VALOR COMMUNICATIONS GROUP INC
Form S-1/A
December 09, 2004

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As filed with the Securities and Exchange Commission on December 9, 2004

Registration No. 333-114298

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Amendment No. 3
to

Form S-1

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

Valor Communications Group, Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware	**4813**	**20-0792300**
(State or other jurisdiction of incorporation or organization)	*(Primary Standard Industrial Classification Code Number)*	*(I.R.S. Employer Identification Number)*

201 E. John Carpenter Freeway, Suite 200

Irving, Texas 75062
(972) 373-1000
(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

WILLIAM M. OJILE, JR., ESQ.

Senior Vice President,
Chief Legal Officer & Secretary
Valor Communications Group, Inc.
201 E. John Carpenter Freeway, Suite 200
Irving, Texas 75062
(972) 373-1000
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

Joshua N. Korff, Esq. **Kirkland & Ellis LLP** **Citigroup Center** **153 East 53rd Street** **New York, New York 10022** **(212) 446-4800**	**Richard L. Muglia, Esq.** **Skadden, Arps, Slate, Meagher & Flom LLP** **Four Times Square** **New York, New York 10036** **(212) 735-3000**

Approximate date of commencement of proposed sale to the public: As soon as practicable after the effective date of this Registration Statement.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933 check the following box. o

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. o

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered(1)	Proposed Maximum Aggregate Offering Price(2)	Amount of Registration Fee(3)
Common Stock, par value $0.01 per share(4)	$550,000,000	$69,685

(1) This registration statement, as originally filed, applied to income deposit securities and senior subordinated notes as well as common stock. With this Amendment No. 3, the Registrant hereby amends this registration statement to apply solely to common stock. The offering of income deposit securities and senior subordinated notes is hereby withdrawn and no income deposit securities or senior subordinated notes are to be registered under this registration statement.

(2) Estimated solely for the purpose of computing the amount of the registration fee pursuant to Rule 457(o) promulgated under the Securities Act of 1933, as amended.

(3) Previously paid.

(4) Includes shares of common stock subject to the underwriter s overallotment option.

The Registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission, acting pursuant to such Section 8(a), may determine.

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Subject to Completion
Preliminary Prospectus dated December 9, 2004

PROSPECTUS

Shares

Common Stock

This is Valor Communications Group, Inc. s initial public offering. Valor Communications Group, Inc. is selling all of the shares.

We expect the public offering price to be between $ and $ per share. Currently, no public market exists for the shares. After pricing of the offering, we expect that the shares will trade on the New York Stock Exchange under the symbol VCG.

Investing in the common stock involves risks that are described in the Risk Factors section beginning on page 10 of this prospectus.

	Per Share	Total
Public offering price	$	$
Underwriting discount	$	$
Proceeds, before expenses, to Valor Communications Group, Inc.	$	$

The underwriters may also purchase up to an additional shares from the selling stockholders, at the public offering price, less the underwriting discount, within 30 days from the date of this prospectus to cover overallotments.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The shares will be ready for delivery on or about , 2005.

Merrill Lynch & Co. **Banc of America Securities LLC** **JPMorgan**

The date of this prospectus is , 2005.

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You should rely only on the information contained in this prospectus. We have not, and the underwriters have not, authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not, and the underwriters are not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus is accurate only as of the date on the front cover of this prospectus. Our business, financial condition, results of operations and prospectus may have changed since that date.

For investors outside the United States: Neither we nor any of the underwriters have done anything that would permit this offering or possession or distribution of this prospectus in any jurisdiction where action for that purpose is required, other than in the United States. You are required to inform yourselves about and to observe any restrictions relating to this offering and the distribution of this prospectus.

SUMMARY

The following is a summary of the principal features of this offering of common stock and should be read together with the more detailed information and financial data and statements contained elsewhere in this prospectus.

Our Company

Overview

We are one of the largest providers of telecommunications services in rural communities in the southwestern United States and, based on the number of telephone lines we have in service, the seventh largest independent (non-Bell) local telephone company in the country. As of September 30, 2004, we operated approximately 548,000 telephone access lines in primarily rural areas of Texas, Oklahoma, New Mexico and Arkansas. We believe that in many of our markets we are the only service provider that offers customers an integrated package of local and long distance voice, high-speed data and Internet access, and enhanced services such as voicemail and caller identification. For the year ended December 31, 2003, we generated revenues of $497.3 million and net income of $58.2 million. In the nine months ended September 30, 2004, we generated revenues of $379.3 million and net income of $25.2 million.

We formed our company in 2000 in connection with the acquisition of select telephone assets from GTE Southwest Corporation, which is now part of Verizon, and have since acquired the local telephone company serving Kerrville, Texas. The rural telephone businesses that we own have been operating in the markets we serve for over 75 years. Since our inception, we have invested substantial resources to improve and expand our network infrastructure to provide high quality telecommunications services and superior customer care. This capital investment, in combination with a focused selling effort, has contributed to an increase in our revenue of $72.4 million, or 17.0%, from 2001 to 2003. We believe that we are well positioned for future revenue and cash flow growth through both expanded service offerings and acquisitions.

We operate our business through telephone company subsidiaries that qualify as rural local exchange carriers under the Telecommunications Act of 1996. Like many rural telephone companies, our business is characterized by stable operating results, revenue and cash flow and a relatively favorable regulatory environment, which includes support payments from the Texas and federal Universal Service Funds. In 2003, 24.1% of our revenues were attributable to such support payments. We have historically experienced less competition than regional Bell operating companies because of the low customer density and high residential component of our customer base. Since our customer base is located in areas that are generally less densely populated than areas served by other rural telephone companies, we believe that we are more insulated from competitive pressures than many other local telecommunications providers. We are not, however, immune to such pressures. Our access line count decreased by approximately 8,800 lines, or 1.6%, during the nine months ended September 30, 2004, and, excluding the number of access lines we gained in the Kerrville acquisition, we experienced access line loss in each of the past two fiscal years.

Our Strengths

Ability to Generate Consistent Cash Flows. We have increased our operating cash flow in each year since our inception by growing revenues, reducing expenses and optimizing our capital expenditures.

Leading Market Position. We maintain our position as the leading provider of telecommunications services in the markets we serve by providing reliable customer service, offering a full range of voice and data services and maintaining a strong local presence in the communities we serve.

Scalable, State-of-the-Art Network Infrastructure. Our investment of more than $350 million since our inception in 2000 to improve and expand our network infrastructure has enabled us to provide additional services to our customers, improve the overall quality of our network and position our company for future cash flow growth.

Wide Array of Integrated Services. We believe that we are the only telecommunications service provider in many of the markets we serve that can provide an integrated package of local, long distance, high-speed data and Internet access as well as a variety of enhanced services such as voicemail and caller identification.

Experienced and Proven Management Team. Our highly experienced senior management team has an average of over 20 years of experience in the local telecommunications industry, including managing the expansion of public telecommunications companies through both internal growth and integration of acquisitions.

Business Strategy

Increase Penetration of Higher Margin Services. We intend to capitalize on our ability to cross-sell higher margin enhanced voice and data services as a bundled package which we believe represents a significant opportunity for us to continue to increase our revenue per customer.

Provide Superior Service and Customer Care. We seek to build long-term customer relationships by providing personalized customer care through three call centers, while also automating many of our customer service functions to enable our customers to interact with our company 24 hours a day, 365 days a year.

Improve Operating Efficiency and Profitability. We strive for greater efficiencies and improved profit margins by consolidating corporate functions, negotiating favorable terms with our suppliers and contractors and focusing capital expenditures on projects that exceed our internal rate of return thresholds.

Pursue Selective Strategic Acquisitions. We believe that there are opportunities to acquire telecommunications assets that are accretive and that we possess the management team, network infrastructure and labor force that can identify, acquire, integrate and successfully support significant growth through acquisitions.

Our Reorganization

All the equity interests in Valor Telecommunications, LLC, or VTC, are currently held by affiliates of Welsh, Carson, Anderson & Stowe, affiliates of Vestar Capital Partners, and affiliates of Citicorp Venture Capital, to whom we refer to collectively as our equity sponsors, our management and employees, and a group of individuals. We refer to these persons and entities collectively throughout this prospectus as our existing equity holders. VTC, together with our equity sponsors, collectively hold substantially all of the outstanding equity interests of Valor Telecommunications Southwest, LLC, or VTS. VTC also currently holds all of the outstanding equity interests of Valor Telecommunications Southwest II, LLC, or VTS II.

As discussed in Detailed Transaction Steps on page 86, immediately prior to and in connection with this offering, we will consummate a reorganization pursuant to which our existing equity holders will contribute all their equity interests in VTC and VTS to Valor Communications Group, Inc., or Valor, in exchange for shares of common stock in the aggregate. Following our reorganization, Valor will exist as a holding company with no direct operations and each of VTC, VTS and VTS II will be either a direct or an indirect wholly-owned subsidiary of Valor. Valor s principal assets are the direct and indirect equity interests of its subsidiaries, all of which are pledged to the creditors under our new credit facility.

Following our reorganization, our management will collectively hold an aggregate of shares of our common stock. In addition, affiliates of Welsh, Carson, Anderson & Stowe, affiliates of Vestar Capital Partners and affiliates of Citicorp Venture Capital, or CVC, will beneficially own %, % and %, respectively, of our common stock. Therefore, Welsh Carson, Vestar and CVC together will be able to exert substantial influence over our company.

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New Credit Facility

On November 10, 2004, we entered into a $1.3 billion senior secured credit facility with a syndicate of financial institutions. The credit facility is comprised of a six-year $100 million senior secured revolving credit facility and a seven-year $1.2 billion senior secured term loan. Contemporaneously, we undertook a seven-year $265.0 million senior secured second lien loan and a seven and a half year $135.0 million senior subordinated loan. Banc of America Securities LLC, a lead manager in this offering, is one of the senior lead arrangers and senior book managers and an affiliate of Banc of America Securities LLC is the administrative agent of the credit facility, the second lien loan and the subordinated loan. An affiliate of J.P. Morgan Securities Inc., a lead manager in this offering, is one of the senior syndication agents and Merrill Lynch, Pierce, Fenner & Smith Incorporated, a lead manager in this offering, is one of the documentation agents on the credit facility, the second lien loan and the subordinated loan. We used the proceeds of the credit facility, the second lien loan and the subordinated loan to (i) repay all amounts owed under our previous senior credit facilities; (ii) redeem $325.5 million of 10% senior subordinated notes due 2010 held primarily by our equity sponsors, including interest accrued thereon; (iii) redeem $159.4 million of preferred interests held by our existing equity investors, including our equity sponsors, in our subsidiary Valor Telecommunications, LLC and (iv) pay $30.7 million in associated transaction costs. Throughout this prospectus, we refer to our entry into the credit facility, second lien loan and senior subordinated loan, and the repayment of our then existing indebtedness with the proceeds thereof, as our debt recapitalization.

As described in Use of Proceeds, we intend to repay in full our second lien loan and senior subordinated loan with the proceeds of this offering. Following repayment of the second lien loan and the senior subordinated loan, we expect to have $1.2 billion of senior debt outstanding under our term loan. In addition, we may issue senior notes concurrently with this offering, in which case we plan to use the proceeds from such issuance to repay a portion of the term loan outstanding under our credit facility.

Concurrently with the closing of this offering, we expect to amend our credit facility to permit us to, subject to certain conditions, pay dividends to holders of our common stock and use the proceeds from this offering in the manner set forth in Use of Proceeds. See Dividend Policy and Restrictions and Description of Certain Indebtedness New Credit Facility. The consummation of this offering is conditioned upon the completion of the amendment to our credit facility. Throughout this prospectus, we refer to this credit facility as so amended as the new credit facility.

Senior Notes

Concurrently with or following this offering, we may issue approximately $ million aggregate principal amount of senior notes in a private offering pursuant to Rule 144A of the Securities Act of 1933. We refer to these notes throughout this prospectus as our senior notes. If we offer these senior notes, we would use the proceeds from such issuance to repay a portion of the term loan outstanding under our new credit facility. This offering is not contingent upon our issuance of senior notes. We expect that if we issue senior notes, they will contain restrictions on our ability to pay dividends that are no more restrictive than those contained in our new credit facility.

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Our Corporate Structure After This Offering

The following chart reflects our capital structure immediately after the offering:

(1) Certain Valor Operating Entities and Kerrville Operating Entities are also borrowers under our new credit facility. Valor Communications Group, Inc., Valor Telecommunications, LLC, Valor Telecommunications Southwest, LLC, Valor Telecommunications Southwest II, LLC and each of our operating subsidiaries guarantee the obligations of these borrowers under the new credit facility.

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THE OFFERING

Shares of common stock offered by Valor Communications Group, Inc	shares
Shares of common stock offered by existing equity holders	shares if the underwriters over-allotment option is exercised in full.
Shares of common stock to be outstanding following the offering	shares.
Dividends	Upon completion of this offering, our board of directors will adopt a dividend policy which reflects an intention to distribute a substantial portion of the cash generated by our business in excess of operating needs, interest and principal payments on our indebtedness and capital expenditures as regular quarterly dividends to our stockholders. In accordance with our dividend policy, we currently intend to pay an initial dividend of $ per share on or about , 2005 and to continue to pay quarterly dividends at an annual rate of $ per share for the first full year following the closing of this offering, but only if and to the extent dividends are declared by our board of directors and are permitted by applicable law and by the terms of our new credit facility. Dividend payments are not guaranteed and our board of directors may decide, in its absolute discretion, at any time and for any reason, not to pay dividends. Dividends on our common stock are not cumulative. See Dividend Policy and Restrictions. We expect that the new credit facility will generally restrict the amount of dividends we may pay to the amount of our available cash, which is defined as Adjusted EBITDA *minus* cash interest expense, capital expenditures (if in excess of a certain amount, unless funded by permitted debt), scheduled and mandatory repayments of our indebtedness, cash taxes and certain other permitted expenses. In addition, we expect that the new credit facility will suspend our ability to pay dividends if our total leverage ratio for the most recently ended four fiscal quarter period exceeds to 1.00. See Description of Certain Indebtedness. Dividends paid by us, to the extent paid out of our current or accumulated earnings and profits, or E&P, as computed for United States federal income tax purposes, will be taxable as dividend income. Under current law, dividend income of United States individuals is generally taxable at long-term capital gains rates. Dividends paid by us in excess of our E&P will be treated first as a non-taxable return of capital and then as gain from the sale of common stock. For a more complete description, see Material United States Federal Tax Considerations.
Listing	We have applied to list our shares of common stock on the New York Stock Exchange under the trading symbol VCG.

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General Information About This Prospectus

Unless we specifically state otherwise, all information in this prospectus:

- assumes an initial public offering price of $ per share of common stock, which represents the mid-point of the range set forth on the cover page of this prospectus;
- assumes no exercise by the underwriters of their over-allotment option; and
- excludes shares of common stock issuable upon exercise of stock options that may be issued under our 2004 Long-Term Incentive Plan.

Risk Factors

You should carefully consider the information under the heading Risk Factors and all other information in this prospectus before investing in our common stock.

Our Corporate Information

We incorporated in Delaware in March 2004. Our principal executive offices are located at 201 E. John Carpenter Freeway, Suite 200, Irving, Texas 75062 and our telephone number is (972) 373-1000. Our website address is www.valortelecom.com. Information included or referred to on our website is not a part of this prospectus.

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Summary Consolidated Financial Information

Valor is a holding company and has no direct operations. Valor was formed for the sole purpose of reorganizing our corporate structure and consummating this offering. Valor s principal assets are the direct and indirect equity interests of its subsidiaries. As a result, we have not provided separate historical financial results for Valor and present only the historical consolidated financial results of Valor Telecommunications, LLC. The following table sets forth our summary consolidated financial information derived from our audited consolidated financial statements for each of the years ended December 31, 2001 through December 31, 2003, and our unaudited consolidated financial information for the nine months ended September 30, 2003 and 2004.

The information in the table below is only a summary and should be read together with our audited consolidated financial statements for the years ended December 31, 2001, 2002 and 2003 and the related notes, our unaudited condensed consolidated financial statements as of September 30, 2004 and for the nine months ended September 30, 2003 and 2004 and Management s Discussion and Analysis of Financial Condition and Results of Operations, all as included elsewhere in this prospectus.

	Year Ended December 31,			Nine Months Ended September 30,	
	2001	2002(1)	2003	2003	2004
	(Dollars in thousands)				
Statement of operations data:					
Operating revenues	$ 424,916	$ 479,883	$497,334	$372,450	$379,279
Operating income	103,298	159,251	182,273	136,285	136,484
Net (loss) income(2)	(53,355)	16,302	58,233	36,975	25,171
Cash flow data from continuing operations:					
Net cash provided by operating activities	$ 100,301	$ 150,383	$166,065	$132,461	$124,660
Net cash used in investing activities	(106,614)	(216,773)	(66,299)	(50,551)	(51,362)
Net cash provided by (used in) financing activities	8,117	71,015	(99,465)	(81,971)	(74,054)
Other data:					
Capital expenditures	$ 107,869	$ 89,527	$ 69,850	$ 53,239	$ 51,520
Acquisition of Kerrville Communications Corporation(3)	$	$ 128,135	$	$	$
Depreciation and amortization(4)	$ 110,843	$ 73,273	$ 81,638	$ 61,039	$ 63,993
Adjusted EBITDA(5)	$ 215,141	$ 240,595	$262,707	$194,879	$206,506
Total access lines(6)	551,599	571,308	556,745	558,790	547,925

	September 30, 2004		
	Actual	Adjustments	Pro Forma As Adjusted(7)
	(Dollars in thousands)		
Balance sheet data:			
Cash and cash equivalents	$ 641	$	$
Net property, plant and equipment	$ 757,976	$	$
Total assets	$2,012,865	$	$
Long-term debt (including current maturities)	$1,405,472	$	$
Notes payable	$ 13,765	$	$
Redeemable preferred interests	$ 370,231	$	$
Total common owners equity	$ 75,033	$	$

(1)

We acquired all the outstanding common stock, preferred stock and common stock equivalents of Kerrville Communications Corporation (KCC) on January 31, 2002 and have included the assets, liabilities and results of operations of KCC from that date.

(2) Net (loss) income reported on the table above is after the effect of minority interest of $(3,595), $615 and $3,568 in 2001, 2002 and 2003, respectively, and $2,364 and $3,171 for the nine months ended September 30, 2003 and 2004, respectively, relating to individual investors interests in our subsidiaries.

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(3) Reflects the purchase price for our acquisition of KCC, net of cash acquired.

(4) In accordance with Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets , effective January 1, 2002, we discontinued the amortization of goodwill. Amortization expense associated with goodwill was $53,900 for the year ended December 31, 2001.

(5) We expect that Adjusted EBITDA will be defined in our new credit facility as: (1) consolidated adjusted net income, as defined therein; *plus* (2) the following items, to the extent deducted from consolidated net income: (a) interest expense; (b) provision for income taxes; (c) depreciation and amortization; (d) certain expenses related to this offering, our recent recapitalization and the other transactions described in Use of Proceeds ; (e) other nonrecurring or unusual costs or losses incurred after the closing date, to the extent not exceeding $10.0 million; (f) unrealized losses on financial derivatives recognized in accordance with SFAS No. 133; (g) losses on sales of assets other than in the ordinary course of business; and (h) all other non-cash charges that represent an accrual for which no cash is expected to be paid in a future period; *minus* (3) the following items, to the extent any of them increases consolidated net income; (v) income tax credits; (w) interest and dividend income (other than in respect of RTFC patronage distribution); (x) gains on asset disposals not in the ordinary course; (y) unrealized gains on financial derivatives recognized in accordance with SFAS No. 133; and (z) all other non-cash income.

We consider Adjusted EBITDA an important indicator to investors in common stock because it provides information related to our ability to provide cash flows to service debt, pay dividends and fund capital expenditures. We present this discussion of Adjusted EBITDA because covenants in our new credit facility contain ratios based on this measure. If our Adjusted EBITDA were to decline below certain levels, covenants in our new credit facility that are based on Adjusted EBITDA, including our interest coverage ratio and total leverage ratio covenants, may be violated and could cause, among other things, a default or mandatory prepayment under our new credit facility, or result in our inability to pay dividends. As such, the summary historical financial information presented above includes our historical Adjusted EBITDA. Adjusted EBITDA is not a measure in accordance with GAAP, and should not be considered a substitute for, operating income (loss), net income (loss), or any other measure of financial performance reported in accordance with GAAP. In addition, Adjusted EBITDA should not be used as a substitute for our various cash flow measures (e.g., operating, investing and financing cash flows), which are discussed in Management s Discussion and Analysis of Financial Condition and Results of Operations.

	Year Ended December 31,			**Nine Months Ended September 30,**	
	2001	**2002**	**2003**	**2003**	**2004**
	(Dollars in thousands)				
Calculation of Adjusted EBITDA:					
Net (loss) income	$ (53,355)	$ 16,302	$ 58,233	$ 36,975	$ 25,171
Adjustments:					
Income tax expense (benefit)(a)		1,649	2,478	2,193	(6,095)
Interest expense	133,156	127,365	119,185	95,300	83,384
Depreciation and amortization	110,843	73,273	81,638	61,039	63,993
Minority interest	(3,595)	615	3,568	2,364	3,171
Loss on interest rate hedging arrangements	14,292	12,348	2,113	2,199	122
Earnings from unconsolidated cellular partnerships		(2,757)	(3,258)	(2,687)	(1,007)
Management fees paid to equity sponsors	1,000	1,000	1,000	750	750
Other income and expense, net(b)	(358)	268	62	(59)	25,060
Loss (income) on discontinued operations	8,443	3,461	(108)		
Cumulative effect of change in accounting principle	4,715				
Impairment on investments in cellular partnerships					6,678
Non-recurring items(c)		7,071	(2,204)	(3,195)	5,279
Total adjustments	268,496	224,293	204,474	157,904	181,335
Adjusted EBITDA	$215,141	$240,595	$262,707	$194,879	$206,506

(a)

Relates to the federal income tax expense of Valor Telecommunications Southwest II, LLC, the holding company of the operating entities relating to our KCC business, which has elected to be taxed as a corporation.

(b) Amount for the nine month period ended September 30, 2004 includes $18.0 million of expense recorded for the repurchase of shares held by individual investors in our minority-owned subsidiaries and $6.8 million of expense we recorded in connection with a previously withdrawn offering.

(c)	Non-recurring items, as defined in the new credit facility:					
	Termination benefits associated with workforce reduction		1,768			279
	MCI bankruptcy		4,998	(3,386)	(3,386)	
	Transaction fees for acquisitions not consummated		305	1,182	191	
	CEO transition payment					5,000
	Total non-recurring items, as defined in the new credit facility		7,071	(2,204)	(3,195)	5,279

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	Year Ended December 31,			Nine Months Ended September 30,	
	2001	2002(1)	2003	2003	2004
	(Dollars in thousands)				
Reconciliation of Net Cash Provided by Operating Activities to Adjusted EBITDA:					
Net cash provided by operating activities	$100,301	$150,383	$166,065	$132,461	$124,660
Adjustments:					
Interest expense	133,156	127,365	119,185	95,300	83,384
Amortization of debt issuance costs	(5,735)	(6,801)	(8,105)	(5,540)	(6,192)
Non-cash interest expense	(29,025)	(32,612)	(17,788)	(27,218)	
Provision for doubtful accounts receivable	(11,378)	(11,393)	(3,298)	(1,883)	(3,159)
Changes in working capital	29,923	(3,291)	(33)	(1,895)	(11,104)
Other, net	(2,743)	7,049	5,795	4,125	5,155
Income tax expense (benefit)		1,649	2,478	2,193	(6,095)
Deferred income taxes		(93)	(450)	(160)	6,756
Other income and expense, net	(358)	268	62	(59)	25,060
Management fees paid to equity sponsors	1,000	1,000	1,000	750	750
Non-recurring items(a)		7,071	(2,204)	(3,195)	(12,709)
Adjusted EBITDA	$215,141	$240,595	$262,707	$194,879	$206,506

(a) Non-recurring items, as defined in the new credit facility:					
Termination benefits associated with workforce reduction		1,768			279
MCI bankruptcy		4,998	(3,386)	(3,386)	
Transaction fees for acquisitions not consummated		305	1,182	191	
Costs related to reorganization transaction					(17,988)
CEO transition payment					5,000
Total non-recurring items, as defined in the new credit facility	—	7,071	(2,204)	(3,195)	(12,709)

(6) We calculate our access lines in service by counting the number of working communication facilities that provide local service that terminate in a central office or to a customers premise. Non-revenue producing lines provisioned for company official use and for test purposes are included in our total access line counts. There were 11,305, 11,258 and 11,703 non-revenue producing lines included in our total access line count at December 31, 2001, 2002 and 2003, which represented 2.0%, 2.0% and 2.1% of our total access line counts, respectively, and 11,340 and 12,158 non-revenue producing lines included in our total access line count at September 30, 2003 and 2004, which represented 2.0% and 2.2% of our total access line count, respectively.

(7) The pro forma as adjusted balance sheet data have been prepared assuming the closing of this offering, the debt recapitalization and the reorganization, including payment of related fees and expenses. The pro forma as adjusted balance sheet data give effect to those

transactions as if they had occurred on September 30, 2004.

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RISK FACTORS

Before you invest in our common stock, you should carefully consider the various risks of the investment, including those described below, together with all of the other information included in this prospectus. If any of these risks actually occurs, our business, financial condition or operating results could be adversely affected.

Risks Relating to Our Common Stock and Our New Credit Facility

You may not receive any dividends.

We are not obligated to pay dividends. Dividend payments are not guaranteed and are within the absolute discretion of our board of directors. Future dividends with respect to shares of our common stock, if any, will depend on, among other things, our results of operations, cash requirements, financial condition, contractual restrictions, business opportunities, anticipated cash needs, provisions of applicable law and other factors that our board of directors may deem relevant. In addition, we have reported a loss from continuing operations in the past.

We might not generate sufficient cash from operations in the future to pay dividends on our common stock in the intended amounts or at all. Our board of directors may decide not to pay dividends at any time and for any reason. Our dividend policy is based upon our directors current assessment of our business and the environment in which we operate, and that assessment could change based on competitive or technological developments (which could, for example, increase our need for capital expenditures), new growth opportunities or other factors. If our cash flows from operations for future periods were to fall below our minimum expectations, we would need either to reduce or eliminate dividends or, to the extent permitted under the terms of our new credit facility, fund a portion of our dividends with borrowings or from other sources. If we were to use working capital or permanent borrowings to fund dividends, we would have less cash and/or borrowing capacity available for future dividends and other purposes, which could negatively affect our financial condition, our results of operations, our liquidity and our ability to maintain or expand our business. Our board is free to depart from or change our dividend policy at any time and could do so, for example, if it were to determine that we had insufficient cash to take advantage of growth opportunities. In addition, our new credit facility will contain, and any agreement we enter into in the future to refinance this indebtedness may contain, limitations on our ability to pay dividends. See Dividend Policy and Restrictions and Description of Certain Indebtedness. The reduction or elimination of dividends may negatively affect the market price of our common stock.

Our dividend policy may limit our ability to pursue growth opportunities.

Upon the completion of this offering, our board of directors will adopt a dividend policy that reflects an intention to distribute a substantial portion of the cash generated by our business in excess of operating needs, interest and principal payments on our indebtedness and capital expenditures as regular quarterly dividends to our stockholders. As a result, we may not retain a sufficient amount of cash to finance growth opportunities or to fund our operations in the event of a significant business downturn. In addition, because a significant portion of cash available to pay dividends will be distributed to holders of our common stock under our dividend policy, our ability to pursue any material expansion of our business, including through acquisitions, increased capital spending or other increases of our expenditures, will depend more than it otherwise would on our ability to obtain third party financing. We cannot assure you that such financing will be available to us at all, or at an acceptable cost. See Dividend Policy and Restrictions.

Our substantial indebtedness could restrict our ability to pay dividends and impact our financing options and liquidity position.

Upon the consummation of this offering, we will have approximately $1.2 billion of total debt outstanding. The degree to which we are leveraged on a consolidated basis could have important consequences to the holders of our common stock, including:

- it may be more difficult to pay dividends on our common stock;

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- our ability to obtain additional financing in the future for working capital, capital expenditures or acquisitions may be limited;

- we may be unable to refinance our indebtedness on terms acceptable to us or at all;

- a significant portion of our cash flow from operations is likely to be dedicated to the payment of the principal of and interest on our indebtedness, thereby reducing funds available for other corporate purposes; for example, as described under Dividend Policy and Restrictions we expect that our interest expense for the year following the offering will be $, which would have represented % of our Adjusted EBITDA for the twelve months ended September 30, 2004; and

- our substantial indebtedness may make us more vulnerable to economic downturns and limit our ability to withstand competitive pressures.

We are subject to restrictive debt covenants that impose operating and financial restrictions on our operations and could limit our ability to grow our business.

We expect that covenants in our new credit facility will impose significant operating and financial restrictions on us. These restrictions prohibit or limit, among other things:

- the incurrence of additional indebtedness and the issuance of preferred stock and certain redeemable capital stock;

- the payment of dividends on, and the repurchase of, capital stock;

- a number of other restricted payments, including investments and acquisitions;

- specified sales of assets;

- specified transactions with affiliates;

- the creation of a number of liens;

- consolidations, mergers and transfers of all or substantially all of our assets; and

- our ability to change the nature of our business.

These restrictions could limit our ability to obtain future financing, make acquisitions, withstand downturns in our business or take advantage of business opportunities. Furthermore, we expect that the new credit facility will require us to maintain specified total leverage and interest coverage ratios and to satisfy specified financial condition tests, and under certain circumstances requires us to make quarterly mandatory prepayments with a portion of our available cash. See Description of Certain Indebtedness New Credit Facility. Our ability to comply with the ratios or tests may be affected by events beyond our control, including prevailing economic, financial and industry conditions.

If we fail to comply with the restrictive covenants in our new credit facility, our senior lenders may accelerate the payment of indebtedness outstanding under our new credit facility.

The terms of our new credit facility may include several restrictive covenants that prohibit us from prepaying our other indebtedness while indebtedness under our new credit facility is outstanding. Our new credit facility also requires us to maintain specified financial ratios and satisfy financial condition tests. Our ability to comply with the ratios or tests may be affected by events beyond our control, including prevailing economic, financial and industry conditions. See the information under Description of Certain Indebtedness for a fuller description of these restrictions and covenants.

A breach of any of these covenants, ratios or tests could result in a default under the new credit facility. Upon the occurrence of an event of default, the lenders could elect to declare all amounts outstanding under the new credit facility, together with accrued interest, to be immediately due and payable. If we were unable to repay or refinance those amounts, the lenders could proceed against the security granted to them to secure that indebtedness. If the lenders accelerate the payment of the indebtedness, our assets may not be sufficient to repay in full this indebtedness.

We are a holding company with no operations, and unless we receive dividends and other payments or distributions, advances and transfers of funds from our subsidiaries, we will be unable to meet our debt service and other obligations.

We are a holding company and conduct all of our operations through our subsidiaries. We currently have no significant assets other than equity interests in our subsidiaries. As a result, we will rely on dividends and other payments or distributions from our subsidiaries to meet our debt service obligations and enable us to pay dividends. The ability of our subsidiaries to pay dividends or make other payments or distributions to us will depend on their respective operating results and may be restricted by, among other things, the laws of their jurisdiction of organization (which may limit the amount of funds available for the payment of dividends), agreements of those subsidiaries, the terms of the new credit facility (under which the equity interests of our subsidiaries will be pledged), and the covenants of any future outstanding indebtedness we or our subsidiaries incur.

If you purchase shares of our common stock, you will experience immediate and substantial dilution.

Investors purchasing common stock in the offering will experience immediate and substantial dilution in the net tangible book value of their shares. At an initial public offering price of $ per share, the midpoint of the range shown on the cover of this prospectus, dilution to new investors is $ per share. Additional dilution will occur upon exercise of any stock options that we issue in the future. If we seek additional capital in the future, the issuance of shares of common stock or securities convertible into shares of common stock in order to obtain such capital may lead to further dilution of your investment. See Dilution.

Our interest expense may increase significantly and could cause our net income and distributable cash to decline significantly.

The new credit facility is subject to periodic renewal or must otherwise be refinanced. We may not be able to renew or refinance the new credit facility, or if renewed or refinanced, the renewal or refinancing may occur on less favorable terms, including higher interest rates. Borrowings under the revolving facility and the term loans will be made at a floating rate of interest. In the event of an increase in the base reference interest rates, our interest expense will increase and could have a material adverse effect on our ability to make cash dividend payments to our stockholders. Our ability to continue to expand our business will, to a large extent, be dependent upon our ability to borrow funds under our new credit facility and to obtain other third party financing, including through the sale of common stock or other securities. We cannot assure you that such financing will be available to us on favorable terms or at all.

Before this offering, there was no public market for our common stock. This may cause volatility in the trading price of the common stock, which could negatively affect the value of your investment.

Prior to this offering, there was no public market for our common stock. The initial public offering price of the common stock will be determined by negotiations between us and the underwriters and may not be indicative of the market price for our common stock in the future. There can be no assurance that an active trading market for our common stock will develop or be sustained after the offering. If a trading market develops, the market price of our common stock may fluctuate widely as a result of various factors, such as period-to-period fluctuations in our operating results, sales of our common stock by principal stockholders, developments in the telecommunications industry, the failure of securities analysts to cover our common stock after this offering or changes in financial estimates by analysts, competitive factors, regulatory developments, economic and other external factors, general market conditions and market conditions affecting the stock of telecommunications companies in particular. Telecommunications companies have in the past experienced extreme volatility in the trading prices and volumes of their securities, which has often been unrelated to operating performance. Any such market volatility may have a significant adverse effect on the market price and marketability of our common stock.

Future sales or the possibility of future sales of a substantial amount of our common stock may depress the price of the shares of our common stock.

Future sales or the availability for sale of substantial amounts of our common stock in the public market could adversely affect the prevailing market price of our common stock and could impair our ability to raise capital through future sales of our equity securities.

Upon consummation of this offering, there will be shares of common stock outstanding. The shares of common stock sold in this offering will be freely transferable without restriction or further registration under the Securities Act. The remaining shares of common stock outstanding, including the shares owned by our existing equity investors, will be restricted securities within the meaning of Rule 144 under the Securities Act, but will be eligible for resale subject to applicable volume, manner of sale, holding period and other limitations of Rule 144. We and certain existing equity investors have agreed to a lock-up, meaning that neither we nor they will sell any shares without the prior consent of the representatives of the underwriters for 180 days after the date of this prospectus. Following the expiration of this 180-day lock-up period, all of the shares of our common stock subject to the lock-up will be eligible for future sale, subject to the applicable volume, manner of sale, holding period and other limitations of Rule 144. See Shares Eligible for Future Sale for a discussion of the shares of common stock that may be sold into the public market in the future. In addition, our existing equity investors have registration rights with respect to the common stock that they will retain following this offering. See Related Party Transactions Securityholders Agreement.

We may issue shares of our common stock or other securities from time to time as consideration for future acquisitions and investments. In the event any such acquisition or investment is significant, the number of shares of our common stock or the number of other securities that we may issue may in turn be significant. In addition, we may also grant registration rights covering those shares of common stock or other securities in connection with any such acquisitions and investments. Any or all of these occurrences could depress the trading prices of our securities.

Limitations on use of our net operating losses may negatively affect our ability to pay dividends to you.

Because certain of our subsidiaries will have an ownership change for purposes of Section 382 of the Internal Revenue Code as a result of our reorganization immediately prior to the consummation of this offering, the use of our current net operating losses to offset our taxable income for taxable periods will be limited pursuant to Section 382 of the Internal Revenue Code. In addition, we may have another ownership change for purposes of Section 382 of the Internal Revenue Code subsequent to this offering if, under certain circumstances, our existing equity holders were to sell within a three-year period all (or most) of our common stock that they received in our reorganization. If we do experience another ownership change, we may be further limited, pursuant to Section 382 of the Internal Revenue Code, in using our then-current net operating losses to offset taxable income for taxable periods (or portions thereof) beginning after the second ownership change. Consequently, in the future we may be required to pay increased cash income taxes because of the Section 382 limitations on our ability to use our net operating losses. Increased cash taxes would reduce our after-tax cash flow available for payment of dividends on our common stock.

Regulatory Risks

We received 24.1% of our 2003 revenues from the Texas and federal Universal Service Funds and any adverse regulatory developments with respect to these funds could curtail our profitability.

We receive Texas and federal Universal Service Fund, or USF, revenues to support the high cost of providing affordable telecommunications services in rural markets. Such support payments constituted 24.1% of our revenues for the year ended December 31, 2003 and 23.9% of our revenues for the nine

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months ended September 30, 2004. Of these support payments, in the year ended December 31, 2003, $103.1 million, or 20.7% of our revenues, and in the nine months ended September 30, 2004, $76.8 million, or 20.2% of our revenues, were received from the Texas USF. In addition, we are required to make contributions to the Texas USF and federal USF each year. Current state and federal regulations allow us to recover these costs by including a surcharge on our customers bills. Furthermore, we incur no incremental costs associated with the support payments we receive or the contributions we are required to make. Thus, if Texas and/or federal regulations changed and we were unable to receive support, such support was reduced, or we are unable to recover the amounts we contribute to the Texas USF and federal USF from our customers, our earnings would be directly and adversely affected. For a more detailed discussion of the regulations affecting our company, see Regulation.

The rules governing USF could be altered or amended as a result of regulatory, legislative or judicial action and impact the amount of USF support that we receive and our ability to recover our USF contributions by assessing surcharges on our customers bills. For example, the enabling statute for the Texas USF will become subject to review and renewal in late 2005 and may be modified. Similarly, in June 2004, the FCC asked the Federal-State Joint Board on Universal Service to review the federal rules relating to universal service support mechanisms for rural carriers, including addressing the relevant costs and the definition of rural telephone company. It is not possible to predict at this time whether state or federal regulators, Congress or state legislatures will order modification to those rules or statutes, or the ultimate impact any such modification might have on us.

In addition, the Texas USF rules provide that the Public Utility Commission of Texas must open an investigation within 90 days after any changes are made to the federal USF. Therefore, changes to the federal USF may prompt similar or conforming changes to the Texas USF. The outcome of any of these legislative or regulatory changes could affect the amount of Texas USF support that we receive, and could have an adverse effect on our business, revenue or profitability.

Reductions in the amount of network access revenue that we receive could negatively impact our results of operations.

In the year ended December 31, 2003, we derived $132.0 million, or 26.6% of our revenues, and in the nine months ended September 30, 2004, we derived $96.3 million, or 25.4% of our revenues, from network access charges. Our network access revenue consists of (1) usage sensitive fees we charge to long distance companies for access to our network in connection with the completion of interstate and intrastate long distance calls, (2) fees charged for use of dedicated circuits and (3) end user fees, which are monthly flat-rate charges assessed on access lines. Federal and state regulatory commissions set these access charges, and they could change the amount of the charges or the manner in which they are charged at any time. The FCC is currently examining proposals to revise interstate access charges and other intercarrier compensation. The outcome of this proceeding is uncertain and could result in significant changes to the way in which we receive compensation from our customers. Also, as people in our markets decide to use Internet, wireless or cable television providers for their local or long distance calling needs, rather than using our wireline network, the reduction in the number of access lines or minutes of use over our network could reduce the amount of access revenue we collect. As penetration rates for these technologies increase in rural markets, our revenues could decline. In addition, if our customers take advantage of favorable calling plans offered by wireless carriers for their long distance calling needs, it could reduce the number of long distance calls made over our network, thereby decreasing our access revenue. Furthermore, the emerging technology application known as Voice over Internet Protocol, or VoIP, can be used to carry voice communications services over a broadband Internet connection. The FCC has ruled that some VoIP arrangements are not subject to regulation as telephone services. Recently, the FCC ruled that certain VoIP services are jurisdictionally interstate, and preempted the ability of the states to regulate such VoIP applications or providers. The FCC has pending a proceeding that will address the applicability of various regulatory requirements to VoIP providers, however, we cannot assure you that this proceeding will result in VoIP providers having to pay access charges. Expanded use of VoIP technology could reduce the access revenues received by local exchange carriers like us. We cannot predict whether or when VoIP may be required to pay or be entitled to receive access charges or universal service fund support, or the extent to which users will substitute VoIP calls for traditional wireline communications or the effect of the growth of VoIP on our revenues.

The introduction of new competitors or the better positioning of existing competitors due to regulatory changes could cause us to lose customers and impede our ability to attract new customers.

Changes in regulations that open our markets to more competitors offering substitute services could impact our profitability because of increases in the costs of attracting and retaining customers and decreases in revenues due to lost customers and the need to offer competitive prices. We face competition from current and potential market entrants, including:

- domestic and international long distance providers seeking to enter, reenter or expand entry into the local telecommunications marketplace;

- other domestic and international competitive telecommunications providers, wireless carriers, resellers, cable television companies and electric utilities; and

- providers of broadband and Internet services.

Regulatory requirements designed to facilitate the introduction of competition, the applicability of different regulatory requirements between our competitors and us, or decisions by legislators or regulators to exempt certain providers or technologies from the same level of regulation that we face, could adversely impact our market position and our ability to offer competitive alternatives.

In November 2003, the FCC ordered us and other local exchange carriers to adopt wireline-to-wireless local number portability. This may help wireless carriers compete against us because if customers switch from traditional local telephone service to wireless service, they can now transfer their local telephone number to their wireless provider. In addition, federal and state regulators and courts are addressing many aspects of our obligations to provide unbundled network elements and discounted wholesale rates to competitors.

New regulations and changes in existing regulations may force us to incur significant expenses.

Our business may also be impacted by legislation and regulation that impose new or greater obligations related to assisting law enforcement, bolstering homeland security, minimizing environmental impacts or addressing other issues that impact our business. For example, existing provisions of the Communications Assistance for Law Enforcement Act, or CALEA, and FCC regulations implementing CALEA require telecommunications carriers to ensure that their equipment, facilities, and services are able to facilitate authorized electronic surveillance. On August 4, 2004, in response to a joint petition filed by the Department of Justice, Federal Bureau of Investigation, and the Drug Enforcement Administration, the FCC launched a Notice of Proposed Rulemaking proposing a thorough examination of the appropriate legal and policy framework of CALEA. In this proceeding, the FCC will examine issues relating to the scope of CALEA s applicability to services such as broadband Internet access, as well as implementation and enforcement issues. We cannot predict the eventual outcome of this proceeding or what compliance with any rules adopted by the FCC may cost. Similarly, we cannot predict whether or when federal or state legislators or regulators might impose new security, environmental or other obligations on our business.

For a more thorough discussion of the regulation of our company and how that regulation may affect our business, see Regulation.

A reduction by a state regulatory body or the FCC of the rates we charge our customers would reduce our revenues and earnings.

The prices, terms and conditions of the services that we offer to local telephone customers are subject to state regulatory approval. If a state regulatory body orders us to reduce a price, withdraws our approval to

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charge a certain price, changes material terms or conditions of a service we offer or refuses to approve or limits our ability to offer a new or existing service, both our revenues and our earnings may be reduced.

FCC regulations also affect the rates that are charged to customers. The FCC regulates tariffs for interstate access and subscriber line charges, both of which are components of our revenues. The FCC currently is considering proposals to reduce interstate access charges for carriers like us. If the FCC lowers interstate access charges without adopting an adequate revenue replacement mechanism, we may be required to recover more revenue through subscriber line charges and Universal Service Funds or forego this revenue altogether. This could reduce our revenue or impair our competitive position.

Our business is subject to extensive regulation that could change in a manner adverse to us.

We operate in a heavily regulated industry, and most of our revenues come from providing services regulated by the Federal Communications Commission, or FCC, and the state public utility commissions. Federal and state communications laws may be amended in the future, and other laws may affect our business. The FCC and the state public utility commissions may add new rules, amend their rules or change the interpretation of their rules at any time. Laws and regulations applicable to us and our competitors may be, and have been, challenged in the courts, and could be changed at any time. We cannot predict future developments or changes to the regulatory environment, or the impact such developments or changes would have on us. See Regulation.

Risks Relating to Our Business

We provide services to our customers over access lines and if we continue to lose access lines our revenues and earnings may decrease.

Our business generates revenue by delivering voice and data services over access lines. We have experienced net access line loss over the past few years, and during the year ended December 31, 2003, the number of access lines we serve declined by 2.6% due to challenging economic conditions, increased competition and the introduction of DSL and cable modems. Furthermore, our access line count decreased by approximately 8,800 lines, or 1.6%, during the nine months ended September 30, 2004. We may continue to experience net access line loss in our markets for an unforeseen period of time. Our inability to retain access lines could adversely affect our revenue and earnings.

Rapid and significant changes in technology in the telecommunications industry could adversely affect our ability to compete effectively in the markets in which we operate.

The rapid introduction and development of enhanced or alternative services that are more cost effective, more efficient or more technologically advanced than the services we offer is a significant source of potential competition in the telecommunications industry. Technological developments may reduce the competitiveness of our networks, make our service offerings less attractive or require expensive and time-consuming capital improvements. If we fail to adapt successfully to technological changes or fail to obtain timely access to important new technologies, we could lose customers and have difficulty attracting new customers or selling new services to our existing customers.

We cannot predict the impact of technological changes on our competitive position, profitability or industry. Wireless and cable technologies that have emerged in recent years provide certain advantages over traditional wireline voice and data services. The mobility afforded by wireless voice services and its competitive pricing appeal to many customers. The ability of cable television providers to offer voice, video and data services as an integrated package provides an attractive alternative to traditional voice services from local exchange carriers. In addition, as the emerging VoIP services develop, some customers may be able to bypass network access charges. Increased penetration rates for these technologies in our markets could cause our revenues to decline.

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The competitive nature of the telecommunications industry could adversely affect our revenues, results of operations and profitability.

The telecommunications industry is very competitive. Increased competition could lead to price reductions, declining sales volumes, loss of market share, higher marketing costs and reduced operating margins. Significant and potentially larger competitors could enter our markets at any time. For example, wireless providers currently compete in most of our rural markets. We expect this competition to continue, and likely become more acute, in the future. We also compete, or may in the future compete, with companies that provide other close substitutes for the traditional telephone services we provide, like cable television, voice over Internet protocol, high-speed fiber optic networks or satellite telecommunications services, and companies that might provide traditional telephone services over nontraditional network infrastructures, like electric utilities. In our largest market in which we serve 74,000 access lines, the incumbent local cable television operator has begun offering an alternative local telephone service. We may experience additional access line loss as a result of this activity, which could have an adverse impact on our revenues and earnings.

For a more thorough discussion of the competition that may affect our business, see Business Competition.

Weak economic conditions may decrease demand for our services.

We are sensitive to economic conditions and downturns in the economy. Downturns in the economies in the markets we serve could cause our existing customers to reduce their purchases of our basic and enhanced services and make it difficult for us to obtain new customers.

We depend on a few key vendors and suppliers to conduct our business and any disruption in our relationship with any one or more of them could adversely affect our results of operations.

We rely on vendors and suppliers to support many of our administrative functions and to enable us to provide long distance services. For example, we currently outsource much of our operational support services to ALLTEL, including our billing and customer care services. Transitioning these support services to another provider could take a significant period of time and involve substantial costs. In addition, we have resale agreements with MCI and Sprint to provide our long distance transmission services. Replacing these resale agreements could be difficult as there are a limited number of national long distance providers. Any disruptions in our relationship with these third party providers could have an adverse effect on our business and operations.

Disruption in our networks and infrastructure may cause us to lose customers and incur additional expenses.

To be successful, we will need to continue to provide our customers with reliable service over our networks. Some of the risks to our networks and infrastructure include: physical damage to access lines, breaches of security, capacity limitations, power surges or outages, software defects and disruptions beyond our control, such as natural disasters and acts of terrorism.

From time to time in the ordinary course of our business, we experience short disruptions in our service due to factors such as cable damage, inclement weather and service failures of our third party service providers. We cannot assure you that we will not experience more significant disruptions in the future. Disruptions may cause interruptions in service or reduced capacity for customers, either of which could cause us to lose customers and incur expenses, and thereby adversely affect our business, revenue and cash flow.

Recent difficulties in the telecommunications industry could negatively impact our revenues and results of operations.

We originate and terminate long distance phone calls on our networks for other interexchange carriers, some of which are our largest customers in terms of revenues. In the year ended December 31, 2003 and the nine months ended September 30, 2004, we generated 17.5% and 16.6%, respectively, of our total revenues from originating and terminating phone calls for interexchange carriers. Several of these interexchange carriers have declared bankruptcy during the past two years or are experiencing substantial financial difficulties. MCI WorldCom (now MCI), which declared bankruptcy in 2002, is one of the major interexchange carriers with which we conduct business. We recorded a net $1.6 million charge due to MCI s failure to pay amounts owed to us. Further bankruptcies or disruptions in the businesses of these interexchange carriers could have an adverse effect on our financial results and cash flows.

Following the consummation of this offering, our equity sponsors will collectively be able to exercise substantial influence over matters requiring stockholder approval and their interests may diverge from the interests of the holders of our common stock.

Following the consummation of this offering, affiliates of Welsh, Carson, Anderson & Stowe, or WCAS, affiliates of Vestar Capital Partners, or Vestar, and affiliates of Citicorp Venture Capital, or CVC, will beneficially own %, % and %, respectively, of our outstanding shares of common stock. As a result, WCAS, Vestar and CVC collectively exercise substantial influence over matters requiring stockholder approval, including decisions about our capital structure. In addition, WCAS has two designees and Vestar has one designee serving on our board of directors. The interests of our equity sponsors may conflict with your interests as a holder of common stock.

Our amended and restated certificate of incorporation and by-laws and several other factors could limit another party s ability to acquire us and deprive our investors of the opportunity to obtain a takeover premium for their securities.

A number of provisions in our amended and restated certificate of incorporation and by-laws will make it difficult for another company to acquire us and for you to receive any related takeover premium on our securities. For example, our amended and restated certificate of incorporation provides that stockholders may not act by written consent and that only our board of directors may call a special meeting. In addition, stockholders are required to provide us with advance notice if they wish to nominate any persons for election to our board of directors or if they intend to propose any matters for consideration at an annual stockholders meeting. Our amended and restated certificate of incorporation authorizes the issuance of preferred stock without stockholder approval and upon such terms as the board of directors may determine. The rights of the holders of shares of our common stock will be subject to, and may be adversely affected by, the rights of holders of any class or series of preferred stock that may be issued in the future.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Some of the statements under Summary, Risk Factors, Dividend Policy and Restrictions, Management s Discussion and Analysis of Financial Condition and Results of Operations, Business, Regulation and elsewhere in this prospectus may include forward-looking statements which reflect our current views with respect to future events and financial performance. Statements which include the words may, will, should, could, would, predicts, potential, continue, future, estimates, expect, intend, plan, believe, project, anticipate and similar stater forward-looking nature identify forward-looking statements for purposes of the federal securities laws or otherwise.

All forward-looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause actual results to differ materially from those indicated in these statements. We believe that these factors include the following:

our high degree of leverage and significant debt service obligations;

our ability to amend our new credit facility in ways that restrict our right to pay dividends on our common stock;

any adverse changes in government regulation;

the risk that we may not be able to retain existing customers or obtain new customers;

the risk of technological innovations outpacing our ability to adapt or replace our equipment to offer comparable services;

the risk of increased competition in the markets we serve;

the risk of weaker economic conditions within the United States;

changes in accounting policies or practices adopted voluntarily or as required by accounting principles generally accepted in the United States; and

the matters described under Risk Factors .

We undertake no obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise.

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USE OF PROCEEDS

Based on an assumed initial public offering price of $ per share of common stock (the midpoint of the range shown on the cover of this prospectus), we estimate that we will receive net proceeds from this offering of approximately $ million after deducting underwriting discounts and commissions and other estimated offering expenses payable by us. We will use these net proceeds as follows:

Repayment of existing indebtedness(1)	$400,000,000
Fees and expenses relating to our reorganization and new credit facility(2)	$
General corporate purposes	$

(1) Comprised of repayment of the $265 million second lien loan and the $135 million senior subordinated loan.

(2) Includes an estimated $ million payable to the lenders under our new credit facility and approximately $ million in the aggregate of legal fees and other miscellaneous expenses associated with our reorganization, including prepayment fees and other expenses associated with our repayment of existing indebtedness.

If the underwriters exercise their overallotment option in full, the underwriters will purchase an aggregate of shares of common stock from our existing equity holders. We will not receive any of the proceeds from the sale of common stock by our existing equity holders.

The second lien loan will mature on November 10, 2011, and the senior subordinated loan will mature on May 10, 2012. As of November 30, 2004, amounts outstanding under the second lien loan bore interest at a weighted average annual rate of 9.93%. Amounts outstanding under the senior subordinated loan bore interest at an annual rate of 12.88%. The proceeds from the second lien loan and the senior subordinated loan, together with the proceeds from our revolving facility and term loans, were used to refinance our then existing credit facilities.

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DIVIDEND POLICY AND RESTRICTIONS

General

Upon completion of this offering, our board of directors will adopt a dividend policy which reflects an intention to distribute a substantial portion of the cash generated by our business in excess of operating needs, interest and principal payments on our indebtedness and capital expenditures as regular quarterly dividends to our stockholders, rather than retaining all such cash for other purposes. This policy reflects our judgment that our stockholders would be better served if we distributed to them a substantial portion of the cash generated by our business.

We believe that our dividend policy will limit, but not preclude, our ability to pursue growth. If we continue paying dividends at the level currently anticipated under our dividend policy, we expect that we would need additional financing to fund significant acquisitions. However, we intend to retain sufficient cash after the distribution of dividends to permit the pursuit of growth opportunities that do not require material capital investment. For further discussion of the relationship of our dividend policy to our ability to pursue potential growth opportunities, see Assumptions and Considerations below.

In accordance with our dividend policy, we currently intend to pay an initial dividend of $ per share on or about , 2005 and to continue to pay quarterly dividends at an annual rate of $ per share for the first full year following the closing of this offering.

In determining our expected initial dividend level, we reviewed and analyzed, among other things:

- our operating and financial results in recent years, including in particular the fact that our Adjusted EBITDA was $215.1 million in 2001; $240.6 million in 2002; $262.7 million in 2003; and $274.3 million in the twelve months ended September 30, 2004;
- our anticipated capital expenditure requirements;
- our expected other cash needs, primarily related to working capital requirements;
- the terms of our debt instruments, including our new credit facility;
- other potential sources of liquidity, including working capital and the possibility of asset sales; and
- various other aspects of our business.

However, as described more fully below, you may not receive any dividends, as a result of the following factors:

- we may not have enough cash to pay dividends due to changes in our operating earnings, working capital requirements and anticipated cash needs;
- we are not required to pay dividends and while the dividend policy adopted by our board of directors contemplates the distribution of a substantial portion of our cash available to pay dividends, our board could modify or revoke this policy at any time;
- even if our dividend policy is not modified or revoked, the actual amount of dividends distributed under the policy and the decision to make any distribution will remain at all times entirely at the discretion of our board of directors;
- the amount of dividends that we may distribute is limited by the covenants in our new credit facility and, potentially, the terms of any future indebtedness that we may incur;
- the amount of dividends that we may distribute is subject to restrictions under Delaware law; and
- our stockholders have no contractual or other legal right to dividends.

We have no history of paying dividends out of our cash flow. Dividends on our common stock are not cumulative.

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Minimum Adjusted EBITDA

We do not as a matter of course make public projections as to future sales, earnings, or other results. However, our management has prepared the estimated financial information set forth below to present the estimated cash available to pay dividends based on estimated minimum Adjusted EBITDA. The accompanying estimated financial information was not prepared with a view toward complying with the Public Company Accounting Oversight Board guidelines with respect to prospective financial information, but, in the view of our management, was prepared on a reasonable basis, reflects the best currently available estimates and judgments, and presents, to the best of management s knowledge and belief, our expected course of action and our expected future financial performance. However, this information is not fact and should not be relied upon as being necessarily indicative of future results, and readers of this prospectus are cautioned not to place undue reliance on the estimated financial information.

Neither our independent registered public accounting firm nor any other independent registered public accounting firm has compiled, examined, or performed any procedures with respect to the estimated financial information contained herein, nor have they expressed any opinion or any other form of assurance on such information or its achievability, and assume no responsibility for, and disclaim any association with, the estimated financial information.

The assumptions and estimates underlying the estimated financial information below are inherently uncertain and, though considered reasonable by our management as of the date of its preparation, are subject to a wide variety of significant business, economic, and competitive risks and uncertainties, including those described under Risk Factors. Accordingly, there can be no assurance that the estimated financial information is indicative of our future performance or that the actual results will not differ materially from the estimated financial information presented below.

We believe that, in order to fund dividends on our common stock for the year following this offering at the level described above solely from cash generated by our business, our Adjusted EBITDA for the year following the offering would need to be at least $ million. As described under Assumptions and Considerations below, we believe that our minimum Adjusted EBITDA for the year following the closing of this offering will be at least $ million and we have determined that our assumptions as to capital expenditures, cash interest expense, income taxes, working capital and availability of funds under our new revolving credit facility are reasonable. We have also determined that if our Adjusted EBITDA for such period is at or above this level, we would be permitted to pay dividends at the level described above under the restricted payment and total leverage covenants that we expect will be contained in our new credit facility. We expect that the senior notes, if issued, will contain restrictions on our ability to pay dividends that are no more restrictive than those contained in our new credit facility.

The following table sets forth our calculation illustrating that $ million of Adjusted EBITDA would be sufficient to fund dividends at the above level for the first full year following the closing of the offering and would satisfy the restricted payment covenant that we expect will be contained in our new credit facility. We expect that Adjusted EBITDA of $ million for the first full year following the closing of the offering would permit us to pay dividends at our anticipated level under all relevant financial and restricted payment covenants and restrictions that we expect will be contained in the new credit facility and any other agreement that governs any other indebtedness we incur.

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	Amount
	(Dollars in thousands)
Estimated Cash Available to Pay Dividends on Common Stock Based On Minimum Adjusted EBITDA	
Minimum Adjusted EBITDA(1)	$
Less:	
Estimated capital expenditures(2)	
Estimated cash interest expense(3)	
Estimated cash income taxes(4)	
	—
Estimated cash available to pay dividends on outstanding common stock(5)	$
Estimated total leverage ratio derived from the above(6)	x
Estimated interest coverage ratio derived from the above(7)	x

(1) In comparing our estimated minimum Adjusted EBITDA to our historical Adjusted EBITDA, our historical Adjusted EBITDA does not include approximately $2.5 million in incremental ongoing expenses associated with being a public issuer, including estimated incremental audit fees, director and officer liability insurance premiums, expenses relating to stockholders meetings, printing expenses, investor relations expenses, additional filing fees, registrar and transfer agent fees, directors fees, additional legal fees, listing fees and miscellaneous fees. In addition, under our new credit facility, we may incur up to $10 million in transaction costs related to permitted acquisitions and other nonrecurring costs in any four consecutive fiscal quarter period. If we spend the $10 million permitted under the new credit facility in the first year following the offering, our minimum Adjusted EBITDA would need to be million.

(2) The majority of our capital expenditures relate to our telecommunications network. For the twelve months ended September 30, 2004, our capital expenditures were approximately $68.1 million. We expect capital expenditures for fiscal 2004 to be approximately $68.8 million and then to decline to approximately $58.8 million in 2005.

(3) Reflects our anticipated cash interest expense under our new credit facility. Accordingly, assumes interest at a weighted average rate of % on $ million outstanding borrowings under the new term facility, a rate of % on the $ million outstanding balance under the new $100.0 million revolving credit facility and a 0.50% commitment fee on an average unused balance of $ million under the new revolving credit facility. Concurrently with this offering, we may issue senior notes and repay term loans outstanding under the new credit facility with the proceeds of such issuance. If we offer these senior notes, we expect that the rate at which interest accrues on amounts outstanding under the senior notes will be greater than the interest rates under our new credit facility, and therefore, although our total indebtedness would not change, our estimated cash interest expense would be greater than the amount presented on the table above.

(4) Reflects estimated cash taxes we will pay on our taxable income at an assumed rate of 38%.

(5) The table below sets forth the assumed number of outstanding shares of common stock upon the closing of this offering and the estimated per share and aggregate dividend amounts payable on such shares during the year following the closing of this offering.

	Number of Shares	Dividends Per Share	Dividends Aggregate
			(In thousands)
Estimated dividends on our outstanding common stock		$	$

(6) Total leverage ratio is calculated under our new credit facility as the ratio of total debt *minus* the sum of debt incurred to maintain our investment in RTFC subordinated capital certificates, and *minus*, to the extent we have no amounts outstanding under our revolving facility, cash and cash equivalents, to Adjusted EBITDA. The new credit facility will provide that under the restricted payments covenant, we may only pay dividends if our total leverage ratio as of the end of the most recently ended four fiscal quarter period is equal to or less than to 1.00. In addition, it is an event of default under the new credit facility if our total leverage ratio exceeds to 1.00. We may not pay dividends under the new credit facility if an event of default has occurred and is continuing.

(7)

Interest coverage ratio is calculated under our new credit facility as the ratio of Adjusted EBITDA to net interest expense. It is an event of default under the new credit facility if our interest coverage ratio for the four-quarter period ended on the last day of any fiscal quarter is less than to 1.00.

The following table illustrates, for our fiscal year ended December 31, 2003 and for the twelve months ended September 30, 2004, the amount of cash that would have been available for distribution to our common stockholders, assuming, in each case, that the debt recapitalization, our reorganization and this

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offering had been consummated at the beginning of such period, subject to the assumptions described in the table.

	Year Ended December 31, 2003	Twelve Months Ended September 30, 2004
	(In thousands)	
PRO FORMA CASH AVAILABLE TO PAY DIVIDENDS		
Net Income	$ 69,674	$ 60,194
Income Taxes	42,637	36,827
Interest Expense	73,266	73,266
Depreciation and amortization	81,638	84,592
EBITDA	267,215	254,879
Earnings from unconsolidated cellular partnerships	(3,258)	(1,578)
Impairment on investments in cellular partnerships		6,678
Other income and expense, net	62	7,193
Loss on discontinued operations	(108)	(108)
Management fees expensed	1,000	1,000
Other non-recurring items, as defined in the new credit facility	(2,204)	6,270
ADJUSTED EBITDA	262,707	274,334
Estimated cash interest expense(1)	(71,994)	(71,994)
Capital expenditures(2)	(69,850)	(68,131)
Estimated additional public company costs(3)	(2,500)	(2,500)
Cash income taxes	(1,100)	(1,100)
CASH AVAILABLE TO PAY DIVIDENDS	$ 117,263	$ 130,609

(1) Reflects our anticipated cash interest expense under our new credit facility. Accordingly, assumes interest at a weighted average rate of % on $ million outstanding borrowings under the new term facility, a rate of % on the $ million outstanding balance under the new $100.0 million revolving credit facility and a 0.50% commitment fee on an average unused balance of $ million under the new revolving credit facility. Concurrently with this offering, we may issue senior notes and repay term loans outstanding under the new credit facility with the proceeds of such issuance. If we offer these senior notes, we expect that the rate at which interest accrues on amounts outstanding under the senior notes will be greater than the interest rates under our new credit facility, and therefore, although our total indebtedness would not change, our estimated cash interest expense would be greater than the amount presented on the table above.

(2) Consists of capital expenditures of $69.9 million and $68.1 million for the year ended December 31, 2003 and the twelve months ended September 30, 2004, respectively. The majority of our capital expenditures relate to our telecommunications network. For a more detailed discussion of our capital expenditures, see Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Cash Used in Investing Activities.

(3) Consists of estimated incremental audit fees, director and officer liability insurance premiums, expenses relating to stockholders meetings, printing expenses, investor relations expenses, additional filing fees, registrar and transfer agent fees, directors fees, additional legal fees, listing fees and miscellaneous fees.

Assumptions and Considerations

Based on a review and analysis conducted by our management and our board of directors, we believe that our minimum Adjusted EBITDA for the first full year following the closing of this offering will be at least $ million, and we have determined that the assumptions in the above tables as to capital expenditures, cash interest expense, income taxes, working capital and availability of funds under our new revolving credit facility are reasonable. We considered numerous factors in establishing our belief concerning the minimum Adjusted EBITDA required to support our dividend policy and our belief that our minimum

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Adjusted EBITDA for the first full year following the offering will be $ million, including the following factors:

- Our Adjusted EBITDA for the twelve-month period ended September 30, 2004 was $274.3 million.

- For fiscal years 2001, 2002 and 2003, our Adjusted EBITDA was $215.1 million, $240.6 million and $262.7 million, respectively.

- For fiscal years 2002 and 2003 and for the twelve months ended September 30, 2004, we incurred $89.5 million, $69.9 million and $68.1 million, respectively, in capital expenditures. We expect capital expenditures for fiscal 2004 to be approximately $68.8 million and then decline to approximately $58.8 million in the year following this offering.

- While our working capital balances varied over the past three years, there has not been a trend toward material working capital growth over that period.

- We have analyzed the impact of our intention to pay dividends at the level described above on our operations and performance in prior years and have determined that our new revolving credit facility would have had sufficient capacity to finance any fluctuations in working capital and other cash needs, including the payment of dividends at the levels described above. We currently do not intend to borrow under our new revolving credit facility to pay dividends.

We have also assumed:

- that our general business climate, including such factors as consumer demand for our services, the level of competition we experience and our regulatory environment, will remain consistent with previous periods; and

- the absence of extraordinary business events, such as new industry-altering technological developments or adverse regulatory developments, that may adversely affect our business, results of operations or anticipated capital expenditures.

If our Adjusted EBITDA for the first year following the closing of this offering were to fall below the $ million level (or if our assumptions as to capital expenditures or interest expense are too low, or if our assumptions as to the sufficiency of our new revolving credit facility to finance our working capital needs prove incorrect, or if other assumptions stated above were to prove incorrect), we may need to either reduce or eliminate dividends or, to the extent we were permitted to do so under the new credit facility, to fund a portion of our dividends with borrowings or from other sources. If we were to use working capital or permanent borrowings to fund dividends, we would have less cash and/or borrowing capacity available for future dividends and other purposes, which could negatively impact our financial condition, our results of operations, our liquidity and our ability to maintain or expand our business. In addition, to the extent we finance capital expenditures with indebtedness, we will begin to incur incremental debt service obligations.

We cannot assure you that our Adjusted EBITDA will in fact equal or exceed the minimum level set forth above, and our belief that it will equal or exceed such level is subject to all of the risks, considerations and factors identified in other sections of this prospectus, including those identified in the section entitled Risk Factors.

As noted above, we have estimated our initial dividend level and the minimum Adjusted EBITDA required to pay dividends at that level only for the first full year following the closing. Moreover, we cannot assure you that we will pay dividends during or following such period at the level estimated above, or at all. Dividend payments are within the absolute discretion of our board of directors and will be dependent upon many factors and future developments that could differ materially from our current expectations. Over time, our capital and other cash needs will invariably be subject to uncertainties, which could affect the level of any dividends we pay in the future.

In accordance with our dividend policy, we intend to distribute, as dividends to our stockholders, a substantial portion of the cash generated by our business in excess of operating needs, interest and principal payments on indebtedness and capital expenditures. We believe that our dividend policy will limit, but not preclude, our ability to pursue growth. If we continue paying dividends at the level currently anticipated under our dividend policy, we expect that we would need additional financing to fund significant acquisitions. Such additional financing could include, among other transactions, the issuance of additional shares of common stock. However, we intend to retain sufficient cash after the distribution of dividends to permit the pursuit of growth opportunities that do not require material capital investments. Management currently has no specific plans to make a significant acquisition or to increase capital spending to expand our business materially. However, management will evaluate potential growth opportunities as they arise and, if our board of directors determines that it is in our best interest to use cash that would otherwise be available for distribution as dividends to pursue an acquisition opportunity, to increase capital spending materially or for some other purpose, the board would be free to depart from or change our dividend policy at any time. Management currently does not anticipate pursuing growth opportunities, including acquisitions, unless they are expected to be at least neutral or accretive to our ability to pay dividends to the holders of our common stock.

Our intended policy to distribute rather than retain a significant portion of the cash generated by our business as regular quarterly dividends is based upon our current assessment of our financial performance, our cash needs and our investment opportunities. If these factors were to change based on, for example, regulatory, competitive or technological developments (which could increase our need for capital expenditures) or new investment opportunities, we would need to reassess that policy.

Restrictions on Payment of Dividends

Delaware Law

Under Delaware law, our board of directors may declare and pay dividends either out of surplus or, if there is no surplus, out of net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year. Surplus is defined as the excess, if any, at any given time, of the total assets of a corporation over its total liabilities and statutory capital. The value of a corporation s assets can be measured in a number of ways and may not necessarily equal their book value. The value of our capital may be adjusted from time to time by our board. Our board may base this determination on our financial statements, a fair valuation of our assets or another reasonable method. Although we believe we will pay dividends at the anticipated levels during the first year following this offering in compliance with Delaware law, our board will periodically seek to assure itself that the statutory requirements will be met before actually declaring dividends. In future years, the board may seek opinions from outside valuation firms to the effect that our net profits or capital surplus is sufficient to allow payment of dividends, and such opinions may not be forthcoming. If we sought and were not able to obtain such an opinion, we likely would not be able to pay dividends.

New Credit Facility

Under the new credit facility, we expect that dividends will be restricted as follows:

Under the restricted payments covenant, we may use all of our available cash for the period (taken as one accounting period) from the first full fiscal quarter that starts after the date of the closing of the new credit facility to the end of our most recently ended fiscal quarter for which internal financial statements are available at the time of such payment, plus certain incremental amounts described in the new credit facility, for the payment of dividends, but we may not in general pay dividends in excess of such amounts. We expect that available cash will be defined in the new credit facility as, on any date of determination, for the period commencing on the first day of the first full fiscal quarter that starts after the date of the closing of the new credit facility and ending on the last day of the fiscal quarter most recently ended for which a compliance certificate has been delivered, an amount equal to the sum (as calculated for us and our subsidiaries on a consolidated basis) of: (a) Adjusted EBITDA for such period minus (b) to the extent not deducted in the determination of Adjusted EBITDA, the sum of the following: (i) interest paid or accrued in such period (but not including amortization of deferred transaction costs or other non-cash interest expense); (ii) capital

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expenditures during such period (other than, if in excess of a certain amount, any thereof financed with the proceeds of permitted debt, and any thereof financed with equity or from the proceeds of permitted asset sales or casualty events); (iii) payments made for permitted acquisitions (other than any thereof financed with the proceeds of permitted debt or equity); (iv) certain other permitted investments; (v) scheduled principal payments, if any, during such period; (vi) mandatory prepayments required under the new credit facility made during such period, other than mandatory prepayments of swing line loans made to finance our investment in RTFC subordinated capital certificates; (vii) cash taxes paid during such period; (viii) costs and expenses associated with any permitted securities offering, investment, acquisition or debt offering (in each case, whether or not successful); and (ix) the cash cost of any extraordinary or unusual losses during such period; plus (c) to the extent not included in the determination of Adjusted EBITDA, interest and dividends received in cash.

We expect that under the new credit facility, we may only pay dividends if our total leverage ratio for the most recently ended fiscal quarter is equal to or less than to 1.0.

We may not pay any dividends if an event of default under the new credit facility has occurred and is continuing. In particular, we expect it will be an event of default if:

- our total leverage ratio, as defined above, exceeds to 1.0; or

- our interest coverage ratio for the four-quarter period ended on the last day of any fiscal quarter, is less than to 1.0.

See Description of Certain Indebtedness New Credit Facility for a more complete description of the dividend restrictions contained in our new credit facility.

Senior Notes

We expect that the indenture that would govern any senior notes we may issue would contain restrictions on the payment of dividends that are no more restrictive than those contained in our new credit facility.

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CAPITALIZATION

The following table sets forth our cash and cash equivalents and capitalization as of September 30, 2004:

on an actual basis;

on a pro forma as adjusted basis as if our debt recapitalization and our reorganization had occurred on that date; and

on a pro forma as adjusted basis as if in addition to our debt recapitalization and our reorganization, this offering, including the use of proceeds from this offering, had occurred on that date and that we had entered into the new credit facility on that date.

	As of September 30, 2004		
	Actual	Pro Forma as Adjusted for the Reorganization and the Debt Recapitalization	Pro Forma as Adjusted for the Offering
Cash and cash equivalents	$ 641	$ 17,669	
Long-term debt, including current portion			
Current maturities of long-term debt	43,031	13,360	
Notes payable	13,765	13,765	
Old credit facilities (long-term portion)	1,045,893		
Existing senior subordinated notes	314,257		
Capital leases	2,291	2,291	
New credit facility(1)		1,588,300	
Total long-term debt	1,419,237	1,617,716	
Redeemable preferred interests	370,231		
Stockholders equity			
Limited liability company interests, no par or stated value	110,633		
Common stock, $0.01 par value per share		396	
Preferred stock, $0.01 par value per share			
Additional paid-in capital		263,172	
Accumulated deficit(2)	(28,195)	(98,950)	
Accumulated other comprehensive loss	(7,371)	(7,371)	
Treasury stock	(34)		
Total common owners equity	75,033	157,247	
Total capitalization	$ 1,865,142	$ 1,792,632	

(1) To the extent we issue senior notes concurrently with this offering and use the proceeds of such issuance to pay a portion of the term loans outstanding under the new credit facility, although our total long-term debt would not change, the amounts shown in the Pro Forma as Adjusted column in the table above with respect to the new credit facility would be reduced by the amount of senior notes we issue, and our long-term debt would include amounts owed under the senior notes.

(2) In connection with the reorganization, management will receive in exchange for their outstanding equity interests resulting in compensation expense to us of approximately $.

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DILUTION

Dilution is the amount by which the portion of the offering price paid by the purchasers of the common stock to be sold in the offering exceeds the net tangible book value or deficiency per share of our common stock after the offering. Net tangible book value or deficiency per share of our common stock is determined at any date by subtracting our total liabilities from our total assets less our intangible assets and dividing the difference by the number of shares of common stock deemed to be outstanding at that date.

Our net tangible book value as of September 30, 2004 was approximately $ million, or $ per share of common stock. After giving effect to our receipt and intended use of approximately $ million of estimated net proceeds (after deducting estimated underwriting discounts and commissions and offering expenses) from our sale of common stock in this offering based on an assumed initial public offering price of $ per share of common stock (the midpoint of the range set forth on the cover page of this prospectus) our pro forma as adjusted net tangible book value as of September 30, 2004 would have been approximately $ million, or $ per share of common stock. This represents an immediate increase in net tangible book value of $ per share of our common stock to existing stockholders and an immediate dilution of $ per share of our common stock to new investors purchasing shares of common stock in this offering.

The following table illustrates this substantial and immediate dilution to new investors:

	Per Share of Common Stock
Initial public offering price per share of common stock	$
Net tangible book value per share as of September 30, 2004	
Increase per share attributable to cash payments made by investors in this offering	
Pro forma as adjusted net tangible book value after this offering	$
Dilution in net tangible book value per share to new investors	$

The following table sets forth on a pro forma basis as of September 30, 2004, assuming no exercise of the over-allotment option:

the total number of shares of our common stock to be owned by the existing equity holders and the total number of shares of our common stock to be owned by the new investors purchasing shares of common stock in this offering;

the total consideration to be paid by the existing equity holders and to be paid by the new investors purchasing shares of common stock in this offering; and

the average price per share of common stock to be paid by existing equity holders (cash and stock) and the average price per share of common stock to be paid by new investors purchasing shares of common stock in this offering:

	Shares of Common Stock Purchased		Total Consideration		Average Price Per Share of Common Stock
	Number	Percent	Amount	Percent	
Existing equity holders		%	$	%	$
New investors		%		%	
Total		100.0%	$	100.0%	

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SELECTED HISTORICAL FINANCIAL INFORMATION

Valor is a holding company and has no direct operations. Valor was formed for the sole purpose of reorganizing our corporate structure and consummating this offering. Valor s principal assets are the direct and indirect equity interests of its subsidiaries. As a result, we have not provided separate historical financial results for Valor and present only the historical consolidated financial results of Valor Telecommunications, LLC. The selected historical consolidated financial information set forth below as of and for the period ended December 31, 2000, as well as the selected historical consolidated financial information as of and for the year ended December 31, 2001, 2002 and 2003, have been derived from our audited consolidated financial statements. The selected historical consolidated financial information as of and for the nine months ended September 30, 2003 and 2004 is unaudited, has been prepared on the same basis as the audited statements, and in the opinion of management, contains all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of our operating results for such period and our financial condition at such date. The financial information for the nine months ended September 30, 2003 and 2004 is not necessarily indicative of the results to be expected for any other interim period or any future fiscal year. In addition, as described in more detail in Business, we acquired, at the time of our formation, select telephone assets from GTE Southwest Corporation. We refer to these properties as the Acquired Businesses and we believe the Acquired Businesses to be the predecessor of our company, prior to formation in 2000. This is because the Acquired Businesses, with the exception of our Kerrville business that was acquired by us in 2002, effectively include nearly all the businesses currently operated by us, and do not include any businesses that have been discontinued or sold. Accordingly, the selected historical financial information below includes the combined accounts of the Acquired Businesses as of and for the year ended December 31, 1999, as well as the combined accounts as of and for the period ended August 31, 2000. The combined accounts do not include any purchase accounting adjustments that occurred as a result of our acquisition of the Acquired Businesses in 2000.

The information in the following table should be read together with our audited consolidated financial statements for the years ended December 31, 2001, 2002 and 2003 and the related notes, our unaudited consolidated financial statements for the nine months ended September 30, 2003 and 2004 and Management s Discussion and Analysis of Financial Condition and Results of Operations, all as included elsewhere in this prospectus.

	Predecessor Company(1)							
	Year Ended December 31, 1999	Period Ended August 31, 2000	Period Ended December 31, 2000(2)	Year Ended December 31, 2001	2002(3)	2003	Nine Months Ended September 30, 2003	2004
	(Dollars in thousands, except per owner unit data)		(Dollars in thousands, except per owner unit data)					
Statement of Operations Data:								
Operating revenues	$367,724	$260,933	$ 148,784	$ 424,916	$ 479,883	$497,334	$372,450	$379,279
Operating expenses	282,719	178,948	164,172	321,618	320,632	315,061	236,165	242,795
Operating income (loss)	85,005	81,985	(15,388)	103,298	159,251	182,273	136,285	136,484
Net income (loss) from continuing operations	57,434	50,678	(71,909)	(44,912)	19,763	58,125	36,975	25,171
Earnings per owners unit:(4)								
Basic and diluted (loss) income from continuing operations:								
Class A and B common interests	n/a	n/a	$ (1.05)	$ (0.58)	$ 0.22	$ 0.73	$ 0.45	$ 0.54
Class C interests	n/a	n/a	$	$	$ 0.09	$ 0.15	$ 0.12	$ (0.29)
Basic and diluted net (loss) income:								
Class A and B common interests	n/a	n/a	$ (1.05)	$ (0.77)	$ 0.17	$ 0.73	$ 0.45	$ 0.54
Class C interests	n/a	n/a	$	$	$ 0.09	$ 0.15	$ 0.12	$ (0.29)
Cash Flow Data:								
Net cash provided by operating activities	$154,279	$119,557	$ 16,197	$ 100,301	$ 150,383	$166,065	$132,461	$124,660
Net cash used in investing activities	$ (85,109)	$ (56,018)	$(1,821,699)	$(106,614)	$(216,773)	$ (66,299)	$ (50,551)	$ (51,362)
Net cash provided by (used in) financing activities	$ (69,170)	$ (63,539)	$ 1,811,613	$ 8,117	$ 71,015	$ (99,465)	$ (81,971)	$ (74,054)

	Predecessor Company(1)							
	Year Ended December 31, 1999	Period Ended August 31, 2000	Period Ended December 31, 2000(2)	Year Ended December 31, 2001	2002(3)	2003	Nine Months Ended September 30, 2003	2004
	(Dollars in thousands)			(Dollars in thousands)				
Other Data:								
Capital expenditures	$85,109	$56,018	$36,918	$107,869	$ 89,527	$69,850	$53,239	$51,520
Acquisition of Kerrville Communications Corporation(5)					$128,135			
Depreciation and amortization(6)	$97,111	$64,103	$40,327	$110,843	$ 73,273	$81,638	$61,039	$63,993

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	Predecessor Company(1)						
	As of December 31, 1999	As of August 31, 2000	As of December 31, 2000(2)	As of December 31, 2001	2002	2003	As of September 30, 2004
	(Dollars in thousands)		(Dollars in thousands)				
Balance Sheet Data:							
Total assets	$573,681	$567,073	$1,935,695	$1,913,057	$2,062,404	$2,039,043	$2,012,865
Long-term debt (including current maturities)			$1,440,643	$1,469,420	$1,544,285	$1,463,973	$1,405,472
Notes payable			$ 70	$ 10,197	$ 1,175	$ 6,687	$ 13,765
Redeemable preferred interests			$ 370,231	$ 370,231	$ 370,231	$ 370,231	$ 370,231

(1) The selected historical financial information presented for the Predecessor Company above was derived from unaudited financial statements prepared on a carve-out basis by GTE Southwest Corporation (the Carve-Out Financial Statements). This information reflects the results of operations and financial position of the Acquired Businesses for the year ended December 31, 1999 and for the period beginning January 1, 2000 through our acquisition date of these businesses. We acquired GTE s business in Oklahoma on July 1, 2000 and GTE s businesses in Texas, New Mexico and Arkansas on September 1, 2000.

(2) Our consolidated financial statements for the period ended December 31, 2000 include the results of operations for the businesses we acquired from GTE in Texas, Oklahoma, New Mexico and Arkansas beginning on the date of acquisition, as well as certain start-up costs that we incurred prior to commencing operations.

(3) We acquired all the outstanding common stock, preferred stock and common stock equivalents of Kerrville Communications Corporation (KCC) on January 31, 2002 and have included the assets, liabilities and results of operations of KCC from that date.

(4) Per unit data is not applicable with respect to periods covered by our Predecessor s Carve-Out Financial Statements.

(5) Reflects the purchase price for our acquisition of KCC, net of cash acquired. Excludes $1,724,119 we paid to purchase predecessor businesses in 2000.

(6) In accordance with Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets, effective January 1, 2002, we discontinued the amortization of goodwill. Amortization expense associated with goodwill was $20,529 for the period ended December 31, 2000 and $53,900 for the year ended December 31, 2001.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION

AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and accompanying notes which appear elsewhere in this prospectus. It contains forward-looking statements that involve risks and uncertainties. Please see Cautionary Statement Regarding Forward-Looking Statements for more information. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those discussed below and elsewhere in this prospectus, particularly under the headings Risk Factors and Cautionary Statement Regarding Forward-Looking Statements.

Overview

We are one of the largest providers of telecommunications services in rural communities in the southwestern United States and the seventh largest independent telephone company in the country. As of September 30, 2004, we operated approximately 548,000 telephone access lines in primarily rural areas of Texas, Oklahoma, New Mexico and Arkansas. We believe that in many of our markets we are the only service provider that offers customers an integrated package of local and long distance voice, high-speed data and Internet access as well as a variety of enhanced services such as voicemail and caller identification. We generated revenues of $497.3 million in the year ended December 31, 2003 and $379.3 million in the nine months ended September 30, 2004.

We formed our company in connection with the acquisition in 2000 of select telephone assets from GTE Southwest Corporation, which is now part of Verizon. Our formation was orchestrated by our equity sponsors Welsh, Carson, Anderson & Stowe, or WCAS, Vestar Capital Partners, Citicorp Venture Capital, Anne K. Bingaman and other individuals.

The rural telephone businesses that we own have been operating in the markets we serve for over 75 years. Since our inception, we have acquired the local telephone company serving Kerrville, Texas and we have invested substantial resources to improve and expand our network infrastructure to provide high quality telecommunications services and superior customer care. We believe that we are well positioned for future revenue and cash flow growth through both expanded service offerings and acquisitions. In November 2004, the Company acquired certain high speed internet and dial-up internet assets along with the related customers and revenues. The assets are located generally in West Texas and Southeastern New Mexico. The purchase price consisted of $1.5 million in cash and the assumption of $0.4 million of leases.

Access lines are an important element of our business. Historically, rural telephone companies have experienced consistent growth in access lines because of positive demographic trends, insulated rural local economies and little competition. Recently, however, many rural telephone companies have experienced a loss of access lines due to challenging economic conditions, increased competition from wireless providers, competitive local exchange carriers and, in some cases, cable television operators. We have not been immune to these conditions. We have been able to mitigate the access line loss through plant improvements, bundling services, win-back programs, increased community involvement and a variety of other programs.

Despite our net losses of access lines, we have generated growth in our revenues each year since our inception in 2000. We have accomplished this by providing our customers with services not previously available in most of our markets such as enhanced voice services and data services, including digital subscriber lines, or DSL, and through acquisitions.

We are subject to regulation primarily by federal and state government agencies. At the federal level, the Federal Communications Commission, or FCC, has jurisdiction over interstate and international telecommunications services. State telecommunications regulators exercise jurisdiction over intrastate telecommunications services. We operate under price cap regulation at the federal level and at the state level in Texas and New Mexico. We are regulated as a rural telephone company in Oklahoma. We are regulated on a rate of return basis in Arkansas. For a more extensive discussion of regulatory matters, see Risk Factors Regulatory Matters and Regulation.

Reorganization

Immediately prior to and in connection with the consummation of this offering, we will reorganize our corporate structure. Our existing equity holders currently own equity interests in Valor Telecommunications, LLC, or VTC, and Valor Telecommunications Southwest, LLC, or VTS. VTC also currently holds all of the outstanding equity interests of Valor Telecommunications Southwest II, LLC, or VTS II. As part of this reorganization, our existing equity holders will contribute their equity interests in VTC and VTS to us in exchange for shares of common stock. As a result of this reorganization, each of VTC, VTS and VTS II will be either a direct or indirect wholly-owned subsidiary of Valor Communications Group, Inc. See Detailed Transaction Steps on page 86.

Impact of Our Reorganization and this Offering on Our Results of Operations and Liquidity

Results of Operations. We have recorded a substantial number of one-time expenses related to our reorganization, the debt recapitalization and this offering, including the following:

- $5.0 million in compensation expense associated with the payment made to our former CEO upon the termination of his previous employment agreement; and

- $18.0 million in expenses associated with our agreement to repurchase minority interests in our wholly-owned subsidiaries Valor Telecommunications Southwest, LLC, a Delaware limited liability company, and Valor Telecommunications Southwest II, LLC, a Delaware limited liability company from a group of the individual investors.

In addition, we expect to record the following expenses:

- $ in compensation expense associated with management s exchange of all of their equity interests in Valor Telecommunications, LLC for an aggregate of ;

- $44.9 million in interest expense from the write-off of deferred financing costs associated with our existing indebtedness;

- $ in legal fees and other miscellaneous expenses associated with our reorganization, repayment of existing indebtedness and this offering;

- $5.0 million in compensation expense for cash transaction bonuses paid to members of our management team in connection with our debt recapitalization; and

- $1.3 million in compensation expense for the portion of cash transaction bonuses that will be paid upon the consummation of this offering to members of our management team in connection with this offering.

We will incur higher expenses as a public company after the consummation of this offering. These expenses will include additional accounting and finance expenses, audit fees, legal fees and increased premiums for director and officer liability insurance coverage. We estimate that these additional expenses will be approximately $2.5 million annually. We also intend to implement a new management compensation plan that will increase compensation expense approximately $5.5 million in 2005 and 2006. Furthermore, to the extent we issue any senior notes, we expect the legal fees and other miscellaneous expenses shown above to increase.

Liquidity. Upon completion of this offering, our board of directors will adopt a dividend policy which reflects an intention to distribute a substantial portion of the cash generated by our business in excess of operating needs, interest and principal payments on our indebtedness and capital expenditures as regular quarterly dividends to our stockholders, rather than retaining all such cash for other purposes. In accordance with this dividend policy, we currently intend to pay an initial dividend of $ per share on or about , 2005 and to continue to pay quarterly dividends at an annual rate of $ per share for the first full year following the closing of this offering. We expect the aggregate impact of this dividend policy in the year following the offering to be $. The cash requirements of the expected dividend policy are in addition to the debt service requirements discussed below in Results of Operations. We expect that the cash requirements discussed here and below in Results of Operations will be funded through cash flow generated from the operations of our business. We will also have access to the $100 million new revolving credit facility to supplement our liquidity position as needed.

Regulatory Matters

We operate in a regulated industry, and the majority of our revenues comes from the provision of regulated telecommunications services, including state and federal support for the provision of telephone services in high-cost rural areas. To further the public policy of providing universal and comparable telecommunications services throughout the United States, state and federal regulatory bodies have historically given support to rural telephone companies to offset the high costs of providing telecommunications services in rural areas. Operating in this regulated industry means that we are also generally subject to certification, service quality, rate regulation, tariff filing and other ongoing regulatory requirements by state and federal regulators.

State Regulation. We operate in Texas, Oklahoma, New Mexico and Arkansas and each state has its own regulatory framework for intrastate services.

In Texas, most of our operations are subject to price caps on our basic telecommunications services, while we maintain pricing flexibility on some non-basic services. While the Texas regulatory structure under which we operate will become subject to review and renewal in late 2005, we do not expect a material change in the benefits we have under current regulation. In addition, on November 23, 2004, the Public Utility Commission of Texas approved a stipulation that settled our pending application for the imposition of an expanded local calling surcharge. The expanded local calling surcharge compensates us for the costs and lost revenues associated with replacing long distance routes between selected towns with flat rated service. We have collected interim surcharges per month since May 2003 through November 2004 totaling $4.1 million. Pending approval of the stipulation, the surcharges billed to customers were refundable. As a result, we deferred revenue recognition of these surcharges. Due to stipulation approval in November 2004, we will record a one-time revenue item of $4.1 million for the period from May 2003 through November 2004. The terms of the stipulation provide that we cannot request an additional surcharge after the current surcharge expires on December 31, 2005.

In New Mexico, we operate under an Alternative Form of Regulation Plan that is specific to our company. The Plan was adopted in 2000 and will expire on March 31, 2006. During its term, the Plan provides for a freeze on the prices of our intrastate telecommunications services, requires us to invest $83 million in capital in New Mexico, provides for a streamlined tariff approval process and prescribes quality of service standards, including penalties for failure to meet certain service levels. Under the Plan in 2005, we will be able to increase our prices for optional services by 10% if we have met certain quality service standards.

Recently enacted legislation mandates that the New Mexico Public Regulation Commission adopt rules tailored to the size and market demographics of local exchange carriers like our company that have between 50,000 and 375,000 access lines and flexible rules that allow pricing freedoms on retail services. It also mandates the streamlining of rules governing the introduction and withdrawal of tariffs and the packaging and bundling of services. Therefore, we will not have to renegotiate and renew our current Plan.

In Oklahoma, legislation was enacted in May 2004 that will regulate us a rural telephone company thereby allowing us significant pricing freedom for our basic services and reducing our costs of regulation.

We also operate under rate of return regulation in the provision of intrastate telecommunications services in Arkansas. We operate approximately 17,000 access lines in Texarkana, Arkansas, which is our only market in Arkansas. Pursuant to an agreement with the Arkansas Public Service Commission, our Arkansas tariffs mirror the prices charged for retail services in our Texas tariffs.

Federal Regulation. Most of our interstate access revenues are regulated pursuant to the FCC s price cap rules. Generally, these rules establish an upper limit for access prices, but allow annual formula-based adjustments and limited pricing flexibility. In 2000, the FCC adopted the Coalition for Affordable Local and Long Distance Service, or CALLS plan, an integrated interstate access reform and universal service framework for price cap local exchange carriers. The CALLS plan allowed subscriber line charges billed to end users to rise, but forced substantial decreases in access charges billed to long distance carriers. The CALLS plan will expire in mid-2005, unless extended by the FCC. We are actively participating in discussions with other industry parties aimed at developing a consensus proposal on inter-carrier compensation that would replace the CALLS plan. In October 2004, we joined with eight other carriers, collectively known as the Intercarrier Compensation Forum, to file a specific reform proposal with the FCC. The outcome of the FCC s proceeding is uncertain, but it could result in significant changes to the way in which we receive compensation from other carriers and our customers. At this time, we cannot estimate whether the FCC or Congress will reform the current system, or, if so, whether and to what extent any changes will affect our access charge revenues or other inter-carrier compensation revenues.

Universal Service Fund

In furtherance of public policy, we receive Universal Service Fund, or USF, revenues from the State of Texas and the federal government to support the high cost of providing telecommunications services in rural markets.

Texas Universal Service Fund. The Texas Universal Service Fund, or the Texas USF, supports eligible telecommunications providers that serve high cost markets. We received $103.1 million from the Texas USF in 2003, representing 20.7% of total revenues for that year and we received $76.8 million from the Texas USF during the nine months ended September 30, 2004, representing 20.2% of total revenues for that period. Texas USF is promulgated under a statute that will become subject to review and renewal in late 2005. We expect that the Texas Legislature will renew the statute or replace it with a similar law that will not materially change the benefits we receive under the current regulatory structure.

Federal Universal Service Fund. The federal USF revenue we receive helps to offset interstate access charges, defrays the high fixed switching costs in areas with fewer than 50,000 access lines and provides support where our average cost per line exceeds 115% of the national average cost per line. In 2003, we received $16.7 million, or 3.4% of our total revenues, in federal USF support and in the nine months ended September 30, 2004, we received $14.0 million, or 3.7% of our total revenues, in federal USF support. On June 8, 2004, the FCC issued a Notice of Proposed Rulemaking seeking comment on a recommended decision of the Federal-State Joint Board on Universal Service, or Joint Board. The Joint Board recommended that the FCC adopt permissive federal guidelines for states to consider in proceedings to designate competitive carriers as eligible to receive universal service support, and it further recommended that the FCC limit the scope of high-cost support to a single connection that provides a subscriber access to the public telephone network. The FCC has until February 27, 2005 to act on these recommendations. On August 16, 2004, the Joint Board issued a notice seeking comments on several issues relating to high-cost universal service support mechanisms for rural carriers and the appropriate rural mechanism to succeed the five-year plan that the FCC created in 2001. Issues under consideration include: the appropriate cost basis for determining support levels for rural carriers, whether to modify the definition of rural carrier and the amount of universal service support available for acquired exchanges. The outcome of these proceedings or other legislative or regulatory changes could affect the amount of federal universal service support that we receive, and could have an adverse effect on our business, revenue or profitability.

Critical Accounting Policies and Use of Estimates

Our financial statements are prepared in accordance with accounting principles that are generally accepted in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Management continually evaluates its estimates and judgments including those related to revenue recognition, allowance for doubtful accounts, pension and postretirement benefits, accounting for goodwill and intangible assets, and estimated useful lives of property, plant and equipment. Actual results may differ from these estimates. We believe that of our significant accounting policies, the following may involve a higher degree of judgment and complexity. (See Note 2 to the consolidated financial statements for a complete discussion of our significant accounting policies.)

Revenue Recognition. Revenue is recognized when evidence of an arrangement between our customer and us exists, the earnings process is complete and collectibility is reasonably assured. The prices for most services are filed in tariffs with the appropriate regulatory bodies that exercise jurisdiction over the various services.

Basic local services, enhanced calling features such as caller identification, special access circuits, long distance flat rate calling plans, and most data services are billed one month in advance. Revenue for these services is recognized in the month services are rendered. The portion of advance-billed revenue associated with services that will be delivered in a subsequent period is deferred and recorded as a current liability under Advance billings and customer deposits in the Consolidated Balance Sheets.

Amounts billed to customers for activating service are deferred and recognized over the average life of the customer. The costs associated with activating such services are deferred and are recognized as an operating expense over the same period. Costs in excess of revenues are recognized as an operating expense in the period of activation.

Revenues for providing usage based services, such as per-minute long distance service and access charges billed to long distance companies for originating and terminating long distance calls on our network, are billed in arrears. Revenues for these services are recognized in the month services are rendered.

Universal Service revenues are government-sponsored support received in association with providing service in mostly rural, high-cost areas. These revenues are typically based on information provided by us and are calculated by the government agency responsible for administering the support program and are recognized in the month the service is performed.

Allowance for doubtful accounts. In evaluating the collectibility of accounts receivable, we assess a number of factors, including a specific customer s or carrier s ability to meet its financial obligations, the length of time the receivable has been past due and historical collection experience. Based on these assessments, we record both specific and general reserves for uncollectible accounts receivable to the amount we ultimately expect to collect from customers and carriers. If circumstances change or economic conditions worsen such that our past collection experience is no longer relevant, our estimate of the recoverability of accounts receivable could be further reduced from the levels reflected in the accompanying consolidated balance sheet.

Pension and postretirement benefits. The amounts recognized in the financial statements related to pension and postretirement benefits are determined on an actuarial basis utilizing several critical assumptions.

A significant assumption used in determining our pension and postretirement benefit expense is the expected long-term rate of return on plan assets. In 2003, we used an expected long-term rate of return of 8.5%. We continue to believe that 8.5% is an appropriate rate of return for our plan assets given our investment strategy and will continue to use this assumption for 2004. The projected portfolio mix of the plan assets is developed in consideration of the expected duration of related plan obligations and as such is more heavily weighted toward equity investments, including public and private equity positions. Our investment policy is to invest 55-75% of the pension assets in equity funds with the remainder being invested in fixed income funds and cash equivalents. The expected return on plan assets is determined by applying the expected long-term rate of return to the market-related value of plan assets. The actual return on our equity portfolio has been significantly below expected return levels due to overall equity market conditions in 2001 and 2002.

Another significant estimate is the discount rate used in the annual actuarial valuation of pension and postretirement benefit plan obligations. In determining the appropriate discount rate at year-end, we considered the current yields on high quality corporate fixed-income investments with maturities corresponding to the expected duration of the benefit obligations. As of December 31, 2003, we reduced the discount rate by 45 basis points to 6.05%.

For the nine months ended September 30, 2004, we have contributed $4.7 million to our pension plan and $0.3 million to our other postretirement benefits plan. We expect to contribute $6.5 million to our defined benefit pension plan in September 2005.

Goodwill and Intangible Assets. During 2001, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, or SFAS 142, which requires that effective January 1, 2002, goodwill recorded in business combinations cease amortizing. SFAS 142 requires that goodwill be reviewed for impairment using fair value measurement techniques. Specifically, goodwill impairment is determined using a two-step process. The first step of the goodwill impairment test is used to identify potential impairment by comparing the fair value of the reporting unit to its carrying value, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired and the second step of the impairment test is unnecessary. If the fair value of the reporting unit is less than the carrying value, the second step of the goodwill impairment test calculation is performed to measure the amount of the impairment charge. The second step of the goodwill impairment test compares the implied fair value of the reporting unit s goodwill with its carrying value. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. That is, the fair value of the reporting unit is allocated to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit. If the implied fair value of goodwill is less than its carrying value, goodwill must be written down to its implied fair value.

Determining the fair value of a reporting unit under the first step of the goodwill impairment test and determining the fair value of individual assets and liabilities of a reporting unit (including unrecognized intangible assets) under the second step of the goodwill impairment test is judgmental in nature and often involves the use of significant estimates and assumptions. These estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and also the magnitude of any such charge. We perform internal valuation analyses and consider other market information that is publicly available. Estimates of fair value are primarily determined using discounted cash flows. This approach uses significant estimates and assumptions including projected future cash flows (including timing) and the selection of a discount rate that reflects the risk inherent in future cash flows.

Upon completion of our initial assessment in May 2002, and our annual assessments in the third quarters of 2002, 2003 and 2004, we determined that no write-down in the carrying value of goodwill was required.

Useful Life of Property, Plant and Equipment. We estimate the useful lives of property, plant and equipment in order to determine the amount of depreciation expense to be recorded during any reporting period. The majority of our telecommunications plant, property and equipment is depreciated using the group method, which develops a depreciation rate based on the average useful life of a specific group of assets, rather than the individual asset as would be utilized under the unit method. The estimated life of the group is based on historical experience with similar assets as well as taking into account anticipated technological or other changes. If technological changes were to occur more rapidly than anticipated or in a different form than anticipated, the useful lives assigned to these assets may need to be shortened, resulting in the recognition of increased depreciation expense in future periods. Likewise, if the anticipated technological or other changes occur more slowly than anticipated, the life of the group could be extended based on the life assigned to new assets added to the group. This could result in a reduction of

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depreciation expense in future periods. We review these types of assets for impairment when events or circumstances indicate that the carrying amount may not be recoverable over the remaining lives of the assets. In assessing impairment, we follow the provisions of Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, or SFAS 144, utilizing cash flows which take into account management s estimates of future operations.

Redeemable Preferred Interests and Phantom Stock Units. We are required to make an estimate of the fair value of our Redeemable Preferred Interests in order to determine the carrying value of the liability at the balance sheet date. In addition, we are required to make an estimate of the fair value of our Phantom Stock Units in order to determine the appropriate related compensation expense. We estimate the fair value of these items by initially determining an overall enterprise value and allocating the enterprise value to the various preferred and common equity components that impact the determination of the fair value of the Redeemable Preferred Interests and the Phantom Stock Units. The enterprise value is estimated through a combination of a discounted cash flow analysis and an enterprise comparability analysis to publicly traded companies in the same industry classification. We expect that after the reorganization of our corporate structure, we will not be required to make an estimate of fair value of these items because both the Redeemable Preferred Interests and the Phantom Stock Units will be exchanged for common stock.

Consolidated Results of Operations

Operating Revenues

The following table sets forth our total average revenue per access line:

	Year Ended December 31,			Nine Months Ended September 30,	
	2001	2002	2003	2003	2004
Total revenue (in thousands)	$424,916	$479,883	$497,334	$372,450	$379,279
Average access lines	552,316	574,922	564,027	565,049	552,335
Average revenue per access line per month	$ 64.11	$ 69.56	$ 73.48	$ 73.24	$ 76.30
Average long distance subscribers	31,117	96,428	159,574	158,635	201,287

Local Service We derive revenues from providing local exchange telephone services to both residential and business customers, including monthly recurring charges from basic service such as local dial-tone and enhanced services such as caller identification, voicemail and call waiting and non-recurring charges for service activation and reconnection of service.

Data Services Revenues are derived from monthly recurring charges for DSL, private lines, Internet and other data related services.

Long Distance Services Revenues are derived from usage charges assessed on long distance and local toll calls and from revenue on flat rate calling plans.

Access Services Network access revenues include switched access, special access, and end user charges. Switched access represents use sensitive charges to long distance companies for access to our network in connection with the completion of interstate and intrastate long-distance calls. Special access represents dedicated circuits, which are typically purchased by long distance companies. End user charges are monthly flat-rate charges assessed on access lines.

Universal Service Fund, or USF We receive monthly payments from state and federal government-sponsored support associated with providing basic telephone services generally in rural, high cost areas.

Other Services Other revenues primarily represent sales of customer premise equipment, or CPE, directory advertising, unbundled network elements and billing and collection fees.

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The following table sets forth our revenues for the periods shown:

	Year Ended December 31,			Nine Months Ended September 30,	
	2001	2002	2003	2003	2004
	(Dollars in thousands)				
Local service	$132,514	$147,130	$156,369	$117,671	$116,305
Data services	17,927	20,741	20,990	15,427	18,592
Long distance services	14,652	22,961	30,816	22,309	28,173
Access services	119,421	133,037	132,047	99,328	96,301
Universal Service Fund	116,305	121,607	119,727	90,476	90,759
Other services	24,097	34,407	37,385	27,239	29,149
	$424,916	$479,883	$497,334	$372,450	$379,279

The following table sets forth several key metrics:

	As of December 31,			As of September 30,	
	2001	2002	2003	2003	2004
Total access lines	551,599	571,308	556,745	558,790	547,925
Long distance subscribers	62,234	130,622	188,526	186,648	214,048
Penetration rate of total access lines	11%	23%	34%	33%	39%
DSL subscribers	511	3,510	8,779	7,803	16,521
Penetration rate of total access lines	0%	1%	2%	1%	3%

Consolidated Revenues

Our consolidated revenues increased $6.8 million, or 1.8% in the first nine months of 2004, as compared to the same period in 2003. In addition, our consolidated revenues increased $17.5 million, or 3.6%, in 2003 and $55 million, or 12.9%, in 2002. Excluding the effect of the KCC acquisition, which occurred in January 2002, revenues increased $29.5 million, or 6.9%, in 2002. Telephone access lines are an important element of our business. The monthly recurring revenue we generate from end users, the amount of traffic that traverses our network and related access charges generated from other carriers, the amount of USF revenue received, and most other revenue streams are directly related to the number of access lines in service. Excluding the effect of the KCC acquisition, we have lost access lines in each of the last two years. We have been able to generate increases in our revenue in each of the last two years by executing a strategy of selling additional services to existing customers and increasing average revenue per line through a combination of new product offerings and bundling of various services. New product offerings include DSL, long distance and other enhanced calling features. The increases in revenue related to this strategy have more than offset the declines in revenue that we have experienced from access line losses. If we continue to lose access lines or if we are unable to continue to successfully execute our strategy, it could slow the rate of our revenue growth or cause our revenue to decline, either of which could have an adverse effect on our results of operations and financial condition.

Competition from wireless service providers is intensifying as the coverage of their networks improves and the price of their product offerings continues to become more attractive to consumers in our markets. In addition, as voice over internet protocol, or VoIP, becomes a more viable product, new competitors could enter our markets and existing competitors could become more formidable. More specifically, cable television operators in some of our markets already offer a broadband product in the form of a high-speed cable modem. VoIP could allow them to offer telephony services to our customers that would bypass our network altogether. If these cable television operators or any other competitors were to successfully offer a VoIP product in any of our markets, we could lose a significant amount of our access lines and revenues in those markets.

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Reflecting a general trend in the rural local exchange carrier industry, the number of access lines that we serve as an incumbent local exchange carrier has been decreasing. We expect that this trend may continue for the near term. In our largest market in which we serve 74,000 access lines, the incumbent local cable television operator has begun offering an alternative local telephone service. We may experience continued pressure on overall access line counts as a result of this activity.

We will attempt to continue to execute our strategy of increasing revenues per access line through the selling of bundled product offerings that include long distance and DSL. We have implemented a number of initiatives to gain new access lines, and retain existing access lines, including the offering of discounts to customers who agree to take service from us for a one-year period, the offering of a triple play bundle that includes satellite television services billed on our bill, and promotional offers, including discounted second lines. Also, and as more fully described in Business - Business Strategy, we hope to retain existing customers through the provision of compelling service offerings and high quality customer service. These efforts may act to mitigate the financial impact of any access line loss we may experience. However, if these actions fail to mitigate access line loss, or we experience a higher degree of access line loss, it could have an adverse impact on our revenues and earnings.

For a more extensive discussion of risks related to loss of access lines, see Risk Factors Risks Relating to Our Business.

Nine Months Ended September 30, 2004 Compared to Nine Months Ended September 30, 2003

Local Service Revenues. Local service revenue decreased $1.4 million to $116.3 million in the first nine months of 2004 from $117.7 million during the same period in 2003. Revenue from the provision of basic service decreased $1.3 million primarily as a result of access line loss. Revenue from extended area services decreased by $0.9 million due to the termination of an agreement we had with another carrier whereby we were compensated for terminating extended area local calls that originated on their network to our customers. The decrease is partially offset by an increase of $0.3 million in sales of enhanced services. The remaining $0.5 million change is due to various other items.

Data Services Revenues. Data services revenues increased $3.2 million, or 21%, to $18.6 million from $15.4 million in the first nine months of 2003. DSL revenues increased $2.2 million as the number of DSL subscribers grew to 16,521 at September 30, 2004. This represents a 112% increase compared to the number of DSL subscribers at September 30, 2003. Revenue for providing dial-up internet access increased $0.7 million as a result of an increase in the subscriber base.

Long Distance Services Revenues. Long distance services revenue increased $5.9 million, or 26%, to $28.2 million in the first nine months of 2004 from $22.3 million during the same period in 2003. Revenues from our flat rate plans and direct-dialed long-distance products increased $3.2 million as a result of adding an average of 43,000 subscribers and $3.4 million as a result of an increase to the monthly recurring rate. These increases were partially offset by a reduction of $0.6 million related to local toll calling customers switching to alternate lower cost service providers and lower calling card revenue.

Access Services Revenues. Access services revenues decreased $3.0 million, or 3%, to $96.3 million in the first nine months of 2004 from $99.3 million during the same period in 2003. Switched access revenue decreased $2.8 million, which was primarily attributable to lower access rates. Revenues decreased an additional $0.6 million as a result of the termination of a contract in which we provided dedicated facilities on one of our microwave towers. These two decreases were partially offset by a $0.4 million increase in end user access charges which was driven by a rate increase.

USF Revenues. USF revenues increased $0.3 million to $90.8 million in the first nine months of 2004, as a result of higher Federal USF.

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Other Services Revenues. Other services revenues increased $1.9 million, or 7%, to $29.1 million in the first nine months of 2004 from $27.2 million during the same period in 2003. $1.2 million of this increase stemmed from the leasing of additional facilities by competitive local telephone companies to deliver service to their customers in our markets.

Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

Local Service Revenues. Local service revenue increased $9.3 million, or 6%, to $156.4 million in 2003 from $147.1 million in 2002, despite declining access lines during the period. Revenue from the provision of basic service decreased $2.3 million primarily as a result of access line loss. This access line related loss was more than offset by an increase of $9.0 million in enhanced services, primarily resulting from our bundle strategy. The remainder of the increase was from activation and reconnection charges.

Data Services Revenues. Data services revenues improved 1% in 2003 to $21.0 million from $20.7 million in 2002. DSL revenues increased $1.8 million and other data revenue increased $1.7 million. The number of DSL subscribers grew by 5,269 during the year. The increase in the number of DSL subscribers represents a 150% increase from 2002. We have been able to grow our data services revenue despite the loss of substantially all the revenue from one of our large Internet service provider customers. The loss of this customer represented a $3.2 million decrease in revenue during 2003.

Long Distance Services Revenues. Long distance services revenue increased $7.8 million, or 34%, to $30.8 million in 2003 from $23.0 million in 2002. Our flat rate plans and direct-dialed long-distance products increased $10.1 million. This increase was partially offset by a reduction in local toll revenue of $2.3 million, or 37%, compared to the previous year. This results primarily from customers switching to one of our new plans offering toll-free local calling or switching to alternate lower cost service providers.

Access Services Revenues. Access services revenues declined $1.0 million to $132.0 million in 2003 from $133.0 million in 2002. Switched access revenue decreased approximately $4.8 million, which was primarily attributable to lower access rates. Lower switched access revenue was partially offset by higher special access and end user revenues. Special access revenues increased by $1.6 million as the demand for special circuits ordered by interexchange carriers to transport their customers voice and data traffic continue to improve. End user revenues increased by $2.2 million, of which $3.8 million was due to an increase in rates, offset by a $1.6 million reduction resulting from a loss in access lines.

USF Revenues. USF revenues declined $1.9 million, or 2%, to $119.7 million in 2003 from $121.6 million in 2002. Texas State USF declined $1.1 million in 2003 compared to 2002 as a result of a loss in access lines.

Other Services Revenues. Other services revenue increased $3.0 million, or 9%, to $37.4 million. $2.4 million of this increase was related to competitive local telephone companies leasing additional facilities to service their customers in our markets. The remaining $0.6 million increase was due primarily to higher directory advertising and other miscellaneous items.

Year Ended December 31, 2002 Compared to Year Ended December 31, 2001

Local Service Revenues. Local service revenue increased $14.6 million, or 11%, to $147.1 million in 2002 from $132.5 million in 2001. Comparing access lines at December 31, 2002 to December 31, 2001, access lines increased 19,709. $4.9 million of the revenue increase and 27,237 of the access line increase was related to our acquisition of Kerrville Communications Corporation, or KCC, in 2002.

Excluding the effects of the KCC acquisition, access lines declined 7,828, or 1.4%, most of which occurred near the end of the year. As a result, this decline had a minimal effect on our 2002 revenues. Revenues excluding the acquisition of KCC increased $9.7 million, or 7.3%. $4.2 million of this increase was related to sales of enhanced services, primarily as a result of our bundled products which we began marketing

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during 2002. Other increases to local service revenues include $3.4 million in activation and reconnection charges and $2.1 million of other miscellaneous increases.

Data Services Revenues. Data services revenues increased $2.8 million, or 16%, to $20.7 million in 2002 from $17.9 million in 2001. $2.5 million of the increase was related to our acquisition of KCC in 2002. The remaining increase was due substantially to our efforts to increase the number of DSL subscribers in our markets and sales of other data products.

Long Distance Services Revenues. Long distance services revenue increased $8.3 million, or 57%, to $23.0 million in 2002 from $14.7 million in 2001. $1.7 million of the revenue increase and approximately 8,400 of the long distance subscriber increase was related to our acquisition of KCC in 2002.

Excluding the effects of the KCC acquisition, revenue from our flat rate plans and direct-dialed long-distance products increased $8.7 million as a result of the number of long distance subscribers increasing by 96% to 122,257 from 62,234 at the end of 2001. This increase was partially offset by a reduction in local toll revenue of $2.1 million. This reduction in local toll results primarily from customers switching to one of our new plans offering toll-free local calling or switching to alternate lower cost service providers.

Access Services Revenues. Access services revenues increased $13.6 million, or 11%, to $133.0 million from $119.4 million for 2002 and 2001, respectively. $8.3 million of the revenue increase was attributable to the acquisition of KCC.

Excluding the effects of the KCC acquisition, access services revenues increased $5.3 million in 2002 as compared to 2001. Higher special access revenues contributed $7.9 million of the increase as inter-exchange carriers purchased special circuits to transport their customers voice and data traffic and from fulfilling pent-up demand for circuits in our exchanges. Adding to the increases in access services revenue in 2002 were higher subscriber line charges of $3.6 million. These increases were offset by lower switched access revenue. Switched access revenue declined by $6.2 million, or 10%, compared to the previous year.

USF Revenues. USF revenues increased $5.3 million, or 5%, to $121.6 million in 2002 from $116.3 million in 2001. $4.1 million of the increase was related to our acquisition of KCC in 2002. The remaining $1.2 million increase was due primarily to higher net federal USF support, partially offset by lower Texas state USF as a result of our declining access lines in Texas.

Other Services Revenues. Other services revenue increased $10.3 million, or 43%, to $34.4 million in 2002 from $24.1 million in 2001. $4.0 million of the increase was related to our acquisition of KCC in 2002. Equipment sales increased $4.0 million from a mix of sales of large systems to business customers, sales of individual phone sets, and other small items. Other miscellaneous items contributed the remaining increase of $2.3 million.

Operating Expenses

Cost of Service. Cost of service includes operational costs of owning and operating our facilities, cost of leasing other facilities to interconnect our network, access charges paid to third parties to transport and terminate toll calls, and the cost of sales of customer premise equipment.

Selling, General and Administrative. Selling, general and administrative expenses represent the cost of billing our customers, operating our call centers, performing sales and marketing activities in support of our efforts to grow revenues, and other general corporate support activities.

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Depreciation and Amortization. Depreciation and amortization includes depreciation of our communications network and equipment and amortization of goodwill through December 31, 2001. The following table sets forth operating expenses for the periods shown:

	Year Ended December 31,			Nine Months Ended September 30,	
	2001	2002	2003	2003	2004
			(Dollars in thousands)		
Cost of service	$105,357	$113,891	$106,527	$ 80,698	$ 78,704
Selling, general and administrative	105,418	133,468	126,896	94,428	100,098
Depreciation and amortization	110,843	73,273	81,638	61,039	63,993
	$321,618	$320,632	$315,061	$236,165	$242,795

Consolidated Operating Expenses

Our consolidated operating expenses increased by $6.6 million, or 3% in the first nine months of 2004 as compared to the same period in 2003. This increase was primarily attributable to a $5.7 million increase in our selling, general and administrative expenses and $3.0 million increase in depreciation and amortization expense, which was partially offset by $2.0 million decrease in cost of service.

Our consolidated operating expenses decreased $5.6 million, or 2%, in 2003 primarily due to our recovery of previously written off receivables associated with MCI Worldcom s bankruptcy and improvements in maintenance and operating costs resulting from improvements we have made to our network infrastructure. Our consolidated operating expenses were essentially flat in 2002 compared to 2001. There were substantial increases in some categories of operating expenses in 2002 primarily caused by our January 2002 acquisition of KCC, increased bad debt expense we incurred on receivables we wrote off resulting from MCI Worldcom s 2002 bankruptcy filing, the staffing of personnel in our call centers, and access charges paid to third parties to transport and terminate long distance calls. These expense increases were offset by a reduction of $53.9 million in amortization expense due to the adoption of FASB 142 in 2002. FASB 142 directed companies to annually test goodwill for impairment rather than amortize goodwill systematically to earnings.

There are a number of factors that could cause our expenses to increase in the future, including but not limited to:

If we were to determine that our goodwill were to become impaired we would be required to write-off the impaired amount under the provisions of FASB 142;

Our ability to successfully negotiate a new collective bargaining agreement with the Local 6171 and Local 7019 of the Communications Workers of America. The current contracts expire on February 28, 2005 and February 14, 2006;

Increasing costs of providing healthcare and postretirement benefits to our existing and former employees;

On October 29, 2004, we announced a workforce reduction of 72 employees. The reduction is a result of new operating efficiencies due to our investments in new customer service technologies and plant improvements, and competitive challenges in our industry. As a result of the reduction, we will record a restructuring charge in the fourth quarter of 2004 of $0.7 million representing termination benefits to be paid to the terminated employees. The termination benefits are expected to be substantially paid by December 31, 2004.

In connection with the proposed offering, we will assess our current management compensation plans to coincide with that of a public company. Implementing these plans could result in additional costs;

Increased costs associated with our responsibilities as a public company; and

The increased presence of competitors in our markets and incremental costs we might incur to retain our existing customers or implement new product offerings.

Our inability to effectively manage any or all of these items could cause our operating expenses to increase in the future and have an adverse effect on our results of operations and financial condition.

Nine Months Ended September 30, 2004 Compared to Nine Months Ended September 30, 2003

Cost of Service. Cost of service decreased $2.0 million, or 2%, to $78.7 million in the first nine months of 2004 from $80.7 million during the same period in 2003. This decrease was attributable to, among other factors, costs for external circuits and network capacity, which declined $1.9 million as a result of efficiencies gained from upgrades we made to our network. In addition, costs to maintain and operate our network declined $0.9 million as a result of the investment we made in our telecommunications infrastructure. Furthermore, a favorable change in estimate from a previously recorded loss contingency caused a reduction of $0.9 million, and variable costs associated with equipment sales declined $0.6 million. Finally, there was a $0.7 million decrease in the amounts that we pay to cellular carriers for traffic settlements.

Offsetting the above noted decreases was a $2.8 million increase in access charges paid to third parties related to the increase in usage from our increasing long distance subscriber base and $0.6 million increase in employee related benefit costs.

Selling, General and Administrative. Selling, general and administrative expense increased $5.7 million, or 6%, to $100.1 million in first nine months of 2004 from $94.4 million during the same period in 2003. The increase was primarily attributable to a $5.0 million one-time transition payment made to our former CEO (see Note 10 to our financial statements for the nine months ended September 30, 2004, included herein) and a $1.5 million charge for probable losses associated with certain legal and tax contingencies. Additionally, we recorded a $3.3 million one-time benefit in first nine months of 2003 upon recovering amounts that we had previously written off as a result of MCI s 2002 bankruptcy. Finally, there was a $0.4 million increase in employee related benefit costs.

Offsetting the above noted increases were decreases of $2.4 million due to vendor price reductions associated with certain back-office functions we have outsourced to a third party service provider and $2.0 million in bad debt expense as a result of improvements we have made to our collections processes.

Depreciation and Amortization. Depreciation and amortization expense increased by $3.0 million, or 5%, to $64.0 million during the first nine months of 2004 as compared to the same period in 2003. Higher depreciation expense resulted from the increased investment in property, plant, and equipment as a result of our spending on capital projects to improve our network infrastructure.

Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

Cost of Service. Cost of service decreased $7.4 million, or 6%, to $106.5 million in 2003 from $113.9 million in 2002. Costs for external circuits and network capacity declined $5.4 million as a result of efficiencies gained from upgrades we made to our network. Costs to maintain and operate our network declined $6.6 million as a result of the investment we made in our telecommunications infrastructure. Additionally, cost of goods sold for customer premise equipment decreased $2.1 million as sales for this equipment slowed during 2003. These decreases were partially offset by higher access charges of $7.4 million paid to third parties related to the increase in usage from our increasing long distance subscriber base. Other miscellaneous items contributed the remaining decrease of $0.7 million.

Selling, General and Administrative. Selling, general and administrative expenses decreased $6.6 million, or 5%, to $126.9 million in 2003 from $133.5 million in 2002. We recorded a $5 million charge during 2002

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as a result of one of our largest customers, MCI, declaring bankruptcy. In 2003, we sold the receivables related to the charge and negotiated setoff of amounts owed by us to MCI against amounts owed by MCI to us, recovering approximately $3.4 million. The effect of these transactions decreased our expense in 2003 as compared to 2002 by $8.4 million. Offsetting this reduction in expense was an increase of $1.8 million of various other miscellaneous expenses.

Depreciation and Amortization. Depreciation and amortization expense increased by $8.4 million, or 11%, to $81.6 million during 2003 as compared to 2002. Higher depreciation expense resulted from our spending on capital projects to improve our network infrastructure.

Year Ended December 31, 2002 Compared to Year Ended December 31, 2001

Cost of Service. Cost of service increased $8.5 million, or 8%, to $113.9 million in 2002 from $105.4 million in 2001. $5.8 million of the increase was related to our acquisition of KCC in 2002. Of the remaining $2.7 million increase, higher access charges of $4.3 million were paid to third parties related to the increased usage from our increasing long distance subscriber base, and higher cost of goods sold for $2.0 million primarily resulted from large equipment system sales in late 2002. These increases were offset by a reduction of $3.6 million, primarily from lower costs for external circuits and network capacity as a result of efficiencies gained from upgrades we made to our network.

Selling, General and Administrative. Selling, general and administrative expenses increased $28.1 million, or 27%, to $133.5 million in 2002 from $105.4 million in 2001. $7.1 million of the increase was from our 2002 acquisition of KCC. Of the remaining $21.0 million, $5.3 million was due principally to headcount increases in our call centers. This was done to eventually shift reliance away from third parties to generate sales and to increase the overall effectiveness of our customer service function. Sales and marketing expense increased $6.4 million as a result of efforts to generate sales of bundle products and long distance. We wrote off approximately $5.0 million of receivables when one of our largest customers, MCI, declared bankruptcy in 2002. Of the remaining $4.3 million increase, $1.4 million was due to a restructuring charge taken in the fourth quarter of 2002 for elimination of 81 positions and $2.9 million was from various other miscellaneous increases.

Depreciation and Amortization. Depreciation and amortization expense decreased $37.5 million to $73.3 million in 2002 from $110.8 million in 2001. $53.9 million of this decrease resulted from our adoption of SFAS 142, which required that goodwill no longer be amortized. Excluding the effects of SFAS 142, depreciation and amortization expense increased $16.4 million. $4.1 million of the increase was related to our acquisition of KCC in 2002. The remaining $12.3 million increase in depreciation expense results from our spending on capital projects to improve our network infrastructure.

Interest Expense

The following table sets forth interest expense:

	Year Ended December 31,			Nine Months Ended September 30,	
	2001	**2002**	**2003**	**2003**	**2004**
	(Dollars in thousands)				
Interest expense	$133,156	$127,365	$119,185	$95,300	$83,384

Interest expense decreased $11.9 million to $83.4 million in the nine months ended September 30, 2004 from $95.3 in the nine months ended September 30, 2003. Interest expense also decreased $8.2 million to $119.2 million in 2003 from $127.4 million in 2002. In each case our decrease in interest expense was due to lower average principal outstanding on our senior debt.

Excluding the effects of the borrowings for the KCC acquisition, our interest expense decreased $10.9 million to $122.3 million in 2002 from $133.2 million in 2001, as a result of our paying down debt.

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This decrease was partially offset by an increase of deferred interest on our subordinated notes and lower capitalized interest as spending for projects declined in 2002 compared to 2001.

Loss on Interest Rate Hedging Arrangements

The following table sets forth our loss on interest rate hedging arrangements:

	Year Ended December 31,			Nine Months Ended September 30,	
	2001	2002	2003	2003	2004
	(Dollars in thousands)				
Loss on interest rate hedging arrangements	$(14,292)	$(12,348)	$(2,113)	$(2,199)	$(122)

The adjustment to mark our hedging arrangements to market value resulted in non-cash income of $7.8 million, $5.6 million and $8.5 million for the nine months ended September 30, 2004 and 2003, and for the year ended December 31, 2003, respectively. For the years ended December 31, 2002 and 2001, our adjustment to mark our hedging arrangements to market value resulted in non-cash expense of $2.7 million and $9.9 million, respectively. The remaining losses relate to cash settlements during the periods. These hedging arrangements expired in November 2004. We are required to enter into new arrangements to hedge our interest rate risk under the terms of our new credit facility by February 10, 2005.

Earnings from Unconsolidated Cellular Partnerships and Other Income and Expense

The following table sets forth other income and expense for the periods shown:

	Year Ended December 31,			Nine Months Ended September 30,	
	2001	2002	2003	2003	2004
	(Dollars in thousands)				
Earnings from unconsolidated cellular partnerships	$	$2,757	$3,258	$2,687	$ 1,007
Impairment on investments in cellular partnerships					(6,678)
Other income and (expense)	$358	$ (268)	$ (62)	$ 59	$(25,060)

Earnings from unconsolidated cellular partnerships represent our share of the earnings in the equity interest of the two cellular partnerships acquired in 2002 as part of the KCC acquisition. In 2002, 2003 and the nine months ended September 30, 2004, we recorded $2.8 million, $3.3 million and $1.0 million, respectively, for these equity earnings.

In 2004, a wireless competitor began constructing facilities in areas serviced by our unconsolidated cellular partnerships. This has resulted in a significant decrease in roaming revenue further decreasing our earnings from the unconsolidated cellular partnerships. In light of the financial results of the cellular partnership through September 30, 2004, we assessed the recoverability of the investments in the unconsolidated cellular partnerships, which resulted in an impairment charge of $6.7 million to the Statement of Operations.

Other income and (expense) represents various other miscellaneous income and expense items, including interest income on our cash balances held at financial institutions. The decrease of $25.1 million in the nine months ended September 30, 2004 is primarily attributable to the purchase of substantially all outstanding equity interests from a group of individual investors associated with our recapitalization, which resulted in $18.0 million of expense and offering costs of $6.8 million that were expensed as a result of our decision to not pursue the previously planned public offering of income deposit securities.

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Income Taxes

The following table sets forth income taxes for the periods shown:

	Year Ended December 31,			Nine Months Ended September 30,	
	2001	2002	2003	2003	2004
	(Dollars in thousands)				
Income tax expense (benefit)	$0	$1,649	$2,478	$2,193	$(6,095)

The income taxes represent those of Valor Telecommunications Southwest II, LLC, which has elected to be taxed as a corporation for federal income tax purposes. (See Note 2, Summary of Significant Accounting Policies and Note 10, Income Taxes of our consolidated financial statements for an expanded discussion of income taxes.) Income tax benefit for the nine months ended September 30, 2004 is primarily attributable to the loss generated at Valor Telecommunications Southwest II, LLC, as a result of expense recognized in connection with the purchase of ownership interests from certain individual investors and the impairment on investment in cellular partnerships.

Minority Interest

The following table sets forth the minority interest for the periods shown:

	Year Ended December 31,			Nine Months Ended September 30,	
	2001	2002	2003	2003	2004
	(Dollars in thousands)				
Minority interest	$3,595	$(615)	$(3,568)	$(2,364)	$(3,171)

Minority interest reflects the share of income and loss of minority shareholders in Valor Telecommunications Southwest, LLC and Valor Telecommunications Southwest II, LLC.

Discontinued Operations

The following table sets forth discontinued operations for the periods shown:

	Year Ended December 31,		
	2001	2002	2003
	(Dollars in thousands)		
Discontinued operations	$(8,443)	$(3,461)	$108

We sold our competitive local exchange carrier in Texas during April 2002 to NTS Communications for $0.2 million. In accordance with the provisions of SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, which was effective for us on January 1, 2002, the revenue, costs and expenses and cash flows of our competitive local exchange business have been excluded from the respective captions in our Consolidated Statements of Operations and Consolidated Statements of Cash Flows, and have been reported through their respective dates of separation as Net income (loss) from discontinued operations and as Net cash used in discontinued operations.

In connection with the sale, we recorded a liability of approximately $2.0 million related to certain employee termination benefits and other exit costs such as non-cancelable leases. As of December 31, 2003 and 2002, approximately $0.1 million and $0.4 million, respectively, of the $2.0 million had not been paid. As of September 30, 2004, a minimal amount remained unpaid. These amounts have been classified as current liabilities in the Consolidated Balance Sheets. Income from discontinued operations of $0.1 million in 2003 represents a revision to the estimates we made in 2002 for recording certain employee termination benefits and other exit costs.

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Cumulative Effect of Change in Accounting Principle

SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, or SFAS 133, as amended by SFAS No. 137, Accounting for Derivative Instruments and Hedging Activities-Deferral of the Effective Date of FASB Statement No. 133, and by SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, which became effective for our company on January 1, 2001, established accounting and reporting standards that required every derivative instrument be recorded in the balance sheet as either an asset or liability measured at fair value, with changes in fair value reflected in the statement of operations.

We entered into interest rate hedge contracts to adjust the interest rate profile of our debt obligations (see Interest Rate Risk below). In addition, our credit arrangements include provisions that require interest rate protection (hedge agreements) for a portion of our variable debt. We entered into interest rate hedging agreements with certain financial institutions to reduce the financial impact of changes in interest rates on our debt. Our interest rate swap and collar agreements did not qualify for hedge accounting under SFAS 133 and therefore are carried at fair market value and included in Deferred credits and other liabilities in the Consolidated Balance Sheets. The transitional unrealized loss on the interest rate hedging arrangements at January 1, 2001 is reflected as the Cumulative effect of change in accounting principle on the Consolidated Statements of Operations. Changes in the fair market value and settlements are recorded as Loss on hedging arrangements each quarter.

Financial Condition and Liquidity

Current Financial Condition. As of September 30, 2004, we had net debt of $1,418.6 million and $75.0 million of common owners equity, compared to net debt of $1,469.2 million and $49.9 million of common owners equity at December 31, 2003, and net debt of $1,544.2 million and $5.6 million of common owners deficit at December 31, 2002. Historically, we have used excess cash generated through operations to pay down long-term debt. As a result, we generally maintain a negative working capital balance. We had a negative working capital balance of $50.4 million and $71.0 million at September 30, 2003 and 2004, respectively, and $29.3 million and $46.2 million at December 31, 2002 and 2003, respectively.

As discussed in more detail below, our management believes that our operating cash flows, cash and cash equivalents, and borrowing capacity under our new credit facility will be sufficient to fund our capital and liquidity needs for the foreseeable future.

Cash Flows

	Years Ended December 31,			Nine Months Ended September 30,	
	2001	2002	2003	2003	2004
	(Dollars in thousands)				
Net cash provided by operating activities	$ 100,301	$ 150,383	$ 166,065	$ 132,461	$ 124,660
Net cash used in investing activities	(106,614)	(216,773)	(66,299)	(50,551)	(51,362)
Net cash provided by (used in) financing activities	8,117	71,015	(99,465)	(81,971)	(74,054)
Net cash used in discontinued operations	(8,373)	(3,662)	(176)	(166)	(17)
Net (decrease) increase in cash and cash equivalents	$ (6,569)	$ 963	$ 125	$ (227)	$ (773)

We began making semi-annual cash payments related to our 10% senior subordinated notes in 2003.

Net cash provided by continuing operations of $124.7 million in the first nine months of 2004, was generated primarily by $25.2 million of income from continuing operations, adjusted to exclude non-cash

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and reorganization items of $85.6 million. The most significant non-cash item in 2004 were depreciation and amortization expense of $64.0 million. We also recognized $18.0 million as a reconciling item to cash provided by continuing operations related to expense incurred in connection with our cash payment to minority shareholders in connection with our reorganization. Net cash provided by continuing operations of $166.1 million in 2003, was generated primarily by $58.1 million of income from continuing operations, adjusted to exclude non-cash items of $102.7 million. The most significant non-cash items in 2003 were depreciation and amortization expense of $81.6 million and non-cash interest expense related items of $17.4 million, which includes amortization of debt issuance costs, unrealized gain on hedging arrangements, and non-cash interest expense on our senior subordinated debt.

Net cash provided by continuing operations of $150.4 million in 2002, was generated primarily by $19.8 million of income from continuing operations, adjusted to exclude non-cash items of $124.8 million. The most significant non-cash items were depreciation and amortization expense of $73.3 million, non-cash interest expense related items of $42.2 million, and $11.4 million of bad debt expense. Cash flows from continuing operations were also favorably impacted by working capital improvements of $3.3 million. The growth in cash flows from continuing operations from 2001 to 2002 relates primarily to the acquisition of KCC in 2002, as well as the unfavorable working capital requirements in 2001.

Net cash provided by continuing operations of $100.3 million in 2001, resulted from a $44.9 million of net loss from continuing operations, adjusted to exclude non-cash items of $168.0 million and working capital requirements of $29.9 million. The most significant non-cash items were depreciation and amortization expense of $110.8 million, non-cash interest expense related items of $49.4 million, and $11.4 million of bad debt expense.

Cash used in investing activities was $51.4 million for the first nine months of 2004, compared to $50.6 million for the nine months of 2003, $66.3 million in 2003, $216.8 million in 2002, and $106.6 million in 2001. The investing activities during 2002 include the cash paid of $128.1 million to acquire all the outstanding common stock, preferred stock and common stock equivalents of KCC. Our investing activities consisted primarily of capital expenditures for property, plant and equipment. We fund capital expenditures to deploy new network services, modernize our property, plant and equipment, position our network infrastructure for future growth, and to meet regulatory obligations.

Capital expenditures for the years ended 2001, 2002, 2003 and the first nine months of 2004 were $107.9 million, $89.5 million, $69.9 million and $51.5 million, respectively. In 2000, we launched an aggressive capital spending program whereby we upgraded much of our infrastructure and replaced outside plant in areas that generated abnormally high routine maintenance costs. This program largely has been completed, which is the principal reason for the decline in capital spending over the last three years. We anticipate that capital spending for 2005 will decline to approximately $58.8 million. Cash used for capital expenditures was partially offset by distributions of $0.6 million for the nine months ended September 30, 2004, $3.5 million in 2003, and $1.9 million in 2002, received from our equity investment in two wireless partnerships. Future cash distributions from these equity investments are uncertain.

Cash used by financing activities was $74.1 million in the first nine months of 2004 and $99.5 million in 2003, compared to cash provided by financing activities of $71.0 million in 2002, and $8.1 million in 2001. These changes are principally due to the net incremental repayments of long-term debt of $59.3 million in the nine months ended September 30, 2004 and $100.0 million in 2003, and net incremental borrowings of $39.2 million in 2002, and net incremental repayments of $2.2 million in 2001, respectively. Cash used by financing activities for the nine months ended September 30, 2004 also includes our $18.6 million purchase of ownership interests from certain individual investors. Cash provided by financing activities in 2002 includes the proceeds from partner capital contribution of $46.1 million, which together with the additional borrowings of $82.0 million, was used primarily to acquire all the outstanding common stock, preferred stock and common stock equivalents of KCC.

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Historically, we have managed our cash on hand through the use of revolving credit facilities to maximize the amount of debt repayment. Of the total net debt repayments of $100.0 million in 2003, $58.9 million were required principal payments and $41.1 million were optional principal payments.

Outstanding Debt and Existing Financing Arrangements

As of September 30, 2004 we had various financing arrangements outstanding with a total borrowing capacity of $1,572.7 million. Of this total borrowing capacity, $153.5 million was available under a revolving credit facility and $1,419.2 million was outstanding as debt (refer to Note 8 to the consolidated financial statements for more details on outstanding debt):

	Total Borrowing Capacity	Unused Capacity	Outstanding Debt
	(Dollars in thousands)		
Senior credit facilities			
Revolver	$ 265,000	$ 153,500	$ 111,500
Bank term loans	412,415		412,415
Rural Telephone Finance Cooperative, or RTFC, term loans	574,850		574,850
10% Senior Subordinated Notes due 2010	314,257		314,257
Capitalized leases and other	6,215		6,215
	$ 1,572,737	$ 153,500	$ 1,419,237

Outstanding Senior Subordinated Notes

As of September 30, 2004, Valor Telecommunications Southwest, LLC had $314.3 million aggregate principal amount of 10% Senior Subordinated Notes due 2010 outstanding. Until our pro forma fixed charge coverage equaled or exceeded one to one, our 10% Senior Subordinated Notes did not pay cash interest, but accrued interest at 12.0% per annum that was converted into additional note principal. During the years ended December 31, 2002 and 2003, we converted $32.6 million and $17.8 million, respectively, of interest into additional note principal. During 2003, we reached the pro forma fixed charged coverage ratio of 1.00 to 1.00 and began making cash interest payments on our 10% Senior Subordinated Notes in December 2003.

All amounts outstanding under these notes were paid in full in connection with our entering into the new credit facility.

New Credit Facility

On November 10, 2004, we entered into a new $1.3 billion senior secured credit facility consisting of a $100.0 million senior secured revolving facility and a $1.2 billion senior secured term loan. At the same time, we entered into a $265.0 million senior secured second lien loan and a $135.0 million senior subordinated loan. We used the proceeds of the credit facility, the second lien loan and the subordinated loan to (i) repay all amounts owed under our previous senior secured credit facilities; (ii) redeem $325.5 million of 10% senior subordinated notes due 2010 held primarily by our equity sponsors, including interest accrued thereon; (iii) redeem $159.4 million of preferred interest held by our existing equity investors, including our equity sponsors, in our subsidiary Valor Telecommunications, LLC and (iv) pay $30.7 million in associated transaction costs.

The agreements for the credit facility, second lien loan and subordinated loan, limit among other things, additional borrowings, transactions with affiliates, capital expenditures and the payment of dividends and the credit facility requires us to maintain certain financial ratios including total leverage and interest coverage ratios. Concurrent with the closing of this offering, we expect to amend our credit facility to, among other modifications, delete restrictions on capital expenditures, permit us to pay dividends to holders of our common stock and use the proceeds from this offering in the manner set forth in Use of

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Proceeds. Throughout this prospectus, we refer to the credit facility as so amended, as our new credit facility. We intend to use the proceeds of this offering to repay the second lien loan and subordinated loan in full, including any prepayment premiums.

Contractual and Other Obligations

In addition to the above financing arrangements, we have commitments under certain contractual arrangements to make future payments for goods and services. These commitments secure the future rights to various assets and services to be used in the normal course of operations. For example, we are contractually committed to make certain minimum lease payments for the use of property under operating lease agreements. In accordance with current accounting rules, the future rights and obligations pertaining to such firm commitments are not reflected as assets or liabilities on the consolidated balance sheet. The following table summarizes our contractual and other obligations at December 31, 2003, and the effect such obligations are expected to have on liquidity and cash flow in future periods:

Payments Due by Period(1)

	2004	2005-2006	2007-2008	Thereafter	Total
			(Dollars in thousands)		
Contractual obligations(2)	$ 50,786	$ 72,204	$ 713	$	$ 123,703
Long-term debt obligations(3)	$154,074	$306,511	$686,909	$867,307	$2,014,801
Capital lease obligations(4)	$ 1,777	$ 2,551	$ 397	$	$ 4,725
Operating lease obligations(5)	$ 2,257	$ 4,400	$ 3,644	$ 2,873	$ 13,174
Total contractual cash obligations	$208,894	$385,666	$691,663	$870,180	$2,156,403

(1) The table above does not include an estimate for income taxes, obligations to preferred equity holders, cash contributions to our pension plan and cash contributions to our post-retirement medical plan which we are required to make but not required to include above.

(2) Our contractual obligations represent our required capital investment in New Mexico, officers salaries under employment agreements, capital expenditure commitments and payments to third party service providers. Effective July 1, 2004, we amended an outsourcing agreement with a third party providing certain back office functions. As a result of the amendment, the contractual obligations noted above are expected to increase (decrease) by approximately the following amounts for the following years:

2004	$ (3,138)
2005-2006	$ (8,592)
2007-2008	$31,070

(3) The long-term debt obligations represent our cash debt service obligations, including both principal and interest. Effective November 10, 2004, we refinanced our existing long-term obligations. As a result of the refinancing, the long-term debt obligations noted above are expected to increase (decrease) by approximately the following amounts for the following years:

2005-2006	$ (48,705)
2007-2008	$ (433,534)
Thereafter	$1,010,881

In determining our long-term debt obligations on our variable interest rate debt, we used the weighted average interest rate as of the end of the applicable period.

(4)