MJD COMMUNICATIONS, INC. AND SUBSIDIARIES

Consolidated Statements of Stockholders' Equity (Deficit)

Years ended December 31, 1999, 1998, and 1997

	Class A common stock	Additional paid-in capital	Accumulated other comprehensive income	Accumulated deficit	Total stockholders' equity (deficit)
	(Dollars in thousands, except share data)				
Balance, December 31, 1996	$ 79	(75)	—	(2,146)	(2,142)
Net loss	—	—	—	(888)	(888)
Issuance of 9,751,600 shares of common stock	98	15,777	—	—	15,875
Conversion of redeemable preferred stock	—	112	—	—	112
Capital contribution	—	924	—	—	924
Repurchase of redeemable preferred stock	—	—	—	(24,541)	(24,541)
Redeemable preferred stock dividends	—	—	—	(279)	(279)
Balance, December 31, 1997	177	16,738	—	(27,854)	(10,939)
Net loss	—	—	—	(8,000)	(8,000)
Preferred stock dividends	—	—	—	(12)	(12)
Issuance of 18,590,800 shares of common stock	185	31,652	—	—	31,837
Reclassification of 1,752,000 shares of common stock subject to put option	(17)	(2,983)	—	—	(3,000)
Balance, December 31, 1998	345	45,407	—	(35,866)	9,886
Net loss	—	—	—	(29,040)	(29,040)
Change in unrealized gain on securities available-for-sale, net of tax effect of $2,566	—	—	4,187	—	4,187
Increase in stock appreciation rights	—	3,386	—	—	3,386
Balance, December 31, 1999	$345	48,793	4,187	(64,906)	(11,581)

See accompanying notes to consolidated financial statements.

MJD COMMUNICATIONS, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Loss

Years ended December 31, 1999, 1998, and 1997

	1999	1998	1997
Net loss	$(29,040)	(8,000)	(888)
Change in unrealized gain on securities available—for—sale, net of tax effect of $2,566	4,187	—	—
Comprehensive loss	$(24,853)	(8,000)	(888)

See accompanying notes to consolidated financial statements.

MJD COMMUNICATIONS, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended December 31, 1999, 1998, and 1997

	1999	1998	1997
	(Dollars in thousands)		
Cash flows from operating activities:			
Net loss	$(29,040)	(8,000)	(888)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Depreciation and amortization	33,342	21,534	9,093
Provision for uncollectible revenue	634	390	—
Deferred income taxes	(6,711)	(1,653)	207
Income from equity method investments	(2,497)	(931)	—
Deferred patronage dividends	(380)	(265)	(585)
Minority interest in income of subsidiaries	100	80	62
Increase (decrease) in put warrant obligation	13,331	714	(295)
Compensation charge for stock appreciation rights	3,386	—	—
Net (gain) loss on sale of investments and other assets	(512)	(630)	17
Loss on early retirement of debt	—	2,897	1,864
Amortization of investment tax credits	(193)	(130)	(31)
Changes in assets and liabilities arising from operations, net of acquisitions:			
Accounts receivable	(853)	5,988	(1,563)
Prepaid and other assets	(23)	253	(106)
Accounts payable	(2,117)	(1,398)	1,664
Acscrued interest payable	384	1,128	720
Accrued liabilities	2,773	689	636
Income taxes recoverable/payable	(3,920)	(5,799)	(956)
Total adjustments	36,744	22,867	10,727
Net cash provided by operating activities	7,704	14,867	9,839
Cash flows from investing activities:			
Acquisitions of telephone properties, net of cash acquired	(53,949)	(217,080)	(30,845)
Acquisition of property, plant, and equipment	(43,509)	(12,433)	(8,262)
Proceeds from sale of property, plant, and equipment	116	107	121
Distributions from investments	2,590	118	63
Payment on covenants not to compete	(988)	(219)	(94)
Acquisition of investments	(349)	(8)	(241)
Proceeds from sale of investments	20,065	4,088	403
Payments received on direct financing leases	—	—	249
Decrease in other assets/liabilities, net	(586)	(95)	(361)
Net cash used in investing activities	(76,610)	(225,522)	(38,967)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt	138,943	510,583	71,134
Repayment of long-term debt	(52,056)	(307,763)	(22,104)
Purchase of stock warrants	(17,500)	—	—
Repurchase of preferred stock and warrants	—	(175)	(31,487)
Dividends paid to preferred stockholders	—	(12)	(279)
Net proceeds from the issuance of common stock	—	31,837	15,875
Loan origination costs	(3,703)	(17,345)	(1,949)
Payment of early retirement benefits	—	—	(25)
Dividends paid to minority stockholders	(4)	(6)	(4)
Release of restricted funds	—	—	561
Repayment of capital lease obligation	(92)	(45)	(25)
Net cash provided by financing activities	65,588	217,074	31,697
Net increase (decrease) in cash and cash equivalents	(3,318)	6,419	2,569
Cash and cash equivalents, beginning of year	13,241	6,822	4,253
Cash and cash equivalents, end of year	$ 9,923	13,241	6,822

See accompanying notes to consolidated financial statements.

MJD COMMUNICATIONS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 1999, 1998, and 1997

(1) Organization and Summary of Significant Accounting Policies

Organization

MJD Communications, Inc. (MJD) provides management services to its wholly-owned subsidiaries: S T Enterprises, Ltd. (STE); MJD Ventures, Inc. (Ventures); MJD Services Corp. (Services); MJD Holdings Corp. (Holdings); FairPoint Communications Corp. (FairPoint); and MJD Capital Corp. STE, Ventures, Services, and Holdings also provide management services to their wholly-owned subsidiaries.

Collectively, the wholly-owned subsidiaries of STE, Ventures, Services, and Holdings primarily provide telephone local exchange services in various states. Operations also include resale of long distance services, internet services, cable services, equipment sales, and installation and repair services. MJD Capital Corp. leases equipment to other subsidiaries of MJD. FairPoint is a competitive local exchange carrier (CLEC) offering local and long distance, internet, and data services in various states.

STE's wholly-owned subsidiaries include Sunflower Telephone Company (Sunflower); Northland Telephone Company of Maine, Inc. and Northland Telephone Company of Vermont, Inc. (the Northland Companies); S T Communications, Inc.; and S T Long Distance, Inc. (S T Long Distance); Venture's wholly-owned subsidiaries include Sidney Telephone Company (Sidney); C-R Communications, Inc. (C-R); Taconic Telephone Corp. (Taconic); Ellensburg Telephone Company (Ellensburg); Chouteau Telephone Company (Chouteau); Utilities, Inc. (Utilities); Chautauqua & Erie Telephone Corporation (C&E); Columbus Grove Telephone Company (Columbus); The Orwell Telephone Company (Orwell) and Telephone Services Company (TSC). Services' wholly-owned subsidiaries include Bluestem Telephone Company (Bluestem); Big Sandy Telecom, Inc. (Big Sandy); Columbine Telecom Company (Columbine); Odin Telephone Exchange, Inc. (Odin); Kadoka Telephone Co. (Kadoka); Ravenswood Communications, Inc. (Ravenswood); Union Telephone Company of Hartford (Union); Armour Independent Telephone Co. (Armour); Yates City Telephone Company (Yates) and WMW Cable TV Co. (WMW).

Principles of Consolidation and Basis of Presentation

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

The accompanying unaudited pro forma balance sheet gives effect to significant subsequent events occurring in January and February 2000, as if they had occurred on December 31, 1999. Those subsequent events include authorizing additional classes of capital stock, issuing and reacquiring capital stock for net proceeds of $159,282,000, borrowing additional debt of $5,400,000, repaying debt and accrued interest payable in the amount of $102,540,077, being released from put obligations on its common stock and recognizing compensation expense in the amount of $28,249,011 for stock-based compensation to employees. See also note 2 for a description of these subsequent events.

The consolidated financial statements have been prepared using generally accepted accounting principles applicable to regulated entities. The Company's telephone subsidiaries follow the accounting for regulated enterprises prescribed by Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation*. This accounting recognizes the economic effects of rate regulation by recording costs and a return on investment, as such amounts are recovered through rates authorized by regulatory authorities. Accordingly, SFAS No. 71 requires the Company's telephone subsidiaries to depreciate telephone plant over useful lives that would otherwise be determined by management.

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

SFAS No. 71 also requires deferral of certain costs and obligations based upon approvals received from regulators to permit recovery of such amounts in future years. The Company's telephone subsidiaries periodically review the applicability of SFAS No. 71 based on the developments in their current regulatory and competitive environments.

Revenue Recognition From Telephone Operations

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

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

Miscellaneous revenues are derived by billing to either end users, access providers, or other parties, services such as directory advertising, billing and collecting services, rent, etc. These services are typically billed under contract or under tariff supervision.

The costs of services resold are based primarily on the direct costs associated with owned and leased transmission capacity and the cost of transmitting and terminating traffic on other carriers' facilities. Revenues and costs of services resold are recognized as services are provided to local and long-distance end users.

Credit Risk

Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of cash and temporary cash investments and trade receivables. The Company places its cash and temporary cash investments with high quality financial institutions. Concentrations of credit risk with respect to trade receivables are limited due to the Company's large number of customers in several states. The Company establishes an allowance for doubtful accounts based upon factors surrounding the credit risk of specific customers, historical trends, and other information.

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

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

Investments

Investments consist of stock in CoBank, ACB (CoBank), Rural Telephone Bank (RTB), the Rural Telephone Finance Cooperative (RTFC), Illuminet Holdings, Inc. (Illuminet), and various cellular companies and partnerships and other minority equity investments in nonregulated entities. For the investments in partnerships, the equity method of accounting is used. All other investments are stated at cost. To determine if an impairment of an investment exists, the Company monitors and evaluates the financial performance of the business in which it invests and compares the carrying value of the investee to the fair values of similar investments, which in certain instances, is based on traditional valuation models utilizing multiples of cash flows. When circumstances indicate that a decline in the fair value of the investment has occurred and the decline is other than temporary, the Company records the decline in value as a realized loss and a reduction in the cost of the security. The Company did not incur any losses from other than temporary declines in fair value in 1999, 1998, and 1997.

At December 31, 1999, the investment in Illuminet stock was classified as available-for-sale in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. SFAS No. 115 requires fair value reporting for certain investments in debt and equity securities with readily determinable fair values. Available-for-sale securities are recorded at fair value. Unrealized holding gains and losses, net of the related tax effect, are excluded from earnings and are reported as a separate component of comprehensive income until realized.

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

Property, Plant, and Equipment

Property, plant, and equipment are carried at cost. Repairs and maintenance are charged to expense as incurred; major renewals and improvements are capitalized. For telephone companies, the original cost of depreciable property retired, together with removal cost, less any salvage realized, is charged to accumulated depreciation. For all other companies, the original cost and accumulated depreciation are removed from the accounts and any gain or loss is included in the results of operations. The telephone companies capitalize estimated costs of debt and equity funds used for construction purposes for projects greater than $100,000. Depreciation is determined using the straight-line method for financial reporting purposes.

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

Debt Issue Costs

Debt issue costs are being amortized over the life of the related debt, ranging from five to ten years. Accumulated amortization of loan origination costs was $3,104,714 and $1,255,730 at December 31, 1999 and 1998, respectively.

Intangible Assets

The covenants not to compete are being amortized over their useful life of three to five years. Accumulated amortization of covenants not to compete was $1,470,000 and $437,500 at December 31, 1999 and 1998, respectively.

Goodwill consists of the difference between the purchase price incurred in acquisitions using the purchase method of accounting and the fair value of net assets acquired. Goodwill is being amortized using the straight-line method over an estimated useful life of forty years. Accumulated amortization of goodwill was approximately $12.4 million and $6.9 million at December 31, 1999 and 1998, respectively.

The Company reviews its long-lived assets, including goodwill, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

Income Taxes

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

Pension and Other Postretirement Plans

One of the Company's subsidiaries sponsored a defined benefit plan covering substantially all of their employees. The benefits were based on years of service and the employee's compensation levels prior to retirement. Benefits under this plan were frozen in connection with the Company's acquisition of the company. Two of the Company's subsidiaries also sponsor other postretirement healthcare benefits for substantially all retirees. The net periodic costs of pension and other postretirement benefit plans are recognized as employees render the services necessary to earn the postretirement benefits.

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

Derivative Financial Instruments

The Company uses interest rate swaps to manage its exposure to fluctuations in interest rates of its variable rate debt. Amounts receivable or payable under interest rate swap agreements are accrued at each balance sheet date and included as adjustments to interest expense.

Stock-Based Compensation

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

Stock Appreciation Rights

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

Reclassifications

Certain amounts have been reclassified for comparability with the 1999 presentation.

Use of Estimates

Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities and reported amounts of revenues and expenses, to prepare these consolidated financial statements in conformity with generally accepted accounting principles. Actual results could differ from those estimates.

(2) Subsequent Events

The accompanying unaudited pro forma balance sheet gives effect to significant subsequent events occurring in January and February 2000, as if they had occurred on December 31, 1999. Those subsequent

(2) Subsequent Events (Continued)

events include authorizing additional classes of capital stock, issuing and reacquiring capital stock for net proceeds of $159,282,000, borrowing additional debt of $5,400,000, repaying debt and accrued interest payable in the amount of $102,540,077, being released from put obligations on its common stock and recognizing compensation expense in the amount of $28,249,011 for stock-based compensation to employees.

Additional Classes of Capital Stock

On January 19, 2000, the Company amended its articles of incorporation to authorize an aggregate of 144,600,000 shares of capital stock. Following the amendment, the authorized share capital of the Company includes the following:

Class A common stock—authorized 60,000,000 voting common shares at a par value of $.01 per share. Class A common shares carry one vote per share.

Class B common stock—authorized 50,000,000 nonvoting, convertible common shares at a par value of $.01 per share. The Class B common shares are automatically convertible into Class A common shares upon the receipt of all governmental approvals necessary to effectuate a change in control. The conversion rate for the Class B common shares to Class A common shares is one-for-one.

Class C common stock—authorized 4,600,000 nonvoting, convertible common shares at a par value of $.01 per share. The Class C common shares are automatically convertible into Class A common shares upon either the completion of an initial public offering of at least $150 million of the Company's Class A common stock or the occurrence of certain conversion events, as defined in the articles of incorporation. The conversion rate for the Class C common shares to Class A common shares is one-for-one.

Series D preferred stock—authorized 30,000,000 nonvoting, convertible, cumulative participating preferred shares at a par value of $.01 per share.

The Series D preferred shares are automatically convertible into Class A common shares upon the receipt of all regulatory approvals necessary to effectuate a change in control. Series D preferred shares may be converted into Class B common shares at any time. The conversion rate for the Series D preferred shares to either Class A or B common shares is one-for-one. Any portion of the accrued and unpaid dividends is also convertible into additional Class A or B common shares based upon a conversion rate of $13.12 per share.

The Series D preferred shares do not provide for the payment of dividends for up to one year following their issuance. If the Series D preferred shares are not converted into Class A common shares within one year of issue, dividends accrue on a daily basis at a rate of 7.0% per annum, retroactively from the date of issue. If not converted by the eighth annual anniversary of their issuance, the dividend rate per annum increases by 2.0% annually up to a maximum dividend rate of 13.0%. In the event that the Company provides a stock dividend to its Class A common shareholders, the holders of Series D preferred shares are entitled to receive a dividend of preferred shares at an equal rate. The Company also has the option of redeeming all outstanding shares of Series D preferred shares at a price equal to liquidation value plus accrued dividends.

MJD COMMUNICATIONS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

December 31, 1999, 1998, and 1997

(2) Subsequent Events (Continued)

On January 23, 2000, the Company declared a twenty-for-one stock split in the form of a stock dividend. This stock split has been given retroactive effect in the accompanying consolidated financial statements.

Issuance and Reacquisition of Capital Stock

Through January 31, 2000, the Company effected the following changes in its capital stock accounts. Dollar amounts are presented in thousands.

	Class A Common subject to put option		Series D Preferred		Class A Common		Class B Common		Class C Common		Additional paid-in capital
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	
Balance at December 31, 1999	1,752,000	$ 3,000	—	$ —	34,450,940	$ 345	—	$ —	—	$—	$ 48,793
Issuance of common stock under stock options and warrants	—	—	—	—	307,200	3	—	—	—	—	132
Issuance of capital stock for cash proceeds, net of direct expenses of approximately $23.4 million	—	—	4,673,920	47	100,160	1	4,243,728	42	4,269,440	42	150,705
Exchange of Class A common shares for Class B common and Series D preferred shares	—	—	16,787,800	168	(25,087,800)	(251)	8,300,000	83	—	—	—
Reclassification of Class A common subject to put option	(1,752,000)	(3,000)	—	—	1,752,000	17	—	—	—	—	2,983
Compensation charges for stock-based compensation	—	—	—	—	—	—	—	—	—	—	28,249
Balance at January 31, 2000	—	$ —	21,461,720	$215	11,522,500	$ 115	12,543,728	$125	4,269,440	$42	$230,862

(2) Subsequent Events (Continued)

Shares of Class A common stock issued under stock options and warrants included 35,300 shares issued under the MJD Communications, Inc. Stock Incentive Plan (1998 Plan), 255,360 shares issued under the 1995 Stock Option Plan (1995 Plan), and 16,580 shares issued pursuant to warrants in a cashless exercise. Options surrendered in lieu of cash were 5,300 under the 1998 Plan and 4,980 under the 1995 Plan. Following the conversion of these Class A common shares into Series D preferred shares, the newly issued Series D preferred shares were sold to a new principal shareholder of the Company.

At a price of $13.12 per share, the Company issued 4,673,920 shares of Series D preferred stock, 100,160 shares of Class A common stock, 4,243,728 shares of Class B common stock and 4,269,440 shares of Class C common stock. Net proceeds from the issuance of capital stock was $159,282,000. Direct costs of approximately $23.4 million associated with the issuance of this capital stock were recorded as a reduction to paid-in capital. These costs included approximately $9.6 million of transaction fees and expenses paid to a new principal shareholder, transaction fees of $8.4 million which will be accrued to be paid to an existing shareholder upon liquidation of their holdings, and $0.4 million for services rendered in consummating the transaction paid to a law firm in which a partner of the firm is a shareholder of the Company. The Company also entered into advisory and consulting agreements with both principal shareholders which require payments to each of approximately $500,000 per annum by the Company through December 31, 2006.

The Company reacquired 25,087,800 Class A common shares in exchange for 16,787,800 shares of Series D preferred stock and 8,300,000 shares of Class B common stock. The Class A common shares were retired upon reacquisition.

Issuance and Repayment of Debt

In January 2000, FairPoint borrowed an additional $5,400,000 under its convertible senior secured revolving credit facility. On January 20, 2000, the Company repaid borrowings of $75,196,802 under the Company's senior secured credit facility and $27,146,966 under FairPoint's credit facility including accrued interest of $196,309. Interest expense on these borrowings was approximately $1.4 million during 1999.

Release of Put Obligation

On January 20, 2000, the Company was released from put obligations associated with shareholder loan agreements secured by 1,752,000 shares of the Company's Class A common shares. As a result, the Company reclassified $3,000,000 from temporary equity to the permanent capital accounts of the Company.

Compensation Expense

On January 20, 2000, the Company's Board of Directors amended a grant of options to purchase 40,600 shares of the Company's Class A common stock under the 1998 Plan to make those options immediately exercisable and fully vested. The options were previously exercisable only upon the occurrence of a qualifying liquidating event, as defined under the 1998 Plan. A compensation charge of $463,002 was recognized in connection with the amendment of the options. As discussed above, these options to purchase shares of Class A common shares were exercised in January 2000, converted into Series D preferred shares, and sold to a new principal shareholder of the Company for cash.

(2) Subsequent Events (Continued)

As discussed above, options to purchase 260,340 shares of Class A common stock under the 1995 Plan were exercised in January 2000, converted into Series D preferred shares and sold to a new principal shareholder of the Company for cash. As a result, the Company recorded a compensation charge of $3,349,665.

On January 20, 2000, certain of the Company's principal shareholders sold newly issued Series D preferred shares for cash to a third party. The transaction was subject to the requirements of shareholders' agreements whereby the selling shareholder is obligated to provide a cash payment to the Company's founding shareholders, including two employee-shareholders. (See also note 10.) In addition, another of the Company's principal shareholders transferred 1,093,060 shares of Series D preferred shares to the employee-shareholders in settlement of its cash payment obligation under the shareholders' agreements. As a result of these transactions, the Company recognized a compensation charge of $8,510,626.

On February 23, 2000, the Company's board of directors approved a transaction whereby the Company will grant stock options under the 1998 Plan to employee participants in the FairPoint Communications Corp. Stock Incentive Plan (FairPoint Plan) in consideration of the cancellation of all options previously granted under the FairPoint Plan. FairPoint also intends to provide a bonus program for option holders in order to maintain the same economic benefits as previously existed under the FairPoint Plan. Under the transaction, which is pending ratification by the FairPoint option holders, the Company will grant options to purchase 1,618,820 shares of Class A common stock under the 1998 Plan at an exercise price of $3.28 per share. Upon cancellation of the Fairpoint options, the Fairpoint Plan will be terminated. The total compensation charge of $15,925,718 related to the option grant will be amortized over the vesting period of five years. This charge has been reflected in the unaudited pro forma balance sheet as of December 31, 1999 as unearned compensation and an increase to additional paid-in capital. The vesting period may accelerate in the event of a change in control, as defined in the plan agreement. FairPoint also intends to provide a cash bonus of $5,308,573 to its employees, which will be amortized over the vesting period of five years. In connection with this transaction, the Company increased the number of shares authorized under the 1998 Plan to 9,817,482 shares.

(3) Acquisitions

Certain subsidiaries of MJD acquired telephone properties through a number of acquisitions in 1998 and 1999.

On March 30, 1998, the Company acquired 100% of the common stock of Taconic. On April 30, 1998, the Company acquired 100% of the common stock of Ellensburg. On June 1, 1998, the Company acquired 100% of the common stock of Chouteau. On November 6, 1998, the Company acquired 100% of the common stock of Utilities. The aggregate purchase price for these acquisitions was $224.1 million.

On February 1, 1999, the Company acquired 100% of the common stock of Ravenswood. On February 16, 1999, the Company acquired 100% of the common stock of Columbus. On April 30, 1999, the Company acquired 100% of the common stock of Union, Armour and WMW. On September 1, 1999, the Company acquired 100% of the common stock of Yates. On December 17, 1999 the Company acquired 100% of the common stock of Orwell. The aggregate purchase price for these acquisitions was $75.3 million.

(3) Acquisitions (Continued)

Acquisition costs were approximately $0.9 million and $1.2 million in 1999 and 1998, respectively. The acquisitions have been accounted for using the purchase method and, accordingly, the results of their operations have been included in the Company's consolidated financial statements from the date of acquisition. The excess of the purchase price and acquisition costs over the fair value of the net identifiable assets acquired was approximately $36.7 million and $156.5 million and has been recognized as goodwill in 1999 and 1998, respectively. The Company's allocation of purchase price for Orwell is preliminary because the Company has not been able to obtain all of the data required to complete the allocation for this recently acquired business.

The allocation of the total net purchase price for the 1999 and 1998 acquisitions are shown on the table below:

	1999	1998
	(Dollars in thousands)	
Current assets	$ 25,484	27,539
Property, plant, and equipment	18,675	85,161
Excess cost over fair value of net assets acquired	36,710	156,540
Other assets	11,598	30,577
Current liabilities	(2,113)	(15,967)
Noncurrent liabilities	(14,131)	(58,606)
Total net purchase price	$ 76,223	225,244

The Company has entered into agreements to acquire two additional rural local exchange carriers in 2000. The aggregate purchase price for the acquisitions is expected to approximate $245.0 million and will be financed through existing and new debt facilities and issuance of equity. (See notes 2 and 6.)

The following unaudited pro forma information presents the combined results of operations of the Company as though the acquisitions in 1999 and 1998 occurred on January 1, 1998. These results include certain adjustments, including amortization of goodwill, increased interest expense on debt related to the acquisitions, and related income tax effects. The pro forma financial information does not necessarily reflect the results of operations if the acquisitions had been in effect at the beginning of each period or which may be attained in the future.

	Pro forma years ended December 31,	
	1999	1998
	(Dollars in thousands) (unaudited)	
Revenues	$156,627	135,706
Loss before extraordinary item	30,912	193
Net loss	30,912	2,714

(4) Property, Plant, and Equipment

A summary of property, plant, and equipment as of December 31, 1999 and 1998 is shown on the table below:

	Estimated life (in years)	1999	1998
		(Dollars in thousands)	
Land	—	$ 1,640	1,442
Buildings and leasehold improvements	2—40	22,993	19,101
Telephone equipment	3—50	327,824	263,029
Cable equipment	3—20	1,615	5,332
Furniture and equipment	3—32	13,433	9,333
Vehicles and equipment	3—27	12,804	10,610
Computer software	3—10	3,567	365
Total property, plant, and equipment		383,876	309,212
Accumulated depreciation		(205,580)	(166,891)
Net property, plant, and equipment		$ 178,296	142,321

The composite depreciation rate for property and equipment was 7.36% in 1999, 7.39% in 1998, and 6.66% in 1997. Construction expenditures for 2000 are expected to approximate $123 million. The Company anticipates funding construction from operations and existing debt facilities.

(5) Investments

At December 31, 1999, the cost, unrealized holding gain, and fair value of Illuminet stock, the Company's only investment classified as available-for-sale, was $573,605, $6,753,275 and $7,326,880, respectively. The unrealized holding gain is reported as a separate component of comprehensive income, net of related taxes of $2,566,245. At December 31, 1998, Illuminet stock was carried at cost, as there was no readily determinable fair value. There were no sales of available-for-sale securities during 1999, 1998 and 1997.

(5) Investments (Continued)

The Company's non-current investments consist of the following at December 31, 1999 and 1998:

	1999	1998
	(Dollars in thousands)	
Investment in cellular companies and partnerships	$22,374	27,047
RTB stock	10,259	6,934
Illuminet stock	—	421
CoBank stock and unpaid deferred CoBank patronage	2,326	1,958
RTFC secured certificates and unpaid deferred RTFC patronage	688	1,055
Other nonmarketable minority equity investments	599	479
Total investments	$36,246	37,894

The investments in cellular partnerships accounted for under the equity method and the Company's ownership percentage as of December 31, 1999 follow:

Chouteau Cellular Telephone Company	33.0%
GTE Ohio RSA #3 LP	25.0%
Illinois Valley Cellular RSA2—I Ptnrs	13.3%
Illinois Valley Cellular RSA2—II Ptnrs	13.3%
Illinois Valley Cellular RSA2—III Ptnrs	13.3%
ILLINET Communications, LLC	9.1%
Orange County-Poughkeepsie Limited Partnership	7.5%
Illinetworks, LLC	7.4%
ILLINET Communications of Central IL LLC	5.2%

(6) Long-term Debt

Long-term debt at December 31, 1999 and 1998 is shown below:

	Pro Forma 1999 (see note 2)	1999	1998
	(unaudited)	(Dollars in thousands)	
Senior secured notes payable, variable rates ranging from 8.13% to 10.00% at December 31, 1999, due 2004 to 2007	$140,316	215,513	141,841
Senior subordinated notes due 2008:			
Fixed rate, 9.50%	125,000	125,000	125,000
Variable rate, 10.32% at December 31, 1999	75,000	75,000	75,000
Senior secured revolving note payable, variable rate of 10.75% to 11.75% at December 31, 1999, due 2004	—	21,747	—
Senior notes payable to RTFC:			
Fixed rate, 9.20%, due 2009	4,532	4,532	4,918
Variable rates ranging from 6.95% to 8.80% at December 31, 1999, due 2009	6,795	6,795	7,362
Subordinated promissory notes payable, 7.00%, due 2005	7,000	7,000	7,000
First mortgage notes payable to Rural Utilities Service, fixed rates ranging from 8.72% to 10.78%, due 2009 to 2016	6,459	6,459	6,679
Other debt, 5.75% to 9.50%, due 2000 to 2004	349	349	312
Total outstanding long-term debt	365,451	462,395	368,112
Less current portion	(3,866)	(3,866)	(3,502)
Total long-term debt, net of current portion	$361,585	458,529	364,610

The approximate aggregate maturities of long-term debt for each of the five years subsequent to December 31, 1999 are as follows:

Fiscal year	(Dollars in thousands)
2000	$ 3,866
2001	4,425
2002	4,601
2003	4,766
2004	112,247
Thereafter	332,490
	$462,395

On March 30, 1998, the Company closed a $315 million senior secured credit facility (the Credit Facility) which committed $75 million of term debt (tranche C) amortized over nine years, $155 million of term debt (tranche B) amortized over eight years, and an $85 million reducing revolving credit facility with a term of 6.5 years. Approximately $215.5 million senior secured notes payable were outstanding under the Credit Facility at December 31, 1999. Borrowings under the facility bear interest at a rate based, at the option of the Company, on the participating banks' prime rate or Euro dollar rate, plus an incremental rate

(6) Long-term Debt (Continued)

of 3.0%, 2.75%, and 2.5% for the Euro dollar margin and 2.0%, 1.75%, and 1.50% for the prime rate margins for the tranche C, tranche B, and revolver facility, respectively. The Credit Facility is secured by a perfected first priority pledge of the stock of certain subsidiaries of the Company as well as the promissory notes evidencing intercompany advances. The Credit Facility is also guaranteed by four of the Company's intermediary holding companies, subject to contractual or regulatory restrictions. The Company pays fees of ½ of 1% per annum on the aggregate unused portion of the revolver and tranche B commitment, in addition to an annual administrative agent's fee. The Company used an interest rate swap agreement, with a notional amount of $25 million, to effectively convert a portion of its variable interest rate exposure to a fixed rate of 9.91%. The swap agreement expires on September 29, 2000. As discussed in note 2, the Company repaid $75.2 million of its borrowings under the Credit Facility in January 2000.

On March 14, 2000, an additional $165 million was committed and available to the Company under the Credit Facility.

The Credit Facility contains various restrictions, including those relating to payment of dividends by the Company. In management's opinion, the Company has complied with all such requirements or obtained a waiver letter for events of non-compliance. Substantially all assets of the Company are collateralized to secure the Credit Facility.

On May 5, 1998, the Company consummated a debt offering consisting of $125 million in aggregate principal amount of Senior Subordinated Notes due 2008 (the Fixed Rate Notes), and $75 million in aggregate principal amount of Floating Rate Callable Securities due 2008 (the Floating Rate Notes). The notes are unsecured obligations of the Company and are subordinated to all existing and future senior indebtedness. Interest on the notes is payable semiannually. Interest on the Fixed Rate Notes is 9.5% and interest on the Floating Rate Notes is equal to a rate per annum at LIBOR plus 418.75 basis points. As to the Floating Rate Notes, the Company used two interest rate swap agreements, with notional amounts of $50 million and $25 million, respectively, to effectively convert its variable interest rate exposure to a fixed rate of 10.01% and 9.95%, respectively. The swap agreements expire on November 1, 2001 and November 1, 2000, respectively.

The Fixed Rate Notes are redeemable, in whole or in part, at the option of the Company, at any time on or after May 1, 2003 at redemption prices (expressed as a percentage of the principal amount) declining annually from 104.7% beginning May 1, 2003 to 100% beginning May 1, 2006 and thereafter, together with accrued interest to the redemption date and subject to certain conditions. Not withstanding the foregoing, on or prior to May 1, 2001, the Company may redeem up to 35% of the aggregate principal amount of the Fixed Rate Notes at a redemption price of 109.5% of the principal amount thereof plus accrued and unpaid interest, if any, to the redemption date, with the proceeds of an equity offering.

The Floating Rate Notes are redeemable, in whole or in part, at any time at the option of the Company, at redemption prices (expressed as a percentage of the principal amount) declining annually from 105% beginning May 1, 1998 to 100% beginning May 1, 2003 and thereafter, together with accrued interest to the redemption date and subject to certain conditions.

The Fixed and Floating Rate Notes' indenture places certain restrictions on the ability of the Company to (i) incur additional indebtedness, (ii) make restricted payments (dividends, redemptions, and certain other payments), (iii) incur liens, (iv) issue and sell stock of a subsidiary, (v) sell or otherwise dispose of property, business, or assets, (vi) enter into sale and leaseback transactions, (vii) engage in

(6) Long-term Debt (Continued)

business other than the telecommunications business, and (viii) engage in transactions with affiliates. In management's opinion, the Company has complied with all such requirements.

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

On October 20, 1999, FairPoint closed a $100 million convertible senior secured revolving credit facility (the FairPoint Credit Facility). Under the FairPoint Credit Facility, funds are available on a revolving basis, for a period up to five years from the date of closing. Borrowings under the FairPoint Credit Facility are secured by all existing and future assets of FairPoint and by 100% of the stock of FairPoint's subsidiaries. Pursuant to the terms of the FairPoint Credit Facility, FairPoint is required to comply with certain financial covenants. Upon an uncured default of certain covenants or if the debt is not paid at final maturity, at the lenders' option, an exchange of all outstanding indebtedness plus outstanding and accrued interest for an equal dollar amount of payment in-kind preferred stock issued by the Company shall be available as additional security. At December 31, 1999, FairPoint was in compliance with all financial covenants. Borrowings under the FairPoint Credit Facility are approximately $21.7 million at December 31, 1999. As discussed in note 2, the Company borrowed an additional $5,400,000 and repaid all borrowings of $27,146,966 under the FairPoint Credit Facility in January 2000.

In conjunction with the senior notes payable to RTFC, one of the Company's subsidiaries, Utilities, is subject to restrictive covenants limiting the amount of dividends that may be paid. At December 31, 1999, Utilities was in compliance with these restrictions.

The Company has available a line of credit, with a total maximum limit of $1,000,000, expiring in 2000. No borrowings have been made under this line of credit at December 31, 1999.

The Company also has $752,000 unsecured demand notes payable to various individuals and entities with interest payable at 5.75%.

(7) Employee Benefit Plans

The Company sponsors a voluntary 401(k) savings plan (the 401(k) Plan) that covers substantially all eligible employees. Each 401(k) Plan year, the Company contributes to the 401(k) Plan an amount of matching contributions determined by the Company at its discretion. For the 401(k) Plan years ended December 31, 1999, 1998, and 1997, the Company matched 100% of each employee's contribution up to 3% of compensation and 50% of additional contributions up to 6%. The 401(k) Plan also allows for a profit sharing contribution that is made based upon management discretion. Total Company contributions to the 401(k) Plan were $2,291,520, $1,163,906, and $422,069, for the years ended December 31, 1999, 1998 and 1997, respectively.

In 1999, the Company began a Non-Qualified Deferred Compensation Plan (the NQDC Plan) that covers certain employees. The NQDC Plan allows highly compensated individuals to defer additional compensation beyond the limitations of the 401(k) Plan. Company matching contributions are subject to the same percentage as the 401(k) Plan. Total Company contributions to the NQDC Plan were $61,583 for the year ended December 31, 1999.

(7) Employee Benefit Plans (Continued)

C&E and Taconic also sponsor defined contribution 401(k) retirement savings plans for union employees. C&E and Taconic match contributions to these plans based upon a percentage of pay of all qualified personnel and make certain profit sharing contributions. Contributions to the plans were approximately $205,000 and $154,000, for the years ended December 31, 1999 and 1998, respectively.

One of the Company's subsidiaries has a defined benefit pension plan covering substantially all of its employees. The benefits are based on years of service and the employee's compensation before retirement. The plan benefits were frozen in 1998 in connection with the Company's acquisition of the subsidiary. There is no additional minimum pension liability required to be recognized and plan assets are sufficient to cover all plan obligations.

Two of the Company's subsidiaries sponsor healthcare plans that provide postretirement medical benefits and other benefits to employees who meet minimum age and service requirements upon retirement. The liabilities for the postretirement medical benefits plans were not material to the consolidated financial statements at December 31, 1999 and 1998.

Certain shareholders of the Company granted stock appreciation rights to certain members of management. The stock appreciation rights are fully vested. The stock appreciation rights may be settled in cash or stock, at the option of the granting shareholders. In connection with the stock appreciation rights, the Company recorded compensation expense of approximately $3,386,000 in 1999.

(8) Income Taxes

Income tax (expense) benefit before extraordinary item consists of the following components:

	1999	1998	1997
	(Dollars in thousands)		
Current:			
Federal	$ (1,109)	346	(1,426)
State	(180)	(17)	(274)
Total current income tax (expense) benefit	(1,289)	329	(1,700)
Investment tax credits	193	130	31
Deferred:			
Federal	5,819	1,047	(130)
State	892	606	(77)
Total deferred income tax (expense) benefit	6,711	1,653	(207)
Total income income tax (expense) benefit	$ 5,615	2,112	(1,876)

MJD COMMUNICATIONS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

December 31, 1999, 1998, and 1997

(8) Income Taxes (Continued)

Total income tax (expense) benefit in 1999, 1998, and 1997, was different than that computed by applying U. S. federal income tax rates to earnings before income taxes. The reasons for the differences are shown below:

	1999	1998	1997
	(Dollars in thousands)		
Computed "expected" tax (expense) benefit	$ 11,748	2,553	(1,585)
State income tax (expense) benefit, net of federal income tax benefit	471	389	(232)
Amortization of investment tax credits	193	130	31
Goodwill amortization	(1,559)	(887)	(186)
Change in fair value of put warrant obligation	(4,681)	(242)	100
Disallowed expenses and other	(557)	169	(4)
Total income tax (expense) benefit	$ 5,615	2,112	(1,876)

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 1999 and 1998 are presented below:

	1999	1998
	(Dollars in thousands)	
Deferred tax assets:		
Federal and state tax loss carryforwards	$ 1,056	1,032
Employee benefits	586	1,010
Allowance for doubtful accounts	213	211
Alternative minimum tax credits	1,930	1,296
Warrants issued in connection with early retirement of debt	—	291
Total gross deferred tax assets	3,785	3,840
Less, valuation allowance	—	—
Net deferred tax assets	3,785	3,840
Deferred tax liabilities:		
Property, plant, and equipment, principally due to depreciation differences	16,605	17,242
Goodwill, due to amortization differences	2,471	1,903
Basis in investments	8,949	11,424
Unrealized gain on investments	2,566	—
Total gross deferred tax liabilities	30,591	30,569
Net deferred tax liabilities	$26,806	26,729

The Company has minimum tax credits of approximately $1.9 million which may be carried forward indefinitely. Management has concluded that no valuation allowance is required because the full benefit of the deferred tax assets will be realized through the future reversals of the deferred tax liabilities.