chairman of the Company's Board of Directors from December 31, 2002 to December 31, 2006. The employment agreement provides that Mr. Johnson will receive an annual base salary of $350,000, an annual discretionary bonus, and Mr. Johnson shall be entitled to participate in all incentive, savings, stock option and retirement plans, practices, policies and programs applicable generally to other senior management. The employment agreement also provides that upon (i) the expiration of Mr. Johnson's employment period, or (ii) the termination of Mr. Johnson's employment as Chief Executive Officer without cause, Mr. Johnson is entitled to receive certain benefits. These benefits include continued medical coverage for Mr. Johnson and his wife until each has reached age 65, the accelerated vesting of all options granted to Mr. Johnson under the Company's 1998 plan and 2000 plan and extension of Mr. Johnson's right to exercise all of his vested options under the 1995 plan and the 2000 plan within certain time periods. If we terminate Mr. Johnson for cause or he voluntarily resigns he is not entitled to any benefits under the employment agreement. If Mr. Johnson's employment is terminated without cause during the term of his employment agreement he is entitled to receive payment of his salary as of the termination event for two years, subject to suspension for a breach of Mr. Johnson's covenant



not to compete with us. Upon the expiration of the term of Mr. Johnson's employment agreement at December 31, 2006, unless extended, he is entitled to receive payment of his salary as of such expiration date for one year thereafter, subject to suspension for a breach of Mr. Johnson's covenant not to compete with us. The employment agreement supersedes and terminates all prior employment agreements and severance arrangements between Mr. Johnson and us.

*Jack H. Thomas*

In December 2001, we entered into a succession agreement with Mr. Thomas, pursuant to which Mr. Thomas resigned from his position as Chief Executive Officer of the Company and we retained him to serve as a non-executive member of our board of directors. In December 2003, Mr. Thomas resigned from his position as a member of the board of directors. The succession agreement provides for Mr. Thomas' right to exercise all of his vested options until the termination of the succession period and the immediate vesting of all unvested options upon a change of control or an early termination of the succession agreement without cause. In December 2003, we entered into a letter agreement with Mr. Thomas, supplementing and modifying the succession agreement. The letter agreement provides that Mr. Thomas and his wife shall continue to receive certain benefits until each is 65 years of age. In addition, the letter agreement extends Mr. Thomas' right to exercise certain fully vested options, subject to certain terms, conditions and trigger events. Furthermore, the letter agreement confirms that the restrictive covenants set forth in certain option plans continue to be in full force and effect until December 11, 2004, unless we subsequently waive the covenants.

*Walter E. Leach, Jr.*

In January 2000, we entered into an employment agreement with Mr. Leach. The employment agreement provides that upon the termination of Mr. Leach's employment due to a change of control, the executive is entitled to receive from us in a lump sum payment an amount equal to such executive's base salary as of the date of termination for a period ranging from twelve months to twenty-four months. For purposes of the previous sentence, a change of control shall be deemed to have occurred if: (a) certain of our stockholders no longer own, either directly or indirectly, shares of our capital stock entitling them to 51% in the aggregate of the voting power for the election of our directors as a result of a merger or consolidation, a transfer of our capital stock or otherwise; or (b) we sell, assign, convey, transfer, lease or otherwise dispose of, in one transaction or a series of related transactions, all or substantially all of our property or assets to any other person or entity. In addition, we have agreed to maintain Mr. Leach's long term disability and medical benefits for a similar period following a change of control.

In December 2003, we entered into a letter agreement with Mr. Leach, supplementing and modifying his employment agreement. The letter agreement provides that following the expiration of his employment agreement, Mr. Leach shall continue as an employee at will. During this period, Mr. Leach is entitled to receive certain benefits. The letter agreement also provides that upon termination of Mr. Leach's employment by us without cause (including upon a change of control), Mr. Leach is entitled to receive from us in a lump sum payment an amount equal to his base salary as of the date of termination for a period of twelve months, plus all accrued and unpaid base salary and benefits as of the date of termination. In addition, Mr. Leach is entitled to receive certain benefits following his termination for twelve months following such date of termination.

*John P. Duda*

In January 2000, we entered into an employment agreement with Mr. Duda. In November 2002, we entered into a letter agreement with Mr. Duda, supplementing and modifying his employment agreement. The letter agreement provides that upon the termination of Mr. Duda's employment with us without cause, Mr. Duda is entitled to receive certain benefits. These benefits include continued long-term disability, term life insurance and medical benefits for twelve months and a lump sum payment from us in an amount equal to twelve months of his base salary as of the date of termination, plus accrued and unpaid base salary and benefits as of the date of termination.



*Peter G. Nixon and Shirley J. Linn*

In November 2002, we entered into a letter agreement with each of Mr. Nixon and Ms. Linn. The letter agreements provide that upon the termination of their respective employment with us without cause, each is entitled to receive from us in a lump sum payment an amount equal to twelve months of such executive's base salary as of the date of termination, plus the continuation of certain benefits, including medical benefits, for twelve months.

## ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table sets forth information regarding beneficial ownership of our class A common stock as of December 31, 2003 for (i) each executive officer named in the "Summary Compensation Table"; (ii) each director, (iii) all of our named executive officers and directors as a group, and (iv) each person who beneficially owns 5% or more of the outstanding shares of our class A common stock. All persons listed have sole voting and investment power with respect to their shares unless otherwise indicated.

The amounts and percentages of common stock reflected in this table assume the conversion of all of our shares of class C common stock into shares of our class A common stock. Our shares of class C common stock are convertible into shares of class A common stock only upon the occurrence of certain events, including (i) the consummation by the Company of an offering of its class A common stock to the public pursuant to which the Company raises at least $150 million in gross proceeds or (ii) any transfer of shares of class C common stock to any person or persons who are not affiliates of the transferor.

| | Number of Shares Beneficially Owned(1) | Percent of Outstanding(1) |
|---|---|---|
| Executive Officers and Directors: | | |
| Eugene B. Johnson(2) | 694,446 | 1.4% |
| Peter G. Nixon(3) | 21,827 | * |
| Walter E. Leach, Jr.(4) | 204,139 | * |
| John P. Duda(5) | 157,880 | * |
| Shirley J. Linn(6) | 19,182 | * |
| Daniel G. Bergstein(7) | 2,300,140 | 4.6% |
| Frank K. Bynum, Jr.(8) | 18,199,496 | 36.4% |
| Anthony J. DiNovi(9) | 21,461,720 | 42.9% |
| George E. Matelich(8) | 18,199,496 | 36.4% |
| Jack H. Thomas(10) | 1,757,590 | 3.5% |
| Kent R. Weldon(9) | 21,461,720 | 42.9% |
| All Executive Officers and Directors as a group (11 persons) | 44,816,420 | 87.9% |
| **5% Stockholders:** | | |
| Kelso Investment Associates V, L.P. and Kelso Equity Partners V, L.P. (8) | 18,199,496 | 36.4% |
| 320 Park Avenue, 24th Floor New York, New York 10022 | | |
| Thomas H. Lee Equity Fund IV, L.P. and affiliates(9) | 21,461,720 | 42.9% |
| 75 State Street Boston, Massachusetts 02109 | | |

* Less than 1%.

(1) Unless otherwise indicated below, the persons and entities named in the table have sole voting and sole investment power with respect to all shares beneficially owned by them, subject to community



property laws where applicable. The percentage of beneficial ownership is based on 50,043,224 shares of common stock outstanding as of December 31, 2003.

(2) Includes 267,266 shares of class A common stock issuable upon exercise of options that are either currently exercisable or become exercisable during the next 60 days. Does not include 1,499,065 shares of class A common stock issuable upon exercise of options that are not currently exercisable or do not become exercisable during the next 60 days.

(3) Includes 12,627 shares of class A common stock issuable upon exercise of options that are either currently exercisable or become exercisable during the next 60 days. Does not include 288,705 shares of class A common stock issuable upon exercise of options that are not currently exercisable or do not become exercisable during the next 60 days.

(4) Includes 204,139 shares of class A common stock issuable upon exercise of options that are either currently exercisable or become

exercisable during the next 60 days. Does not include 838,539 shares of class A common stock issuable upon exercise of options that are not currently exercisable or do not become exercisable during the next 60 days.

(5) Includes 157,880 shares of class A common stock issuable upon exercise of options that are either currently exercisable or become exercisable during the next 60 days. Does not include 632,820 shares of class A common stock issuable upon exercise of options that are not currently exercisable or do not become exercisable during the next 60 days.

(6) Includes 19,182 shares of class A common stock issuable upon exercise of options that are either currently exercisable or become exercisable during the next 60 days. Does not include 123,162 shares of class A common stock issuable upon exercise of options that are not currently exercisable or do not become exercisable during the next 60 days.

(7) Includes 2,135,140 shares of class A common stock owned by JED Communications Associates, Inc., a corporation owned 100% by Mr. Bergstein and members of his immediate family and 165,000 shares of class A common stock owned by certain of Mr. Bergstein's family members, for which Mr. Bergstein has both voting and disposition power.

(8) Includes 16,427,726 shares of class A common stock owned by Kelso Investment Associates V, L.P., or KIAV, and 1,771,770 shares of class A common stock owned by Kelso Equity Partners V, L.P., or KEPV. KIAV and KEPV, due to their common control, could be deemed to beneficially own each other's shares, but each disclaims such beneficial ownership. Joseph S. Schuchert, Frank T. Nickell, Thomas R. Wall, IV, George E. Matelich, Michael B. Goldberg, David I. Wahrhaftig, Frank K. Bynum, Jr. and Philip E. Berney may be deemed to share beneficial ownership of shares of class A common stock owned of record by KIAV and KEPV, by virtue of their status as general partners of the general partner of KIAV and as general partners of KEPV. Messrs. Schuchert, Nickell, Wall, Matelich, Goldberg, Wahrhaftig, Bynum and Berney share investment and voting power with respect to securities owned by KIAV and KEPV, but disclaim beneficial ownership of such securities.

(9) Shares of class A common stock held by Thomas H. Lee Equity Fund IV, L.P. may be deemed to be beneficially owned by THL Equity Advisors IV, LLC, the general partner of Thomas H. Lee Equity Fund IV, L.P., Thomas H. Lee Partners, L.P., Thomas H. Lee Advisors, LLC, the general partner of Thomas H. Lee, L.P., Mr. DiNovi, Mr. Weldon and the other members of Thomas H. Lee Advisors, LLC. Each of such persons disclaims beneficial ownership of such shares.

(10) Includes 284,200 shares of class A common stock issuable upon exercise of options that are either currently exercisable or become exercisable during the next 60 days. Does not include 850,000 shares of class A common stock issuable upon exercise of options that are not currently exercisable or do not become exercisable during the next 60 days.



**Equity Compensation Plan Information**

| Plan Category | Number of Shares to be issued upon exercise of outstanding options, warrants and rights (a) | Weighted-average exercise price of outstanding options, warrants, and rights (b) | Number of shares remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c) |
|---|---|---|---|
| Equity compensation plans approved by stockholders | 6,737,674 | $ 2.85 | 13,476,036 |
| Equity compensation plans not approved by stockholders | 0 | $ 0 | 0 |

For a description of our equity compensation plans, see "Item 11. Executive Compensation."

## ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

### Financial Advisory Agreements

We entered into a Management Services Agreement with THL Equity Advisors IV, LLC, or THL Advisors, dated as of January 20, 2000, and an Amended and Restated Financial Advisory Agreement, dated as of January 20, 2000, with Kelso, pursuant to which THL Advisors and Kelso provide us certain consulting and advisory services related, but not limited to, equity financings and strategic planning. Each of these agreements expires on the earlier to occur of (i) December 31, 2006 or (ii) solely with respect to the Management Services Agreement, the date that THL Advisors ceases to own, and solely with respect to the Amended and Restated Financial Advisory Agreement, the date that Kelso Investment Associates V, L.P., or KIAV, and Kelso Equity Partners V, L.P., or KEPV, collectively cease to own at least 10% of the number of shares of our stock they held as of January 20, 2000. Pursuant to these agreements, we pay to each of THL Advisors and Kelso annual advisory fees of $500,000, payable on a quarterly basis, we reimburse them for out of pocket expenses, and we have agreed to indemnify them against certain liabilities they may incur in connection with their provision of advisory services. In addition, we agreed to pay a transaction fee of approximately $8.4 million to Kelso, which fee is payable upon the earlier of (i) an initial public offering of our class A common stock, (ii) a sale of the Company to a third party or parties, whether structured as a merger, sale of stock, sale of assets, recapitalization or otherwise or (iii) KIAV and KEPV ceasing to own, collectively, at least 10% of the number of shares of our stock they held collectively as of January 20, 2000. In connection with our equity financing and recapitalization in January 2000, we terminated our financial advisory agreement with Carousel Capital Partners, L.P., a former significant stockholder, and the original financial advisory agreement with Kelso. We paid advisory fees and out of pocket expenses of approximately $1,020,850 in the aggregate to THL Advisors and Kelso in the year ended December 31, 2003.

### Legal Services

Daniel G. Bergstein, a director of the Company, is a senior partner of Paul, Hastings, Janofsky & Walker LLP, a law firm, which provides legal services to us. In the year ended December 31, 2003, we paid Paul Hastings approximately $1,270,575 for legal services and expenses.

**Stockholders Agreement and Registration Rights Agreement**

In connection with our January 2000 equity financing and recapitalization, we entered into a stockholders agreement with our stockholders, dated as of January 20, 2000, which contains provisions relating to, among other things: (i) the designation of members to our board of directors (including two members to be designated by THL, two members by Kelso and the designation jointly by THL and Kelso of Daniel G. Bergstein, Eugene B. Johnson and Jack H. Thomas, (ii) restrictions on transfers of shares, (iii) procedures to be followed under certain circumstances with respect to a sale of the



Company, (iv) the requirement that our stockholders take certain actions in connection with an initial public offering or a sale of the Company, (v) the requirement of the Company to sell shares to the stockholders under certain circumstances upon authorization of an issuance or sale of additional shares, (vi) the participation rights of stockholders in connection with a sale of shares by other stockholders, and (vii) our right to purchase all (but not less than all) of the shares of a management stockholder in the event of resignation, termination of employment, death or disability. The stockholders agreement also provides that we must obtain the consent of THL and Kelso in order for us to incur debt in excess of $5 million.

We entered into a registration rights agreement with certain of our stockholders, dated as of January 20, 2000, pursuant to which such stockholders have the right in certain circumstances and, subject to certain conditions, to require us to register shares of our common stock held by them under the Securities Act of 1933. Under the registration rights agreement, except in limited circumstances, we are obligated to pay all expenses in connection with such registration.

**Founder Compensation Arrangements**

Daniel G. Bergstein, Jack H. Thomas, Meyer Haberman and Eugene B. Johnson, our founding stockholders, have entered into an arrangement with Walter E. Leach, Jr. and John P. Duda pursuant to which such stockholders have agreed to provide compensation to Mr. Leach and Mr. Duda upon the occurrence of certain specified liquidation events with respect to us, based on our value at the time of such liquidation event.

## ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The following table sets forth the aggregate fees billed to the Company during fiscal years 2002 and 2003 by KPMG LLP:

| | 2002 | 2003 |
|---|---|---|
| Audit Fees | $ 540,000 | $ 533,000 |
| All Other Fees: | | |
| Audit-Related Fees | $ 26,000 | $ 496,000 |
| Tax Fees | 146,000 | 156,000 |
| Total of All Other Fees | $ 172,000 | $ 652,000 |

*Audit-Related Fees* consist of fees for assurance and related services that are reasonably related to the performance of the audit or review of the Company's financial statements. This category includes fees related to audit services not required by statute or regulations, due diligence services related to acquisitions and divestitures and consulting services related to financial accounting and reporting standards. During 2003, $479,000 of audit related fees were associated with the March 6, 2003 refinancing activities.

*Tax Fees* consist of fees for professional services for tax compliance, tax advice and tax planning. These services include assistance regarding federal and state tax compliance, return preparation and tax audits.

The audit committee pre-approves all audit and non-audit services performed by our independent auditor.

The audit committee has considered whether the provision of non-audit services is compatible with maintaining the independence of KPMG LLP and has concluded that it is.



# PART IV

## ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

**(a) The following documents are filed as part of this report:**

(1) Financial Statements

The following items are included in Part II, Item 8 of this report:

INDEPENDENT AUDITORS' REPORT
CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2001, 2002 AND 2003:

Consolidated Balance Sheets as of December 31, 2002 and 2003
Consolidated Statements of Operations for the Years Ended December 31, 2001, 2002 and 2003
Consolidated Statements of Stockholders' Equity (Deficit) for the Years Ended December 31, 2001, 2002 and 2003
Consolidated Statements of Comprehensive Income (Loss) for the Years Ended December 31, 2001, 2002 and 2003
Consolidated Statements of Cash Flows for the Years Ended December 31, 2001, 2002 and 2003
Notes to Consolidated Financial Statements for the Years Ended December 31, 2001, 2002 and 2003

In addition, certain financial statements required by Section 309 of Regulation S-X have been filed as exhibits hereto and are incorporated by reference herein.

(2) Financial Statement Schedules

The following financial statement schedule is filed below:
Schedule II-Valuation and Qualifying Accounts.

(3) The exhibits filed as part of this report are listed in the Index to Exhibits immediately preceding such exhibits, which Index to Exhibits is incorporated herein by reference.

**(b) Reports on Form 8 K**

On October 8, 2003, the Company filed a Current Report on Form 8-K disclosing that Eugene B. Johnson and Walter E. Leach, Jr., executive officers of the Company, participated in a high yield conference sponsored by Deutsche Bank Securities.

On October 14, 2003, the Company filed a Current Report on Form 8-K disclosing that on September 30, 2003, MJD Services, a wholly-owned subsidiary of the Company, completed the sale of all of the capital stock owned by MJD Services of Union Telephone Company of Hartford, Armour Independent Telephone Co., WMW Cable TV Co. and Kadoka Telephone Co. to Golden West Telephone Properties, Inc. The disclosure included the following pro forma financial information: Basis of Presentation, Pro Forma Condensed Consolidated Balance Sheet as of June 30, 2003, Pro Forma Condensed Consolidated Statement of Operations for the year ended December 31, 2002, and Notes to Pro Forma Condensed Consolidated Financial Statements

On October 14, 2003, the Company filed an amendment to its Current Report on Form 8-K filed on October 14, 2003 to include a conformed signature which was inadvertently omitted.

On November 5, 2003, the Company filed a Current Report on Form 8-K announcing operating results for the nine months ended September 30, 2003. The disclosure included the Company's and its subsidiaries Condensed Consolidated Balance Sheets for September 30, 2003 (unaudited) and December 31, 2002, the Company's and its subsidiaries Condensed Consolidated Statements of



Operations (unaudited) for the three months ended September 30, 2003 and 2002, the Company's and its subsidiaries Condensed Consolidated Statements of Cash Flows (unaudited) for the nine months ended September 30, 2003 and 2002, the Company's Consolidated and Rural Local Exchange Financial Information for the three months and nine months ended September 30, 2003 and 2002, the Company's Sequential Financial Information for the quarters ending September 30, June 30, and March 31, 2003 and December 31 and September 30, 2002, the Company's EBITDA Reconciliation for the three and nine months ended September 30, 2003 and 2002 and the Company's Sequential QTR/QTR Free Cash Flow.

On November 21, 2003, the Company filed a Current Report on Form 8-K disclosing that Walter E. Leach, Jr. and Peter G. Nixon, executive officers of the Company, participated in a high yield conference sponsored by Credit Suisse First Boston.

On December 5, 2003, the Company filed a Current Report on Form 8-K disclosing that on December 1, 2003, MJD Ventures, a wholly owned subsidiary of the Company, completed the purchase of all of the capital stock owned by Community Service Communications Inc. of CST and CCI.



**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FAIRPOINT COMMUNICATIONS, INC.

Date: March 23, 2004

By: /s/ WALTER E. LEACH, JR.

Name: Walter E. Leach, Jr.
Title: Senior Vice President and Chief Financial Officer

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, this report has been signed by the following persons in the capacities and on the dates indicated.

| Signatures | Title | Date |
|---|---|---|
| /s/ EUGENE B. JOHNSON<br>Eugene B. Johnson | Chairman of the Board of Directors and Chief Executive Officer (Principal Executive Officer) | March 23, 2004 |
| /s/ WALTER E. LEACH, JR.<br>Walter E. Leach, Jr. | Senior Vice President and Chief Financial Officer (Principal Financial Officer) | March 23, 2004 |
| /s/ LISA R. HOOD<br>Lisa R. Hood | Vice President and Controller (Principal Accounting Officer) | March 23, 2004 |
| /s/ DANIEL G. BERGSTEIN<br>Daniel G. Bergstein | Director | March 23, 2004 |
| /s/ FRANK K. BYNUM, JR.<br>Frank K. Bynum, Jr. | Director | March 23, 2004 |
| /s/ ANTHONY J. DINOVI<br>Anthony J. DiNovi | Director | March 23, 2004 |
| /s/ GEORGE E. MATELICH<br>George E. Matelich | Director | March 23, 2004 |
| /s/ KENT R. WELDON<br>Kent R. Weldon | Director | March 23, 2004 |



## ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K.

(a) Exhibits

| Exhibit No. | Description |
|---|---|
| 2.1 | Stock Purchase Agreement dated as of January 4, 2000 by and among FairPoint, Thomas H. Lee Equity IV, L.P., Kelso Investment Associates V, L.P., Kelso Equity Partners V, L.P., Carousel Capital Partners, L.P. and certain other signatories thereto.(1) |
| 2.2 | Stock Purchase Agreement dated as of April 18, 2003 and as amended June 20, 2003 by and among FairPoint, Community Service Communications Inc., Community Service Telephone Co. and Commtel Communications, Inc.(11) |
| 2.3 | Stock Purchase Agreement dated as of May 9, 2003 by and among Golden West Telephone Properties, Inc., MJD Services Corp., Union Telephone Company of Hartford, Armour Independent Telephone Co., WMW Cable TV Co. and Kadoka Telephone Co.(10) |
| 2.4 | Agreement and Plan of Merger dated as of June 18, 2003 by and among FairPoint, MJD Ventures, Inc., FairPoint Berkshire Corporation and Berkshire Telephone Corporation.(11) |
| 3.1 | Seventh Amended and Restated Certificate of Incorporation of FairPoint.(8) |
| 3.2 | By Laws of FairPoint.(3) |
| 3.3 | Certificate of Designation of Series A Preferred Stock of FairPoint.(8) |

| | |
|---|---|
| 4.1 | Indenture, dated as of May 5, 1998, between FairPoint and United States Trust Company of New York, relating to FairPoint's \$125,000,000 9 1/2% Senior Subordinated Notes due 2008 and \$75,000,000 Floating Rate Callable Securities due 2008.(2) |
| 4.2 | Indenture, dated as of May 24, 2000, between FairPoint and United States Trust Company of New York, relating to FairPoint's \$200,000,000 12 1/2% Senior Subordinated Notes due 2010.(3) |
| 4.3 | Indenture, dated as of March 6, 2003, between FairPoint and The Bank of New York, relating to FairPoint's \$225,000,000 11 7/8% Senior Notes due 2010.(9) |
| 4.4 | Form of Initial Fixed Rate Security.(2) |
| 4.5 | Form of Initial Floating Rate Security.(2) |
| 4.6 | Form of Exchange Fixed Rate Security.(2) |
| 4.7 | Form of Exchange Floating Rate Security.(2) |
| 4.8 | Form of 144A Senior Subordinated Note due 2010.(3) |
| 4.9 | Form of Regulation S Senior Subordinated Note due 2010.(3) |
| 4.10 | Form of Initial Senior Note due 2010.(9) |
| 4.11 | Form of Exchange Senior Note due 2010.(9) |
| 4.12 | Form of Series A Preferred Stock Certificate of FairPoint.(8) |
| 10.1 | Amended and Restated Credit Agreement dated as of March 30, 1998 and amended and restated as of March 6, 2003, among FairPoint, various lending institutions, Bank of America, N.A., Wachovia Bank, N.A. and Deutsche Bank Trust Company Americas.(9) |



| | |
|---|---|
| 10.2 | First Amendment to Credit Agreement dated December 17, 2003 by FairPoint Communications, Inc, the credit parties named therein, Wachovia Bank, National Association and Deutsche Bank Trust Company Americas.* |
| 10.3 | Amended and Restated Subsidiary Guaranty dated as of March 6, 2003 by FairPoint Broadband, Inc., MJD Ventures, Inc., MJD Services Corp. and ST Enterprises Ltd.(9) |
| 10.4 | Amended and Restated Pledge Agreement dated as of March 6, 2003 by Carrier Services, ST Enterprises, Ltd., FairPoint Broadband, Inc., MJD Services Corp., MJD Ventures, Inc., C R Communications, Inc., Ravenswood Communications, Inc. and Utilities Inc.(9) |
| 10.5 | Amended and Restated Preferred Stock Issuance and Capital Contribution Agreement dated as of May 10, 2002 among FairPoint, Wachovia Bank, National Association and various lending institutions.(8) |
| 10.6 | Amended and Restated Tax Sharing Agreement dated November 9, 2000 by and among FairPoint and its Subsidiaries.(4) |
| 10.7 | Form of A Term Note.(9) |
| 10.8 | Form of C Term Note Floating Rate.(9) |
| 10.9 | Form of C Term Note Fixed Rate.(9) |
| 10.10 | Form of RF Note.(9) |
| 10.11 | Stockholders' Agreement dated as of January 20, 2000 of FairPoint.(1) |
| 10.12 | Registration Rights Agreement dated as of January 20, 2000 of FairPoint.(1) |
| 10.13 | Management Services Agreement dated as of January 20, 2000 by and between FairPoint and THL Equity Advisors IV, LLC.(1) |
| 10.14 | Amended and Restated Financial Advisory Agreement dated as of January 20, 2000 by and between FairPoint and Kelso & Company, L.P.(1) |
| 10.15 | Non Competition, Non Solicitation and Non Disclosure Agreement dated as of January 20, 2000 by and between FairPoint and JED Communications Associates, Inc.(1) |
| 10.16 | Non Competition, Non Solicitation and Non Disclosure Agreement dated as of January 20, 2000 by and between FairPoint and Daniel G. Bergstein.(1) |

| | |
|---|---|
| 10.17 | Non Competition, Non Solicitation and Non Disclosure Agreement dated as of January 20, 2000 by and between FairPoint and Meyer Haberman.(1) |
| 10.18 | Employment Agreement dated as of January 20, 2000 by and between FairPoint and John P. Duda.(1) |
| 10.19 | Letter agreement dated as of November 21, 2002 by and between FairPoint and John P. Duda, supplementing Employment Agreement dated as of January 20, 2000.(9) |
| 10.20 | Employment Agreement dated as of January 20, 2000 by and between FairPoint and Walter E. Leach, Jr.(1) |
| 10.21 | Letter Agreement, dated as of December 15, 2003, by and between FairPoint and Walter E. Leach, Jr., supplementing Employment Agreement dated as of January 20, 2000.* |
| 10.22 | Letter agreement dated as of November 11, 2002 by and between FairPoint and Peter G. Nixon.(9) |



| | |
|---|---|
| 10.23 | Letter agreement dated as of November 13, 2002 by and between FairPoint and Shirley J. Linn.(9) |
| 10.24 | Institutional Stockholders Agreement dated as of January 20, 2000 by and among FairPoint and the other parties thereto.(1) |
| 10.25 | FairPoint 1995 Stock Option Plan.(3) |
| 10.26 | FairPoint Amended and Restated 1998 Stock Incentive Plan.(3) |
| 10.27 | FairPoint Amended and Restated 2000 Employee Stock Incentive Plan.* |
| 10.28 | Employment Agreement dated as of December 31, 2002 by and between FairPoint and Eugene B. Johnson.(9) |
| 10.29 | Succession Agreement dated as of December 31, 2001 by and between FairPoint and Jack H. Thomas.(7) |
| 10.30 | Letter Agreement, dated as of December 15, 2003, by and between FairPoint and Jack H. Thomas, supplementing Succession Agreement dated as of December 31, 2001.* |
| 14 | FairPoint Code of Ethics for Financial Professionals.* |
| 21 | Subsidiaries of FairPoint.* |
| 31.1 | Certification required by 18 United States Code Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes Oxley Act of 2002.* |
| 31.2 | Certification required by 18 United States Code Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes Oxley Act of 2002.* |
| 32.1 | Certification required by 18 United States Code Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes Oxley Act of 2002.*† |
| 32.2 | Certification required by 18 United States Code Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes Oxley Act of 2002.*† |
| 99.1 | Audited financial statements for the Orange County Poughkeepsie Limited Partnership for the years ended December 31, 2003, 2002 and 2001.* |
| 99.2 | Audited financial statements for the Illinois Valley Cellular RSA 2-I Partnership for the years ended December 31, 2002 and 2001.* |
| 99.3 | Unaudited financial statements for the Illinois Valley Cellular RSA 2-I Partnership for the six months ended June 30, 2003.* |
| 99.4 | Audited financial statements for the Illinois Valley Cellular RSA 2-III Partnership for the years ended December 31, 2002 and 2001.* |
| 99.5 | Unaudited financial statements for the Illinois Valley Cellular RSA 2-III Partnership for the six months ended June 30, 2003.* |

* Filed herewith.



† Pursuant to Securities and Exchange Commission Release No. 33-8238, this certification will be treated as "accompanying" this annual

Report on Form 10-K and not "filed" as part of such report for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of Section 18 of the Securities Exchange Act of 1934 and this certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act 1934, except to the extent that the registrant specifically incorporates it by reference.

(1) Incorporated by reference to the annual report of FairPoint for the year ended 1999, filed on Form 10-K.

(2) Incorporated by reference to the registration statement on Form S-4 of FairPoint, declared effective as of October 1, 1998.

(3) Incorporated by reference to the registration statement on Form S-4 of FairPoint, declared effective as of August 9, 2000.

(4) Incorporated by reference to the quarterly report of FairPoint for the period ended September 30, 2000, filed on Form 10-Q.

(5) Incorporated by reference to the quarterly report of FairPoint for the period ended June 30, 2001, filed on Form 10-Q.

(6) Incorporated by reference to the current report on Form 8-K, filed on November 18, 2001.

(7) Incorporated by reference to the annual report of FairPoint for the year ended 2001, filed on Form 10-K.

(8) Incorporated by reference to the quarterly report of FairPoint for the period ended March 31, 2002, filed on Form 10-Q.

(9) Incorporated by reference to the annual report of FairPoint for the year ended 2002, filed on Form 10-K.

(10) Incorporated by reference to the quarterly report of FairPoint for the period ended March 31, 2003, filed on Form 10-Q.

(11) Incorporated by reference to the registration statement on Form S-4 of FairPoint, declared effective as of July 22, 2003.



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QuickLinks

QuickLinks -- Click here to rapidly navigate through this document

**Exhibit 10.2**

*FIRST AMENDMENT TO CREDIT AGREEMENT*

FIRST AMENDMENT TO CREDIT AGREEMENT (this "*First Amendment*"), dated as of December 17, 2003, among FAIRPOINT COMMUNICATIONS, INC. (f/k/a MJD Communications, Inc.), a Delaware corporation (the "*Borrower*"), the undersigned Credit Parties, the lenders from time to time party to the Credit Agreement referred to below (the "*Lenders*"), WACHOVIA BANK, N.A., as Documentation Agent (the "*Documentation Agent*"), BANK OF AMERICA, N.A., as Syndication Agent (the "*Syndication Agent*"), and DEUTSCHE BANK TRUST COMPANY AMERICAS (f/k/a Bankers Trust Company), as Administrative Agent (in such capacity, the "*Administrative Agent*" and, together with the Documentation Agent and the Syndication Agent, collectively, the "*Agents*"). Unless otherwise indicated, all capitalized terms used herein and not otherwise defined shall have the respective meanings provided such terms in the Credit Agreement referred to below.

W I T N E S S E T H:

WHEREAS, the Borrower, the Lenders and the Agents are parties to an Amended and Restated Credit Agreement, dated as of March 30, 1998 and amended and restated as of March 6, 2003 (as so amended and restated, the "*Credit Agreement*"); and

WHEREAS, subject to the terms and conditions of this First Amendment, the parties hereto wish to amend the Credit Agreement and enter into certain agreements relating to the Credit Agreement, in each case as herein provided;

NOW, THEREFORE, it is agreed:

I. *Amendments and Agreements to Credit Agreement.*

1. Section 1.01 of the Credit Agreement is hereby amended by inserting the text "(including, in the case of Incremental A Term Loans, the terms and conditions of Section 1.15)" immediately prior to the first comma appearing in said Section.

2. Section 1.01(a) of the Credit Agreement is hereby amended by (i) deleting the text "A Term Facility (each, an "*A Term Loan*" and, collectively, the "*A Term Loans*")" appearing in said Section and inserting the text "Initial A Term Facility (each, an "*Initial A Term Loan*" and, collectively, the "*Initial A Term Loans*")" in lieu thereof, (ii) deleting each reference to the text "A Term Loans" appearing in subclauses (ii) and (iii) of the first sentence of said Section and in the last sentence of said Section and inserting the text "Initial A Term Loans" in lieu thereof and (iii) deleting each reference to the text "A Term Commitment" appearing in said Section and inserting the text "Initial A Term Commitment" in lieu thereof.

3. Section 1.01 of the Credit Agreement is hereby further amended by inserting the following new clause (e) at the end of said Section:

> "(e) Loans under the Incremental A Term Facility (each, an "*Incremental A Term Loan*" and, collectively, the "*Incremental A Term Loans*") (i) shall be made to the Borrower by each Lender with an Incremental A Term Commitment pursuant to a single drawing on the Incremental A Term Borrowing Date, (ii) except as hereinafter provided, may, at the option of the Borrower, be incurred and maintained as, and/or converted into, Base Rate Loans or Eurodollar Loans, *provided* that all Incremental A Term Loans incurred on the Incremental A Term Borrowing Date shall be added to the then outstanding Borrowings of Initial A Term Loans as provided in Section 1.15(c) and (iii) shall not exceed in an aggregate principal amount for any Lender in respect of any incurrence of Incremental A Term Loans the Incremental A Term Commitment, if any, of such Lender as in effect immediately prior to such incurrence. Once repaid, Incremental A Term Loans may not be reborrowed.".

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4. Section 1.04(a) of the Credit Agreement is hereby amended by inserting the text "(or, in the case of a funding of Incremental A Term Loans on the Incremental A Term Borrowing Date, in an amount equal to such Lender's Incremental A Term Commitment)" immediately prior to the period at the end of the first sentence of said Section.

5. Section 1.05 of the Credit Agreement is hereby amended by (i) deleting the word "The" appearing in clause (a) of said Section and inserting the text "Subject to Section 1.05(g) hereof," in lieu thereof and (ii) inserting the following new clause (g) at the end of said Section:

> "(g) Notwithstanding anything to the contrary contained above or elsewhere in this Agreement, Notes shall only be delivered to Lenders which at any time specifically request the delivery of such Notes. No failure of any Lender to request or obtain a Note evidencing its Loans to the Borrower shall affect or in any manner impair the obligations of the Borrower to pay the Loans (and all related Obligations) which would otherwise be evidenced thereby in accordance with the requirements of this Agreement, and shall not in any way affect the security or guaranties therefor provided pursuant to the various Credit Documents. Any Lender which does not have a Note evidencing its outstanding Loans shall in no event be required to make the notations otherwise described in preceding clause (f). At any time when any Lender requests the delivery of a Note to evidence any of its Loans, the Borrower shall promptly execute and deliver to the respective Lender the requested Note in the appropriate amount or amounts to evidence such Loans.".

6. Section 1.07 of the Credit Agreement is hereby amended by (i) deleting the text "A Term Loans" appearing in said Section and inserting the text "Initial A Term Loans, Incremental A Term Loans" in lieu thereof and (ii) deleting the text "A Term Commitments" appearing in said Section and inserting the text "Initial A Term Commitments, Incremental A Term Commitments" in lieu thereof.

7. Section 1.14 of the Credit Agreement is hereby amended by (i) inserting the text "on or prior to June 30, 2004" immediately following the text "have the right to request" appearing in clause (a) of said Section, (ii) deleting the text "$10,000,000" appearing in clause (a) of said Section and inserting the text "$35,000,000" in lieu thereof, (iii) deleting the word "and" appearing immediately prior to subclause (vi) of clause (a) of said Section and inserting a comma in lieu thereof, (iv) inserting the text "and (vii) any provision of an Incremental Revolving Commitment pursuant to this Section 1.14 shall occur on or prior to June 30, 2004" immediately prior to the period at the end of clause (a) of said Section, (v) inserting the text "(x)" immediately after the text "Section 1.14," appearing in the first sentence of clause (b) of said Section and (vi) inserting the following text immediately prior to the period at the end of the first sentence of clause (b) of said Section:

"and (y) the Borrower shall deliver to the Administrative Agent (I) an opinion or opinions, in form and substance reasonably satisfactory to the Administrative Agent, from counsel to the Borrower reasonably satisfactory to the Administrative Agent and dated such date, covering such matters relating to the provision of the Incremental Revolving Commitment as may be reasonably requested by the Administrative Agent and (II) a solvency certificate from the Chief Financial Officer of the Borrower, dated the Incremental Revolving Commitment Date, in form and substance satisfactory to the Administrative Agent,".

8. Section 1 of the Credit Agreement is hereby further amended by inserting the following new Section 1.15:

"1.15 *Incremental A Term Loan Commitments*. (a) So long as the Incremental Commitment Requirements are satisfied at the time of the delivery of the request referred to below, the Borrower shall have the right to request on or prior to June 30, 2004 that one or more Lenders (and/or one or more other Persons which will become Lenders as provided below) provide Incremental A Term Commitments and, subject to the terms and conditions contained in this



Agreement, make Incremental A Term Loans pursuant thereto; it being understood and agreed, however, that (i) no Lender shall be obligated to provide an Incremental A Term Commitment as a result of any such request by the Borrower, and until such time, if any, as such Lender has agreed in its sole discretion to provide an Incremental A Term Commitment and executed and delivered to the Administrative Agent an Incremental A Term Commitment Agreement as provided in clause (b) of this Section 1.15, such Lender shall not be obligated to fund any Incremental A Term Loans, (ii) any Lender (or, in the circumstances contemplated by clause (v) below, any other Person which will qualify as an Eligible Transferee) may so provide an Incremental A Term Commitment without the consent of any other Lender, (iii) each provision of Incremental A Term Commitments pursuant to this Section 1.15 shall be in a minimum aggregate amount (for all Lenders (including in the circumstances contemplated by clause (v) below, Eligible Transferees who will become Lenders)) of at least $2,500,000 and in integral multiples of $500,000 in excess thereof, (iv) the aggregate amount of all Incremental A Term Commitments permitted to be provided pursuant to this Section 1.15 shall not exceed $10,000,000, (v) the Borrower may request Incremental A Term Commitments from Persons reasonably acceptable to the Administrative Agent which would qualify as Eligible Transferees hereunder, *provided* that any such Incremental A Term Commitment provided by any such Eligible Transferee which is not already a Lender shall be in a minimum amount (for such Eligible Transferee) of at least $2,500,000 (and with the fees to be paid to such Eligible Transferee to be no greater than those fees to be paid to the then existing Lenders (if any) providing Incremental A Term Commitments) and (vi) all actions taken by the Borrower pursuant to this Section 1.15 shall be done in coordination with the Administrative Agent.

(b) In connection with any provision of Incremental A Term Loan Commitments pursuant to this Section 1.15, (i) the Borrower, the Administrative Agent and each such Lender or other Eligible Transferee (each, an "*Incremental A Term Lender*") which agrees to provide an Incremental A Term Commitment shall execute and deliver to the Administrative Agent an Incremental A Term Commitment Agreement substantially in the form of Exhibit L hereto (appropriately completed), with the effectiveness of such Incremental A Term Lender's Incremental A Term Commitment to occur upon delivery of such Incremental A Term Commitment Agreement to the Administrative Agent, the payment of any fees required in connection therewith (including, without limitation, any agreed upon up-front or arrangement fees owing to the Administrative Agent) and the satisfaction of the Incremental Commitment Requirements and the other terms and conditions described in this Section 1.15 and (ii) the Borrower shall deliver to the Administrative Agent (x) an opinion or opinions, in form and substance reasonably satisfactory to the Administrative Agent, from counsel to the Borrower reasonably satisfactory to the Administrative Agent and dated such date, covering such matters relating to the provision of the Incremental A Term Commitments as may be reasonably requested by the Administrative Agent and (y) a solvency certificate from the Chief Financial Officer of the Borrower, dated the Incremental A Term Borrowing Date, in form and substance satisfactory to the Administrative Agent. The Administrative Agent shall promptly notify each Lender as to the effectiveness of each Incremental A Term Commitment Agreement, and at such time (i) Annex I to the Credit Agreement shall be deemed modified to reflect the Incremental A Term Commitments of such Incremental A Term Lenders and (ii) to the extent requested by any Incremental A Term Lender, an A Term Note will be issued at the Borrower's expense, to such Incremental A Term Lender, to be in conformity with the requirements of Section 1.05 (with appropriate modification) to the extent needed to reflect the new Incremental A Term Loans made by such Incremental A Term Lender.

(c) In connection with each incurrence of Incremental A Term Loans pursuant to Section 1.01(e), the Lenders and the Borrower hereby agree that, notwithstanding anything to the contrary contained in this Agreement, the Borrower and the Administrative Agent may take all



such actions as may be necessary to ensure that all Lenders with outstanding A Term Loans continue to participate in each Borrowing of outstanding A Term Loans (after giving effect to the incurrence of Incremental A Term Loans pursuant to Section 1.01(e)) on a *pro rata* basis, including by adding the Incremental A Term Loans to be so incurred to the then outstanding Borrowings of Initial A Term Loans on a *pro rata* basis even though as a result thereof such new Incremental A Term Loans (to the extent required to be maintained as Eurodollar Loans) may effectively have a shorter Interest Period than the then outstanding Borrowings of Initial A Term Loans, and it is hereby agreed that, to the extent the Incremental A Term Loans are to be so incurred or added to the then outstanding Borrowings of Initial A Term Loans which are maintained as Eurodollar Loans, the Lenders that have made such Incremental A Term Loans shall be entitled to receive from the Borrower such amounts, as reasonably determined by the respective Lenders, to compensate them for funding the various Incremental A Term Loans during an existing Interest Period (rather than at the beginning of the respective Interest Period, based upon rates then applicable thereto). All determinations by any Lender pursuant to the immediately preceding sentence shall, absent manifest error, be final and conclusive and binding on all parties hereto.".

9. Section 2.01 of the Credit Agreement is hereby amended by deleting clause (f) of said Section in its entirety and inserting the following new clause (f) in lieu thereof:

"(f) The Borrower shall pay to the Administrative Agent for distribution to each Incremental Lender such fees and other amounts, if any, as are specified in the relevant Incremental Commitment Agreement, with the fees and other amounts, if any, to be payable on the respective Incremental Commitment Date.".

10. Section 2.03 of the Credit Agreement is hereby amended by deleting clauses (a) and (b) of said Section in their entirety and inserting the following new clauses (a) and (b) in lieu thereof:

"(a) The Total Initial A Term Commitment and the Total Revolving Commitment (and the Initial A Term Commitment and Revolving Commitment of each Lender with such a Commitment) shall terminate in their entirety on the Expiration Date unless the Restatement Effective Date has occurred on or before such date.

(b) (i) The Total Initial A Term Commitment (and the Initial A Term Commitment of each Lender with such a Commitment) shall terminate in its entirety on the Restatement Effective Date (after giving effect to the making of Initial A Term Loans on such date).

(ii) The Total Incremental A Term Commitment (and the Incremental A Term Commitment of each Lender with such a Commitment) shall terminate in its entirety on the Incremental A Term Borrowing Date (after giving effect to the making of Incremental A Term Loans on such date).".

11. Section 5.05 of the Credit Agreement is hereby amended by deleting clause (a) of said Section in its entirety and inserting the following new clause (a) in lieu thereof:

"(a) (i) The proceeds of all Initial A Term Loans shall be utilized to effect the Refinancing and to pay certain fees and expenses relating to the Transaction.

(ii) The proceeds of all Incremental A Term Loans shall be utilized for general corporate and working capital purposes (including, without limitation, Permitted Acquisitions) of the Borrower and its Subsidiaries.".

12. Section 5.05(b) of the Credit Agreement is hereby amended by inserting the text "and to repay Indebtedness of FairPoint Carrier Services under the FairPoint Carrier Services Credit Agreement" immediately after the text "Carrier Services Expenditures" appearing in said Section.



13. Section 7.04(m) of the Credit Agreement is hereby amended by deleting clause (i) of said Section and the text "and (ii)" appearing immediately after such clause in their entirety.

14. Section 7.06(n) of the Credit Agreement is hereby amended by (i) deleting the text "on the Restatement Effective Date" in the first place it appears in said Section and inserting such text immediately after the text "incurrence of Loans" appearing in said Section and (ii) deleting clause (y) of said Section in its entirety and inserting the following new clause (y) in lieu thereof:

"(y) cash on hand and/or proceeds from the incurrence of Revolving Loans in an aggregate amount not to exceed $25.0 million, so long as FairPoint Carrier Services promptly uses the full amount of the proceeds of such contribution or loan to repay amounts owing under the FairPoint Carrier Services Credit Agreement.".

15. The Lenders hereby agree that, notwithstanding anything to the contrary contained in Sections 7.03 and 7.04 of the Credit Agreement, Indebtedness of FairPoint Carrier Services under the FairPoint Carrier Services Credit Agreement, and Liens on assets of FairPoint Carrier Services and its Subsidiaries (including the capital stock of such Subsidiaries) securing such Indebtedness, shall be permitted to be outstanding on the date FairPoint Carrier Services becomes a Subsidiary under the Credit Agreement, so long as (and only so long as) all of such Indebtedness is promptly repaid in full, all commitments thereunder and guaranties thereof are terminated, and all of such Liens are promptly released (but, in any event, by close of business on such date).

16. Section 7.06 of the Credit Agreement is hereby amended by deleting clause (k) of said Section in its entirety and inserting the following new clause (k) in lieu thereof:

"(k) [Intentionally omitted]".

17. Section 7.13 of the Credit Agreement is hereby amended by deleting the table appearing in said Section in its entirety and inserting the following new table in lieu thereof:

| "Fiscal Quarter Ended | Ratio |
|---|---|
| September 30, 2003 | 1.75:1.0 |
| December 31, 2003 | 2.00:1.0 |
| March 31, 2004 | 2.00:1.0 |
| June 30, 2004 | 2.00:1.0 |
| September 30, 2004 | 2.00:1.0 |
| December 31, 2004 | 1.75:1.0 |
| March 31, 2005 | 1.75:1.0 |
| June 30, 2005 | 1.75:1.0 |
| September 30, 2005 | 1.75:1.0 |
| December 31, 2005 | 1.50:1.0 |
| March 31, 2006 | 1.50:1.0 |
| June 30, 2006 | 1.50:1.0 |
| September 30, 2006 | 1.50:1.0 |
| December 31, 2006 | 1.25:1.0 |

| | |
|---|---|
| March 31, 2007 | 1.25:1.0". |



18. The definition of "Borrowing" appearing in Section 9 of the Credit Agreement is hereby amended by (i) deleting the word "and" appearing at the end of clause (x) of said definition and inserting a comma in lieu thereof and (ii) inserting the text "and (z) any Incremental A Term Loans incurred pursuant to Section 1.01(e) shall be considered part of the related Borrowing of the then outstanding Initial A Term Loans to which such Incremental A Term Loans are added pursuant to Section 1.15; it being understood and agreed, however, that for purposes of Section 1.08, the incurrence of Incremental A Term Loans on the Incremental A Term Borrowing Date shall be deemed to be a "Borrowing" of such Loans" immediately before the period at the end of said definition.

19. The definition of "Credit Documents" appearing in Section 9 of the Credit Agreement is hereby amended by inserting the text ", each Incremental A Term Commitment Agreement," immediately after the text "Incremental Revolving Commitment Agreement" appearing in said definition.

20. Section 9 of the Credit Agreement is hereby further amended by (i) deleting the definitions of "A Term Commitment", "A Term Facility", "A Term Loan", "Carrier Services Back-Stop Letters of Credit", "Commitment", "Excluded FairPoint Carrier Services Refinancing Proceeds", "Excluded Permitted Subordinated Debt Proceeds", "Facility", "Incremental Commitment Requirements", "Lender", "Total A Term Commitment" and "Total Commitment" appearing in said Section and (ii) inserting in the appropriate alphabetical order the following new definitions:

"*A Term Loan*" shall mean, collectively, each Initial A Term Loan and each Incremental A Term Loan.

"*Commitment*" shall mean, with respect to each Lender, such Lender's Initial A Term Commitment, Incremental A Term Commitment and/or Revolving Commitment.

"*Excluded Permitted Subordinated Debt Proceeds*" shall mean the Excluded Preferred Stock Refinancing Proceeds.

"*Facility*" shall mean any of the credit facilities established under this Agreement, *i.e.*, the Initial A Term Facility, the Incremental A Term Facility, the C Term Facility-Fixed Rate, the C Term Facility-Floating Rate or the Revolving Facility; *provided* that for purposes of Section 1.06 and the definition of "Borrowing", the Initial A Term Facility and the Incremental A Term Facility shall be deemed to be a single "Facility".

"*First Amendment*" shall mean the First Amendment to this Agreement, dated as of December , 2003.

"*First Amendment Effective Date*" shall have the meaning provided in the First Amendment.

"*Incremental A Term Borrowing Date*" shall mean the date on which the Borrower incurs Incremental A Term Loans pursuant to Section 1.01(e), which date shall (x) be the date of the effectiveness of the Incremental A Term Commitment Agreement pursuant to which such Incremental A Term Loans are to be made and (y) in any event, occur on or prior to June 30, 2004.

"*Incremental A Term Commitment*" shall mean, with respect to each Incremental A Term Lender, the commitment of such Incremental A Term Lender to make Incremental A Term Loans pursuant to Section 1.01(e) on the Incremental A Term Borrowing Date, as such commitment is set forth in the Incremental A Term Commitment Agreement delivered pursuant to Section 1.15(b) and as same may be terminated pursuant to Sections 2.02, 2.03 and/or 8 or (y) adjusted from time to time as a result of assignments to or from such Lender pursuant to Sections 1.13 and/or 11.04(b).



"*Incremental A Term Commitment Agreement*" shall mean an Incremental A Term Commitment Agreement substantially in the form of Exhibit L (appropriately completed).

"*Incremental A Term Facility*" shall mean the Facility evidenced by the Total Incremental A Term Commitment.

"*Incremental A Term Lender*" shall have the meaning provided in Section 1.15(b).

"*Incremental A Term Loan*" shall have the meaning provided in Section 1.01(e).

"*Incremental Commitment*" shall mean any Incremental A Term Commitment and/or any Incremental Revolving Commitment, as the context may require.

"*Incremental Commitment Agreement*" shall mean any Incremental A Term Commitment Agreement and/or any Incremental Revolving Commitment Agreement, as the context may require.

"*Incremental Commitment Date*" shall mean any Incremental A Term Borrowing Date or any Incremental Revolving Commitment Date, as the context may require.

"*Incremental Commitment Requirements*" shall mean, with respect to any request for an Incremental Commitment made pursuant to Section 1.14 or Section 1.15 or any provision of an Incremental Commitment on a given Incremental Commitment Date, the satisfaction of each of the following conditions: no Default or Event of Default then exists or would result from the incurrence of Loans pursuant to an Incremental Commitment (for purposes of such determination, assuming the relevant Loans in an aggregate principal amount equal to the full amount of Incremental Commitments then requested or provided had been incurred, and the proposed Permitted Acquisition (if any) to be financed with the proceeds of such Loans had been consummated, on such date of request or Incremental Commitment Date, as the case may be).

"*Incremental Lender*" shall mean any Incremental A Term Lender and/or any Incremental RF Lender, as the context may require.

"*Initial A Term Commitment*" shall mean, with respect to each Lender, the amount set forth opposite such Lender's name on Annex I hereto directly below the column entitled "Initial A Term Commitment", as the same may be (x) reduced or terminated pursuant to Sections 2.02, 2.03 and/or 8 or (y) adjusted from time to time as a result of assignments to or from such Lender pursuant to Sections 1.13 and/or 11.04(b).

"*Initial A Term Facility*" shall mean the Facility evidenced by the Total Initial A Term Commitment.

"*Initial A Term Loan*" shall have the meaning provided in Section 1.01(a).

"*Lender*" shall mean each financial institution listed on Annex I, as well as any Person that becomes a "Lender" hereunder pursuant to Section 1.01(e), 1.13, 1.14, 11.04(b) or 11.17.

"*Total Commitment*" shall mean the sum of the Total Initial A Term Commitment, the Total Incremental A Term Commitment and the Total Revolving Commitment.

"*Total Incremental A Term Commitment*" shall mean the sum of the Incremental A Term Commitments of each of the Lenders.

"*Total Initial A Term Commitment*" shall mean the sum of the Initial A Term Commitments of each of the Lenders.

21. Section 11.10 of the Credit Agreement is hereby amended by deleting the text "A Term Loan Commitment" appearing in said Section and inserting the text "Initial A Term Commitment" in lieu thereof.



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22. Section 11.12 of the Credit Agreement is hereby amended by deleting clause (b) of said Section in its entirety and inserting the following new clause (b) in lieu thereof:

"(b) Notwithstanding anything to the contrary contained in clause (a) above of this Section 11.12, the Borrower, the Administrative Agent and each Incremental Lender may, in accordance with the provisions of Sections 1.14 and 1.15, enter into an Incremental Commitment Agreement, *provided* that after the execution and delivery by the Borrower, the Administrative Agent and each such Incremental Lender of such Incremental Commitment Agreement, such Incremental Commitment Agreement may thereafter only be modified in accordance with the requirements of clause (a) above of this Section 11.12.".

23. Section 11.16 of the Credit Agreement is hereby amended by deleting the penultimate sentence of said Section in its entirety and inserting the following new sentence in lieu thereof:

"The registration of any provision of Incremental Commitments pursuant to Sections 1.14 and 1.15 shall be recorded by the Administrative Agent on the Register only upon the acceptance of the Administrative Agent of a properly executed and delivered Incremental Commitment Agreement.".

24. Section 11.17 of the Credit Agreement is hereby deleted in its entirety and the following new Section 11.17 is inserted in lieu thereof:

"11.17 *Additions of New Lenders.* (a) On and as of the occurrence of the Restatement Effective Date in accordance with Section 11.10 hereof, each Person that is a New Lender at such time shall become a "Lender" under, and for all purposes of, this Agreement and the other Credit Documents.

(b) On and as of the occurrence of the First Amendment Effective Date in accordance with the First Amendment, each Person whose name appears on Annex I to the Credit Agreement that was not a Lender immediately prior to giving effect to the First Amendment Effective Date shall become a "Lender" under, and for all purposes of, this Agreement and the other Credit Documents.".

25. The Credit Agreement is hereby further amended by inserting new Exhibit L thereto in the form of Exhibit L attached hereto.

II. *Miscellaneous Provisions.*

1. In order to induce the Lenders to enter into this First Amendment, the Borrower hereby represents and warrants that:

(a) no Default or Event of Default exists as of the First Amendment Effective Date (as defined below), both before and after giving effect to this First Amendment; and

(b) all of the representations and warranties contained in the Credit Agreement or the other Credit Documents are true and correct in all material respects on the First Amendment Effective Date, both before and after giving effect to this First Amendment, with the same effect as though such representations and warranties had been made on and as of the First Amendment Effective Date (it being understood that any representation or warranty made as of a specific date shall be true and correct in all material respects only as of such specific date).

2. This First Amendment is limited as specified and shall not constitute a modification, acceptance or waiver of any other provision of the Credit Agreement or any other Credit Document.

3. This First Amendment may be executed in any number of counterparts and by the different parties hereto on separate counterparts, each of which counterparts when executed and delivered shall be an original, but all of which shall together constitute one and the same instrument. A complete set of counterparts shall be lodged with the Borrower and the Administrative Agent.

**4. THIS FIRST AMENDMENT AND THE RIGHTS AND OBLIGATIONS OF THE PARTIES HEREUNDER SHALL BE CONSTRUED IN ACCORDANCE WITH AND GOVERNED BY THE LAW OF THE STATE OF NEW YORK.**

5. This First Amendment shall become effective on the date (the "*First Amendment Effective Date*") on which each of the following conditions shall have been satisfied:

(i) each of the Borrower, each other Credit Party, the Administrative Agent, the Required RF/A TF Lenders and the Required C TF Lenders shall have signed a counterpart hereof (whether the same or different counterparts) and shall have delivered (including by way of facsimile transmission) the same to the Administrative Agent at its Notice Office; and

(ii) the Borrower shall have paid to the Administrative Agent and the Lenders all fees, costs and expenses (including, without limitation, legal fees and expenses) payable to the Administrative Agent and the Lenders, to the extent then due and set forth in a reasonably detailed invoice made available to the Borrower.

6. The Borrower hereby covenants and agrees, so long as the First Amendment Effective Date occurs, to pay to each Lender which has executed and delivered to the Administrative Agent (or its designee) a counterpart hereof by the later to occur of (x) 12:00 noon (New York time) on December 17, 2003 and (y) 5:00 p.m. (New York time) on the First Amendment Effective Date (such later date, the "*Outside Date*"), a non-refundable cash amendment fee equal to 0.15% of the sum of (i) each such Lender's Revolving Commitment (as in effect immediately prior to the First Amendment Effective Date) and (ii) the aggregate outstanding principal amount of such Lender's Term Loans (determined immediately prior to the First Amendment Effective Date), which fee shall not be subject to counterclaim or set-off for, or be otherwise affected by, any claim or dispute relating to any other matter and shall be paid by the Borrower to the Administrative Agent for distribution to the Lenders on the second Business Day following the Outside Date.

7. By executing and delivering a copy hereof, each Credit Party hereby agrees that all Loans (including, without limitation, all Revolving Loans incurred pursuant to the increase in the Total Revolving Commitment pursuant to this First Amendment) (x) shall be fully guaranteed pursuant to the Subsidiary Guaranty in accordance with the terms and provisions thereof and (y) shall be (and are) secured pursuant to the Pledge Agreement.

8. From and after the First Amendment Effective Date, all references in the Credit Agreement and each of the other Credit Documents to the Credit Agreement shall be deemed to be references to the Credit Agreement as modified hereby.

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IN WITNESS WHEREOF, each of the parties hereto has caused a counterpart of this First Amendment to be duly executed and delivered as of the date first above written.

FAIRPOINT COMMUNICATIONS, INC.
(f/k/a MJD Communications, Inc.)

By: /s/ TIMOTHY W. HENRY

Name: Timothy W. Henry
Title: Vice President of Finance & Treasurer

ST ENTERPRISES, LTD.,
as a Subsidiary Guarantor and a Pledgor

By: /s/ TIMOTHY W. HENRY

Name: Timothy W. Henry
Title: Vice President of Finance & Treasurer

FAIRPOINT BROADBAND, INC.,
as a Subsidiary Guarantor and a Pledgor

By: /s/ TIMOTHY W. HENRY

Name: Timothy W. Henry
Title: Vice President of Finance & Treasurer

MJD SERVICES CORP.,
as a Subsidiary Guarantor and a Pledgor

By: /s/ TIMOTHY W. HENRY

Name: Timothy W. Henry
Title: Vice President of Finance & Treasurer

MJD VENTURES, INC.,
as a Subsidiary Guarantor and a Pledgor

By: /s/ TIMOTHY W. HENRY

Name: Timothy W. Henry
Title: Vice President of Finance & Treasurer

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C-R COMMUNICATIONS, INC.,
as a Pledgor

By: /s/ TIMOTHY W. HENRY

Name: Timothy W. Henry
Title: Vice President of Finance & Treasurer

COMERCO, INC.,
as a Pledgor

By: /s/ TIMOTHY W. HENRY

Name: Timothy W. Henry
Title: Vice President of Finance & Treasurer

GTC COMMUNICATIONS, INC.,
as a Pledgor

By: /s/ TIMOTHY W. HENRY

Name: Timothy W. Henry
Title: Vice President of Finance & Treasurer

RAVENSWOOD COMMUNICATIONS, INC.,
as a Pledgor

By: /s/ TIMOTHY W. HENRY

Name: Timothy W. Henry
Title: Vice President of Finance & Treasurer

UTILITIES, INC.,
as a Pledgor

By: /s/ TIMOTHY W. HENRY

Name: Timothy W. Henry
Title: Vice President of Finance & Treasurer

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DEUTSCHE BANK TRUST COMPANY AMERICAS
(f/k/a Bankers Trust Company), Individually, as Administrative Agent and as Collateral Agent

By: /s/ ANCA TRIFAN

Name: Anca Trifan
Title: Director

BANK OF AMERICA, N.A.,
Individually and as Syndication Agent

By: /s/ ROBERT KLAWINSKI

Name: Robert Klawinski
Title: Managing Director

WACHOVIA BANK, NATIONAL ASSOCIATION
(f/k/a First Union National Bank), Individually and as Documentation Agent

By: /s/ MARK L. COOK

Name: Mark L. Cook
Title: Director

COBANK, ACB

By: /s/ JOHN COLE

Name: John Cole
Title: Vice President

CREDIT SUISSE FIRST BOSTON

By:

Name:
Title:

---

CITICORP NORTH AMERICA, INC.

By: /s/ MICHAEL P. PSYLLOS

Name: Michael P. Psyllos
Title: Vice President

SEQUILS-CUMBERLAND I, LTD.
By: Deerfield Capital Management LLC, as Collateral Manager

By: /s/ MARK E. WITTNEBEL

Name: Mark E. Wittnebel
Title: Sr. Vice President

ROSEMONT CLO, LTD.
By: Deerfield Capital Management LLC, as Collateral Manager

By: /s/ MARK E. WITTNEBEL

Name: Mark E. Wittnebel
Title: Sr. Vice President

BRYN MAWR CLO, LTD.
By: Deerfield Capital Management LLC, as Collateral Manager

By: /s/ MARK E. WITTNEBEL

Name: Mark E. Wittnebel
Title: Sr. Vice President

BLUE SQUARE FUNDING LIMITED SERIES 3

By:

Name:
Title:

---

CITIGROUP INVESTMENTS CORPORATE LOAN FUND INC.
By: Travelers Asset Management International Company LLC

By:

Name:
Title:

MORGAN STANLEY PRIME INCOME TRUST

By: ____________________

Name:
Title:

GSC PARTNERS GEMINI FUND LIMITED
By: GSCP (NJ), L.P. as Collateral Monitor
By: GSCP (NJ), Inc., as its General Partner

By: ____________________

Name:
Title:

ARES LEVERAGED INVESTMENT FUND II, L.P.
By: Ares Management II, L.P.
Its: General Partner

By: /s/ JEFF MOORE

Name: Jeff Moore
Title: Vice President

ARES IV CLO, LTD.
By: Ares CLO Management IV, L.P. Investment Manager By: Ares CLO GP IV, LLC Its Managing Member

By: /s/ JEFF MOORE

Name: Jeff Moore
Title: Vice President

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ARES VI CLO LTD.
By: Ares CLO Management VI, L.P. Investment Manager By: Ares CLO GPVI, LLC Its Managing Member

By: /s/ JEFF MOORE

Name: Jeff Moore
Title: Vice President

THE CIT GROUP/EQUIPMENT FINANCING, INC.

By: /s/ STEVEN K. REEDY

Name: Steven K Reedy
Title: Vice President

SENIOR DEBT PORTFOLIO
By: BOSTON MANAGEMENT AND RESEARCH, as Investment Manger

By: /s/ PAYSON F. SWAFFIELD

Name: Payson F. Swaffield
Title: Vice President

THE TRAVELERS INSURANCE COMPANY

By: /s/ ALLEN CANTRELL

Name: Allen Cantrell
Title: Investment Officer

OXFORD STRATEGIC INCOME FUND
By: Eaton Vance Management as Investment Advisor

By: /s/ PAYSON F. SWAFFIELD

Name: Payson F. Swaffield

Title: Vice President

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EATON VANCE SENIOR INCOME TRUST
By: Eaton Vance Management as Investment Advisor

By: /s/ PAYSON F. SWAFFIELD

Name: Payson F. Swaffield
Title: Vice President

GRAYSON & CO
By: Boston Management and Research as Investment Advisor

By: /s/ PAYSON F. SWAFFIELD

Name: Payson F. Swaffield
Title: Vice President

ELF FUNDING TRUST I
By: Highland Capital Management, L.P. as Collateral Manager

By:

Name:
Title:

MUIRFIELD TRADING LLC

By:

Name:
Title:

OLYMPIC FUNDING TRUST, SERIES 1999-1

By:

Name:
Title:

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JISSEKIKUN FUNDING, LTD.
By: Pacific Investment Management Company LLC, as its Investment Advisor

By: /s/ MOHAN V. PHANSALKAR

Name: Mohan V. Phansalkar
Title: Executive Vice President

COLUMBUS LOAN FUNDING LTD.
By: Travelers Asset Management International Company LLC

By:

Name:
Title:

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**EXHIBIT L**

**FORM OF INCREMENTAL**
***A TERM COMMITMENT AGREEMENT***

[Name(s) of Lender(s)]

[Date]

Fairpoint Communications, Inc.
521 E. Morehead Street, Suite 250

Charlotte, North Carolina 28202

Attention: Tim Henry

Re: *Incremental A Term Commitment*

Ladies and Gentlemen:

Reference is hereby made to the Credit Agreement, dated as of March 30, 1998 and amended and restated as of March 6, 2003 (as so amended and restated and as the same may be further amended, amended and restated, modified or supplemented from time to time, the "*Credit Agreement*"), among Fairpoint Communications, Inc. (the "*Borrower*" or "*you*"), the lenders from time to time party thereto (the "*Lenders*"), Bank of America, N.A., as Syndication Agent, Wachovia Bank, N.A., as Documentation Agent, and Deutsche Bank Trust Company Americas, as Administrative Agent (in such capacity, the "*Administrative Agent*"). Unless otherwise defined herein, capitalized terms used herein shall have the respective meanings set forth in the Credit Agreement.

Each Lender (each, an "*Incremental A Term Lender*") party to this letter agreement (this "*Agreement*") hereby severally agrees to provide the Incremental A Term Commitment set forth opposite its name on Annex I attached hereto (for each such Incremental A Term Lender, its "*Incremental A Term Commitment*"). Each Incremental A Term Commitment provided pursuant to this Agreement shall be subject to the terms and conditions set forth in the Credit Agreement, including Section 1.15 thereof.

[Each Incremental A Term Lender and the Borrower acknowledge and agree that, with respect to the Incremental A Term Commitment provided by such Incremental A Term Lender pursuant to this Agreement, such Incremental A Term Lender shall receive an upfront fee equal to that amount set forth opposite its name on Annex I attached hereto, which upfront fee shall be due and payable to such Incremental A Term Lender on the effective date of this Agreement.]

Each Incremental A Term Lender, to the extent that it is not already a Lender under the Credit Agreement, (i) confirms that it is an Eligible Transferee, (ii) confirms that it has received a copy of the Credit Agreement and the other Credit Documents, together with copies of the financial statements referred to therein and such other documents and information as it has deemed appropriate to make its own credit analysis and decision to enter into this Agreement and to become a Lender under the Credit Agreement, (iii) agrees that it will, independently and without reliance upon the Administrative Agent or any other Lender and based on such documents and information as it shall deem appropriate at the time, continue to make its own credit decisions in taking or not taking action under the Credit Agreement, (iv) appoints and authorizes the Syndication Agent, the Documentation Agent, the Administrative Agent and the Collateral Agent to take such action as agent on its behalf and to exercise such powers under the Credit Agreement and the other Credit Documents as are delegated to the Syndication Agent, the Documentation Agent, the Administrative Agent and the Collateral Agent, as the case may be, by the terms thereof, together with such powers as are reasonably incidental thereto, (v) agrees that it will perform in accordance with their terms all of the obligations which by the terms of the Credit Agreement are required to be performed by it as a Lender, and (vi) in the case of

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each such Incremental A Term Lender organized under the laws of a jurisdiction outside the United States, attaches the applicable forms described in Section 3.04(b) of the Credit Agreement certifying as to its entitlement to a complete exemption from United States withholding taxes with respect to all payments to be made under the Credit Agreement and the other Credit Documents.

The Borrower acknowledges and agrees that all Obligations with respect to Incremental A Term Loans made pursuant to an Incremental A Term Commitment shall be secured pursuant to the Pledge Agreement in accordance with the terms and provisions thereof. Each Parent Company acknowledges and agrees that all Obligations with respect to A Term Loans made pursuant to an Incremental A Term Commitment shall be fully guaranteed pursuant to the Subsidiary Guaranty in accordance with the terms and provisions thereof and shall be secured pursuant to the Pledge Agreement in accordance with the terms and provision thereof.

The effective date of this Agreement shall be the date on which (i) the parties hereto have executed a counterpart of this Agreement and delivered same to the Administrative Agent at the Notice Office, (ii) all fees required to be paid in connection herewith have been paid and (iii) the Incremental Commitment Requirements and all other conditions set forth in the Credit Agreement (including Section 1.15 thereof), which date shall be no later than June 30, 2004.

You may accept this Agreement by signing the enclosed copies in the space provided below, and returning one copy of same to us before the close of business on , . If you do not so accept this Agreement by such time, our Incremental A Term Commitments set forth in this Agreement shall be deemed cancelled.

After the execution and delivery to the Administrative Agent of a fully executed copy of this Agreement (including by way of counterparts and by fax) by the parties hereto, this Agreement may only be changed, modified or varied by written instrument in accordance with the requirements for the modification of Credit Documents pursuant to Section 11.12 of the Credit Agreement.

* * *



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**THIS AGREEMENT SHALL BE CONSTRUED IN ACCORDANCE WITH AND GOVERNED BY THE LAW OF THE STATE OF NEW YORK.**

Very truly yours,

[NAME OF LENDER]

By ____________________

Name:
Title:

Agreed and Accepted
this day of , :

FAIRPOINT COMMUNICATIONS, INC.

By: ______________________________

Name:
Title:

[NAMES OF OTHER CREDIT PARTIES](1)

By: ______________________________

Name:
Title:

DEUTSCHE BANK TRUST COMPANY AMERICAS,
as Administrative Agent

By: ______________________________

Name:
Title:

(1) Insert signature blocks for each other Credit Party.



**ANNEX I**

| Name of Incremental A Term Lender | Amount of Incremental A Term Commitment | Upfront Fee |
|---|---|---|
| | | |
| Total: | | |

QuickLinks -- Click here to rapidly navigate through this document

**Exhibit 10.21**

December 15, 2003

Mr. Walter E. Leach, Jr.
Senior Vice President and Chief Financial Officer
FairPoint Communications, Inc.
521 East Morehead Street
Suite 250
Charlotte, North Carolina 28202

Dear Walt:

This letter agreement shall supplement and modify your Employment Agreement with FairPoint Communications, Inc. dated as of January 20, 2000 (the "Employment Agreement"), which Employment Agreement shall expire by its own terms, without renewal, on December 31, 2003.

Following expiration of your Employment Agreement at December 31, 2003, you shall continue as an employee at will, as provided in Section 1 of the Employment Agreement; provided, however, that the $6,000 annual allowance for long term disability and term life insurance premiums set forth in Section 2(b)(iv) of the Employment Agreement shall continue to be available to you, as will your use of a Company automobile (with reasonable expense reimbursement therefore). Should your employment be terminated thereafter by the Company without Cause (including upon a Change of Control), you shall be entitled to receive, in a lump sum payment from the Company, an amount equal to your Base Salary as of the date of termination for a period of twelve (12) months, plus all accrued and unpaid base salary and benefits as of the date of termination. In addition, the Company shall maintain your long-term disability, term life insurance and medical benefits described in Section 2(b)(iv) of the Employment Agreement for a period of twelve (12) months following the date of your termination.

If the foregoing is acceptable to you, please indicate your concurrence with the terms of this letter agreement by signing below.

Sincerely,

/s/ GENE JOHNSON

Gene Johnson

EBJ/bcs

ACCEPTED AND AGREED to as of the
15th day of December 2003

/s/ WALTER E. LEACH, JR.

Walter E. Leach, Jr.

QuickLinks -- Click here to rapidly navigate through this document

**Exhibit 10.27**

**FAIRPOINT COMMUNICATIONS, INC.**
**Amended and Restated 2000 Employee Stock Incentive Plan**

**1. Purposes.**

The purpose of the Plan (as such term and any other capitalized term used herein without definition are defined in Section 2) is to foster and promote the long-term financial success of the Company and Subsidiaries and materially increase shareholder value by (*a*) motivating superior performance by Participants in the Plan, (*b*) encouraging and providing for the acquisition of an ownership interest in the Company by Employees and (*c*) enabling the Company and Subsidiaries to attract and retain the services of an outstanding management team upon whose judgment, interest and special effort the successful conduct of its and their operations is largely dependent.

**2. Definitional Matters.**

(a) *Certain Definitions*. Capitalized terms used herein without definition shall have the respective meanings set forth below:

*Act* means the Securities Exchange Act of 1934, as amended.

*Board* means the Board of Directors of the Company.

*Cause:* (*i*) the refusal or neglect of the Participant to perform substantially his or her lawful employment-related duties, following written notice from the Company describing in reasonable detail such refusal or neglect and an opportunity for 30 days to cure the condition which is the subject of such notice, (*ii*) the Participant's personal dishonesty, willful misconduct or breach of fiduciary duty, (*iii*) the Participant's conviction of or entering a plea of guilty or *nolo contendere* to a crime constituting a felony or his or her willful violation of any law, rule, or regulation (other than a traffic violation or similar offense or violation which in no way adversely affects the Company or its reputation or the ability of the Participant to perform his or her employment-related duties or to represent the Company) or (*iv*) the breach by the Participant of any written covenant or agreement with the Company or any of its subsidiaries not to disclose any material information pertaining to the Company or such subsidiary or not to compete or interfere with the Company or such subsidiary; *provided that*, with respect to any Participant who is party to an employment agreement with the Company, "Cause" shall have the meaning specified in such Participant's employment agreement (but not any severance agreement) or, in the case of any such Participant who is not party to an employment agreement but is a party to the Stockholders' Agreement, "Cause" shall have the meaning specified in the Stockholders' Agreement.

*Change in Control* means the occurrence of any of the following events:

(1) the members of the Board at the beginning of any consecutive twenty-four calendar month period (the "*Incumbent Directors*") cease for any reason to constitute at least a majority of the members of the Board; *provided that* any director whose election, or nomination for election, by the Company's stockholders was approved by a vote of at least a majority of the members of the Board then still in office who were members of the Board at the beginning of such twenty-four calendar month period other than as a result of a proxy contest, or any agreement arising out of an actual or threatened proxy contest, shall be treated as an Incumbent Director; or

(2) any "person," including a "group" (as such terms are used in Sections 13(d) and 14(d)(2) of the Act), but excluding Kelso, THL, the Company, any Subsidiary or any employee benefit plan of the Company or any Subsidiary, is or becomes the "beneficial owner" (as defined in Rule 13(d)(3) under the Act), directly or indirectly, of securities of the Company representing 20% or more of the combined voting power of the Company's then outstanding securities; or

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(3) the stockholders of the Company approve a definitive agreement (*A*) for the merger or other business combination of the Company with, or into, another corporation, a majority of the directors of which were not directors of the Company immediately prior to the merger and in which the stockholders of the Company immediately prior to the effective date of such merger own a percentage of the voting power that is less than one-half of the percentage of the voting power they owned in the Company immediately prior to such transaction, or (*B*) for the sale or other disposition of all or substantially all of the assets of the Company; *provided*, in each case, that such transaction shall have been consummated; or

(4) the purchase of 20% or more of Common Stock pursuant to any tender or exchange offer made by any "person," including a "group" (as such terms are used in Sections 13(d) and 14(d)(2) of the Act) other than Kelso, THL, the Company, any Subsidiary or an employee benefit plan of the Company or any Subsidiary.

Notwithstanding the foregoing, a Change in Control shall not be deemed to occur in the event the Company files for bankruptcy, liquidation or reorganization under the United States Bankruptcy Code.

*Change in Control Price* means the highest price per share of Common Stock offered in conjunction with any transaction resulting in a Change in Control (as determined in good faith by the Committee if any part of the offered price is payable other than in cash), or, in the case of a Change in Control occurring solely by reason of a change in the composition of the Board, the highest Fair Market Value of the Common Stock on any of the 30 trading days immediately preceding the date on which a Change in Control occurs.

*Code* means the Internal Revenue Code of 1986, as amended.

*Committee* means the Compensation Committee of the Board or such other committee as the Board may from time to time designate to administer the Plan (or, in the absence of any such designation, the Board); *provided that*, following the Public Offering, any such committee shall consist of two or more members, each of whom shall be a "Non-Employee Director" within the meaning of Rule 16b-3, as promulgated under the Act, and an "outside director" within the meaning of Section 162(m) of the Code.

*Common Stock* means the Class A common stock of the Company, par value $0.01 per share.

*Company* means FairPoint Communications, Inc. a Delaware corporation, and any successor thereto.

*Disability:* the termination of the employment of any Participant by the Company or any of its subsidiaries shall be deemed to be by reason of a "Disability" if, as a result of such Participant's incapacity due to reasonably documented physical or mental illness, such Participant shall have been unable for more than six months within any 12-month period to perform his or her duties with the Company or such subsidiary on a full-time basis and within 90 days after written notice of termination has been given to such Participant such Participant shall not have returned to the full time performance of his or her duties. The date of termination in the case of a termination for "Disability" shall be deemed to be the last day of the aforementioned 90-day period. Notwithstanding the foregoing, with respect to any Participant who is a party to an employment agreement (but not any severance agreement) with the Company, "Disability" shall have the meaning, if any, specified in such Participant's employment agreement.

*Employee* means any full-time employee of the Company or any Subsidiary.

*Executive Officer* means any Employee that is subject to Section 16(b) of the Exchange Act with respect to equity securities of the Company.



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*Fair Market Value* means (i) if no Public Offering has occurred, the fair market value of a share of Common Stock as determined in accordance with Sections 3.4 and 3.5 of the Stockholders' Agreement; *provided that* for the purpose of such determination all outstanding Options hereunder shall be deemed to be outstanding shares of Common Stock; or, following a Public Offering, the average of the closing sales prices for a share of Common Stock as reported on a national securities exchange for each of the ten business days preceding the date of determination or the average of the last transaction prices for a share of Common Stock as reported on a nationally recognized system of price quotation for each of the ten business days preceding the date of determination. In the event that there are no Common Stock transactions reported on such exchange or system on such date, Fair Market Value shall mean the closing price on the immediately preceding date on which Common Stock transactions were so reported.

*Incentive Award* means an award of Options under Section 5 of the Plan and/or an award of Restricted Stock Units under Section 6 of the Plan.

*Kelso* means, collectively, Kelso Investment Associates V, L.P. and Kelso Equity Partners V, L.P.

*Option* means the right to purchase Common Stock pursuant to the terms of the Plan at a stated price for a specified period of time. For purposes of the Plan, an Option may be either (*i*) an "Incentive Stock Option" (ISO) within the meaning of Section 422 of the Code or (*ii*) a "Nonstatutory Stock Option" (NSO). Unless the Committee shall otherwise specify at the time of grant, any Option granted hereunder shall be a Nonstatutory Stock Option.

*Participant* means any Employee designated by the Committee to receive an Incentive Award under the Plan.

*Plan* means this FairPoint Communications, Inc. 2000 Employee Stock Incentive Plan, as set forth herein and as the same may be amended from time to time in accordance with its terms.

*Prior Plan* means the Amended and Restated Stock Option Plan of the Company, adopted by the Company pursuant to the Board's resolutions dated August 20, 1998, as in effect on the date of adoption of this Plan.

*Public Offering* means the Company's offering of common stock to the general public through a registration statement filed with the Securities and Exchange Commission that covers (together with prior effective registrations) (*i*) not less than 50% of the then outstanding shares of common stock of the Company on a fully diluted basis and treating all outstanding Options hereunder as outstanding shares of Common Stock or (*ii*) shares of Common Stock of the Company that will be traded on any of the New York Stock Exchange, the American Stock Exchange or the National Association of Securities Dealers Automated Quotation System after the close of any such general public offering.

*Restricted Period* means the period during which Restricted Stock Units are subject to forfeiture.

*Restricted Stock Unit* means the right to receive a share of Common Stock in accordance with the terms and conditions of Section 6 hereof that is forfeitable by the Participant until the achievement of a specified period of future service or otherwise as determined by the Committee or in accordance with the terms of the Plan.

*Retirement* means termination of a Participant's employment on or after the date the Participant attains age 65.



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*Stockholders' Agreement* means the Stockholders' Agreement, dated as of January 20, 2000, among the Company and holders of the Common Stock, as amended and in effect from time to time.

*Subsidiary* means any corporation in which the Company owns, directly or indirectly, stock representing 50% or more of the voting power of all classes of stock entitled to vote and any other business organization, regardless of form, in which the Company possesses directly or indirectly 50% or more of the total combined equity interests.

*THL* means Thomas H. Lee Equity Fund IV, L.P. and the parties listed on Schedule A to Stockholders' Agreement.

(b) *Gender and Number*. Except when otherwise indicated by the context, words in the masculine gender used in the Plan shall include the feminine gender, the singular shall include the plural, and the plural shall include the singular.

**3. Powers of The Committee**

The Committee shall be responsible for the administration of the Plan, including, without limitation, determining which Employees receive Incentive Awards, what kind of Incentive Awards are granted under the Plan and for what number of shares, and the other terms and conditions of each such Incentive Award. The Committee may establish different terms and conditions for different types of Incentive Awards, for different Participants receiving the same type of Incentive Award and for the same Participant for each Incentive Award such Participant may receive, whether or not granted at different times. The Committee shall have the responsibility of construing and interpreting the Plan and of establishing and amending such rules and regulations as it may deem necessary or desirable for the proper administration of the Plan. Any decision or action made or taken or to be taken by the Committee in connection with the construction, administration, interpretation and effect of the Plan and of the Committee's rules and regulations, shall, to the maximum extent permitted by applicable law, be within the Committee's absolute discretion (except as otherwise specifically provided herein) and shall for all purposes be final, conclusive and binding upon the Company, all Participants and any person claiming under or through any Participant, and shall be given deference in any proceeding with respect to, or arising out of, the Plan. The Committee may consult with legal counsel, who may be counsel to the Company, and shall not incur any liability for any action taken in good faith in reliance upon the advice of counsel.

**4. Common Stock Subject to Plan**

(a) *Number*. Subject to the provisions of Section 4(b) and (c), the number of shares of Common Stock subject to Incentive Awards under the Plan may not exceed a sum of 10,019,200 shares of Common Stock plus the number of shares of Common Stock available for grant under the Prior Plan on the date this Plan is adopted and the shares (if any) which, after the effective date of the Plan, become available for Incentive Awards under this Plan in accordance with Section 4(b) below. The maximum number of shares of Common Stock subject to Incentive Awards granted to any single Participant in any calendar year is 1,500,000 shares of Common Stock. Without limiting the generality of the foregoing, whenever shares are received by the Company in connection with the exercise of any Option granted under the Plan, only the net number of shares actually issued shall be counted against the foregoing limit. The shares to be delivered under the Plan may consist, in whole or in part, of treasury Common Stock or authorized but unissued Common Stock not reserved for any other purpose.

(b) *Cancelled, Terminated, or Forfeited Incentive Awards*. Any shares of Common Stock subject to any Incentive Award granted hereunder or under the Prior Plan which for any reason is cancelled or forfeited, terminated or otherwise settled without the lapse of restriction or the issuance of any Common Stock shall be available for further purchase or grant under the Plan.



(c) *Adjustment in Capitalization*. In the event of any Common Stock dividend or Common Stock split, recapitalization (including, without limitation, the payment of an extraordinary cash dividend), merger, consolidation, combination, spin-off, distribution of assets to stockholders, exchange of shares, or other similar corporate change or other similar event that affects the Common Stock such that an adjustment is required to preserve, or to prevent enlargement of, the benefits or potential benefits made available under this Plan, the Committee shall, in such manner as the Committee shall deem equitable, adjust any or all of (*i*) the number and kind of shares of capital stock which thereafter may be offered and sold under the Plan (including, without limitation, adjusting the limits on the number and types of Incentive Awards that may be made under the Plan), (*ii*) the number and kinds of shares of capital stock subject to outstanding Incentive Awards and (*iii*) the exercise price with respect to any Options. Additionally, the Committee may make provisions for a cash payment to a Participant or a person who has an outstanding Incentive Award in lieu of, or as a part of, such adjustment. However, the number of shares of capital stock subject to any Incentive Award shall always be a whole number.

**5. Stock Options**

(a) *Grant of Options*. Options may be granted to Participants at such time or times as shall be determined by the Committee. Options granted under the Plan may be of two types: (*i*) Incentive Stock Options and (*ii*) Nonstatutory Stock Options, *provided* that no Incentive Stock Option shall be granted to any Employee who is not eligible to receive such an Option under Section 422 of the Code and the regulations thereunder. The Committee shall have complete discretion in determining the number of Options, if any, to be granted to a Participant. Without limiting the foregoing, the Committee may grant Options containing provisions for the issuance to the Participant, upon exercise of such Option and payment of the exercise price therefore with previously owned shares of Common Stock, of an additional Option for the number of shares so delivered. Each Option shall be evidenced by an option agreement that shall specify the type of Option granted, the exercise price, the duration of the Option, the number of shares of Common Stock to which the option pertains, and such other terms and conditions not inconsistent with the Plan as the Committee shall determine.

(b) *Option Price*. Unless otherwise determined by the Committee at the time of grant, Options granted pursuant to the Plan shall have an exercise price which is not less than the Fair Market Value of a share of Common Stock on the date the Option is granted.

(c) *Exercise of Options*. Subject to Section 9(e), Options awarded under the Plan shall be exercisable at such times, and shall be subject to such restrictions and conditions, including the performance of a minimum period of service or the satisfaction of performance goals, as the Committee may impose, either at or after the time of grant of such Options; *provided that* no Option shall be exercisable on or after the tenth anniversary of the date on which it is granted.

(d) *Payment*. The Committee shall establish procedures governing the exercise of Options which shall require that (*x*) as a condition to the issuance of any shares of Common Stock upon the exercise of the Options prior to a Public Offering, the Participant become a party to the Stockholders' Agreement with respect to such shares and (*y*) written notice of exercise be given to the Company. No shares shall be delivered pursuant to any exercise of an Option unless arrangements satisfactory to the Committee have been made to ensure full payment of the option price. Without limiting the generality of the foregoing, the Committee may provide, on such terms and conditions as the Committee deems appropriate, that payment of the option price may be made (*i*) in cash or its equivalent, (*ii*) at any time following a Public Offering by exchanging shares of Common Stock (which are not subject to any pledge or other security interest or encumbrance) owned by the optionholder for at least six months (or such longer period as is required by applicable accounting standards to avoid a charge to earnings) having an aggregate Fair Market Value on the date of exercise equal to such aggregate Option exercise price or in a combination of cash and such unencumbered shares of Common Stock, (*iii*) at any time following a Public Offering, through an arrangement with a broker approved by the Company whereby



payment of the exercise price is accomplished with the proceeds of the sale of Stock or (*iv*) by any combination of the foregoing, *provided that* the combined value of all cash and cash equivalents paid and the Fair Market Value of any Common Stock so tendered to the Company, valued as of the date of such tender, is at least equal to such option price.

(e) *Termination of Employment*. Unless otherwise determined by the Committee at the time of grant, upon termination of a Participant's employment for any reason, any Options which have not become exercisable in accordance with the terms thereof shall be cancelled upon such termination of employment.

(f) *Termination of Employment Due to Death, Disability or Retirement*. Unless otherwise determined by the Committee at the time of grant, in the event a Participant's employment terminates by reason of death, Disability or Retirement, any Options granted to such Participant which are exercisable at the date of his or her death, Disability or Retirement may be exercised at any time prior to the earlier of the expiration of the term of the Options and the first anniversary of the Participant's termination of employment (or such other period as the Committee shall determine at the time of grant).

(g) *Termination of Employment for Any Other Reason*. Unless otherwise determined by the Committee at or after the time of grant, in the event the employment of the Participant shall terminate for any reason other than those specified in Section 5(f), any Options granted to such Participant which are exercisable at the date of the Participant's termination of employment may be exercised at any time prior to the earlier of the expiration of the term of the Options and the sixtieth day following the Participant's termination of employment; *provided that*, if a Participant's employment is terminated for Cause, all Options granted to such Participant which are then outstanding shall be immediately forfeited (whether or not then exercisable).

(h) *Incentive Stock Options*. Notwithstanding anything in the Plan to the contrary, no term of the Plan relating to Incentive Stock Options shall be interpreted, amended or altered, nor shall any discretion or authority granted under the Plan be so exercised, so as to disqualify the Plan under Section 422 of the Code.

(i) *Buyout*. The Committee may at any time offer to buy out an Option previously granted for a payment in cash, based on such terms and conditions as the Committee shall establish and communicate to the optionholder at the time that such offer is made. In addition, prior to a Public Offering, unless otherwise provided in the applicable Option Agreement evidencing the Option, upon any termination of a Participant's employment with the Company, the Company may repurchase all or any portion of the vested Options then held by such Participant as of the date of such termination for a cash payment equal to the excess, if any, of (*i*) the Fair Market Value of the shares of Common Stock subject to such Option (or to the portion thereof so purchased), over (*ii*) the aggregate Option exercise price for such shares and on such other terms and conditions as the Committee shall establish at the date of grant.

**6. Restricted Stock Units**

(a) *Grants of Restricted Stock Units*. Grants of Restricted Stock Units may be awarded to Participants at such time or times as shall be determined by the Committee. The Committee shall determine the number of Restricted Stock Units, if any, to be granted to a Participant, and the applicable Restricted Period. Each award of Restricted Stock Units shall be made pursuant to a Restricted Stock Unit agreement that shall include, among other things, provisions providing (i) for appropriate restrictions on the transfer of any Restricted Stock Units, including restrictions on transfer of such Restricted Stock Units during the period specified therein prior to and following a Public Offering, and (ii) for such other terms and provisions not inconsistent with the Plan as are determined by the Committee.



(b) *Restrictions on Transferability*. Except as provided in Section 9(a) or in the Restricted Stock Unit agreement, no Restricted Stock Unit may be sold, transferred, pledged, assigned or otherwise alienated or hypothecated until the lapse of the Restricted Period. Thereafter, any shares of Common Stock issued in respect of Restricted Stock Units may only be sold, transferred, pledged, assigned or otherwise alienated or hypothecated in compliance with all applicable securities laws, the Stockholders' Agreement and any other agreement to which the issued shares are subject.

(c) *Termination of Employment Due to Death, Disability, or Retirement*. Unless otherwise determined by the Committee at the time of grant, upon termination of a Participant's employment by reason of death, Disability or Retirement, the Restricted Period applicable to any Restricted Stock Units shall immediately lapse and all such Restricted Stock Units of the Participant shall immediately vest.

(d) *Termination of Employment for Any Other Reason*. Unless otherwise determined by the Committee at the time of grant, upon termination of a Participant's employment for any reason other than those specified in Section 6(c) prior to the expiration of the Restricted Period applicable to any Restricted Stock Units, any such Restricted Stock Units then remaining subject to restrictions shall be forfeited and cancelled upon such termination of employment.

(e) *Buyout*. The Committee may at any time offer to buy out a Restricted Stock Unit previously granted for a payment in cash, based on such terms and conditions as the Committee shall establish and communicate to the Participant at the time that such offer is made.

**7. Change in Control**

(a) *Accelerated Vesting and Payment*. Subject to the provisions of Section 7(b) below, in the event of a Change in Control, each Option shall be cancelled in exchange for a payment in cash of an amount equal to the excess, if any, of the Change in Control Price over the exercise price for such Option. Subject to the provisions of Section 7(b) below, in the event of a Change in Control, the Restricted Period in respect of all Restricted Stock Units shall immediately lapse and all Restricted Stock Units of the Participant shall immediately vest and the Company shall pay to the Employee an amount equal to the Fair Market Value of the shares of Common Stock otherwise transferable to the Employee upon the lapse of the Restricted Period.

(b) *Alternative Awards*. Notwithstanding Section 7(a), no cancellation, acceleration of exercisability, vesting, cash settlement or other payment shall occur with respect to any Incentive Award if the Committee reasonably determines in good faith prior to the occurrence of a Change in Control that such Incentive Award shall be honored or assumed, or new rights substituted therefor (such honored, assumed or substituted option hereinafter called an "Alternative Award"), by a Participant's employer (or the parent or a subsidiary of such employer) immediately following the Change in Control, provided that any such Alternative Award must:

(i) provide such Participant (or each Participant in a class of Participants) with rights and entitlements substantially equivalent to or better than the rights, terms and conditions applicable under such Incentive Award, including, but not limited to, an identical or better exercise or vesting schedule and identical or better timing and methods of payment;

(ii) have substantially equivalent economic value to such Incentive Award (determined at the time of the Change in Control); and

(iii) have terms and conditions which provide that in the event that the Participant's employment is involuntarily terminated or constructively terminated, any conditions on a Participant's rights under, or any restrictions on transfer or exercisability applicable to, each such Alternative Award shall be waived or shall lapse, as the case may be.



For this purpose, a constructive termination shall mean a termination by a Participant following a material reduction in the Participant's base salary or a Participant's incentive compensation opportunity or a material reduction in the Participant's responsibilities, in any such case without the Participant's written consent.

(c) *Limitation on Benefits*. Notwithstanding anything contained in the Plan or an Option agreement or Restricted Stock Unit agreement to the contrary, if and to the extent any acceleration of vesting of or payment or deemed payment with respect to any Option or Restricted Stock Unit (collectively, the "Payments") would, absent application of this section, be an "excess parachute payment" within the meaning of section 280G of the Code (and the regulations promulgated thereunder), such Options or Restricted Stock Units shall not accelerate and/or such payment or deemed payment shall be reduced if and to the extent necessary to avoid any such acceleration, payment or deemed payment from being an "excess parachute payment". If Payments that would otherwise be reduced or eliminated pursuant to the immediately preceding sentence would not be so reduced or eliminated if the shareholder approval requirements of section 280G(b)(5) of the Code are capable of being satisfied, the Company shall use its reasonable best efforts to cause such Payments to be submitted for such approval prior to the Change in Control giving rise to such Payments.

**8. Amendment, Modification, And Termination of Plan**

The Board at any time may terminate or suspend the Plan, and from time to time may amend or modify the Plan, *except that* no amendment, modification, or termination of the Plan shall in any manner adversely affect rights of a holder of any Incentive Award theretofore granted under the Plan, without the consent of the Participant to whom such Incentive Award was granted. Notwithstanding the foregoing, the Board may not increase the total number of shares of Common Stock subject to the Plan without shareholder approval (except pursuant to Section 4(c)).

**9. Miscellaneous Provisions**

(a) *Nontransferability of Incentive Awards*. Unless the Committee shall permit (on such terms and conditions as it shall establish) an Incentive Award to be transferred to a member of the Participant's immediate family or to a trust or similar vehicle for the benefit of such immediate family members (collectively, the "*Permitted Transferees*"), no Incentive Award shall be assignable or transferable except by will or the laws of descent and distribution, and, except to the extent required by law, no right or interest of any Participant in, and to, any Incentive Award granted under the Plan shall be subject to any lien, obligation or liability of the Participant. All rights with respect to Incentive Awards granted to a Participant under the Plan shall be exercisable during his lifetime only by such Participant or, if applicable, the Permitted Transferees. The rights of a Permitted Transferee shall be limited to the rights conveyed to such Permitted Transferee, who shall be subject to, and bound by, the terms of the agreement or agreements between the Participant and the Company.

(b) *Beneficiary Designation*. Each Participant under the Plan may from time to time name any beneficiary or beneficiaries (who may be named contingently or successively) to whom any benefit under the Plan is to be paid or by whom any right under the Plan is to be exercised in case of such Participant's death. Each designation will revoke all prior designations by the same Participant, shall be in a form prescribed by the Committee, and will be effective only when filed by the Participant in writing with the Committee during his lifetime. In the absence of any such designation, benefits remaining unpaid at the Participant's death shall be paid to, or exercised by, the Participant's surviving spouse, if any, or otherwise to, or by, his estate.

(c) *No Guarantee of Employment or Participation*. Nothing in the Plan shall be deemed to interfere with or limit in any way the right of the Company or any Subsidiary to terminate any Participant's employment at any time, or to confer upon any Participant any right to continue in the



employ of the Company or any Subsidiary. No Employee shall have a right to be selected as a Participant, or, having been so selected, to receive any future Incentive Award grants.

(d) *Tax Withholding*. The Company shall have the right to deduct from all amounts paid to a Participant in cash (whether under this Plan or otherwise) any taxes required by law to be withheld in respect of any Options or Restricted Stock Units under this Plan. No shares of Common Stock shall be issued pursuant to any Option or upon the termination of the Restricted Period applicable to any Restricted Stock Units unless and until arrangements satisfactory to the Committee shall have been made to satisfy any withholding tax obligations with respect to such Option or Restricted Stock Unit. Without limiting the generality of the foregoing, the Company shall have the right to retain, and the Committee may, subject to such terms and conditions as it may establish from time to time, permit Participants to elect to tender, Common Stock (including Common Stock issuable in respect of an Option or upon the termination of the Restricted Period applicable to a Restricted Stock Unit) to satisfy, in whole or in part, the amount required to be withheld.

(e) *Compliance with Legal and Exchange Requirements*. The Plan, the granting of Incentive Awards and exercising of Options thereunder, and the other obligations of the Company under the Plan shall be subject to all applicable Federal and State laws, rules, and regulations and to such approvals by any regulatory or governmental agency as may be required. The Company, in its discretion, may postpone the granting of Incentive Awards and the exercising of Options, the issuance or delivery of Common Stock under any Option or upon the termination of the Restricted Period applicable to any Restricted Stock Unit or any other action under the Plan for as long as necessary to permit the Company, with reasonable diligence, to complete stock exchange listing or registration or qualification of such Common Stock or other action required under any Federal or State law, rule or regulation and may require any Participant to make such representations and furnish such information as it may consider appropriate in connection with the issuance or delivery of Common Stock in compliance with applicable laws, rules, and regulations. The Company shall not be obligated by virtue of any provision of the Plan to recognize the grant of an Incentive Award or exercise of any Option or to otherwise sell or issue Common Stock in violation of any such laws, rules, or regulations; and any postponement of the grant of any Incentive Award and exercise of any Option under this provision shall not extend the term of such Incentive Awards, and neither the Company nor its directors or officers shall have any obligation or liability to the Participant with respect to any Incentive Award (or Common Stock issuable thereunder) that shall lapse because of such postponement.

(f) *Indemnification*. Each person who shall be or shall have been a member of the Committee or of the Board shall be indemnified for, and held harmless by the Company against, any loss, cost, liability, or expense that may be imposed upon, or reasonably incurred by, him in connection with, or resulting from, any claim, action, suit, or proceeding to which he may be made a party or in which he may be involved by reason of any action taken or failure to act under the Plan and against and from any and all amounts paid by him in settlement thereof, with the Company's approval, or paid by him in satisfaction of any judgment in any such action, suit, or proceeding against him; *provided* such person shall give the Company an opportunity, at its own expense, to handle and defend the same before he undertakes to handle and defend it on his own behalf. The foregoing right of indemnification shall not be exclusive and shall be independent of any other rights of indemnification to which such persons may be entitled under the Company's Articles of Incorporation or By-laws, by contract, as a matter of law, or otherwise.

(g) *Effective Date*. Subject to the approval of the shareholders of the Company, the Plan shall be effective on April 1, 2000. No Incentive Awards may be granted under the Plan after April 1, 2010.

(h) *No Limitation on Compensation*. Nothing in the Plan shall be construed to limit the right of the Company or Subsidiaries to establish other plans or to pay compensation to the Employees, in cash or property, in a manner which is not expressly authorized under the Plan.



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(i) *Deferrals*. The Committee may postpone the exercising of Options, the issuance or delivery of Common Stock under any Option or Restricted Stock Unit or any action permitted under the Plan in order to prevent the Company or any Subsidiary being denied a Federal income tax deduction with respect to any Option other than an Incentive Stock Option.

(j) *Governing Law*. The Plan shall be construed in accordance with, and governed by, the laws of the State of New York, without reference to principles of conflict of laws which would require application of the law of another jurisdiction, except to the extent that the corporate law of the State of Delaware specifically and mandatorily applies.

(k) *No Impact On Benefits*. Except as may otherwise be specifically stated under any employee benefit plan, policy or program, no amount payable in respect of any Option shall be treated as compensation for purposes of calculating an Employee's right under any such plan, policy or program.

(l) *No Constraint on Corporate Action*. Nothing in this Plan shall be construed *(i)* to limit, impair or otherwise affect the Company's right or power to make adjustments, reclassifications, reorganizations or changes of its capital or business structure, or to merge or consolidate, or dissolve, liquidate, sell, or transfer all or any part of its business or assets or (*ii*) except as provided in Section 8, to limit the right or power of the Company or any Subsidiary to take any action which such entity deems to be necessary or appropriate.



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Exhibit 10.27

FAIRPOINT COMMUNICATIONS, INC. Amended and Restated 2000 Employee Stock Incentive Plan

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**Exhibit 10.30**

December 15, 2003

***Transmitted via Federal Express***

Mr. Jack H. Thomas
18800 Peninsula Cove Lane
Cornelius, North Carolina 28031

Dear Jack:

This letter agreement shall supplement and modify your Succession Agreement with FairPoint Communications, Inc. (the "Company") dated as of December 31, 2001 (the "Succession Agreement"), which Succession Agreement shall expire by its own terms, without renewal, on December 31, 2003.

As provided in Paragraph 4(b) of the Succession Agreement, you and Wanda shall each be entitled to continued Company-provided medical coverage until each of you reaches sixty-five years of age.

You currently have 284,200 fully vested options under the Company's 1995 Stock Option Plan. Notwithstanding anything to the contrary in Paragraph 1(d)(ii) of your 1995 Incentive Stock Option Agreement, the Company hereby agrees to extend your right to exercise all of these 1995 options until March 24, 2005, subject to all other terms and conditions and other Option exercise trigger events set forth in the 1995 Option Plan and your 1995 Incentive Stock Option Agreement.

No action is needed upon expiration of the Succession Agreement with respect to your 850,000 fully vested options under the Company's 1998 Option Plan as they do not need to be exercised until a Sale of the Company or other triggering event, all as provided in the 1998 Option Plan and in your 1998 Non-Qualified Stock Option Agreement. As you are aware, such options are not presently exercisable. The 1998 Options will expire on May 21, 2008, the Normal Expiration Date, as provided in your 1998 Non-Qualified Stock Option Agreement. This extended exercise period is available to you because your December 31, 2001 cessation of employment was a Special Termination (as defined in Paragraph 4(a) of your 1998 Non-Qualified Stock Option Agreement), being an involuntary termination by the Company without cause.

The Company takes this opportunity to confirm that the restrictive covenants set forth in Paragraph 9 of the 1995 Incentive Stock Option Agreement continue in full force and effect for one year from your resignation from the Company's Board of Directors, until December 11, 2004. We are quite willing to consider a waiver of these restrictive covenants with respect to any particular opportunity you may bring to us.

If the foregoing is acceptable to you, please indicate your concurrence with the terms of this letter agreement by signing below. Please return the enclosed copies of this letter agreement in the envelope provided.

Sincerely,

/s/ GENE JOHNSON

Gene Johnson

EBJ/bcs
Encl.

ACCEPTED AND AGREED to as of
the 15th day of December 2003

/s/ JACK H. THOMAS

Jack H. Thomas

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**RESIGNATION**

I hereby resign as a director of FairPoint Communications, Inc. and of each of its subsidiaries as of December 11, 2003.

/s/ JACK H. THOMAS

Jack H. Thomas



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Exhibit 10.30

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**Exhibit 14**

**FairPoint Communications, Inc.**

**Code of Ethics for Financial Professionals**

Employees are FairPoint Communications, Inc.'s most important asset. Accordingly, FairPoint expects all its and its subsidiaries' employees to act with the highest standards of personal and professional honesty and integrity in all aspects of their activities, to comply with applicable laws, rules and regulations, to deter wrongdoing and to comply with all policies and procedures adopted by FairPoint that govern the conduct of its employees.

In response to rules adopted by the United States Securities and Exchange Commission under Section 406 of the Sarbanes-Oxley Act of 2002, FairPoint has adopted this Code of Ethics for Financial Professionals. This Code sets forth written standards that are designed to deter wrongdoing and to promote honest and ethical conduct by FairPoint's senior financial officers, including its chief executive officer, and is a supplement to FairPoint's Code of Conduct and the other policies and procedures that govern the conduct of employees of FairPoint and its subsidiaries. In addition to applying to FairPoint's chief executive officer, chief financial officer, vice president of finance and treasurer, controller and regional controllers, this Code of Ethics for Financial Professionals shall apply to all of the other persons employed by FairPoint or its subsidiaries who have significant responsibility for preparing or overseeing the preparation of FairPoint's financial statements and the other financial data included in FairPoint's periodic reports to the Securities and Exchange Commission and in other public communications made by FairPoint that are designated from time to time by the chief financial officer as senior financial professionals.

As a senior financial professional employed by FairPoint or one of its subsidiaries, I agree to use my best efforts and abilities at all times to:

1. Act with honesty and integrity and promote honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest in my personal and professional relationships, and promote honest and ethical conduct among my colleagues by setting an example of such for them through my own conduct.

2. Protect the confidentiality of information I obtain in the course of my work, except when I am authorized or otherwise legally obligated to disclose such information, and not use any confidential information for personal advantage.

3. Produce full, fair, accurate, timely and understandable disclosure in reports and other documents that FairPoint or its subsidiaries file with, or submit to, the Securities and Exchange Commission and in other public communications made by FairPoint or its subsidiaries.

4. Comply with applicable laws, rules and regulations of any federal, state or local government or of any other public or private regulatory organization.

5. Act in good faith, responsibly, with due care, competence and diligence without misrepresenting material facts or allowing my independent judgment to be subordinated to that of another.

6. Use and control all of the assets and resources employed or entrusted to me by FairPoint in a responsible and ethical manner.

7. Report any conduct that I believe could be a possible violation of this Code of Ethics for Financial Professionals promptly to FairPoint's general counsel or to a member of FairPoint's board of directors serving on the audit committee of the board.

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I understand that I am prohibited from directly or indirectly taking any action to fraudulently influence, coerce, manipulate or mislead FairPoint's or its subsidiaries' independent public auditors for any purpose.

I also understand that I will be held accountable for my adherence to this Code of Ethics for Financial Professionals, and that my failure to observe the terms of this Code of Ethics for Financial Professionals may result in disciplinary action up to and including immediate termination. In addition, I understand that my agreement to comply with all of the terms of this Code of Ethics for Financial Professionals does not constitute a contract of employment. Finally, I understand that violations of this Code of Ethics for Financial Professionals may constitute violations of law, which could result in civil and criminal penalties for me, my supervisors and/or FairPoint.

**I acknowledge that I have received and read FairPoint's Code of Ethics for Financial Professionals, have had an opportunity to ask questions about it and understand all of my obligations under it.**

Please print your name: ______________________________

Please sign here: ______________________________ Date ________________________



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Exhibit 14

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**Exhibit 21**

**FAIRPOINT COMMUNICATIONS, INC.**
**(formerly known as MJD Communications, Inc.)**
**SUBSIDIARIES**

| Name | Jurisdiction of Incorporation |
| --- | --- |
| **ST Enterprises, Ltd.** | **Kansas** |
| STE/NE Acquisition Corp. (d/b/a Northland Telephone Co. of Vermont) | Delaware |
| Sunflower Telephone Company, Inc. | Kansas |
| Northland Telephone Company of Maine, Inc. | Maine |
| ST Computer Resources, Inc. | Kansas |
| ST Long Distance, Inc. | Delaware |
| **MJD Ventures, Inc.** | **Delaware** |
| Marianna and Scenery Hill Telephone Company | Pennsylvania |
| Marianna Tel, Inc. | Pennsylvania |
| The Columbus Grove Telephone Company | Ohio |
| Quality One Technologies, Inc. | Ohio |
| C-R Communications, Inc. | Illinois |
| C-R Telephone Company | Illinois |
| C-R Cellular, Inc. | Illinois |
| C-R Long Distance, Inc. | Illinois |
| Taconic Telephone Corp. | New York |
| Taconic Cellular Corp. | New York |
| Taconic Technology Corp. | New York |
| Taconic TelCom Corp. | New York |
| Taconet Wireless Corp. | New York |
| Taconet Corp. | New York |
| Ellensburg Telephone Company | Washington |
| Elltel Long Distance Corp. | Delaware |
| Sidney Telephone Company | Maine |
| Utilities, Inc. | Maine |
| Standish Telephone Company | Maine |
| China Telephone Company | Maine |
| Maine Telephone Company | Maine |
| UI Long Distance, Inc. | Maine |
| UI Communications, Inc. | Maine |
| UI Telecom, Inc. | Maine |
| Telephone Service Company | Maine |
| Chouteau Telephone Company | Oklahoma |
| Chouteau Telecommunications & Electronics, Inc. | Oklahoma |
| Chautauqua and Erie Telephone Corporation | New York |
| Chautauqua & Erie Communications, Inc. (d/b/a C & E Teleadvantage) | New York |
| Chautauqua & Erie Network, Inc. | New York |
| C & E Communications, Ltd. | New York |
| Western New York Cellular, Inc. | New York |
| Chautauqua Cable, Inc. | New York |
| The Orwell Telephone Company | Ohio |
| Orwell Communications, Inc. | Ohio |
| GTC Communications, Inc. (f/k/a TPG Communications, Inc.) | Delaware |
| St. Joe Communications, Inc. | Florida |
| GTC, Inc. | Florida |
| GTC Finance Corporation (f/k/a TPGC Finance Corporation) | Delaware |
| Peoples Mutual Telephone Company | Virginia |
| Peoples Mutual Services Company | Virginia |

| | |
|---|---|
| Peoples Mutual Long Distance Company | Virginia |
| Fremont Telcom Co. | Idaho |
| Fremont Broadband, LLC | Delaware |
| Fretel Communications, LLC | Idaho |
| Comerco, Inc. | Washington |
| YCOM Networks, Inc. | Washington |
| FairPoint Berkshire Corporation | New York |
| Community Service Telephone Co. | Maine |
| Commtel Communications Inc. | Maine |
| **MJD Services Corp.** | **Delaware** |
| Bluestem Telephone Company | Delaware |
| Big Sandy Telecom, Inc. | Delaware |
| Odin Telephone Exchange, Inc. | Illinois |
| Columbine Telecom Company (f/k/a Columbine Acquisition Corp.) | Delaware |
| Ravenswood Communications, Inc. | Illinois |
| The El Paso Telephone Company | Illinois |
| Gemcell, Inc. | Illinois |
| El Paso Long Distance Company | Illinois |
| Yates City Telephone Company | Illinois |
| **FairPoint Carrier Services, Inc.** | **Delaware** |
| (f/k/a FairPoint Communications Solutions Corp., f/k/a FairPoint Communications Corp.) | |
| FairPoint Communications Solutions Corp.—New York | Delaware |
| FairPoint Communications Solutions Corp.—Virginia | Delaware |
| **FairPoint Broadband, Inc.** | **Delaware** |
| **MJD Capital Corp.** | **South Dakota** |



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Exhibit 21

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**Exhibit 31.1**

**CERTIFICATION**

I, Eugene B. Johnson, certify that:

1. I have reviewed this annual report on Form 10-K of FairPoint Communications, Inc. (the "Company");

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this annual report;

4. The Company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in the Securities Exchange Act of 1934, as amended (the "Exchange Act") rule 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act rules 13a-15(f) and 15d-15(f)) for the Company and we have:

   (i) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report was being prepared;

   (ii) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (iii) evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this annual report; and

   (iv) disclosed in this report any change in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter (the Company's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting; and

5. The Company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the audit committee of Company's board of directors (or persons performing the equivalent function):

   (v) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonable likely to adversely affect the Company's ability to record, process, summarize and report financial information; and

   (vi) any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal controls over financial reporting.

Date: March 23, 2004

/s/ EUGENE B. JOHNSON

Eugene B. Johnson
*Chief Executive Officer*

**Exhibit 31.2**

**CERTIFICATION**

I, Walter E. Leach, Jr., certify that:

1. I have reviewed this annual report on Form 10-K of FairPoint Communications, Inc. (the "Company");

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this annual report;

4. The Company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in the Securities Exchange Act of 1934, as amended (the "Exchange Act") rule 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in the Exchange Act rules 13a-15(f) and 15d-15(f)) for the Company and we have:

    (i) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report was being prepared;

    (ii) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    (iii) evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this annual report; and

    (iv) disclosed in this report any change in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter (the Company's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting; and

5. The Company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the audit committee of Company's board of directors (or persons performing the equivalent function):

    (i) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonable likely to adversely affect the Company's ability to record, process, summarize and report financial information; and

    (ii) any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal controls over financial reporting.

Date: March 23, 2004

/s/ WALTER E. LEACH, JR.

Walter E. Leach, Jr.
*Chief Executive Officer*

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**Exhibit 32.1**

**CERTIFICATION PURSUANT TO**
**18 U.S.C. SECTION 1350,**
**AS ADOPTED PURSUANT TO**
**SECTION 906 OF THE SARBANES OXLEY ACT OF 2002**

In connection with the Annual Report of FairPoint Communications, Inc. (the "Company") on Form 10-K for the year ended December 31, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Eugene B. Johnson, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes Oxley Act of 2002, that:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ EUGENE B. JOHNSON

Eugene B. Johnson
*Chief Executive Officer*

Date: March 23, 2004

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

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**Exhibit 32.2**

**CERTIFICATION PURSUANT TO**
**18 U.S.C. SECTION 1350,**
**AS ADOPTED PURSUANT TO**
**SECTION 906 OF THE SARBANES OXLEY ACT OF 2002**

In connection with the Annual Report of FairPoint Communications, Inc. (the "Company") on Form 10-K for the year ended December 31, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Walter E. Leach, Jr., Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes Oxley Act of 2002, that:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ WALTER E. LEACH, JR.

Walter E. Leach, Jr.
*Chief Executive Officer*

Date: March 23, 2004

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

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**Exhibit 99.1**

# *Orange County—Poughkeepsie Limited Partnership*

**Independent Auditors' Report**

**Financial Statements**
Years Ended December 31, 2003, 2002 and 2001

## ORANGE COUNTY—POUGHKEEPSIE LIMITED PARTNERSHIP

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**INDEPENDENT AUDITORS' REPORT**

To the Partners of Orange County—Poughkeepsie Limited Partnership:

We have audited the accompanying balance sheets of Orange County—Poughkeepsie Limited Partnership (the "Partnership") as of December 31, 2003 and 2002, and the related statements of operations, changes in partners' capital, and cash flows for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the Partnership's management. Our responsibility is to express an opinion on these 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Partnership as of December 31, 2003 and 2002, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America.

/s/ DELOITTE & TOUCHE LLP
New York, New York
February 23, 2004

**ORANGE COUNTY—POUGHKEEPSIE LIMITED PARTNERSHIP**

**BALANCE SHEETS**
**DECEMBER 31, 2003 AND 2002**
**(Dollars in Thousands)**

| | 2003 | 2002 |
|---|---|---|
| **ASSETS** | | |
| CURRENT ASSETS: | | |
| Accounts receivable, net of allowances of $20 and $1 in 2003 and 2002, respectively | $ 73 | $ 117 |
| Unbilled revenue | 866 | 1,125 |
| Due from general partner | 19,766 | 33,881 |
| Prepaid expenses and other current assets | 48 | 34 |
| Total current assets | 20,753 | 35,157 |
| PROPERTY, PLANT AND EQUIPMENT—Net | 29,622 | 29,473 |
| DEFERRED CHARGES AND OTHER ASSETS—Net | 1 | 2 |
| TOTAL ASSETS | $ 50,376 | $ 64,632 |
| **LIABILITIES AND PARTNERS' CAPITAL** | | |
| CURRENT LIABILITIES: | | |
| Accounts payable and accrued liabilities | $ 348 | $ 1,235 |
| Advance billings | 310 | 247 |
| Total current liabilities | 658 | 1,482 |
| COMMITMENTS AND CONTINGENCIES (NOTES 5 and 7) | | |
| PARTNERS' CAPITAL | 49,718 | 63,150 |
| TOTAL LIABILITIES AND PARTNERS' CAPITAL | $ 50,376 | $ 64,632 |

See notes to financial statements.



**ORANGE COUNTY—POUGHKEEPSIE LIMITED PARTNERSHIP**

**STATEMENTS OF OPERATIONS**
**YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001**
**(Dollars in Thousands)**

| | 2003 | 2002 | 2001 |
|---|---|---|---|
| OPERATING REVENUE: | | | |
| Service revenue | $ 144,643 | $ 114,591 | $ 81,952 |
| OPERATING COSTS AND EXPENSES: | | | |
| Cost of service | 17,248 | 11,652 | 9,691 |
| General and administrative | 2,123 | 2,900 | 2,625 |
| Depreciation and amortization | 5,179 | 4,225 | 3,583 |
| Total operating costs and expenses | 24,550 | 18,777 | 15,899 |
| OPERATING INCOME | 120,093 | 95,814 | 66,053 |
| INTEREST AND OTHER INCOME—Net | 1,475 | 1,555 | 1,167 |
| NET INCOME | $ 121,568 | $ 97,369 | $ 67,220 |

See notes to financial statements.

## ORANGE COUNTY—POUGHKEEPSIE LIMITED PARTNERSHIP

### STATEMENTS OF CHANGES IN PARTNERS' CAPITAL
### YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001
### (Dollars in Thousands)

| | General Partner | | Limited Partners | | |
|---|---|---|---|---|---|
| | NYNEX Mobile Limited Partnership 2 | Verizon Wireless of the East LP | Taconic Telephone Corporation | Warwick Valley Telephone Company | Total Partners' Capital |
| BALANCE, JANUARY 1, 2001 | $ 41,277 | $ — | $ 3,642 | $ 3,642 | $ 48,561 |
| Net income | 57,138 | — | 5,041 | 5,041 | 67,220 |
| Distribution to partners | (59,500) | — | (5,250) | (5,250) | (70,000) |
| BALANCE, DECEMBER 31, 2001 | 38,915 | — | 3,433 | 3,433 | 45,781 |
| Net income | 46,092 | 36,671 | 7,303 | 7,303 | 97,369 |
| Distribution to partners | (25,500) | (42,500) | (6,000) | (6,000) | (80,000) |
| Transfer of Partnership interest | (59,507) | 59,507 | — | — | — |
| BALANCE, DECEMBER 31, 2002 | — | 53,678 | 4,736 | 4,736 | 63,150 |
| Net income | — | 103,332 | 9,118 | 9,118 | 121,568 |
| Distribution to partners | — | (114,750) | (10,125) | (10,125) | (135,000) |
| BALANCE, DECEMBER 31, 2003 | $ — | $ 42,260 | $ 3,729 | $ 3,729 | $ 49,718 |

See notes to financial statements.



## ORANGE COUNTY—POUGHKEEPSIE LIMITED PARTNERSHIP

### STATEMENTS OF CASH FLOWS
### YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001
### (Dollars in Thousands)

| | 2003 | 2002 | 2001 |
|---|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net income | $ 121,568 | $ 97,369 | $ 67,220 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Provision for uncollectible accounts receivable, net of recoveries | 30 | 0 | (31) |
| Depreciation and amortization | 5,179 | 4,225 | 3,583 |
| Changes in certain assets and liabilities: | | | |
| Accounts receivable | 14 | 378 | 1,795 |
| Unbilled revenue | 259 | 420 | (433) |
| Prepaid expenses and other current assets | (14) | 104 | (30) |
| Deferred charges and other assets | 1 | 3 | 2 |
| Accounts payable and accrued liabilities | (887) | 901 | (1,646) |
| Advance billings | 63 | 51 | 24 |

| | | | |
|---|---|---|---|
| Net cash provided by operating activities | 126,213 | 103,451 | 70,484 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Capital expenditures | (5,328) | (7,706) | (4,887) |
| Proceeds from sale of property, plant and equipment | — | 64 | — |
| Net cash used in investing activities | (5,328) | (7,642) | (4,887) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Decrease (increase) in due from general partner, net | 14,115 | (15,809) | 4,403 |
| Distribution to partners | (135,000) | (80,000) | (70,000) |
| Net cash used in financing activities | (120,885) | (95,809) | (65,597) |
| INCREASE IN CASH | — | — | — |
| CASH, BEGINNING OF YEAR | — | — | — |
| CASH, END OF YEAR | $ — | $ — | $ — |

See notes to financial statements.



**ORANGE COUNTY—POUGHKEEPSIE LIMITED PARTNERSHIP**

**NOTES TO FINANCIAL STATEMENTS**
**YEARS ENDED DECEMBER 31, 2003, 2002, AND 2001**
**(Dollars in Thousands)**

## 1. ORGANIZATION AND MANAGEMENT

***Orange County—Poughkeepsie Limited Partnership***—Orange County—Poughkeepsie Limited Partnership (the "Partnership") was formed in 1987. The principal activity of the Partnership is providing wholesale cellular service to resellers who operate principally in the Orange County and Poughkeepsie, New York service areas.

The partners and their respective ownership percentages as of December 31, 2003 are as follows:

| | |
|---|---|
| Managing and general partner: | |
| Verizon Wireless of the East LP* | 85.0% |
| Limited partners: | |
| Taconic Telephone Corporation ("Taconic") | 7.5% |
| Warwick Valley Telephone Company ("Warwick") | 7.5% |

* Prior to August 15, 2002 NYNEX Mobile LP 2 was the managing and general partner of the Partnership. On August 15, 2002 NYNEX Mobile LP 2 transferred its 85% partnership interest to its affiliate, Verizon Wireless of the East LP. Verizon Wireless of the East LP is a partnership between Verizon Wireless of Georgia LLC (the General Partner) and Verizon Wireless Acquisition South LLC (the LP), which hold a controlling interest, and Price Communications which has a preferred interest. Verizon Wireless of the East LP is a partnership which is consolidated by Cellco Partnership (d/b/a Verizon Wireless) ("Cellco").

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

***Revenue Recognition***—The Partnership earns revenue by providing access to the network (access revenue) and for usage of the network (airtime/usage revenue), which includes roaming and long distance revenue. In general, access revenue is billed one month in advance and is recognized when earned; the unearned portion is classified in advance billings. Airtime/usage revenue, roaming revenue and long distance revenue are recognized when service is rendered and included in unbilled revenue until billed. The Partnership's revenue recognition policies are in accordance with the Securities and Exchange Commission's Staff Accounting Bulletin ("SAB") No. 101, *Revenue Recognition in Financial Statements* and Staff Accounting Bulletin ("SAB") No. 104, *Revenue Recognition.*

Approximately 98%, 98%, and 96% of the Partnership's 2003, 2002 and 2001 revenue is affiliate revenue due to the fact that Cellco is the Partnership's primary reseller. The wholesale rates charged to Cellco do not necessarily reflect current market rates. The Partnership continues to re-evaluate the rates and expects these rates to be reduced in the future consistent with market trends and the terms of the limited partnership agreement (See Note 4).

Cellular service revenues resulting from a cellsite agreement with Cellco are recognized based upon an allocation of airtime minutes (See Note 4).

***Use of Estimates***—The preparation of 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 reported amounts of assets and liabilities and the disclosure of contingent



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assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Estimates are used for, but not limited to, the accounting for: allocations, allowance for uncollectible accounts receivable, unbilled revenue, depreciation and amortization, useful life and impairment of assets, accrued expenses, taxes, and contingencies. Estimates and assumptions are periodically reviewed and the effects of any material revisions are reflected in the financial statements in the period that they are determined to be necessary.

***Operating Expenses***—Operating expenses include expenses incurred directly by the Partnership, as well as an allocation of administrative and operating costs incurred by the general partner or its affiliates on behalf of the Partnership. Services performed on behalf of the Partnership are provided by employees of Cellco. These employees are not employees of the Partnership and therefore, operating expenses include direct and allocated charges of salary and employee benefit costs for the services provided to the Partnership. The Partnership believes such allocations, based on the Partnership's percentage of customers or gross adds, as applicable, are reasonable.

***Property, Plant and Equipment***—Property, plant and equipment primarily represents costs incurred to construct and enhance Mobile Telephone Switching Offices ("MTSOs") and cell sites within the Partnership's network. The cost of property, plant and equipment is depreciated over its estimated useful life using the straight-line method of accounting. Leasehold improvements are amortized over the shorter of their estimated useful lives or the term of the related lease. Major improvements to existing plant and equipment are capitalized. Routine maintenance and repairs that do not extend the life of the plant and equipment are charged to expense as incurred.

Upon the sale or retirement of property, plant and equipment, the cost and related accumulated depreciation or amortization is eliminated from the accounts and any related gain or loss is reflected in the Statements of Operations.

Network engineering costs incurred during the construction phase of the Partnership's network and real estate properties under development are capitalized as part of property, plant and equipment and recorded as construction in progress until the projects are completed and placed into service.

***FCC Licenses***—The Federal Communications Commission ("FCC") issues licenses that authorize cellular carriers to provide service in specific cellular geographic service areas. The FCC grants licenses for terms of up to ten years. In 1993 the FCC adopted specific standards to apply to cellular renewals, concluding it will reward a license renewal to a cellular licensee that meets certain standards of past performance. Historically, the FCC has granted license renewals routinely. The current term of both of the Partnership's FCC licenses expire in January 2008. Both of the Partnership's licenses are recorded on the books of Cellco. Cellco believes it will be able to meet all requirements necessary to secure renewal of the Partnership's cellular licenses.

***Valuation of Assets***—Long-lived assets, including property, plant and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. The carrying amount of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the



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asset. The impairment loss, if determined to be necessary, would be measured as the amount by which the carrying amount of the asset exceeds the fair value of the asset.

The FCC licenses recorded on the books of Cellco are evaluated for impairment, by Cellco, under the guidance set forth in Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets." The FCC licenses are treated as an indefinite life intangible asset under the provisions of SFAS No. 142 and are not amortized, but rather are tested for impairment annually or between annual dates, if events or circumstances warrant. All of the licenses in Cellco's nationwide footprint are tested in the aggregate for impairment under SFAS No. 142. When testing the carrying value of the wireless licenses for impairment, Cellco determines the fair value of the aggregated wireless licenses by subtracting from enterprise discounted cash flows (net of debt) the fair value of all of the other net tangible and intangible assets of Cellco, including previously unrecognized intangible assets. If the fair value of the aggregated wireless licenses as determined above is less than the aggregated carrying amount of the licenses, an impairment will be recognized by Cellco. Any impairment loss recognized by Cellco will be allocated to its consolidated subsidiaries based upon a reasonable methodology. No impairment was recognized in 2003 and 2002. Future tests for impairment will be performed by Cellco at least annually and more often if events or circumstances warrant.

***Concentrations***—To the extent the Partnership's customer receivables become delinquent, collection activities commence. The general partner accounts for 88.8% and 88.2% of the accounts receivable balance at December 31, 2003, and 2002 respectively. The Partnership maintains an allowance for losses based on the expected collectibility of accounts receivable.

Approximately 98%, 98%, and 96% of the Partnership's 2003, 2002 and 2001 revenue is affiliate revenue.

The general partner relies on local and long-distance telephone companies, some of whom are related parties, and other companies to provide certain communication services. Although management believes alternative telecommunications facilities could be found in a timely manner, any disruption of these services could potentially have an adverse impact on the Partnership's operating results.

Although the general partner attempts to maintain multiple vendors for equipment, which are important components of its operations, they are currently acquired from only a few sources. Certain of these products are in turn utilized by the Partnership and are important components of the Partnership's operations. If the suppliers are unable to meet the general partner's needs as it builds out its network infrastructure and sells service and equipment, delays and increased costs in the expansion of the Partnership's network infrastructure or losses of potential customers could result, which would adversely affect operating results.

***Financial Instruments***—The Partnership's trade receivables and payables are short-term in nature, and accordingly, their carrying value approximates fair value.

***Income Taxes***—The Partnership is not a taxable entity for Federal and state income tax purposes. Any taxable income or loss is apportioned to the partners based on their respective partnership interests and is reported by them individually.



***Segments***—The Partnership has one reportable business segment and operates domestically only. The Partnership's products and services are materially comprised of wireless telecommunications services.

***Due from General Partner***—Due from General Partner principally represents the Partnership's cash position. The general partner manages all cash and financing activities of the Partnership. As such, the change in Due from General Partner is reflected as a financing activity in the Statements of Cash Flows. Additionally, administrative and operating costs incurred by the general partner on behalf of the Partnership are charged to the Partnership through this account. Interest income is based on the average monthly outstanding balance in this account and is calculated by applying Cellco's average cost of borrowing from Verizon Global Funding, a wholly owned subsidiary of Verizon Communications. The cost of borrowing was approximately 5.0%, 5.5%, and 4.6% at December 31, 2003, 2002 and 2001, respectively. Included in Other Income, Net is net interest income related to the Due from General Partner balance of $1,472, $1,553 and $1,167 for the years ended December 31, 2003, 2002 and 2001, respectively.

***Recently Issued Accounting Pronouncements***—In June 2001, the Financial Accounting Standards Board, ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 143, "Accounting for Asset Retirement Obligations." This standard requires entities to recognize the fair value of any legal obligation associated with the retirement of long-lived assets and to capitalize that amount as a part of the book value of the long-lived asset. That cost is then depreciated over the remaining life of the underlying long-lived asset. The Partnership adopted the standard January 1, 2003. The adoption of SFAS No. 143 had no material effect on the Partnership's financial statements.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." This standard re-addresses financial accounting and reporting for the impairment or disposal of long-lived assets. It concludes that one accounting model be used for long-lived assets to be disposed of by sale and broadens the presentation of discontinued operations to include more disposal transactions. The Partnership adopted the standard effective January 1, 2002. The adoption of SFAS No. 144 had no material effect on the Partnership's financial statements.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities". This standard nullifies Emerging Issue Task Force (EITF) Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." This standard requires the recognition of a liability for a cost associated with an exit or disposal activity at the time the liability is incurred, rather than at the commitment date to exit a plan as required by EITF 94-3. The Partnership adopted this standard January 1, 2003. The adoption of SFAS No. 146 had no material effect on the Partnership's financial statements.

In May 2003 the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." This standard establishes guidance for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances) because that financial statement embodies an obligation of the issuer. Many of those instruments were previously classified as equity.



This standard was effective for financial instruments entered into or modified after May 31, 2003. For existing instruments created before the issuance date of this statement, this standard was effective July 1, 2003. The adoption of SFAS 150 had no material effect on the Partnership's financial statements.

***Reclassifications***—Certain reclassifications have been made to the 2002 and 2001 year financial statements to conform to the current year presentation.

***Distributions***—The Partnership is required to make distributions to its partners on a quarterly basis based upon the Partnership's operating results, cash availability and financing needs as determined by the general partner at the date of the distribution. In January 2004, the Partnership made a distribution of $22 million to its partners.

**3. PROPERTY, PLANT AND EQUIPMENT, NET**

Property, plant and equipment, net, consists of the following:

| (Dollars in Thousands) | Useful Lives | December 31, 2003 | 2002 |
|---|---|---|---|
| Buildings and improvements | 10-40 years | $ 11,245 | $ 10,521 |
| Wireless plant equipment | 3-15 years | 44,525 | 40,502 |
| Furniture, fixtures and equipment | 2-7 years | 318 | 318 |
| | | 56,088 | 51,341 |
| Less accumulated depreciation | | (26,466) | (21,868) |
| Property, plant and equipment, net | | $ 29,622 | $ 29,473 |

Property, plant, and equipment, net, includes the following:

Allocated capitalized network engineering costs of $415 and $466 were recorded during the years ended December 31, 2003 and 2002 respectively.

Construction-in-progress included in certain of the classifications shown above, principally wireless plant equipment, amounted to $852 and $2,373 at December 31, 2003 and 2002 respectively.

Depreciation expense for the years ended December 31, 2003, 2002 and 2001 was $5,179, $4,225 and $3,582 respectively.



## 4. TRANSACTIONS WITH AFFILIATES

Significant transactions with affiliates are summarized as follows:

| (Dollars in Thousands) | Years Ended December 31, 2003 | 2002 | 2001 |
|---|---|---|---|
| **Revenue:** | | | |
| Operating revenues (b) | $ 138,796 | $ 109,232 | $ 76,609 |
| Cellsite allocated revenues (c) | 2,963 | 3,037 | 1,981 |
| **Cost of Service:** | | | |
| Direct telecommunication charges (a) | 274 | 302 | 335 |
| Allocation of cost of service (a) | 3,315 | 1,105 | 1,737 |
| Allocation of switch usage cost (a) | 7,256 | 5,077 | 3,760 |
| **Selling, General and Administrative:** | | | |
| Allocation of certain general and administrative expenses (a) | 1,797 | 1,399 | 1,497 |

(a) Expenses were allocated based on the Partnership's percentage of customers, gross adds or minutes of use where applicable. The Partnership believes the allocations are reasonable.

(b) Affiliate operating revenues primarily represent revenues generated from transactions with Cellco, the Partnership's primary reseller. The wholesale rates charged to Cellco do not necessarily reflect current market rates. The Partnership continues to re-evaluate the rates and expects these rates to be reduced in the future consistent with market trends and the terms of the limited partnership agreement.

(c) Cellsite allocated revenues, based on the Partnership's percentage of minutes of use, result from the Partnership sharing a cell site with the Catskills RSA Limited Partnership, an affiliate entity.

## 5. COMMITMENTS

The general partner, on behalf of the Partnership, and the Partnership have entered into operating leases for facilities and equipment used in its operations. Some lease contracts include renewal options that include rent expense adjustments based on the Consumer Price Index. For the years ended December 31, 2003, 2002 and 2001, the Partnership recognized a total of $1,234, $1,100 and $934, respectively, as rent expense related to payments under these operating leases, which is included in cost of service and general and administrative expenses in the accompanying Statements of Operations.

Future minimum rental commitments under noncancelable operating leases, excluding renewal options which the Partnership intends to exercise, for the years shown are as follows:

| (Dollars in Thousands) Years | Amount |
|---|---|
| 2004 | $ 1,248 |
| 2005 | 1,161 |
| 2006 | 1,062 |

| | | |
|---|---|---|
| 2007 | | 878 |
| 2008 | | 764 |
| 2009 and thereafter | | 851 |
| Total minimum payments | $ | 5,964 |



From time to time the general partner enters into purchase commitments, primarily for network equipment, on behalf of the Partnership.

### 6. VALUATION AND QUALIFYING ACCOUNTS

| (Dollars in Thousands) | Balance at Beginning of the Year | Additions Charged to Operations | Write-offs Net of Recoveries | Balance at End of the Year |
|---|---|---|---|---|
| Accounts Receivable Allowances: | | | | |
| 2002 | $ — | $ 1 | $ — | $ 1 |
| 2003 | 1 | 49 | (30) | 20 |

### 7. CONTINGENCIES

Cellco is subject to lawsuits and other claims including class actions, product liability, patent infringement, intellectual property, antitrust, partnership disputes, and claims involving relations with resellers and agents. Cellco is also defending lawsuits against Cellco and other participants in the wireless industry alleging various adverse effects as a result of wireless phone usage. Various consumer class action lawsuits allege that the Cellco breached contracts with consumers, violated certain state consumer protection laws and other statutes and defrauded customers through concealed or misleading billing practices. Certain of these lawsuits and other claims may impact the Partnership. These litigation matters may involve indemnification obligations by third parties and/or affiliated parties covering all or part of any potential damage awards against Cellco and the Partnership and/or insurance coverage. Attorneys general in a number of states are investigating certain sales, marketing and advertising practices. All of the above matters are subject to many uncertainties, and outcomes are not predictable with assurance.

The Partnership may be allocated a portion of the damages that may result upon adjudication of these matters if the claimants prevail in their actions. Consequently, the ultimate liability with respect to these matters at December 31, 2003 cannot be ascertained. The potential effect, if any, on the financial condition and results of operations of the Partnership, in the period in which these matters are resolved, may be material.

In addition to the aforementioned matters, Cellco is subject to various other legal actions and claims in the normal course of business. While Cellco's legal counsel cannot give assurance as to the outcome of each of these matters, in management's opinion, based on the advice of such legal counsel, the ultimate liability with respect to any of these actions, or all of them combined, will not materially affect the financial position or operating results of the Partnership.

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QuickLinks

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**Exhibit 99.2**

## INDEPENDENT AUDITORS' REPORT

To the Partners of
Illinois Valley Cellular RSA 2-I Partnership

We have audited the accompanying balance sheets of Illinois Valley Cellular RSA 2-I Partnership (an Illinois partnership) as of December 31, 2002 and 2001, and the related statements of income, partners' capital, and cash flows for each of three years in the period ended December 31, 2002. These financial statements are the responsibility of the Operating Partner's management. Our responsibility is to express an opinion on these 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as, evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Illinois Valley Cellular RSA 2-I Partnership as of December 31, 2002 and 2001, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

/s/ KIESLING ASSOCIATES LLP
Madison, Wisconsin
March 1, 2003



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## ILLINOIS VALLEY CELLULAR RSA 2-1 PARTNERSHIP

### BALANCE SHEETS
**December 31, 2002 and 2001**

| | 2002 | 2001 |
|---|---|---|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | $ 117,870 | $ 102,338 |
| Accounts receivable | | |
| Due from customers | | |
| Less allowance of $116,500 and $110,000, respectively | 1,079,795 | 1,176,246 |
| Affiliates | 233,674 | 115,664 |
| Other | 58,018 | 65,137 |
| Prepaids | 97,384 | 3,446 |
| | 1,586,741 | 1,462,831 |
| PROPERTY AND EQUIPMENT | | |
| Plant in service | 13,342,101 | 11,149,052 |
| Less accumulated depreciation | (6,833,198) | (6,022,436) |
| | 6,508,903 | 5,126,616 |
| Plant under construction | 5,704 | 5,845 |
| | 6,514,607 | 5,132,461 |
| OTHER NONCURRENT ASSETS | | |
| Investments | 159,144 | 235,647 |
| TOTAL ASSETS | $ 8,260,492 | $ 6,830,939 |

**ILLINOIS VALLEY CELLULAR RSA 2-1 PARTNERSHIP**

**BALANCE SHEETS**
**December 31, 2002 and 2001**

| | 2002 | 2001 |
|---|---|---|
| LIABILITIES AND PARTNERS' CAPITAL | | |
| CURRENT LIABILITIES | | |
| Current portion of long-term debt | $ — | $ 659,340 |
| Capital lease obligation | 21,287 | — |
| Notes Payable | 1,000,000 | — |
| Accounts Payable: | | |
| Trade | 204,101 | 24,314 |
| Affiliates | 608,248 | 316,154 |
| Other | 290,254 | 244,508 |
| Accrued liabilities—affiliate | 136,559 | 98,078 |
| Accrued commissions | 71,288 | 76,912 |
| Advance billings | 279,853 | 246,652 |
| Other | 168,064 | 122,044 |
| | 2,779,654 | 1,788,002 |
| LONG-TERM OBLIGATIONS | | |
| Capital lease obligation | 96,620 | |
| PARTNERS' CAPITAL | 5,384,218 | 5,042,937 |
| TOTAL LIABILITIES AND PARTNERS' CAPITAL | $ 8,260,492 | $ 6,830,939 |

The accompanying notes are an integral part of these financial statements



**ILLINOIS VALLEY CELLULAR RSA 2-I PARTNERSHIP**

**STATEMENTS OF INCOME**
**Years Ended December 31, 2002, 2001 and 2000**

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| OPERATING REVENUES | | | |
| Retail service | $ 6,513,308 | $ 6,123,233 | $ 6,095,261 |
| Roamer service | 3,131,185 | 4,020,995 | 3,184,181 |
| Equipment sales | 181,442 | 180,670 | 149,909 |
| Miscellaneous services | 1,069,743 | 906,974 | 693,533 |
| | 10,895,678 | 11,231,872 | 10,122,884 |
| OPERATING EXPENSES | | | |
| Cost of services | 4,572,661 | 4,358,681 | 3,439,668 |
| Cost of equipment sales | 1,017,085 | 937,143 | 890,065 |
| Selling, general and administrative | 3,986,972 | 3,723,723 | 3,229,256 |
| Depreciation | 956,339 | 748,968 | 772,698 |
| | 10,533,257 | 9,768,515 | 8,331,687 |
| OPERATING INCOME | 362,421 | 1,463,357 | 1,791,197 |
| OTHER INCOME (EXPENSES) | | | |
| Interest expense | (43,862) | (78,081) | (154,861) |
| Interest during construction | 9,534 | — | — |

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Other, net | 13,188 | 28,039 | 33,284 |
| | (21,140) | (50,042) | (121,577) |
| NET INCOME | $ 341,281 | $ 1,413,315 | $ 1,669,620 |

The accompanying notes are an integral part of these financial statements.



**ILLINOIS VALLEY CELLULAR RSA 2-I PARTNERSHIP**

**STATEMENTS OF PARTNERS' CAPITAL**
**December 31, 2002, 2001, and 2000**

| | Total |
|---|---|
| Balance at December 31, 1999 | $ 2,859,792 |
| Net income | 1,669,620 |
| Distribution | (549,994) |
| Balance at December 31, 2000 | 3,979,418 |
| Net income | 1,413,315 |
| Distribution | (349,796) |
| Balance at December 31, 2001 | 5,042,937 |
| Net income | 341,281 |
| Balance at December 31, 2002 | $ 5,384,218 |

The accompanying notes are an integral part of these financial statements.



**ILLINOIS VALLEY CELLULAR RSA 2-I PARTNERSHIP**

**STATEMENTS OF CASH FLOWS**
**Years Ended December 31, 2002, 2001, and 2000**

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Net income | $ 341,281 | $ 1,413,315 | $ 1,669,620 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation | 956,539 | 748,968 | 772,698 |
| Provision for losses on accounts receivable | (6,500) | (24,000) | (8,000) |
| Changes in assets and liabilities: | | | |
| (Increase) Decrease in: | | | |
| Accounts receivable | (7,940) | (225,823) | (9,609) |
| Prepaids | (93,938) | — | — |
| Increase (Decrease) in: | | | |
| Accounts payable | 517,627 | 102,857 | (135,409) |
| Other | 112,078 | 95,298 | (47,291) |
| Net cash provided by operating activities | 1,819,147 | 2,110,615 | 2,242,009 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Capital expenditures | (2,214,901) | (995,505) | (889,583) |
| Proceeds from the sale of investments, net | 76,503 | 87,431 | 88,012 |
| Net cash used in investing activities | (2,138,398) | (908,074) | (801,571) |

CASH FLOWS FROM FINANCING ACTIVITIES

| | | | |
|---|---|---|---|
| Proceeds from short-term borrowings | 1,000,000 | — | — |
| Repayment of long-term borrowings | (659,340) | (801,751) | (933,040) |
| Payments of capital lease obligations | (5,877) | — | — |
| Partnership distribution | — | (349,796) | (549,994) |
| Net cash provided by/(used in) financing activities | 334,783 | (1,151,547) | (1,483,034) |
| Net Increase (Decrease) in Cash and Cash Equivalents | 15,532 | 50,994 | (42,596) |
| Cash and Cash Equivalents at Beginning of Year | 102,338 | 51,344 | 93,940 |
| Cash and Cash Equivalents at End of Year | $ 117,870 | $ 102,338 | $ 51,344 |

The accompanying notes are an integral part of these financial statements.



**ILLINOIS VALLEY CELLULAR RSA 2-I PARTNERSHIP**

**NOTES TO FINANCIAL STATEMENTS**

**NOTE 1. ORGANIZATION**

The Illinois Valley Cellular RSA 2-I Partnership (Partnership) is organized pursuant to the provisions of the Illinois Uniform Partnership Act. The Partnership was formed on November 8, 1989, to fund, establish, and provide cellular service within a portion of the Illinois RSA 2 Cellular Geographic Service Area. At December 31, 2002, 2001, and 2000, the general partners and their respective ownership percentages in the Partnership were as follows:

| Partner | Percentage |
|---|---|
| Verizon Wireless | 40.00% |
| CENCOMM, Inc. | 6-2/3 |
| C-R Cellular, Inc. | 6-2/3 |
| DePue Communications, Inc. | 6-2/3 |
| Gemcell, Inc. | 6-2/3 |
| Gridley Cellular, Inc. | 6-2/3 |
| Leonore Cellular, Inc. | 6-2/3 |
| Marseilles Cellular, Inc. | 6-2/3 |
| McNabb Cellular, Inc. | 6-2/3 |
| Tonica Cellular, Inc. | 6-2/3 |
| | 100.00% |

Marseilles Cellular, Inc. (MC) was elected by the Partnership to serve as the operating and network partner of the Partnership.

The partners make capital contributions, share in the operating results, and receive distributions from the Partnership in accordance with their respective ownership percentages.

**NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Basis of Presentation*

The accounting policies of the Partnership conform to accounting principles generally accepted in the United States of America. Management uses estimates and assumptions in preparing its financial statements. Those estimates and assumptions affect the reported amounts of assets, liabilities, revenues, and expenses, and the disclosure of contingent assets and liabilities. Actual results may differ from those estimates.

*Property and Equipment*

The Partnership's property and equipment is stated at cost, including labor and overheads associated with construction and capitalized interest.

Depreciation is computed by applying the straight-line method. The estimated service lives for depreciable plant and equipment are: 10 to 20 years for cell site towers and shelter; 7 to 10 years for radio frequency equipment, electronic mobile exchange and base site controller equipment; 7 to 10 years for furniture and fixtures; and 3 to 5 years for computer equipment.

When depreciable properties are sold, or otherwise disposed of, any resulting gains or losses are included in the determination of income.

*Long-Lived Assets*

The Partnership recognizes impairment losses on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amount.

*Revenue Recognition*

The Partnership earns revenue by providing access to the cellular network (access revenue) and for usage of the cellular network (airtime and toll revenue). Access revenue is billed one month in advance and is recognized when earned. Airtime (including roaming) and toll revenues are recognized when the services are rendered. Other revenues are recognized when services are performed and include, primarily, connection revenues. Equipment sales are recognized upon delivery of the equipment to the customer.

The Partnership generates revenue from charges to its customers when they use their cellular phones in other wireless providers' markets. Until 2002, the Partnership included this revenue on a net basis in cost of services in its statement of operations. Expense associated with this revenue, charged by third-party wireless providers, is also included in cost of services. The Partnership used this method because it has passed through to its customers most of the costs related to these revenues. However, the wireless industry and the Partnership have increasingly been using pricing plans that include flat rate pricing and larger home service areas. Under these types of plans, amounts charged to the Partnership by other wireless providers may not necessarily be passed through to its customers.

In 2002, the Partnership adopted a policy to include these revenues as retail revenue rather than cost of services on a net basis. Roamer revenue includes only the revenue from other wireless providers' customers who use the Partnership's network. Retail revenue and cost of services of $881,197 and $985,702 for 2001 and 2000, respectively, were reclassified to conform to this presentation. This change in presentation has no impact on operating income, net income or partners' equity.

*Expense Recognition*

Pursuant to the Partnership Agreement, expenses included in the Statements of Income represent expenses incurred by the Partnership, including an allocation of administrative and operations costs from the operating partner.

*Income Taxes*

The Internal Revenue Code and applicable state statutes provide that income and expenses of a partnership are not separately taxable to the Partnership, but rather accrue directly to the partners. Accordingly, no provision for federal or state income taxes has been made in the financial statements.

*Advertising Costs*

Advertising costs are expensed as incurred. Advertising expenses were $346,620, $294,841, and $337,750 in 2002, 2001, and 2000, respectively.



*Cash Equivalents*

All highly liquid investments with a maturity of three months or less at the time of purchase are considered cash equivalents. The carrying value of cash and cash equivalents approximates its fair value due to the short maturity of the instruments.

*Reclassifications*

Certain reclassifications have been made to the 2001 and 2000 financial statements to conform with the 2002 presentation.

**NOTE 3. PROPERTY AND EQUIPMENT**

The components of property and equipment were as follows:

| | 2002 | 2001 |
|---|---|---|
| Land and land improvements | $ 545,333 | $ 541,618 |
| Buildings | 1,324,949 | 1,277,987 |
| Electronic mobile exchange and base site controller equipment | 3,955,971 | 3,462,373 |
| Cell site towers and equipment | 3,784,222 | 3,422,232 |
| Radio frequency equipment | 3,054,024 | 1,966,997 |
| Other | 677,602 | 477,845 |
| Total property and equipment | 13,342,101 | 11,149,052 |
| Less accumulated depreciation | (6,833,198) | (6,022,436) |
| Net property and equipment | 6,508,903 | 5,126,616 |
| Plant under construction | 5,704 | 5,845 |
| Total net property and equipment | $ 6,514,607 | $ 5,132,461 |

Property and equipment and accumulated depreciation include $123,784 and $2,947, respectively, at December 31, 2002, for capital leases. Property and equipment acquired with capital leases in 2002 was $123,784.

**NOTE 4. INVESTMENTS**

Investments include $65,934 and $146,109 at December 31, 2002 and 2001, respectively, of Rural Telephone Finance Cooperative (RTFC) subordinated capital certificates (SCC). Such SCC's were purchased from RTFC as a condition of obtaining long-term financing for the Partnership and are carried at cost. The SCC's are non-interest bearing and are returned as the related RTFC loan is repaid. The stock purchases were fully financed through the issuance of long-term debt obligations to RTFC. It is not practical to estimate the fair value for these investments due to a lack of quoted market prices.

**NOTE 5. NOTES PAYABLE**

In 2002, the Partnership entered into a $1,000,000 revolving line of credit loan agreement with RTFC. While the agreement is scheduled to mature on the one year anniversary of the advance, the



Partnership may borrow, repay, and reborrow from time to time until the agreement expires on January 3, 2005. Interest is due quarterly and is based on the prevailing bank prime rate plus one and one-half percent or such lessor amount as determined by RTFC. The rate at December 31, 2002, was 5.8%. The agreement is subject to the provisions of the mortgage and security agreement described below. In addition, the aggregate amount of outstanding principal balance of all Partnership unsecured indebtedness is limited to $1,000,000 at any one time.

The maximum amount of short-term borrowings at any month-end during 2002 was $1,000,000.

**NOTE 6. LONG-TERM DEBT**

Long-term debt consists of:

| | 2001 |
|---|---|
| RTFC notes—variable rate | $ 513,032 |
| RTFC notes—variable rate | 146,308 |
| Total long-term debt | 659,340 |
| Less current portion | (659,340) |
| | $ — |

The mortgage notes outstanding at December 31, 2001, are to be repaid in equal quarterly installments covering principal and interest beginning two to five years after date of issue and expiring by 2002. The interest rate on the debt is a variable rate established periodically by the RTFC. The rate at December 31, 2001, was 5.3%.

Substantially all assets of the Partnership are pledged as security under the mortgage and security agreement with the RTFC.

The mortgage and security and loan agreements underlying the RTFC notes contain certain restrictions on Partnership distributions, return of partner capital contributions, and investment in, or loans to others. In 2000, the Partnership received a waiver from the lender to make partnership distributions. Also included in the loan agreement is a provision which requires the partners to infuse, on an ongoing basis, the greater of sufficient amounts of equity to accommodate any cash shortfalls or certain specified amounts. Further, the Partnership is required, under the loan agreement, to achieve a debt service coverage ratio of not less than 1.25.

Of the funds available under the RTFC approved loans, including amendments, all amounts were advanced as of December 31, 2002.

Cash paid for interest net of amounts capitalized for 2002, 2001, and 2000, totaled $25,021, $92,928, and $158,095, respectively.

The fair value of the partnership debt is estimated based on the discounted value of future cash flows expected to be paid using current rates of borrowing for similar types of debt. The fair value of debt approximates carrying value at December 31, 2002 and 2001.



**NOTE 7. RELATED PARTY TRANSACTIONS**

MC, as operating and network partner, performed certain technical, professional, and administrative services on behalf of the Partnership. In accordance with the Partnership Agreement, MC is reimbursed by the Partnership for the Partnership's share of these costs. MC allocates these costs to the various cellular systems to which they provide service based on each entity's customer access lines. Reimbursed expenses in 2002, 2001, and 2000 were $2,224,397, $1,944,325, and $1,725,222, respectively. These reimbursed expenses are classified and presented under the Operating Expenses category to which each relates.

In addition, $276,062, $252,406, and $223,877 were paid to an affiliate of MC for contract labor, interest, and other services in 2002, 2001, and 2000, respectively.

Certain cellular equipment sold to subscribers by the Partnership is provided to the Partnership by a related entity at cost. Cost of goods sold is recorded by the Partnership at the time of sale.

The Partnership has an arrangement with Illinois Valley Cellular RSA 2, Inc. (Switching Company) to provide switching services to the Partnership. The stockholders of the Switching Company own 53% of the Partnership. In 2002, switching and toll roaming services of $546,600 and $1,716,618, respectively, were provided to the Partnership. These services in 2001 were $455,250 and $1,592,348, respectively, and in 2000 were $423,525 and $1,004,834, respectively. The Switching Company received $511,669, $334,881, and $293,108 of access and billing and collecting services from the Partnership in 2002, 2001, and 2000, respectively.

**NOTE 8. CONCENTRATIONS OF CREDIT RISK**

Financial instruments that potentially subject the Partnership to concentrations of credit risk consist principally of cash equivalents and accounts receivable. The Partnership grants credit to cellular customers located primarily within its portion of the Illinois RSA 2 cellular geographic service area, to other cellular carriers, and to other telecommunications carriers.

The Partnership maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Partnership has not experienced any losses in such accounts. The Partnership believes it is not exposed to any significant credit risk on cash and cash equivalents.

Retail service revenues are derived from customers located primarily within the Partnership's portion of the Illinois RSA 2 cellular geographic service area. The Partnership grants credit to these customers, substantially all of whom are local residents of this geographic area.

Roamer cellular revenues are derived under arrangements with other wireless carriers (roaming partners) whose customers use the Partnership's network to place or complete calls. Roaming revenues from Verizon Wireless accounted for 21%, 31%, and 22% of total operating revenues in 2002, 2001, and 2000, respectively.



**NOTE 9. LEASE COMMITMENTS**

Future minimum rental payments under leases for facilities have initial non-cancelable lease terms at December 31, 2002 as follows:

| | Capitalized Leases | Operating Leases |
|---|---|---|
| 2003 | $ 32,612 | $ 154,200 |
| 2004 | 30,103 | 145,200 |
| 2005 | 30,104 | 130,400 |
| 2006 | 30,104 | 113,180 |
| 2007 | 20,069 | 65,750 |
| Thereafter | — | — |
| Total minimum lease payments | $ 142,992 | $ 608,730 |
| Less amount representing interest | 25,085 | |
| Present value of minimum lease payments including current maturities of $21,287 | $ 117,907 | |

The cell site leases are renewable for four additional five-year periods under similar terms at the end of the initial term. Lease terms provide for certain adjustments of the payments in the renewal periods.

The Partnership has an office building lease with an affiliate of MC for an initial term of five years. The Partnership's portion of the annual base rental, included in the future minimum rental payments above, is $68,400. A contingent rental provision allows for increases in base rent for real estate taxes and operating costs in excess of base operating costs. The agreement includes an option to extend the lease for an additional five years.

Rental expense for all cancelable and non-cancelable operating leases totaled $199,503, $139,150, and $114,856 in 2002, 2001, and 2000, respectively.

**NOTE 10. ALLOWANCE FOR UNCOLLECTIBLES**

The Company uses the reserve method to recognize uncollectible customer accounts. The following activity has been recognized under this method.

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Balance, December 31 | $ 110,000 | $ 134,000 | $ 142,000 |
| Provision for uncollectibles | 67,489 | 33,902 | 107,037 |
| Accounts written off, net of recoveries | 60,989 | 57,902 | 115,037 |
| Balance, December 31 | $ 116,500 | $ 110,000 | $ 134,000 |

**NOTE 11. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)**

The following table presents summarized quarterly results.

| | Quarter | | | |
|---|---|---|---|---|
| | 1st | 2nd | 3rd | 4th |
| **2002** | | | | |
| Operating revenues | $ 2,665,525 | $ 2,732,486 | $ 2,784,279 | $ 2,713,388 |
| Operating income | $ 300,775 | $ 181,779 | $ 69,549 | $ (189,682) |
| Net income | $ 310,158 | $ 175,016 | $ 64,205 | $ (208,098) |
| **2001** | | | | |
| Operating revenues | $ 2,457,057 | $ 2,897,386 | $ 2,994,715 | $ 2,882,714 |
| Operating income | $ 238,467 | $ 378,592 | $ 402,836 | $ 443,462 |
| Net income | $ 222,770 | $ 357,551 | $ 387,483 | $ 445,511 |

Quarterly operating results are not necessarily representative of operations for a full year for various reasons, including seasonal variations in customer calling patterns and timing of promotional activities.

**NOTE 12. RECENT ACCOUNTING DEVELOPMENTS**

In June 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires entities to record the fair value of the liability for legal obligations associated with an asset retirement in the period in which the obligation is incurred. When the liability is initially recorded, the entity capitalizes the cost of the asset retirement obligation by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset.

In April 2002, the FASB issued No. 145, "Rescission of FASB Statements No.4, 44, and 64, Amendment of FASB Statement No.13, and Technical Corrections." SFAS No. 145 rescinds FASB Statement No.4, "Reporting Gains and Losses from Extinguishment of Debt," and an amendment of that Statement, FASB Statement No.64, "Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements." SFAS No. 145 also rescinds FASB Statement No. 44, "Accounting for Intangible Assets of Motor Carriers," and amends FASB Statement No. 13, "Accounting for Leases."

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," SFAS No. 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." This interpretation elaborates on the disclosures required in financial statements concerning obligations under certain guarantees. It also clarifies the requirements related to the recognition of liabilities by a guarantor at the inception of certain guarantees. The disclosure requirements of this interpretation were effective on December 31, 2002. No disclosures were required at December 31, 2002.

The Partnership has not yet determined the impact the adoption of these Standards will have on its financial position, results of operations, and cash flows.

QuickLinks -- Click here to rapidly navigate through this document

**Exhibit 99.3**

**RSA 2-I**
**Balance Sheet (Unaudited)**
**June 30, 2003**

| | |
|---|---|
| **ASSETS** | |
| **Current Assets** | |
| Cash & Cash Equivalents | $ 80,038 |
| Accounts Receivable | |
| Due from Customers | |
| Less Allowance for Uncollectible of $164,402 | 1,653,482 |
| Affiliates | 431,163 |
| Prepayments | 107,379 |
| **Total Current Assets** | 2,272,062 |
| **Plant & Equipment** | |
| Plant In Service | 13,605,649 |
| Less Accumulated Depreciation | (7,432,892) |
| | 6,172,757 |
| Plant Under Construction | 57,033 |
| | 6,229,790 |
| **Other Noncurrent Assets** | |
| Investments | 94,246 |
| **TOTAL ASSETS** | $ 8,596,098 |
| **LIABILITIES AND PARTNERS' CAPITAL** | |
| **Current Liabilities:** | |
| Note Payable | $ 1,000,000 |
| Accounts Payable | |
| Trade | 227,579 |
| Affiliates | 567,877 |
| Accrued Liabilities | 415,807 |
| Advanced Billings | 279,853 |
| Accrued Taxes | 112,762 |
| Capital Lease Obligation | 21,287 |
| Other | 161,572 |
| **Total Current Liabilities** | 2,786,737 |
| **Long Term Liabilities** | |
| Capital Lease Obligation | 86,123 |
| Asset Retirement Obligation | 129,136 |
| **Total Long Term Liabilities** | 215,259 |
| **Partner's Capital** | 5,594,102 |
| **TOTAL LIABILITIES & PARTNERS' CAPITAL** | $ 8,596,098 |

**RSA 2-I**
**Statement of Income (Unaudited)**
**for the Six Months Ending June 30, 2003**

| | | |
|---|---|---|
| **Operating Revenues** | | |
| Retail service | $ | 3,636,082 |
| Roamer service | | 2,344,412 |
| Equipment sales | | 122,749 |
| Miscellaneous services | | 505,930 |
| | | 6,609,173 |
| **Operating Expenses** | | |
| Cost of services | | 3,053,145 |
| Cost of eauipment sales | | 554,923 |
| Selling, general and administrative | | 2,120,550 |
| Depreciation | | 582,000 |
| | | 6,310,618 |
| **Operating Income** | | 298,555 |
| **Other Expenses** | | |
| Interest expense | | 40,010 |
| **Net Income before cumulative effect of change in accounting principle** | | 258,545 |
| **Cumulative effect of change in accounting principle** | | (48,663) |
| **Net Income** | $ | 209,882 |



QuickLinks

Exhibit 99.3

QuickLinks -- Click here to rapidly navigate through this document

**Exhibit 99.4**

## INDEPENDENT AUDITORS' REPORT

To the Partners of
Illinois Valley Cellular RSA 2-III Partnership

We have audited the accompanying balance sheets of Illinois Valley Cellular RSA 2-III Partnership (an Illinois partnership) as of December 31, 2002 and 2001, and the related statements of income, partners' capital, and cash flows for each of three years in the period ended December 31, 2002. These financial statements are the responsibility of the Operating Partner's management. Our responsibility is to express an opinion on these 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as, evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Illinois Valley Cellular RSA 2-III Partnership as of December 31, 2002 and 2001, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

/s/ KIESLING ASSOCIATES LLP
Madison, Wisconsin
March 1, 2003



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## ILLINOIS VALLEY CELLULAR RSA 2-III PARTNERSHIP

### BALANCE SHEETS
**December 31, 2002 and 2001**

| | 2002 | 2001 |
|---|---|---|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | $ 81,145 | $ 48,377 |
| Accounts receivable: | | |
| Due from customers | | |
| Less allowance of $85,000 and $80,000, respectively | 565,754 | 697,422 |
| Affiliates | 69,741 | 72,718 |
| Other | 20,554 | 23,620 |
| Prepaids | 104,236 | 3,855 |
| | 841,430 | 845,992 |
| PROPERTY AND EQUIPMENT | | |
| Plant in service | 7,124,486 | 5,816,790 |
| Less accumulated depreciation | (3,356,524) | (2,834,086) |
| | 3,767,962 | 2,982,704 |
| OTHER NONCURRENT ASSETS | | |
| Investments | 73,140 | 100,147 |
| Other | 1,215 | 1,215 |
| | 74,355 | 101,362 |
| TOTAL ASSETS | $ 4,683,747 | $ 3,930,058 |

**ILLINOIS VALLEY CELLULAR RSA 2-III PARTNERSHIP**

**BALANCE SHEETS**
**December 31, 2002 and 2001**

| | 2002 | 2001 |
|---|---|---|
| LIABILITIES AND PARTNERS' CAPITAL | | |
| CURRENT LIABILITIES | | |
| Current portion of long-term debt | $ — | $ 236,690 |
| Capital lease obligation | 11,495 | — |
| Notes payable | 1,500,000 | 400,000 |
| Accounts payable: | | |
| Trade | 107,184 | 38,031 |
| Affiliates | 401,580 | 429,224 |
| Other | 130,070 | 151,128 |
| Accrued commissions | 39,849 | 51,572 |
| Advance billings | 2,383 | 3,683 |
| Other | 154,660 | 123,789 |
| | 2,347,221 | 1,434,117 |
| LONG-TERM OBLIGATIONS | | |
| Capital lease obligation | 52,175 | — |
| PARTNERS' CAPITAL | 2,284,351 | 2,495,941 |
| TOTAL LIABILITIES AND PARTNERS' CAPITAL | $ 4,683,747 | $ 3,930,058 |

The accompanying notes are an integral part of these financial statements.



**ILLINOIS VALLEY CELLULAR RSA 2-III PARTNERSHIP**

**STATEMENTS OF INCOME**
**Years Ended December 31, 2002, 2001, and 2000**

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| OPERATING REVENUES | | | |
| Retail service | $ 3,469,059 | $ 3,227,973 | $ 3,047,399 |
| Roamer service | 2,521,150 | 3,344,344 | 2,573,368 |
| Equipment sales | 101,694 | 111,163 | 85,863 |
| Miscellaneous services | 788,808 | 637,263 | 442,516 |
| | 6,880,771 | 7,320,743 | 6,149,146 |
| OPERATING EXPENSES | | | |
| Cost of sales | 3,628,394 | 3,563,141 | 2,817,688 |
| Cost of equipment sales | 578,473 | 570,489 | 555,587 |
| Selling, general, and administrative | 2,280,964 | 2,080,607 | 1,758,277 |
| Depreciation | 580,137 | 493,940 | 489,717 |
| | 7,067,968 | 6,708,177 | 5,621,269 |
| OPERATING INCOME | (187,257) | 612,566 | 527,877 |
| OTHER INCOME (EXPENSES) | | | |
| Interest expense | (52,682) | (56,560) | (103,842) |
| Interest during construction | 20,308 | — | — |
| Other, net | 8,041 | 14,352 | 13,129 |

| | | | |
|---|---|---|---|
| | (24,333) | (42,208) | (90,713) |
| NET INCOME | $ (211,590) | $ 570,358 | $ 437,164 |

The accompanying notes are an integral part of these financial statements.



**ILLINOIS VALLEY CELLULAR RSA 2-III PARTNERSHIP**

**STATEMENTS OF PARTNERS' CAPITAL**
**December 31, 2002, 2001, and 2000**

| | Total |
|---|---|
| Balance at December 31, 1999 | $ 1,988,174 |
| Net Income | 437,164 |
| Distribution | (99,994) |
| Balance at December 31, 2000 | 2,325,344 |
| Net Income | 570,358 |
| Distribution | (399,761) |
| Balance at December 31, 2001 | 2,495,941 |
| Net Income (Loss) | (211,590) |
| Balance at December 31, 2002 | $ 2,284,351 |

The accompanying notes are an integral part of these financial statements.



**ILLINOIS VALLEY CELLULAR RSA 2-III PARTNERSHIP**

**STATEMENTS OF CASH FLOWS**
**Years Ended December 31, 2002, 2001, and 2000**

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Net income | $ (211,590) | $ 570,358 | $ 437,164 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation | 580,137 | 493,940 | 489,717 |
| Provision for losses on accounts receivable | 5,000 | 10,000 | (25,000) |
| Changes in assets and liabilities: | | | |
| (Increase) Decrease in: | | | |
| Accounts receivable | 132,711 | (239,549) | 88,558 |
| Prepaids | (100,381) | — | — |
| Increase (Decrease) in: | | | |
| Accounts payable | 20,451 | 311,892 | (390,032) |
| Other | 17,852 | (11,548) | 26,737 |
| Net cash provided by operating activities | 444,180 | 1,135,093 | 627,144 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Capital expenditures | (1,298,556) | (484,229) | (129,498) |
| Proceeds from the sale of investments, net | 27,007 | 46,302 | 128,861 |
| Net cash used in investing activities | (1,271,549) | (437,927) | (637) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |

| | | | |
|---|---|---|---|
| Proceeds from short-term borrowings | 1,100,000 | — | — |
| Repayment of long-term borrowings | (236,690) | (293,659) | (493,234) |
| Payments of capital lease obligations | (3,173) | — | — |
| Partnership distribution | — | (399,761) | (99,994) |
| Net cash provided by/(used in) financial activities | 860,137 | (693,420) | (593,228) |
| Net Increase in Cash and Cash Equivalents | 32,768 | 3,746 | 33,279 |
| Cash and Cash Equivalents at Beginning of Year | 48,377 | 44,631 | 11,352 |
| Cash and Cash Equivalents at End of Year | $ 81,145 | $ 48,377 | $ 44,631 |

The accompanying notes are an integral part of these financial statements.



**ILLINOIS VALLEY CELLULAR RSA 2-III PARTNERSHIP**

**NOTES TO FINANCIAL STATEMENTS**

**NOTE 1. ORGANIZATION**

The Illinois Valley Cellular RSA 2-III Partnership (Partnership) is organized pursuant to the provisions of the Illinois Uniform Partnership Act. The Partnership was formed on November 6, 1989, to fund, establish, and provide cellular service within a portion of the Illinois RSA 2 Cellular Geographic Service Area. At December 31, 2002, 2001, and 2000, the general partners and their respective ownership percentages in the Partnership were as follows:

| Partner | Percentage |
|---|---|
| Illinois SMSA Limited Partnership | 20.00% |
| Chicago SMSA Limited Partnership | 20.00% |
| CENCOMM, Inc. | 6-2/3 |
| C-R Cellular, Inc. | 6-2/3 |
| DePue Communications, Inc. | 6-2/3 |
| Gemcell, Inc. | 6-2/3 |
| Gridley Cellular, Inc. | 6-2/3 |
| Leonore Cellular, Inc. | 6-2/3 |
| Marscilles Cellular, Inc. | 6-2/3 |
| McNabb Cellular, Inc. | 6-2/3 |
| Tonica Cellular, Inc. | 6-2/3 |
| | 100.00% |

Marscilles Cellular, Inc. (MC) was elected by the Partnership to serve as the operating and network partner of the Partnership.

The partners make capital contributions, share in the operating results, and receive distributions from the Partnership in accordance with their respective ownership percentages.

**NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Basis of Presentation*

The accounting policies of the Partnership conform to accounting principles generally accepted in the United States of America. Management uses estimates and assumptions in preparing its financial statements. Those estimates and assumptions affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities. Actual results may differ from those estimates.

*Property and Equipment*

The Partnership's property and equipment is stated at cost, including labor and overheads associated with construction and capitalized interest.

Depreciation is computed by applying the straight-line method. The estimated service lives for depreciable plant and equipment are: 15 years for buildings; 7 to 15 years for cell site towers; 7 to 10 years for electronic mobile exchange and base site controller equipment; 7 years for furniture and fixtures; and 5 years for computer equipment.

When depreciable properties are sold, or otherwise disposed of, any resulting gains or losses are included in the determination of income.

*Long-Lived Assets*

The Partnership recognizes impairment losses on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amount.

*Revenue Recognition*

The Partnership earns revenue by providing access to the cellular network (access revenue) and for usage of the cellular network (airtime and toll revenue). Access revenue is billed one month in advance and is recognized when earned. Airtime (including roaming) and toll revenues are recognized when the services are rendered. Other revenues are recognized when services are performed and include, primarily, connection revenues. Equipment sales are recognized upon delivery of the equipment to the customer.

The Partnership generates revenue from charges to its customers when they use their cellular phones in other wireless providers' markets. Until 2002, the Partnership included this revenue on a net basis in cost of services in its statement of operations. Expense associated with this revenue, charged by third-party wireless providers, is also included in cost of services. The Partnership used this method because it has passed through to its customers most of the costs related to these revenues. However, the wireless industry and the Partnership have increasingly been using pricing plans that include flat rate pricing and larger home service areas. Under these types of plans, amounts charged to the Partnership by other wireless providers may not necessarily be passed through to its customers.

In 2002, the Partnership adopted a policy to include the revenue as retail revenue rather than cost of services on a net basis. Roamer revenue includes only the revenue from other wireless providers' customers who use the Partnership's network. Retail revenue and cost of services of $523,315 and $589,604 for 2001 and 2000, respectively, were reclassified to conform to this presentation. This change in presentation has no impact on operating income, net income, or partners' equity.

*Expense Recognition*

Pursuant to the Partnership Agreement, expenses included in the Statements of Income represent expenses incurred by the Partnership, including an allocation of administrative and operations costs from the operating partner.

*Income Taxes*

The Internal Revenue Code and applicable state statutes provide that income and expenses of a partnership are not separately taxable to the Partnership, but rather accrue directly to the partners. Accordingly, no provision for federal or state income taxes has been made in the financial statements

*Advertising Costs*

Advertising costs are expensed as incurred. Advertising expenses were $203,997, $162,430, and $170,659 in 2002, 2001 and 2000, respectively.

*Cash Equivalents*

All highly liquid investments with a maturity of three months or less at the time of purchase are considered cash equivalents. The carrying value of cash and cash equivalents approximates its fair value due to the short maturity of the investments.



*Reclassifications*

Certain reclassifications have been made to the 2001 and 2000 financial statements to conform with the 2002 presentation.

**NOTE 3. PROPERTY AND EQUIPMENT**

The components of property and equipment were as follows:

| | 2002 | 2001 |
|---|---|---|
| Land and Land improvements | $ 233,179 | $ 232,978 |
| Buildings | 642,311 | 594,346 |
| Electronic mobile exchange and base site controller equipment | 2,479,042 | 2,097,221 |
| Cell site towers and equipment | 1,855,225 | 1,436,055 |
| Other | 1,914,729 | 1,456,190 |
| Total property and equipment | 7,124,486 | 5,816,790 |
| Less accumulated depreciation | (3,356,524) | (2,834,086) |
| Total net property and equipment | $ 3,767,962 | $ 2,982,704 |

Property and equipment and accumulated depreciation include $66,843 and $796, respectively, at December 31, 2002, for capital leases. Property and equipment acquired with capital leases in 2002 was $66,843.

**NOTE 4. INVESTMENTS**

Investments include $23,669 and $53,035 at December 31, 2002 and 2001, respectively, of Rural Telephone Finance Cooperative (RTFC) subordinated capital certificates (SCC). Such SCCs were purchased from RTFC as a condition of obtaining long-term financing for the Partnership and are carried at cost. The SCCs are non-interest bearing and are returned as the related RTFC loan is repaid. The stock purchases were fully financed through the issuance of long-term debt obligations to RTFC. It is not practical to estimate the fair value for these investments due to a lack of quoted market prices.

**NOTE 5. NOTES PAYABLE**

Notes payable consist of:

| | 2002 | 2001 |
|---|---|---|
| RTFC lines of credit | $ 500,000 | $ 400,000 |
| RTFC revolving line of credit | 1,000,000 | — |
| | $ 1,500,000 | $ 400,000 |

Interest on the lines of credit is at a variable rate (5.8% and 5.3% at December 31, 2002 and 2001, respectively).

In 2002, the Partnership entered into a $1,000,000 revolving line of credit loan agreement with RTFC. While the agreement is scheduled to mature on the one year anniversary of the advance, the Partnership may borrow, repay, and reborrow from time to time until the agreement expires on January 3, 2005. Interest is due quarterly and is based on the prevailing bank prime rate plus one and one-half percent or such lessor amount as determined by RTFC. The rate at December 31, 2002 was



5.8%. The agreement is subject to the provisions of the mortgage and security agreement described below. In addition, the aggregate amount of outstanding principal balance of all Partnership unsecured indebtedness is limited to $1,000,000 at any one time.

The maximum amount of short-term borrowings at any month-end during 2002 and 2001 were $1,500,000 and $500,000, respectively.

**NOTE 6. LONG-TERM DEBT**

Long-term debt consists of:

| | 2001 |
|---|---|
| RTFC notes—variable rate | $ 160,160 |
| RTFC notes—variable rate | $ 76,530 |
| Total long-term debt | 236,690 |
| Less current portion | (236,690) |
| | $ — |

These mortgage notes outstanding at December 31, 2001, are to be repaid in equal quarterly installments covering principal and interest beginning two to three years after date of issue and expiring by 2002. The interest rate on the debt is a variable rate established periodically by the RTFC. The rate at December 3, 2001, was 5.3%.

Substantially all assets of the Partnership are pledged as security under the mortgage and security agreement with the RTFC.

The mortgage and security and loan agreements underlying the RTFC notes contain certain restrictions on Partnership distributions, return of partner capital contributions, and investment in, or loans to others. In 2000, the Partnership received a waiver from the lender to make partnership distributions. Also included in the loan agreement is a provision, which requires the partners to infuse, on an ongoing basis, the greater of sufficient amounts of equity to accommodate any cash shortfalls or certain specified amounts. Further, the Partnership is required, under the loan agreement, to achieve a debt service coverage ratio of not less than 1.25.

Of the funds available under the RTFC approved loans, including amendments, all amounts were advanced as of December 31, 2002.

Cash paid for interest net amounts capitalized for 2002, 2001, and 2000 totaled $24,922, $62,028, and $97,253, respectively.

The fair value of the partnership debt is estimated based on the discounted value of future cash flows expected to be paid using current rates of borrowing for similar types of debt. The fair value of debt approximates carrying value at December 31, 2002 and 2001.

**NOTE 7. RELATED PARTY TRANSACTIONS**

MC, as operating and network partner, performed certain technical, professional, and administrative services on behalf of the Partnership. In accordance with the Partnership Agreement, MC is reimbursed by the Partnership's share of these costs. MC allocates these costs to the various cellular systems to which they provide service based on each entity's customer access lines. Reimbursed expenses in 2002, 2001, and 2000 were $1,194,151; $1,040,212; and $885,246; respectively. These reimbursed expenses are classified and presented under the Operating Expenses category to which each relates.

In addition, $107,974, $105,260, and $96,678 were paid to an affiliate of MC for contract labor, interest, and other services in 2002, 2001, and 2000, respectively.

Certain cellular equipment sold to subscribers by the Partnership is provided to the Partnership by a related entity at cost. Cost of goods sold is recorded by the Partnership at the time of sale.

The Partnership has an arrangement with Illinois Valley Cellular RSA 2, Inc. (Switching Company) to provide switching services to the Partnership. The stockholders of the Switching Company own 53% of the Partnership. In 2002, switching and toll roaming services of $794,832 and $1,431,105, respectively, were provided to the Partnership. These services in 2001 were $767,976 and $1,311,962, respectively and in 2000 were $719,858 and $816,461, respectively. The Switching Company received $414,548, $353,983, and $231,694 of access and billing and collecting services from the Partnership in 2002, 2001, and 2000, respectively.

**NOTE 8. CONCENTRATIONS OF CREDIT RISK**

Financial instruments that potentially subject the Partnership to concentrations of credit risk consist principally cash equivalents and accounts receivable. The Partnership grants credit to cellular customers located primarily within its portion of the Illinois RSA 2 cellular geographic service area, to other cellular carriers, and to other telecommunications carriers.

The Partnership maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Partnership has not experienced any losses in such accounts. The Partnership believes it is not exposed to any significant credit risk on cash and cash equivalents.

Retail cellular revenues are derived from customers located primarily within the Partnership's portion of the Illinois RSA 2 cellular geographic service area. The Partnership grants credit to these customers, substantially all of whom are local residents of this geographic area.

Roamer cellular revenues are derived under arrangements with other wireless carriers (roaming partners) whose customers use the Partnership's network to place of complete calls. Roaming revenues from Verizon Wireless accounted for 34%, 43%, and 30% of total operating revenues in 2002, 2001, and 2000, respectively.



**NOTE 9. LEASE COMMITMENTS**

Future minimum rental payments under leases for facilities have initial non-cancelable lease terms at December 31, 2002 as follows:

| | Capitalized Leases | Operating Leases |
|---|---|---|
| 2003 | $ 17,611 | $ 93,538 |
| 2004 | 15,956 | 71,086 |
| 2005 | 16,256 | 62,036 |
| 2006 | 16,256 | 55,436 |
| 2007 | 10,837 | 34,952 |
| Thereafter | — | — |
| Total minimum lease payments | $ 76,916 | $ 317,096 |
| Less amount representing interest | 13,246 | |
| Present value of minimum lease payments including current maturities of $11,495 | $ 63,670 | |

Cell site leases are renewable for four additional five-year periods under similar terms at the end of the initial term. Lease terms provide for certain adjustment of the payments in the renewal periods.

The Partnership has an office building lease with an affiliate of MC for an initial term of five years. The Partnership's portion of the annual base rental, included in the future minimum rental payments above, is $36,936. A contingent rental provision allows for increases in base rent for real estate taxes and operating costs in excess of base operating costs. The agreement includes an option to extend the lease for an additional five years.

Rental expense for all cancelable and non-cancelable operating leases totaled $122,319, $95,515, and $90,900 in 2002, 2001, and 2000, respectively.

**NOTE 10. ALLOWANCE FOR UNCOLLECTIBLES**

The Company uses the reserve method to recognize uncollectible customer accounts. The following activity has been recognized under this method.

| | 2002 | 2001 | 2000 |
|---|---|---|---|

| | | | |
|---|---|---|---|
| Balance, December 31 | $ 80,000 | $ 70,000 | $ 95,000 |
| Provision for uncollectibles | 51,226 | 36,991 | 47,460 |
| Accounts written off, net of recoveries | 46,226 | 26,991 | 72,460 |
| Balance, December 31 | $ 85,000 | $ 80,000 | $ 70,000 |



**NOTE 11. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)**

The following table presents summarized quarterly results.

| | Quarter | | | |
|---|---|---|---|---|
| | 1st | 2nd | 3rd | 4th |
| **2002** | | | | |
| Operating revenues | $ 1,707,412 | $ 1,698,737 | $ 1,745,740 | $ 1,728,822 |
| Operating income | $ 48,352 | $ (19,292) | $ (45,733) | $ (170,584) |
| Net income | $ 51,725 | $ (26,825) | $ (52,226) | $ (184,262) |
| **2001** | | | | |
| Operating revenues | $ 1,614,897 | $ 1,872,348 | $ 1,911,963 | $ 1,921,535 |
| Operating income | $ 114,963 | $ 153,201 | $ 169,279 | $ 175,123 |
| Net income | $ 107,694 | $ 136,992 | $ 156,622 | $ 169,050 |

Quarterly operating results are not necessarily representative of operations for a full year for various reasons, including seasonal variations in customer calling patterns and timing of promotional activities.

**NOTE 12. RECENT ACCOUNTING DEVELOPMENTS**

In June 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires entities to record the fair value of the liability for legal obligations associated with an asset retirement in the period in which the obligation is incurred. When the liability is initially recorded, the entity capitalizes the cost of the asset retirement obligation by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." SFAS No. 145 rescinds FASB Statement No. 4, "Reporting Gains and Losses from Extinguishment of Debt," and an amendment of that Statement, FASB Statement No. 64, "Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements." SFAS No. 145 also rescinds FASB Statement No. 44, "Accounting for Intangible Assets of Motor Carriers," and amends FASB Statement No. 13, "Accounting for Leases."

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," SFAS No. 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan.

In November 2002, the FASB issued Interpretation No.45, "Guarantor's Accounting and Disclosure Requirements for Gaurantees, Including Indirect Guarantees of Indebtedness of Others." This interpretation elaborates on the disclosures required in financial statements concerning obligations under certain guarantees. It also clarifies the requirements related to the recognition of liabilities by a guarantor at the inception of certain guarantees. The disclosure requirements of this interpretation were effective on December 31, 2002. No disclosures were required at December 31, 2002.

The Partnership has not yet determined the impact the adoption of these Standards will have on its financial position, results of operations, and cash flows.

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**Exhibit 99.5**

**RSA 2-III**
**Balance Sheet (Unaudited)**
**June 30, 2003**

| | | |
|---|---|---|
| **ASSETS** | | |
| **Current Assets** | | |
| Cash & Cash Equivalents | $ | 33,376 |
| Accounts Receivable | | |
| Due from Customers | | |
| Less Allowance for Uncollectible of $118,647 | | 936,584 |
| Affiliates | | 242,373 |
| Prepayments | | 136,797 |
| **Total Current Assets** | | 1,349,130 |
| **Plant & Equipment** | | |
| Plant In Service | | 7,325,699 |
| Less Accumulated Depreciation | | (3,741,072) |
| | | 3,584,627 |
| Plant Under Construction | | 7,442 |
| | | 3,592,069 |
| **Other Noncurrent Assets** | | |
| Investments | | 50,439 |
| Deferred Charges | | 1,215 |
| **Total Other NonCurrent Assets** | | 51,654 |
| **TOTAL ASSETS** | $ | 4,992,853 |
| **LIABILITIES AND PARTNERS' CAPITAL** | | |
| **Current Liabilities:** | | |
| Capital Lease Obligation | $ | 11,495 |
| Note Payable | | 1,500,000 |
| Accounts Payable | | |
| Trade | | 135,549 |
| Affiliates | | 542,888 |
| Accrued Liabilities | | 241,255 |
| Advanced Billings | | 2,383 |
| Accrued Taxes | | 128,880 |
| Other | | 93,748 |
| **Total Current Liabilities** | | 2,656,198 |
| **Long Term Liabilities** | | |
| Capital Lease Obligation | | 46,506 |
| Asset Retirement Obligation | | 165,789 |
| **Total Long Term Liabilities** | | 212,295 |
| **Partner's Capital** | | 2,124,360 |
| **TOTAL LIABILITIES & PARTNERS' CAPITAL** | $ | 4,992,853 |

**RSA 2-III**
**Statement of Income (Unaudited)**
**for the Six Months Ending June 30, 2003**

| | | |
|---|---|---|
| **Operating Revenues** | | |
| Retail service | $ | 1,963,145 |
| Roamer service | | 1,816,313 |
| Equipment sales | | 55,035 |
| Miscellaneous services | | 374,008 |
| | | 4,208,501 |
| **Operating Expenses** | | |
| Cost of services | | 2,443,176 |
| Cost of equipment sales | | 270,594 |
| Selling, general and administrative | | 1,155,437 |
| Depreciation | | 354,000 |
| | | 4,223,207 |
| **Operating Income** | | (14,706) |
| **Other Expenses** | | |
| Interest expense | | 47,121 |
| **Net Loss before cumulative effect of change in accounting principle** | | (61,827) |
| **Cumulative effect of change in accounting principle** | | (98,165) |
| **Net Loss** | $ | (159,992) |



QuickLinks

Exhibit 99.5