customers to newer wireless technologies as part of ALLTEL's customer retention efforts, partially offset by the effects of vendor rebates previously discussed. The increase in cost of products sold in 2003 was consistent with the growth in wireless customer activations, the selling of higher–priced digital phones and the Company's customer retention efforts. In addition, the wireless property acquisitions completed in 2003 and 2002 accounted for $41.7 million of the overall increase in cost of products sold in 2003.

Selling, general, administrative and other expenses increased $46.9 million, or 4 percent, in 2004 and $196.9 million, or 21 percent, in 2003. The increase in selling, general, administrative and other expenses in 2004 primarily reflected increased commission costs of $34.0 million compared to 2003 driven by increased sales of ALLTEL's Total and National Freedom rate plans and a higher mix of postpay gross customer additions, as compared to 2003. Commission rates paid to the Company's internal sales force and outside agents are higher on the sales of ALLTEL's more profitable postpay rate plans than comparable rates paid on other lower–margin rate plans offered by the Company. In addition, selling, general, administrative and other expenses in 2004 reflected higher insurance costs resulting from an increase in the number of customer claims filed related to wireless equipment protection plans, consistent with the growth in sales of those plans previously discussed. The acquisition of the wireless properties completed in 2003 and 2002 accounted for approximately $101.5 million of the overall increase in selling, general, administrative and other expenses in 2003. Advertising costs also increased $31.5 million in 2003, primarily due to increased promotional activities, including the launch of a new national advertising campaign designed to promote ALLTEL's brand name recognition among consumers. Data processing costs increased $15.4 million in 2003, consistent with non–acquisition–related growth in wireless customers, while general and administrative expenses increased $34.8 million in 2003, primarily due to additional costs incurred to complete, for various acquisitions, the conversion of these operations to ALLTEL's billing and operational support systems.

Depreciation and amortization expense increased $67.8 million, or 10 percent, in 2004 and $93.4 million, or 16 percent, in 2003. The increases in depreciation and amortization expense in both 2004 and 2003 were primarily due to growth in wireless plant in service consistent with ALLTEL's plans to expand and upgrade its network facilities. The acquisitions of wireless properties completed in 2003 and 2002 accounted for approximately $41.3 million of the overall increase in depreciation and amortization expense in 2003.

Primarily as a result of growth in revenues and sales discussed above, wireless segment income increased $22.2 million, or 2 percent, in 2004 and $50.1 million, or 5 percent, in 2003. The growth in segment income in 2004 attributable to increased revenues and sales was partially offset by increased network costs attributable to the significant growth in customer usage and additional costs associated with the Company's retention efforts and initiatives designed to improve customer satisfaction and reduce postpay churn. In addition to these factors, wireless segment income in 2004 also reflected increased customer acquisition costs of $22.3 million consistent with the growth in gross postpay customer additions, excluding acquisitions. The acquisitions of the wireless properties completed in 2003 and 2002 accounted for approximately $28.4 million of the overall increase in segment income in 2003. Although revenues and sales attributable to the wireless property acquisitions increased $321.3 million in 2003, the corresponding increase in operating expenses of $292.9 million nearly offset the growth in revenues and sales. The reduction in operating margin in 2003 attributable to the acquisitions primarily reflected the effects of transitioning the acquired CenturyTel properties to ALLTEL's negotiated wholesale roaming rates, increased selling–related expenses due to volume growth in new customer activations and the additional costs incurred to convert the acquired operations to ALLTEL's billing and operational support systems. Segment income in 2003 also reflected $25.0 million of the overall increase in ALLTEL's pension expense previously discussed.

Cost to acquire a new customer is used to measure the average cost of adding a new customer and represents sales, marketing and advertising costs and the net equipment cost, if any, for each new customer added. The increase in cost to acquire a new customer in 2004 primarily reflected the increase in commissions expense and a higher mix of postpay gross customer additions, partially offset by improved margins on the sales of wireless handsets. Cost to acquire a new customer increased in 2003 primarily due to the increase in advertising costs previously discussed, partially offset by lower equipment subsidies and the effects of spreading the customer acquisition costs over a proportionately higher number of gross customer additions (excluding acquisitions) as compared to 2002. The improved margins on the sale of wireless handsets in 2003 primarily reflected increased retail prices associated with the selling of higher–priced digital phones and the effects of increased vendor rebates and purchase volume discounts received by ALLTEL. For both 2004 and 2003, approximately 66 percent of the gross customer additions came from ALLTEL's internal distribution channels, compared to approximately 70 percent in 2002. ALLTEL's internal sales distribution channels include Company retail stores and kiosks located in shopping malls, other retail outlets and mass merchandisers. Incremental sales costs at a Company retail store or kiosk are significantly lower than commissions paid to dealers. Although ALLTEL intends to manage the costs of acquiring new customers during 2005 by continuing to enhance its internal distribution channels, the Company will also continue to utilize its large dealer network.

Set forth below is a summary of the restructuring and other charges related to the wireless operations that were not included in the determination of segment income for the years ended December 31:

(Millions)	2004	2003	2002
Severance and employee benefit costs	$ 8.6	$ 1.3	$ 6.4
Relocation costs	2.7	–	–
Lease and contract termination costs	0.5	–	5.2
Computer system conversion and other integration costs	–	–	4.0
Write–down of cell site equipment	–	–	7.1
Write–down of software development costs	–	7.6	0.3
Write–down of certain facilities	0.7	–	–
Branding and signage costs	–	–	4.1
Other exit costs	0.4	–	–
Total restructuring and other charges	$12.9	$ 8.9	$27.1

Regulatory Matters–Wireless Operations

ALLTEL is subject to regulation by the FCC as a provider of Commercial Mobile Radio Services ("CMRS"). The Telecommunications Act of 1996 (the "96 Act") provides wireless carriers numerous opportunities to provide an alternative to the long–distance and local exchange services provided by local exchange telephone companies and interexchange carriers. Under the Act and the FCC's rules, wireless telecommunications carriers are entitled to receive reciprocal compensation from local exchange carriers ("LECs") for calls transmitted from the LECs' networks and terminated on the wireless carriers' networks. Additionally, wireless operators may bill and collect access charges from interexchange carriers pursuant to contract. Presently, the Company's wireless operations do not bill access charges to interexchange carriers. In April 2001, the FCC released a notice of proposed rulemaking addressing inter–carrier compensation issues. Under this rulemaking, the FCC proposed a "bill and keep" compensation method that would overhaul the existing rules governing reciprocal compensation and access charges. The FCC is expected to issue a further notice of proposed rulemaking on this matter in response to inter–carrier compensation proposals from various carrier groups in 2005. Furthermore, various wireline companies have initiated a number of state proceedings to address inter–carrier compensation for traffic that originates or terminates on wireless carriers' networks. The outcome of the FCC and state proceedings could change the way ALLTEL receives compensation from, and remits compensation to, other carriers as well as its wireless customers. At this time, ALLTEL cannot estimate whether any such changes will occur or, if they do, what the effect of the changes on its wireless revenues and expenses would be.

CMRS providers in the top 100 markets were required by the FCC to implement by November 24, 2003 (and, for all other markets, by May 24, 2004, or six months after the carrier receives its first request to port, whichever is later) wireless local number portability ("WLNP"), which permits customers to retain their existing telephone number when switching to another telecommunications carrier. Additionally, on November 10, 2003, the FCC released a decision providing guidance on number porting between wireline and wireless carriers, or "intermodal porting". The FCC required LECs in the top 100 markets, beginning on November 24, 2003 (and beginning on May 24, 2004 for all other markets), to port numbers to wireless carriers where the coverage area of the wireless carrier (*i.e.*, the area in which the wireless carrier provides service) overlaps the geographic location of the rate center in which the wireline number is provisioned, provided that the wireless carrier maintains the rate center designation of the number. An appeal by the United States Telecommunications Association ("USTA"), along with certain rural telephone companies, of the FCC's November 10, 2003 decision is pending before the U.S. Court of Appeals for the District of Columbia Circuit (the "D.C. Circuit Court"). To date, the volume of intermodal porting requests processed by the Company for wireless customers has not been significant. In addition, various state public service commissions have granted the requests of rural LECs to suspend their obligations to port numbers to CMRS carriers.

Wireless service providers are required by the FCC to provide enhanced 911 emergency service ("E–911") in a two–phased approach. In phase one, carriers must, within six months after receiving a request from a phase one enabled Public Safety Answering Point ("PSAP"), deliver both the caller's number and the location of the cell site to the PSAP serving the geographic territory from which the E–911 call originated. A phase one–enabled PSAP is generally one that is capable of receiving and utilizing the number and cell site location data transmitted by the carrier. ALLTEL has generally complied with the phase one requirements and provides service to phase one capable PSAPs. As a result of certain technology and deployment issues, the six month window in which service is to be provided under the FCC rules has, in certain instances and in accordance with the rules, been extended by mutual agreement between ALLTEL and the particular PSAPs involved.

In phase two, CMRS carriers like ALLTEL have opted for a handset–based solution must determine, for originated calls, the location of the caller within fifty meters for 67 percent of the originated calls and 150 meters for 95 percent of the originated calls. The phase two requirements were set to begin by October 1, 2001, but, because of certain technology and other factors, the Company requested a limited waiver of these requirements, as did virtually every other carrier. On July 26, 2002, the FCC released an order granting a temporary stay of the E–911 emergency implementation rules as they applied to the Company (the "FCC Order"). The FCC Order provides for a phased–in deployment of Automatic Location Identification ("ALI") capable network or handset–based technology that began on March 1, 2003. ALI capability permits more accurate identification of the caller's location by PSAPs. Under the FCC Order, the Company was required to: (1) begin selling and activating ALI–capable handsets prior to March 1, 2003; (2) ensure that, as of May 31, 2003, at least 25 percent of all new handsets activated were ALI–capable; (3) ensure that, as of November 30, 2003, at least 50 percent of all new handsets activated were ALI–capable; (4) ensure that 100 percent of its digital handsets activated were ALI–capable as of May 31, 2004; and (5) ensure that penetration of ALI–capable handsets among its customers will reach 95 percent no later than December 31, 2005. ALLTEL began selling ALI–capable handsets in June 2002 and to date has complied with the handset deployment thresholds under the FCC's Order, or otherwise obtained short–term relief from the FCC to facilitate certain recent acquisitions. Based on the current pace of customer migration to ALI–capable handsets, including the additional subscribers acquired through recent acquisitions, ALLTEL may have difficulty complying with the December 31, 2005 requirement to be 95 percent penetrated without incurring a significant increase in its operating costs.

To ensure affordable access to telecommunications services throughout the United States, the FCC and many state commissions administer universal service programs. CMRS providers are required to contribute to the federal universal service fund ("USF") and are required to contribute to some state universal service funds. Under FCC rules, CMRS providers also are eligible to receive support from the federal USF if they obtain certification as an Eligible Telecommunications Carrier ("ETC"). The federal universal service program is under legislative, regulatory and industry scrutiny as a result of the growth in the fund and structural changes within the telecommunications industry. The structural changes include an increase in the number of ETC's receiving money from the universal service fund and a migration of customers from wireline service to VoIP providers that, today, are not required to contribute to the universal service program. There are several FCC proceedings underway that are considering changes to the way the universal service programs are funded and the way universal service funds are disbursed to program recipients. The specific proceedings are discussed in greater detail below.

During 2004, the Company sought ETC certification by the FCC and various state commissions. In September 2004, the Company received ETC approval by the FCC in certain non–rural properties in Alabama, Virginia, Georgia, North Carolina and Florida. ALLTEL also obtained approval of ETC applications from state commissions for certain of its properties in Michigan, Mississippi, Arkansas, Wisconsin, West Virginia, Louisiana and Kansas. The Company began receiving USF support associated with these ETC certifications in Michigan, Mississippi, Arkansas, Wisconsin and West Virginia in the first quarter of 2004, and for Louisiana and Kansas in the fourth quarter of 2004. The Company also sought ETC certification from the state commission in Arizona. On November 2, 2004, the Arizona commission granted ETC certification to ALLTEL subject to various conditions. On December 15, 2004, the Company notified the Arizona commission that the Company declined to accept the ETC certification in Arizona because the conditions associated with the certification were overly burdensome and could have hindered the Company's ability to effectively compete. ALLTEL received approximately $50.0 million of gross USF subsidies in 2004 related to the approved ETC petitions and net USF subsidies of approximately $42.0 million after deducting the portion of USF subsidies distributed to its unaffiliated partners in certain markets. ALLTEL expects to receive net USF subsidies of approximately $25.0 million per quarter in 2005.

The FCC, in conjunction with the Federal/State Joint Board on Universal Service, is considering changes to the USF program, including strengthening the requirements in the ETC certification process and modifying the services qualified to receive USF support. The Joint Board recommended that the FCC adopt optional more stringent federal guidelines to assist states in the ETC certification process and limit USF support to a single "primary" connection per customer. In the 2005 Omnibus Appropriations Bill, Congress included language that prevents the FCC from enacting a primary line restriction on universal service support recommended to the FCC by the Joint Board. The Joint Board also asked the FCC to provide guidance on whether states choosing to apply these guidelines could rescind existing ETC designations if the states subsequently found that such designations were no longer in the public interest. Finally, the Joint Board recommended that states strengthen the annual ETC certification process to ensure USF funds are used "only for the provision, maintenance and upgrading of facilities for which the support is intended". If adopted, these changes would adversely affect the availability of USF to ALLTEL's wireless business, although until the final FCC Order is released (expected to occur in February 2005) and the specific changes, if any, are determined, the Company cannot estimate the specific impact that these changes would have.

The FCC mandated that, effective October 1, 2004, the Universal Service Administrative Company ("USAC") must begin accounting for the USF program in accordance with generally accepted accounting principles for federal agencies, rather than the accounting rules that USAC formerly used. This accounting method change subjected USAC to the Anti–Deficiency Act (the "ADA"), the effect of which could have caused delays in USF payments to USF program recipients and significantly increase the amount of USF regulatory fees charged to wireline and wireless consumers. In December 2004, Congress passed legislation to exempt USAC from the ADA for one year to allow for a more thorough review of the impact the ADA would have on the universal service program.

In October 2003, the FCC issued an order adopting rules that allow CMRS licensees to lease spectrum to others. The FCC further streamlined its rules to facilitate spectrum leasing in a subsequent order issued in September 2004. The FCC's spectrum leasing rules revise the standards for transfer of control and provide new options for the lease of spectrum to providers of new and existing wireless technologies. The FCC also deleted the rule prohibiting ownership of both A and B block cellular systems in the same rural service area. The FCC decisions provide increased flexibility to wireless companies with regard to obtaining additional spectrum through leases and retaining spectrum acquired in conjunction with wireless company acquisitions. The Company's evaluation of opportunities created as a result of these decisions is on going.

The Communications Assistance for Law Enforcement Act ("CALEA") requires wireless and wireline carriers to ensure that their networks have the capability and capacity to accommodate law enforcement agencies' lawful intercept requests. The FCC has imposed various obligations and compliance deadlines, with which ALLTEL has either complied or, in accordance with CALEA, filed a request for an extension of time. On August 18, 2004, the U.S. Department of Justice ("DOJ") objected to ALLTEL's pending extension request relating to the Company's packet–mode services insofar as that extension request relates to ALLTEL's "Touch2Talk" walkie–talkie service. ALLTEL is initiating discussions with DOJ personnel in an effort to address the DOJ's concerns. In response to a petition filed by the DOJ and other federal agencies, the FCC in August 2004 initiated a rulemaking to adopt new rules under CALEA pertaining to wireless and wireline carriers' packet mode communications services, including Internet protocol ("IP") based services. The FCC concurrently issued a declaratory ruling concerning the appropriate treatment of push–to–talk services under CALEA. Rules or precedents adopted as a result of these proceedings could impose new costs and obligations on ALLTEL and other carriers. The Company's "Touch2Talk" service is compliant with CALEA standards. The Company's packet services network requires a modest upgrade to be fully compliant with CALEA standards for packet requests from Law Enforcement. The cost of the upgrade is immaterial and will not adversely affect the Company's operations.

Communications–Wireline Operations

(Dollars in millions, except access lines in thousands)	2004	2003	2002
Revenues and sales:			
Local service	$1,115.7	$1,136.8	$1,017.9
Network access and long–distance	1,047.9	1,055.5	943.5
Miscellaneous	256.2	243.8	218.3
Total revenues and sales	2,419.8	2,436.1	2,179.7
Costs and expenses:			
Cost of services	704.3	737.2	645.1
Cost of products sold	28.7	29.1	24.8
Selling, general, administrative and other	244.3	259.4	251.2
Depreciation and amortization	516.5	526.5	465.6
Total costs and expenses	1,493.8	1,552.2	1,386.7
Segment income	$ 926.0	$ 883.9	$ 793.0
Access lines in service (excludes DSL lines)	3,009.4	3,095.6	3,167.3
Average access lines in service	3,061.5	3,136.8	2,852.2
Average revenue per customer per month (a)	$65.87	$64.72	$63.69

Notes:

(a) Average revenue per customer per month is calculated by dividing total wireline revenues by average access lines in service for the period.

Wireline operations consist of ALLTEL's Incumbent Local Exchange Carrier ("ILEC"), CLEC and Internet operations. Wireline revenues and sales decreased $16.3 million, or 1 percent, in 2004 and increased $256.4 million, or 12 percent, in 2003. Customer access lines decreased 3 percent during the twelve months ended December 31, 2004. The Company lost approximately 86,000 and 72,000 access lines during 2004 and 2003, respectively, primarily as a result of the effects of wireless and broadband substitution for the Company's wireline services.

The Company expects the number of access lines served by its wireline operations to continue to be adversely affected by wireless and broadband substitution in 2005.

To slow the decline of revenue during 2005, the Company will continue to emphasize sales of enhanced services and bundling of its various product offerings including Internet, long–distance and high–speed data transport services (digital subscriber line or "DSL"). Deployment of DSL service is an important strategic initiative for ALLTEL. For the twelve month period ended December 31, 2004, the number of DSL subscribers grew almost 60 percent to approximately 243,000 customers, or 12 percent of the Company's addressable access lines. The growth in the Company's DSL customers more than offset the decline in customer access lines that occurred during 2004 noted above. As further discussed below, revenues generated from the sales of data and enhanced services increased in 2004, which helped to offset the adverse effects on wireline revenues resulting from the loss of access lines.

Local service revenues decreased $21.1 million, or 2 percent, in 2004 and increased $118.9 million, or 12 percent, in 2003. Local service revenues reflected reductions in basic service access line revenues of $27.0 million in 2004, as compared to 2003, consistent with the overall decline in access lines discussed above. The decline in local service revenues attributable to access line loss was partially offset by growth in revenues derived from the sales of enhanced products and services and equipment protection plans. Revenues from these services increased $7.3 million in 2004 compared to 2003, reflecting continued demand for these products and services. The acquisition of wireline properties in Kentucky accounted for $119.9 million of the overall increase in local service revenues in 2003. In addition to the effects of the acquisition, local service revenues in 2003 also reflected growth in revenues derived from the sales of enhanced products and services, reflecting increased demand for these services. Revenues from these enhanced services increased $9.3 million in 2003 compared to 2002. The increase in local service revenues in 2003 attributable to the Kentucky acquisition and additional revenues earned from enhanced products and services were partially offset by the effects of the overall decline in access lines noted above.

Network access and long–distance revenues decreased $7.6 million, or 1 percent, in 2004 and increased $112.0 million, or 12 percent, in 2003. Primarily due to the overall decline in access lines discussed above, network access usage and toll revenues decreased $4.3 million in 2004 compared to 2003. Compared to 2003, high–cost universal service funding received by ALLTEL's wireline subsidiaries decreased $20.3 million in 2004. The decrease in USF revenues resulted from increases in the national average cost per loop combined with the effects of the Company's cost control efforts and reduced capital expenditures in its wireline operations. Receipts from the high–cost USF fund are based on a comparison of each company's embedded cost per loop to a national average cost per loop. The national average cost per loop is expected to increase again in 2005 in order to balance the high cost fund at the FCC established cap. Given the recent increasing trends in the national average cost per loop and the Company's continued focus on controlling operating costs and capital expenditures in its wireline business, ALLTEL expects 2005 high–cost USF receipts to decline by $8.0 million, compared to 2004. The decline in network access and long–distance revenues attributable to access line loss and decreased USF funding was primarily offset by growth in revenues from data services, which increased $17.0 million in 2004, reflecting increased demand for high–speed data transport services. The acquisition of wireline properties in Kentucky accounted for $109.8 million of the overall increase in network access and long–distance revenues in 2003. In addition to the effects of the acquisition, network access and long–distance revenues in 2003 also reflected growth in revenues from data services of $12.6 million reflecting increased demand for these services. The increase in network access and long–distance revenues in 2003 attributable to the acquisition and growth in data services was partially offset by reductions in intrastate network access usage and toll revenues, which decreased $19.6 million from 2002, consistent with the overall decline in access lines discussed above.

Miscellaneous revenues primarily consist of charges for Internet services, directory advertising, customer premise equipment sales, and billing and collection services provided to long–distance companies. Miscellaneous revenues increased $12.4 million, or 5 percent, in 2004 and $25.5 million, or 12 percent, in 2003. Primarily driven by growth in DSL customers, revenues from the Company's Internet operations increased $12.4 million from 2003. Miscellaneous revenues for 2004 also reflected a $4.4 million increase in directory advertising revenues from 2003. Directory advertising revenues for 2004 included additional revenues of approximately $14.9 million associated with the initial publication of directories in the acquired Kentucky and Nebraska markets, partially offset by lower directory advertising revenues in ALLTEL's other wireline markets as compared to 2003. The decline in directory advertising revenues in ALLTEL's other wireline markets were due primarily to a change in the number and mix of directories published. The increase in miscellaneous revenues attributable to the Internet and directory publishing operations was partially offset in 2004 by a $2.6 million decline from 2003 in customer premise equipment sales and rentals due to lower customer demand for purchasing or leasing landline–based communications equipment. The acquisition of wireline properties in Kentucky accounted for $18.8 million of the overall increases in miscellaneous revenues in 2003 as compared to 2002.

In addition to the effects of the acquisition, miscellaneous revenues in 2003 also reflected growth in revenues derived from Internet services, partially offset by a decrease in revenues earned from billing and collection services. Revenues from Internet services' increased $12.8 million in 2003, primarily due to customer growth, while the decrease in revenues from billing and collection of $2.5 million was consistent with the overall decline in toll revenues previously discussed.

Primarily due to the DSL customer growth and increased sales of enhanced products and services, average revenue per customer per month increased 2 percent in 2004 compared to 2003. Future growth in average revenue per customer per month will depend on the Company's success in sustaining growth in sales of DSL and enhanced services to new and existing customers.

Cost of services decreased $32.9 million, or 4 percent, in 2004 and increased $92.1 million, or 14 percent, in 2003. Cost of services for 2004 reflected reductions in interconnection and customer service expenses and the effects of incremental strike–related expenses and maintenance costs incurred in 2003, as further discussed below. Interconnection expenses decreased $8.2 million from 2003, consistent with the declines in toll revenues and access lines discussed above. Compared to 2003, customer service expenses decreased $3.3 million in 2004, primarily due to cost savings from the Company's continued efforts to control operating expenses. The acquisition of wireline properties in Kentucky accounted for $106.0 million of the overall increase in cost of services in 2003. Included in cost of services for the acquired wireline properties in Kentucky were $6.0 million of additional maintenance costs incurred during the first quarter of 2003 to repair damage caused by severe winter storms and incremental expenses of approximately $14.9 million associated with a strike that began in early June and ended on October 1, 2003, when the Company signed a new collective bargaining agreement impacting approximately 400 ALLTEL employees in Kentucky represented by the Communications Workers of America. The increase in 2003 attributable to the acquisition was partially offset by a reduction in interconnection expenses, which decreased $9.9 million in 2003, consistent with the decrease in toll revenues noted above.

Cost of products sold decreased slightly in 2004 and increased $4.3 million, or 17 percent, in 2003. The decrease in 2004 was consistent with the decline in sales and leasing of customer premise equipment discussed above. Conversely, the acquisition of wireline properties in Kentucky accounted for $5.1 million of the overall increase in cost of products sold in 2003.

Selling, general, administrative and other expenses decreased $15.1 million, or 6 percent, in 2004 and increased $8.2 million, or 3 percent, in 2003. The decrease in selling, general, administrative and other expenses in 2004 resulted from reductions in data processing charges and salaries and employee benefit costs, primarily reflecting cost savings from the Company's continued efforts to control operating expenses. Compared to 2003, data processing charges declined $3.7 million, while employee benefit costs and salaries decreased $12.1 million during 2004. The acquisition of the wireline properties in Kentucky accounted for approximately $21.7 million of the overall increase in selling, general, administrative and other expenses in 2003. The increase in 2003 attributable to the acquisition was partially offset by a reduction in data processing charges, which decreased $15.4 million in 2003.

Depreciation and amortization expense decreased $10.0 million, or 2 percent, in 2004 and increased $60.9 million, or 13 percent, in 2003. The decrease in depreciation and amortization expense in 2004 primarily resulted from a reduction in depreciation rates for the Company's Nebraska operations, reflecting the results of a triennial study of depreciable lives completed by ALLTEL in the second quarter of 2004 as required by the Nebraska Public Service Commission. Depreciation expense increased in 2003 due to growth in wireline plant in service and additional depreciation attributable to the acquisition of wireline properties in Kentucky. The acquisition accounted for $60.0 million of the overall increase in depreciation and amortization expense in 2003.

Wireline segment income increased $42.1 million, or 5 percent, in 2004 and $90.9 million, or 11 percent, in 2003. The increase in 2004 primarily reflected the selling of additional services and features to existing wireline customers, growth in the Company's Internet operations, the effects of the incremental strike–related and maintenance costs incurred in 2003 and the Company's cost savings and expense control efforts discussed above. The acquisition of wireline properties in Kentucky accounted for $55.7 million of the overall increase in segment income in 2003. Wireline segment income for 2003 also reflected the effects of the incremental strike–related expenses and $6.6 million of the overall increase in ALLTEL's pension expense previously discussed, partially offset by cost savings resulting from the Company's continued efforts to control operating expenses.

Set forth below is a summary of the restructuring and other charges related to the wireline operations that were not included in the determination of segment income for the years ended December 31:

(Millions)	2004	2003	2002
Severance and employee benefit costs	$11.2	$ 7.0	$ 6.6
Relocation costs	1.2	–	–
Lease and contract termination costs	(1.9)	–	3.8
Computer system conversion and other integration costs	–	–	17.0
Write–down of software development costs	–	1.8	4.1
Branding and signage costs	–	–	3.7
Other exit costs	0.7	–	2.2
Total restructuring and other charges	$11.2	$ 8.8	$37.4

Regulatory Matters–Wireline Operations

Except for the Kentucky properties acquired in 2002 and the Nebraska operations acquired in 1999, ALLTEL's ILEC operations follow the accounting for regulated enterprises prescribed by SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation". Criteria that would give rise to the discontinuance of SFAS No. 71 include (1) increasing competition restricting the regulated ILEC subsidiaries' ability to establish prices to recover specific costs and (2) significant changes in the manner in which rates are set by regulators from cost–based regulation to another form of regulation. On a quarterly basis, ALLTEL reviews the criteria to determine whether the continuing application of SFAS No. 71 is appropriate. Many of the Company's ILEC operations have begun to experience competition in their local service areas. Sources of competition to ALLTEL's local exchange business include, but are not limited to, resellers of local exchange services, interexchange carriers, satellite transmission services, wireless communications providers, cable television companies, and competitive access service providers including those utilizing Unbundled Network Elements–Platform ("UNE–P"), voice–over–Internet–protocol ("VoIP") providers and providers using other emerging technologies. Through December 31, 2004, this competition has not had a material adverse effect on the results of operations of ALLTEL's ILEC operations.

Although the Company believes that the application of SFAS No. 71 continues to be appropriate, it is possible that changes in regulation, legislation or competition could result in the Company's ILEC operations no longer qualifying for the application of SFAS No. 71 in the near future. If ALLTEL's ILEC operations no longer qualified for the application of SFAS No. 71, the accounting impact to the Company would be an extraordinary non–cash credit to operations. The non–cash credit would consist primarily of the reversal of the regulatory liability for cost of removal included in accumulated depreciation, which amounted to $171.7 million as of December 31, 2004. At this time, ALLTEL does not expect to record any impairment charge related to the carrying value of its ILEC plant. Under SFAS No. 71, ALLTEL currently depreciates its ILEC plant based upon asset lives approved by regulatory agencies or as otherwise allowed by law. Upon discontinuance of SFAS No. 71, ALLTEL would be required to revise the lives of its property, plant and equipment to reflect the estimated useful lives of the assets. The Company does not expect any revisions in asset lives to have a material adverse effect on its ILEC operations.

Most states in which ALLTEL's ILEC subsidiaries operate have adopted alternatives to rate–of–return regulation, either through legislative or state public service commission actions. The Company has elected alternative regulation for certain of its ILEC subsidiaries in Alabama, Arkansas, Florida, Georgia, Kentucky, Nebraska, North Carolina, Ohio, Pennsylvania, South Carolina, and Texas. The staff of the Kentucky Public Service Commission has challenged ALLTEL's ability to remain covered by the small company alternative regulation plan under which a portion of the Company's Kentucky operations presently operates. The Kentucky PSC is expected to address the issue in 2005. The Missouri Public Service Commission has ruled that the Company is not eligible for alternative regulation. The Company has appealed that decision, although the Missouri commission's action will not affect the Company's local service and intrastate access rates. ALLTEL continues to evaluate alternative regulation options in markets where its ILEC subsidiaries are presently not subject to alternative regulation plan.

A number of carriers have begun offering voice telecommunications services utilizing Internet protocol as the underlying means for transmitting those calls. This service, commonly known as voice–over–Internet–protocol ("VoIP") telephony, is challenging existing regulatory definitions and raises questions as to how such services should be regulated, if at all. Several state commissions have attempted to assert jurisdiction over VoIP services, but federal courts in New York and Minnesota have indicated that the FCC preempts the states with respect to jurisdiction. On March 10, 2004, the FCC released a notice of proposed rulemaking seeking comment on the appropriate regulatory treatment of IP–enabled communications services. The proposed rulemaking sought comment on the differences between IP–enabled services and

traditional telephony services, and the distinctions between different types of IP–enabled services. The FCC indicated that the cost of the public switched telephone network should be borne equitably among those that use it and seeks comment on the specific regulatory requirements that should be extended to IP–enabled service providers, including requirements relating to E–911, disability accessibility, access charges, and universal service.

Although the FCC's rulemaking regarding IP–enabled services remains pending, the FCC has adopted three orders establishing broad parameters for the regulation of such services. Specifically, on February 12, 2004, the FCC released an order declaring Pulver.com's "free" IP–based, peer–to–peer service that requires specialized telephone equipment or software for computers is not a telecommunications service, but rather was an unregulated information service subject to federal jurisdiction. On April 21, 2004, the FCC denied a waiver petition filed by AT&T requesting that its IP telephony service be exempt from access charges. The FCC ruled that AT&T's IP telephony service, which converted voice calls to IP format for some portion of the routing over the public switched telephone network prior to converting the calls back to their original format, is a regulated telecommunications service subject to interstate access charges. On November 12, 2004, the FCC ruled that Internet–based service provided by Vonage Holdings Corporation should be subject to federal rather than state jurisdiction. Several state commissions have filed appeals of the FCC's Vonage decision to various federal appellate courts. Other aspects of the Vonage petition for declaratory ruling, including how the service should be classified for regulatory purposes, remain pending. Also pending at the FCC is a petition filed by Level 3 Communications Inc. asking the FCC to forbear from imposing interstate or intrastate access charges on Internet–based calls that originate or terminate on the public switched telephone network. In 2004, the FCC initiated a rulemaking regarding the regulatory framework for implementing CALEA and tentatively concluded that CALEA should apply to VoIP services. If the FCC determines that IP–enabled services are not subject to similar levels of regulatory requirements, including contributions to federal and state universal service programs, other federal and state tax obligations and quality of service metrics, the Company's regulated local exchange operations will be at a competitive disadvantage. Until the FCC issues its decision in these proceedings, the Company cannot estimate the impact on its operations.

On October 8, 2004, the FCC granted in part and denied in part a petition filed by Core Communications requesting that the FCC forbear from enforcing provisions of the FCC's 2001 Internet Service Provider ("ISP") Remand Order. The FCC granted forbearance from the ISP Remand Order's growth caps and new market rule finding they were no longer in the public interest. The FCC denied forbearance from the ISP Remand Order's rate cap and mirroring rules. Various parties have filed for reconsideration with the FCC and appeals have been filed with the D.C. Circuit Court. If the FCC's decision in this Order is upheld, the Company is likely to incur an operating expense for delivering ISP–bound traffic to competitive wireline service providers that it has not had before. The Company is not able to estimate the amount of this additional expense because ISP–bound minutes traversing its network are not presently recorded, although it is very likely that the negative impact to operating margin would be less than $10.0 million annually.

In April 2001, the FCC released a notice of proposed rulemaking addressing inter–carrier compensation. Under this rulemaking, the FCC asked for comment on a "bill and keep" compensation method that would significantly modify the existing rules governing reciprocal compensation and access charges. A number of state proceedings have also been initiated by various wireline companies to address compensation with respect to traffic that originates or terminates with wireless carriers or competitive wireline service providers. The outcome of the FCC and state proceedings could change the way ALLTEL receives compensation from, and remits compensation to, other carriers and its end users. Several industry associations have presented proposals to the FCC for the reform of inter–carrier compensation and universal service collection and distribution mechanisms. The FCC is expected to issue a further notice of proposed rulemaking seeking comment on these proposals in 2005. Until this proceeding concludes and the changes to the existing rules are established, if any, ALLTEL cannot estimate the potential impact the proposed changes would have on its ILEC revenues and expenses, nor the timing of the potential changes.

The federal universal service program is under legislative, regulatory and industry participant scrutiny as a result of the recent growth in the fund and structural changes within the telecommunications industry. The structural changes include and increase in the number of ETC's receiving money from the universal service fund and a migration of customers from wireline service to VoIP providers that, today, are not required to contribute to the universal service program. There are a number of FCC proceedings underway that are considering changes to the way the universal service programs are funded and the way universal service funds are disbursed to program recipients. The specific proceedings are discussed in greater detail below.

In May 2001, the FCC adopted the Rural Task Force Order that established an interim universal service mechanism that will govern compensation for rural telephone companies for the ensuing five years. The interim mechanism has allowed rural carriers to continue receiving high–cost funding based on their embedded costs. On June 2, 2004, the FCC asked the Federal/State Joint Board on Universal Service (the "Joint Board") to review the FCC's rules as they pertain to rural

telephone companies and to determine what changes, if any, should be made to the existing high–cost support mechanism when the current funding program expires in June 2006. The Joint Board sought comment on such a mechanism on August 16, 2004, but has taken no further action. In addition, the Joint Board sought comment on whether companies operating multiple study areas within a state should consolidate them for purposes of calculating universal service support. If the FCC implements this proposal, ALLTEL's universal service revenues would be reduced from their current level by approximately $15.0 million annually. However, the Company cannot estimate the impact of the potential change from embedded cost to another methodology until the specific changes, if any, are adopted.

On November 8, 2002, the FCC requested that the Joint Board review certain of the FCC's rules relating to the high–cost universal support levels and the process by which carriers are designated as ETCs. On February 27, 2004, the Joint Board issued its recommended decision regarding a number of issues related to USF support for ETCs. Among its recommendations, the Joint Board suggested that the FCC should adopt optional federal guidelines to assist with state ETC designations and limit support to a single primary connection per customer. On June 8, 2004, the FCC asked for comments on the Joint Board's recommended decision, but did not elaborate or reach tentative conclusions on any of the Joint Board's recommendations. The 2005 Omnibus Appropriations Bill includes a provision that prevents the FCC from enacting a primary line restriction on universal service support recommended to the FCC by the Joint Board. ALLTEL does not expect that the above proceedings will have any material impact on its wireline universal service funding.

As previously discussed under "Regulatory Matters – Wireless Operations", the FCC mandated that, effective October 1, 2004, USAC must begin accounting for the USF program in accordance with generally accepted accounting principles for federal agencies, rather than the accounting rules that USAC formerly used. This accounting method change subjected USAC to the ADA, the effect of which could have caused delays in USF payments to USF program recipients and significantly increase the amount of USF regulatory fees charged to wireline and wireless consumers. In December 2004, Congress passed legislation to exempt USAC from the ADA for one year to allow for a more thorough review of the impact the ADA would have on the universal service program.

On December 20, 2001, the FCC released a notice of proposed rulemaking initiating the first triennial review of the FCC's policies on unbundled network elements ("UNEs") including UNE–P. UNE–P is created when a competing carrier obtains all the network elements needed to provide service from the ILEC at a discounted rate. On August 21, 2003, the FCC released the text of its Triennial Review Order. The FCC adopted new rules governing the obligations of ILECs to unbundle certain elements of their local networks for use by competitors. As part of the Triennial Review Order the FCC also opened a further notice of proposed rulemaking to consider the "pick and choose" rule under which a competing carrier could select from among the various terms of interconnection offered by an ILEC in its various interconnection agreements. On July 13, 2004, the FCC released an order eliminating the "pick and choose" rule, replacing it with an "all–or–nothing" rule. Under the new rules, a requesting carrier may only adopt an effective interconnection agreement in its entirety, taking all rates, terms and conditions of the adopted agreement. The FCC explained that it eliminated the "pick and choose" rule to promote commercial negotiations and produce agreements better tailored to meet carriers' individuals needs.

On March 2, 2004, the D.C. Circuit Court overturned key portions of the FCC's Triennial Review Order. The D.C. Circuit Court's decision vacated the nationwide impairment standard, as well as the FCC's delegation of authority to the states, while generally upholding ILEC broadband relief. The D.C. Circuit Court's decision was to become effective on May 3, 2004. On March 31, 2004, the FCC commissioners urged carriers to begin private commercial negotiations to resolve issues surrounding the competitor's access to unbundled network elements. To provide additional time for these negotiations, the FCC requested and was granted a 45–day extension to June 15, 2004 of the May 3, 2004 effective date of the D.C. Circuit Court's decision to vacate the UNE rules. The Supreme Court denied all petitions for review.

On September 13, 2004, the FCC released its Interim UNE Order requiring incumbent ILECs to maintain the status quo through March 13, 2005 and indicated that it would release permanent rules prior to that date. Under the interim rules, ILECs are required to provide mass–market switching, enterprise market loops and dedicated transport under the same rates, terms and conditions as in effect on June 15, 2004. If permanent rules are not adopted by March 13, 2005, UNE rates generally would increase by 15 percent for existing CLEC customers for a six–month period ending September 13, 2005. In both cases, the interim rates would be discarded if and when the FCC adopts permanent UNE rules. Various parties have filed an appeal of the Interim UNE Order and a writ of mandamus to strike down the Interim UNE Order and order the FCC to adopt compliant rules, both of which remain pending before the D.C. Circuit. On December 15, 2004, the FCC adopted permanent UNE rules, although the text of the order has not been released. These permanent rules appear to eliminate UNE–P as a CLEC entry strategy by dropping mass market switching from the required list of UNEs and reduce CLEC access to high–capacity loops and transport based on economic conditions in relevant wire centers. These permanent rules apparently will establish a twelve–month transition for most of the UNEs being eliminated. Until these scenarios unfold and the proceeding has worked its way through the courts, the ultimate impact of the Triennial

Review proceeding and permanent UNE rules on ALLTEL's ILEC operations cannot be determined, however it is not expected to be material.

On September 15, 2003, the FCC launched its first comprehensive review of the rules that establish wholesale pricing of UNEs. The notice of proposed rulemaking sought comment on a variety of UNE and resale pricing–related issues and on a proposal to make total element long–run incremental cost methodology ("TELRIC") rules more closely account for the "real–world" attributes of the incumbent carrier's network. The FCC has not issued an Order in this proceeding but if this proposal were adopted, the result would likely be increased UNE prices. The potential increases are not expected to have a material increase on the Company's wireline operations.

During the first quarter of 2002, the FCC initiated a rulemaking to evaluate the appropriate framework for broadband access to the Internet over wireline facilities. In the notice of proposed rulemaking, the FCC tentatively concluded that wireline broadband Internet access should be classified as an "information service" rather than a telecommunications service and, therefore, should not be subject to common carrier regulation. The FCC sought comments on their tentative conclusion, but has not reached a final order. In a related proceeding released March 15, 2002, the FCC issued a declaratory ruling concluding that cable modem service was an interstate "information service" and not a cable service or a telecommunications service. The FCC sought comment on whether there are legal or policy reasons why it should reach different conclusions with respect to wireline broadband Internet access and cable modem service, but has not reached a final order. On October 6, 2003, the U.S. Court of Appeals for the Ninth Circuit (the "Ninth Circuit Court") rejected the FCC's classification of cable modem service as solely an unregulated "information service", finding a portion of the service to be a telecommunications service. The FCC requested a rehearing before the full Ninth Circuit Court, but the request was denied on March 31, 2004. The Ninth Circuit Court ruling was scheduled to become effective April 8, 2004, but the Ninth Circuit Court stayed the ruling pending appeal to the U. S. Supreme Court. On December 3, 2004, the Supreme Court agreed to hear the case and a ruling is expected in the summer of 2005. It remains uncertain whether cable modem service will ultimately fall under common carrier regulation of the 96 Act and whether cable companies will be required to provide nondiscriminatory access to their networks. At this time, ALLTEL cannot estimate what impact, if any, these broadband proceedings may have on its ILEC operations.

Section 251(b) of the Communications Act of 1934 (the "34 Act"), as amended, requires, in part, that local exchange carriers provide local number portability to any requesting telecommunications carrier. Wireless carriers are generally defined as "telecommunications carriers" under the 34 Act, and are therefore eligible to port numbers with wireline carriers, which is referred to as "intermodal porting". As previously discussed under "Regulatory Matters -- Wireless Operations", on November 10, 2003, the FCC released a decision providing guidance on intermodal porting issues. The intermodal porting requirement took effect on November 24, 2003 for wireline carriers in the top 100 MSAs and on May 24, 2004 for wireline carriers operating in markets below the top 100 MSAs. The majority of the Company's wireline operations are conducted in markets below the top 100 MSAs and were subject to the later May 24, 2004 implementation date for intermodal porting. To date, implementation of intermodal porting has not had a significant impact on the Company's wireline operating results.

Because certain of the regulatory matters discussed above are under FCC or judicial review, resolution of these matters continues to be uncertain, and ALLTEL cannot predict at this time the specific effects, if any, that the 96 Act, regulatory decisions and rulemakings, and future competition will ultimately have on its ILEC operations.

Communications Support Services Operations

(Millions, except customers in thousands)	2004	2003	2002
Revenues and sales:			
Product distribution	$ 421.2	$ 407.4	$ 371.3
Long–distance and network management services	304.9	320.1	316.2
Directory publishing	155.9	122.6	119.1
Telecommunications information services	41.8	108.9	119.1
Total revenues and sales	923.8	959.0	925.7
Costs and expenses:			
Cost of services	257.9	299.0	295.3
Cost of products sold	514.2	486.9	439.2
Selling, general, administrative and other	54.7	60.5	69.2
Depreciation and amortization	34.3	36.2	37.8
Total costs and expenses	861.1	882.6	841.5
Segment income	$ 62.7	$ 76.4	$ 84.2
Long–distance customers	1,770.8	1,680.2	1,542.2

Communications support services revenues and sales decreased $35.2 million, or 4 percent, in 2004 and increased $33.3 million, or 4 percent, in 2003. As noted in the table above, the decrease in revenues and sales in 2004 reflected declines in long–distance and network management services and telecommunications information services, partially offset by an increase in sales of telecommunications equipment and data products and directory publishing revenues. Revenues attributable to long–distance and network management services declined $15.2 million in 2004. Although the number of long–distance customers served increased during 2004, revenues derived from external customers decreased $10.7 million from 2003, primarily due to declining usage by residential customers and a reduction in customer billing rates due to competition. Revenues earned from affiliates for network management services also decreased $4.5 million in 2004, primarily due to a reduction in intercompany billing rates which took effect April 1, 2004. Telecommunications information services revenues decreased $67.1 million in 2004, primarily due to the December 2003 sale of certain assets and related liabilities, including selected customer contracts and capitalized software development costs, to Convergys, and the loss of one of ALLTEL's remaining unaffiliated wireline services customers. The customer contracts sold to Convergys represented approximately 48 percent of the total revenues and sales reported by the telecommunications information services operations in 2003.

Sales of telecommunications and data products increased $13.8 million in 2004, reflecting increased sales to non–affiliates of $31.4 million compared to 2003, primarily attributable to increased sales of higher priced wireless handsets that include advanced features and that are capable of various data applications to retailers and other distributors. Conversely, compared to 2003, sales to affiliates decreased $17.6 million in 2004, primarily due to a reduction in capital expenditures by the Company's wireline operations. Directory publishing revenues increased $33.3 million in 2004, primarily due to an increase in the number of directory contracts published, including the initial publication of directories for the acquired Kentucky and Nebraska operations previously discussed. In addition, the increase in 2004 also reflected a change in accounting for directory contracts in which the Company has a secondary delivery obligation. Effective January 1, 2003, ALLTEL began deferring a portion of its revenues and related costs to provide for secondary deliveries. As a result, revenues and related costs associated with any directories for which secondary deliveries were required, but not yet made, were deferred, resulting in a reduction in directory publishing revenues in 2003 of $5.3 million.

The increase in revenues and sales in 2003 primarily reflected growth in sales of telecommunications and data products, which increased $36.1 million from 2002. Sales to non–affiliates increased $60.0 million in 2003, primarily due to increased sales of wireless handsets to retailers and other distributors. Conversely, the general reduction in capital spending by telecommunications companies adversely affected sales to non–affiliates in 2003, reflecting current economic conditions and the industry's emphasis on controlling costs. In 2003, sales to affiliates decreased $23.9 million from 2002, consistent with the overall reduction in capital expenditures related to ALLTEL's wireline operations. Compared to 2002, revenues from long–distance and network management services increased $3.9 million in 2003, primarily due to 9 percent growth in ALLTEL's customer base for long–distance services, partially offset by reductions in customer billing rates due to competition. Directory publishing revenues increased $3.5 million in 2003, primarily reflecting additional revenues of $6.1 million attributable to growth in the number of directory contracts published. The revenues earned from these additional contracts were partially offset by a change in accounting for directory contracts in which the Company has a secondary delivery obligation as discussed above. Telecommunications information services revenues decreased $10.2 million in 2003, primarily resulting from a reduction in programming services provided to one customer, lost operations due to a contract termination and the completion in 2002 of customer specific conversion projects and other transitional services.

Primarily due to the decrease in revenues and sales noted above, communications support services segment income decreased $13.7 million, or 18 percent, in 2004. The adverse effects on segment income attributable to the decrease in revenues and sales in 2004 were partially offset by improved profit margins in the directory publishing operations. Profit margins for the directory publishing operations in 2003 had been adversely affected by increased selling, marketing and other start–up costs incurred in order for the Company's publishing subsidiary to begin providing all directory publishing services, except printing, for all directory contracts published in 2004. Except for a limited number of directory contracts published in 2003, these publishing services were previously contracted out to a third party. Partially offsetting the 2004 improvement in the profit margins of the directory publishing operations attributable to the favorable effects of the start–up costs incurred in 2003 was an increase in bad debt expense of $6.1 million. Although revenues and sales increased in 2003, communications support services segment income decreased primarily due to lower profit margins realized by the product distribution and directory publishing operations. Profit margins for the product distribution operations decreased in 2003 due to a shift in the mix of products sold to non–affiliates, as a proportionately higher percentage of these sales consisted of lower margin wireless handsets. Profit margins for the directory publishing operations in 2003 were adversely affected by the increased selling, marketing and other start–up costs discussed above.

Set forth below is a summary of the restructuring and other charges related to the communications support services operations that were not included in the determination of segment income for the years ended December 31:

(Millions)	2004	2003	2002
Severance and employee benefit costs	$ 0.5	$ –	$ 1.8
Relocation costs	0.1	–	–
Lease and contract termination costs	–	(0.5)	3.6
Write–down of software development costs	–	3.8	–
Total restructuring and other charges	$ 0.6	$ 3.3	$ 5.4

Segment Capital Requirements
The primary uses of cash for ALLTEL's operating segments are capital expenditures for property, plant and equipment and expenditures for capitalized software development to support the Company's wireless and wireline operations. Annual capital expenditures and expenditures for software development by operating segment are forecasted as follows for 2005:

(Millions)	Capital Expenditures			Software Development	Totals		
Wireless	$ 865.0	–	$ 940.0	$ 40.0	$ 905.0	–	$ 980.0
Wireline	370.0	–	380.0	5.0	375.0	–	385.0
Communications support services	15.0	–	25.0	–	15.0	–	25.0
Corporate	5.0	–	10.0	–	5.0	–	10.0
Totals	$1,255.0	–	$1,355.0	$ 45.0	$1,300.0	–	$1,400.0

Capital expenditures for 2005 will be primarily incurred for further deployment of digital wireless technology, including high–speed wireless data capabilities, in the Company's existing and acquired wireless markets. The forecasted spending levels in 2005 are subject to revision depending on changes in future capital requirements of the Company's business segments. Each of ALLTEL's operating segments in 2004 generated positive cash flows sufficient to fund the segments' day–to–day operations and to fund their capital requirements. The Company expects each of the operating segments to continue to generate sufficient cash flows in 2005 to fund their operations and capital requirements.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

(Millions, except per share amounts)	2004	2003	2002
Cash flows from (used in):			
Operating activities	$ 2,466.8	$ 2,474.7	$ 2,392.2
Investing activities	(1,258.4)	(1,265.9)	(4,494.6)
Financing activities	(1,381.2)	(1,218.2)	2,079.5
Discontinued operations	–	531.8	91.3
Effect of exchange rate changes	(0.1)	0.8	3.0
Change in cash and short–term investments	$ (172.9)	$ 523.2	$ 71.4
Total capital structure (a)	$12,707.0	$12,881.6	$12,639.2
Percent equity to total capital (b)	56.1%	54.5%	47.5%
Book value per share (c)	$23.58	$22.46	$19.27

(a) Computed as the sum of long–term debt including current maturities, redeemable preferred stock and total shareholders' equity.

(b) Computed by dividing total shareholders' equity by total capital structure as computed in (a) above.

(c) Computed by dividing total shareholders' equity less preferred stock by the total number of common shares outstanding at the end of the year.

Cash Flows from Operations
Cash provided from operations continued to be ALLTEL's primary source of funds. Cash provided from operations in 2004 and 2003 reflected growth in earnings from the Company's business segments. In addition to earnings growth, cash flows from operations in both years also reflected changes in working capital requirements, including timing differences in the billing and collection of accounts receivables, purchases of inventory and the payment of trade payables and taxes. Cash provided from operations also reflected contributions to ALLTEL's qualified pension plan of $100.0 million in both 2004 and 2003 and $50.0 million in 2002. During 2004, ALLTEL generated sufficient cash flows from operations to fund its capital expenditure requirements, dividend payments, stock repurchase program and scheduled long–term debt payments as further discussed below. The Company expects to generate sufficient cash flows from operations to fund its operating requirements in 2005.

Cash Flows from Investing Activities
Capital expenditures continued to be ALLTEL's primary use of capital resources. Capital expenditures were $1,125.4 million in 2004, $1,137.7 million in 2003 and $1,154.8 million in 2002. Capital expenditures in each of the past three years were incurred to construct additional network facilities, to deploy digital technology in the Company's existing and acquired wireless markets and to upgrade ALLTEL's telecommunications network in order to offer other communications services, including long-distance, Internet, DSL and "Touch-2-Talk" communications services. Capital expenditures for 2004 also included the Company's initial investment in wireless EV-DO technology in several markets. ALLTEL expects to deploy EV-DO technology in 6 to 10 additional markets in 2005. During each of the past three years, ALLTEL funded substantially all of its capital expenditures through internally generated funds. As indicated in the table above under "Segment Capital Requirements", ALLTEL expects capital expenditures to be approximately $1,255.0 million to $1,355.0 million for 2005, which will be funded primarily from internally generated funds. Investing activities also included outlays for capitalized software development costs, which were $32.3 million in 2004, $56.7 million in 2003 and $58.4 million in 2002. As indicated in the table above under "Segment Capital Requirements", ALLTEL expects expenditures for capitalized software development to be approximately $45.0 million for 2005, which also will be funded from internally generated funds.

During 2004, cash outlays for the purchase of property, net of cash acquired, were $185.1 million. In 2004, ALLTEL purchased wireless properties in Florida, Louisiana and Ohio for $71.2 million in cash, acquired the remaining ownership interest in wireless properties in Georgia for $62.9 million in cash and purchased additional ownership interests in wireless properties in Mississippi, North Carolina, Ohio and Wisconsin for $49.6 million in cash. In addition, during 2004, ALLTEL also purchased additional partnership interests in wireless properties in Louisiana and Wisconsin in which the Company owned a majority interest in exchange for $1.4 million in cash and a portion of the Company's ownership interest in a wireless partnership serving the St. Louis, Missouri market. During 2003, cash outlays for the purchase of property, net of cash acquired, were $160.6 million. In 2003, ALLTEL purchased wireless properties in Arizona and Mississippi for $87.4 million in cash, acquired the remaining ownership interest in two wireless properties in Michigan for $60.0 million in cash, and purchased additional ownership interests in wireless properties in Mississippi, New Mexico, Virginia and Wisconsin for $13.2 million in cash. Cash outlays for the purchase of property, net of cash acquired, were $3,365.5 million in 2002 and primarily consisted of $1,735.2 million for the purchase of wireline properties in Kentucky from Verizon ($1,928.7 million total purchase price less $193.5 million deposit including accrued interest paid in October 2001) and $1,595.3 million for the purchase of wireless assets from CenturyTel. In addition, during 2002, ALLTEL also purchased a wireline property in Georgia for $17.9 million and acquired additional ownership interests in wireless properties in Arkansas, Louisiana and Texas for $17.1 million in cash.

Cash flows from investing activities included $7.5 million in 2002 of advance lease payments received from American Tower for the leasing of 1,773 of the Company's cell site towers. As further discussed in Note 15 to the consolidated financial statements, ALLTEL signed an agreement to lease American Tower certain of the Company's cell site towers in exchange for cash paid in advance. ALLTEL is obligated to pay American Tower a monthly fee per tower for management and maintenance services for the duration of the fifteen-year lease agreement.

Cash flows from investing activities for 2003 included proceeds from the sale of assets of $46.1 million, principally consisting of $37.0 million received by ALLTEL from the sale of certain assets related to the Company's telecommunications information services operations, as previously discussed. Cash flows from investing activities for 2002 included proceeds from the sale of assets of $24.1 million received by ALLTEL in connection with the sale of a wireless property in Pennsylvania, as previously discussed.

Cash flows from investing activities also included proceeds from the return on or sale of investments of $88.6 million in 2004, $48.3 million in 2003 and $51.9 million in 2002. These amounts primarily consisted of cash distributions received from ALLTEL's wireless minority investments. The increase in distributions received in 2004 was consistent with the improved operating results of these investments, as previously discussed. Conversely, the decrease in 2003 primarily reflected ALLTEL's acquisitions of the remaining ownership interest in two wireless properties in Michigan and of a controlling interest in a Wisconsin wireless partnership completed during 2003, as previously discussed.

Cash Flows from Financing Activities
Dividend payments remained a significant use of the Company's capital resources. Common and preferred dividend payments amounted to $467.6 million in 2004, $436.4 million in 2003 and $423.1 million in 2002. The increases in each year primarily reflected growth in the annual dividend rates on ALLTEL's common stock. On October 21, 2004, the Company's Board of Directors approved an increase in the quarterly common stock dividend rate of 3 percent from $.37 to $.38 per share. This action raised the annual dividend rate to $1.52 per share and marked the 44th consecutive year in which ALLTEL has increased its common stock dividend. ALLTEL expects to continue the payment of cash dividends during 2005. Sources of funding future dividend payments include available cash on hand and operating cash flows.

ALLTEL's maximum borrowing capacity under its commercial paper program is $1.5 billion. ALLTEL classifies commercial paper borrowings as long–term debt, because they are intended to be maintained on a long–term basis and are supported by the Company's revolving credit agreements. During 2003, the Company amended its $1.0 billion revolving credit agreement so that the expiration date of the entire $1.0 billion line of credit would be October 1, 2005. On July 30, 2003, the Company entered into an additional $500.0 million, 364–day revolving credit agreement that expired on July 28, 2004. On July 28, 2004, the Company replaced its existing $1.0 billion revolving credit agreement with a new five–year revolving credit agreement with a $1.5 billion line of credit. No borrowings were outstanding under the revolving credit agreements as of December 31, 2004, 2003 and 2002.

Under the commercial paper program, commercial paper borrowings are fully supported by the available borrowings under the revolving credit agreements. Accordingly, the total amount outstanding under the commercial paper program and the indebtedness incurred under the revolving credit agreements may not exceed $1.5 billion. No commercial paper borrowings were outstanding at December 31, 2004 or 2003, compared to $25.0 million and $230.1 million outstanding as of December 31, 2002 and 2001, respectively. During 2004, the Company did not incur any borrowings under the commercial paper program. During 2003, the Company incurred additional commercial paper borrowings to fund the wireless property acquisitions in Arizona, Mississippi and Michigan, as previously discussed, and to retire a $450.0 million, 7.125 percent senior unsecured note that was due March 1, 2003. As previously discussed, during the second quarter of 2003, the Company repaid all borrowings outstanding under its commercial paper program utilizing a portion of the cash proceeds ALLTEL received in connection with the April 1, 2003 sale of the financial services division of its information services subsidiary to Fidelity National. ALLTEL also used a portion of the cash proceeds from the sale to retire all long–term debt outstanding under the Rural Utilities Services, Rural Telephone Bank and Federal Financing Bank programs as further discussed below. During 2002, the Company incurred commercial paper borrowings in the amount of $442.5 million to fund a portion of the purchase price of the Verizon and CenturyTel acquisitions.

Retirements of long–term debt amounted to $277.3 million in 2004, $763.4 million in 2003 and $265.8 million in 2002. Retirements of long–term debt in 2004 primarily consisted of the repayment of a $250.0 million unsecured note due April 1, 2004. Retirements of long–term debt in 2003 included the repayment of a $450.0 million unsecured note due March 1, 2003 and the retirement of $249.1 million of long–term debt outstanding under the Rural Utilities Services, Rural Telephone Bank and Federal Financing Bank programs. Retirements of long–term debt in 2003 also included the net reduction from December 31, 2002 in commercial paper borrowings of $25.0 million. The net reduction from December 31, 2001 in commercial paper borrowings of $205.1 million represented the majority of the long–term debt retired in 2002. Additional scheduled long–term debt retirements, net of commercial paper and the prepayment of long–term debt, amounted to $27.3 million in 2004, $39.3 million in 2003 and $60.7 million in 2002. (See Note 5 to the consolidated financial statements for additional information regarding the Company's long–term debt.)

As previously discussed, to fund the cost of the acquisition of wireline properties in Kentucky and wireless properties from CenturyTel, during May 2002, ALLTEL sold 27.7 million equity units and received net proceeds of $1.34 billion. The equity units had a stated amount of $50 per unit and included a purchase contract pursuant to which the holder agreed to purchase shares of ALLTEL common stock on May 17, 2005. The number of shares to be purchased will be determined at the time the purchase contracts are settled based on the then current price of ALLTEL's common stock and will range between 0.8280 and 1.0101 shares of ALLTEL common stock per equity unit. The equity units also included $50 principal amount of senior notes, which bear interest at an initial rate of 6.25 percent and mature on May 17, 2007. In the event of a successful initial remarketing of the senior notes on or after February 17, 2005, the remarketing agent will reset the interest rate on the senior notes. ALLTEL expects the reset interest rate on the senior notes will range between 4.50 percent and 5.00 percent. In June 2002, the Company also issued $1.5 billion of unsecured long–term debt consisting of $800.0 million of 7.0 percent senior notes due July 1, 2012 and $700.0 million of 7.875 percent senior notes due July 1, 2032. Net proceeds from this debt issuance were $1.47 billion, after deducting the underwriting discount and other offering expenses. The net proceeds from the issuance of the equity units and debt securities of $2.81 billion represented all of the long–term debt issued in 2002.

On January 22, 2004, ALLTEL's Board of Directors adopted a stock repurchase plan authorizing the Company to repurchase up to $750.0 million of its outstanding common stock over a two year period ending December 31, 2005. Under the repurchase plan, ALLTEL may repurchase shares, from time to time, on the open market or in negotiated transactions, as circumstances warrant, depending upon market conditions and other factors. Sources of funding the stock buyback program include available cash on hand, operating cash flows and borrowings under the Company's commercial paper program. During 2004, ALLTEL repurchased 11.2 million of its common shares at a total cost of $595.3 million under this plan.

Cash flows used in financing activities also included distributions to ALLTEL's minority investors in wireless markets operated in partnership with other companies. Cash payments to these minority investors were $66.9 million in 2004, compared to $67.5 million in 2003 and $57.9 million in 2002.

Liquidity and Capital Resources
The Company believes it has sufficient cash and short–term investments on hand ($484.9 million at December 31, 2004) and has adequate operating cash flows to finance its ongoing operating requirements, including capital expenditures, repayment of long–term debt, payment of dividends, funding the stock repurchase plan, and financing the cash payment required to complete the pending wireless property exchange with Cingular previously discussed. Sources of funding available to the Company to finance the $1.0 billion cash portion of the pending merger transaction with Western Wireless and the $1.2 billion of term loans outstanding under the Western Wireless credit facility that become due immediately upon the closing of the merger would include: (1) cash proceeds of $1.4 billion to be received by ALLTEL on May 17, 2005 from the sale of ALLTEL common stock to holders of the Company's equity units, as further discussed below under "Obligation to Sell Shares of ALLTEL Common Stock"; (2) proceeds from monetizing ALLTEL's investment portfolio and (3) borrowings under the Company's commercial paper program, of which all $1.5 billion was available for issuance at December 31, 2004. Additional sources of funding available to ALLTEL include: (1) additional debt or equity securities under the Company's March 28, 2002, $5.0 billion shelf registration statement, of which approximately $730 million remained available for issuance at December 31, 2004; (2) additional debt securities issued in the private placement market and (3) interim bank financing.

ALLTEL's commercial paper and long–term credit ratings with Moody's Investors Service ("Moody's"), Standard & Poor's Corporation ("Standard & Poor") and Fitch Ratings ("Fitch") were as follows as of December 31, 2004:

Description	Moody's	Standard & Poor	Fitch
Commercial paper credit rating	Prime–1	A–1	F1
Long–term debt credit rating	A2	A	A
Outlook	Stable	Negative	Stable

Factors that could affect ALLTEL's short and long–term credit ratings would include, but not be limited to, a material decline in the Company's operating results and increased debt levels relative to operating cash flows resulting from future acquisitions or increased capital expenditure requirements. If ALLTEL's credit ratings were to be downgraded from current levels, the Company would incur higher interest costs on new borrowings, and the Company's access to the public capital markets could be adversely affected. A downgrade in ALLTEL's current short or long–term credit ratings would not accelerate scheduled principal payments of ALLTEL's existing long–term debt.

The revolving credit agreement contains various covenants and restrictions including a requirement that, as of the end of each calendar quarter, ALLTEL maintain a total debt–to–capitalization ratio of less than 65 percent. For purposes of calculating this ratio under the revolving credit agreement, total debt would include amounts classified as long–term debt (excluding mark–to–market adjustments for interest rate swaps), current maturities of long–term debt outstanding, short–term debt and any letters of credit or other guarantee obligations. As of December 31, 2004, the Company's total debt to capitalization ratio was 43.7 percent. In addition, the indentures and borrowing agreements, as amended, provide, among other things, for various restrictions on the payment of dividends by the Company. Retained earnings unrestricted as to the payment of dividends by the Company amounted to $6,142.2 million at December 31, 2004. There are no restrictions on the payment of dividends among members of ALLTEL's consolidated group.

At December 31, 2004, current maturities of long–term debt were $225.0 million and included a $200.0 million, 6.75 percent senior unsecured note due September 15, 2005. The Company expects to fund the payment of this note at maturity through either available cash on hand, operating cash flows or commercial paper borrowings.

Pension Plans
ALLTEL maintains a qualified defined benefit pension plan, which covers substantially all employees. Prior to January 1, 2005, employees of ALLTEL's directory publishing subsidiary did not participate in the plan. The Company also maintains a supplemental executive retirement plan that provides unfunded, non–qualified supplemental retirement benefits to a select group of management employees. In addition, the Company has entered into individual retirement agreements with certain retired executives providing for unfunded supplemental pension benefits. As further illustrated in Note 8 to the consolidated financial statements, total pension expense related to these plans was $32.0 million in 2004, $41.0 million in 2003 and $8.8 million in 2002. ALLTEL's pension expense for 2005 is estimated to be approximately $40.7 million.

Annual pension expense for 2005 was calculated based upon a number of actuarial assumptions, including an expected long–term rate of return on qualified pension plan assets of 8.50 percent and a discount rate of 6.00 percent. In developing the expected long–term rate of return assumption, ALLTEL evaluated historical investment performance, as well as input from its investment advisors. Projected returns by such advisors were based on broad equity and bond indices. The Company also considered the pension plan's historical returns since 1975 of 11.1 percent. ALLTEL's expected long–term rate of return on qualified pension plan assets is based on a targeted asset allocation of 70 percent to equities, with an expected long–term rate of return of 10 percent, and 30 percent to fixed income assets, with an expected long–term rate of return of 5 percent. Because of market fluctuations and cash contributions funded in late December to the qualified pension plan by ALLTEL of $100.0 million that had not yet been reinvested, the actual asset allocation as of December 31, 2004 was 65.6 percent to equities, 23.3 percent to fixed income assets and 11.1 percent in money market funds and other interest bearing investments. The Company regularly reviews the actual asset allocation of its qualified pension plan and periodically rebalances its investments to achieve the targeted allocation. ALLTEL continues to believe that 8.5 percent is a reasonable long–term rate of return on its qualified pension plan assets. For the year ended December 31, 2004, the actual return on qualified pension plan assets was 11.4 percent. ALLTEL will continue to evaluate its actuarial assumptions, including the expected rate of return, at least annually, and will adjust them as necessary. Lowering the expected long–term rate of return on the qualified pension plan assets by 0.50 percent (from 8.50 percent to 8.00 percent) would result in an increase in pension expense of approximately $4.9 million in 2005.

The discount rate selected is based on a review of current market interest rates of high–quality, fixed–rate debt securities adjusted to reflect the duration of expected future cash outflows for pension benefit payments. In developing the discount rate assumption for 2004, ALLTEL reviewed the high–grade bond indices published by Moody's and Standard & Poor's as of December 31, 2004, which are based on debt securities with average maturities of 30 years. These maturities are shorter than the term of the Company's expected future cash outflows, reflecting the younger workforce in the Company's wireless business. To account for the longer duration of its expected future pension benefit payments, the Company analyzed market data and constructed a hypothetical portfolio of high quality bonds with maturities that mirrored the expected payment stream of the benefit obligation. The discount rate determined on this basis decreased from 6.40 percent at December 31, 2003 to 6.00 percent at December 31, 2004. Lowering the discount rate by 0.25 percent (from 6.00 percent to 5.75 percent) would result in an increase in pension expense of approximately $7.3 million in 2005.

As of December 31, 2004, ALLTEL had cumulative unrecognized actuarial losses of $226.9 million, compared to $181.7 million at December 31, 2003. These actuarial losses are included in the calculation of the Company's annual pension expense subject to the following amortization methodology. Unrecognized actuarial gains or losses that exceed 17.5 percent of the greater of the projected benefit obligation or market–related value of plan assets are amortized into pension expense on a straight–line basis over five years. Unrecognized actuarial gains and losses below the 17.5 percent corridor are amortized over the average remaining service life of active plan participants (approximately 14 years at December 31, 2004). In applying this amortization method, the estimated pension expense of $40.2 million for 2005 includes $30.6 million of the unrecognized actuarial loss at December 31, 2004.

ALLTEL made a $100.0 million contribution to its qualified pension plan in December 2004. ALLTEL does not expect that any contribution to the plan calculated in accordance with the minimum funding requirements of the Employee Retirement Income Security Act of 1974 will be required in 2005. Future contributions to the plan will depend on various factors, including future investment performance, changes in future discount rates and changes in the demographics of the population participating in the Company's qualified pension plan.

Other Postretirement Benefits

The Company provides postretirement healthcare and life insurance benefits for eligible employees. Retired employees share a portion of the cost of these benefits. The Company funds the accrued costs of these plans as benefits are paid. As further illustrated in Note 8 to the consolidated financial statements, total postretirement expense was $25.9 million in 2004, $25.0 million in 2003 and $21.5 million in 2002. ALLTEL's postretirement expense for 2005 is estimated to be approximately $23.9 million.

Annual postretirement expense for 2005 was calculated based upon a number of actuarial assumptions, including a healthcare cost trend rate of 10.00 percent and a discount rate of 6.00 percent. Consistent with the methodology used to determine the appropriate discount rate for the Company's pension obligations, the discount rate selected for postretirement benefits is based on a hypothetical portfolio of high quality bonds with maturities that mirrored the expected payment stream of the benefit obligation. The discount rate determined on this basis decreased from 6.40 percent at December 31, 2003 to 6.00 percent at December 31, 2004. Lowering the discount rate by 0.25 percent (from 6.00 percent to 5.75 percent) would result in an increase in postretirement expense of approximately $0.4 million in 2005.

The healthcare cost trend rate is based on the Company's actual medical claims experience and future projections of medical costs. For the year ended December 31, 2004, a one percent increase in the assumed healthcare cost trend rate would increase the postretirement benefit cost by approximately $1.6 million, while a one percent decrease in the rate would reduce the postretirement benefit cost by approximately $1.3 million.

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") became law. Beginning in 2006, the Act will provide for a prescription drug benefit under Medicare Part D, as well as a federal subsidy to plan sponsors of retiree healthcare plans that provide a prescription drug benefit to participants that is at least actuarially equivalent to the benefit that will be available under Medicare. The amount of the federal subsidy will be based on 28 percent of an individual beneficiary's annual eligible prescription drug costs ranging between $250 and $5,000. On May 19, 2004, the FASB issued Staff Position No. 106–2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" ("FSP No. 106–2"). FSP No. 106–2 clarified that the federal subsidy provided under the Act should be accounted for as an actuarial gain in calculating the accumulated postretirement benefit obligation and annual postretirement expense. FSP No. 106–2 became effective as of July 1, 2004. As of December 31, 2004, the Department of Health and Human Services had yet to issue final regulations on the determination of actuarial equivalence and the federal subsidy. Based on its current understanding of the Act, ALLTEL determined that a substantial portion of the prescription drug benefits provided under its postretirement benefit plan would be deemed actuarially equivalent to the benefits provided under Medicare Part D. Effective July 1, 2004, ALLTEL prospectively adopted FSP No. 106–2 and remeasured its accumulated postretirement benefit obligation as of that date to account for the federal subsidy, the effects of which resulted in an $18.3 million reduction in the Company's accumulated postretirement benefit obligation and a $2.9 million reduction in the Company's 2004 postretirement expense. On January 21, 2005, the Department of Health and Human Services issued final federal regulations related to the federal subsidy. ALLTEL is currently evaluating the effects, if any, that these final rules may have on its future benefit costs and accumulated postretirement benefit obligation.

Off–Balance Sheet Arrangements

The Company does not use securitization of trade receivables, affiliation with special purpose entities, variable interest entities or synthetic leases to finance its operations. Additionally, the Company has not entered into any arrangement requiring ALLTEL to guarantee payment of third party debt or to fund losses of an unconsolidated special purpose entity.

As defined by the Securities and Exchange Commission's rules and regulations, the Company is a party to off–balance sheet arrangements, consisting of certain guarantees related to the sale of assets and ALLTEL's future obligation to sell a variable number of its common shares. Information pertaining to these arrangements is presented below.

Guarantees

As further discussed in Note 14 to the consolidated financial statements, in conjunction with the sale of the financial services division to Fidelity National, ALLTEL agreed to indemnify Fidelity National for any damages resulting from ALLTEL's breach of warranty or non–fulfillment of certain covenants under the sales agreement, that exceed 1.5 percent of the purchase price, or $15.75 million, up to a maximum of 15 percent of the purchase price, or $157.5 million. The Company believes because of the low probability of being required to pay any amount under this indemnification, the fair value of this obligation is immaterial to the consolidated results of operations, cash flows and financial condition of the Company. Accordingly, the Company has not recorded a liability related to it. ALLTEL also agreed to indemnify Fidelity National from any future tax liability imposed on the financial services division related to periods prior to the date of sale. ALLTEL's obligation to Fidelity National under this indemnification is not subject to a maximum amount. At December 31, 2004, the Company has recorded a liability for tax contingencies of approximately $8.3 million related to the operations of the financial services division for periods prior to the date of sale that management has assessed as probable and estimable, which should adequately cover any obligation under this indemnification.

In connection with the sale of assets to Convergys, ALLTEL agreed to indemnify Convergys for any damages resulting from ALLTEL's breach of warranty under the sales agreement that exceed $500,000, up to a maximum of $10.0 million. In addition, the Company agreed to indemnify Convergys for any damages resulting from non–fulfillment of certain covenants or liabilities arising from the ownership, operation or use of the assets included in the sale. This indemnification is not subject to a maximum obligation. The Company believes because of the low probability of being required to pay any amount under these indemnifications, the fair value of these obligations is immaterial to the consolidated results of operations, cash flows and financial condition of the Company. Accordingly, the Company has not recorded a liability related to these indemnifications.

Obligation to Sell Shares of ALLTEL Common Stock
As previously discussed, to fund the cost of the acquisitions completed in August 2002, ALLTEL sold 27.7 million equity units and received net proceeds of $1.34 billion. The equity units include a purchase contract which obligates the holder to purchase, and obligates ALLTEL to sell, on May 17, 2005, for $50, a variable number of newly issued common shares of ALLTEL. The number of ALLTEL shares issued will be determined at the time the purchase contracts are settled based upon the then current price of ALLTEL's common stock. If the price of the Company's common stock is equal to or less than $49.50, then ALLTEL will deliver 1.0101 shares to the holder of the equity unit. If the price of the Company's common stock is greater than $49.50 but less than $60.39, then ALLTEL will deliver a fraction of shares equal to $50 divided by the then current price of ALLTEL's common stock. Finally, if the price of the Company's common stock is equal to or greater than $60.39, then ALLTEL will deliver 0.8280 shares to the holder. Accordingly, upon settlement of the purchase contracts on May 17, 2005, ALLTEL will receive proceeds of approximately $1,385.0 million and will deliver between 22.9 million and 28.0 million common shares in the aggregate.

Contractual Obligations and Commitments
Set forth below is a summary of ALLTEL's material contractual obligations and commitments as of December 31, 2004:

	Payments Due by Period				
(Millions)	Less than 1 Year	1–3 Years	3–5 Years	More than 5 Years	Total
Long–term debt, including current maturites (a)	$ 225.0	$2,054.9	$ 347.8	$2,895.7	$ 5,523.4
Interest payments on long–term debt obligations	335.9	641.1	454.2	2,196.0	3,627.2
Operating leases	147.4	193.7	92.1	74.8	508.0
Cash payment to complete pending acquisition (b)	170.0	–	–	–	170.0
Purchase obligations (c)	265.9	122.7	18.6	–	407.2
Site maintenance fees — cell sites (d)	30.1	64.9	71.6	291.7	458.3
Other long–term liabilities (e)	318.1	536.8	219.7	1,213.5	2,288.1
Total contractual obligations and commitments	$1,492.4	$3,614.2	$1,204.1	$6,671.6	$12,982.4

(a) Excludes $(13.1) million of unamortized discounts and the fair value of interest rate swap agreements of $67.1 million included in long–term debt at December 31, 2004.

(b) As previously discussed, on November 26, 2004, ALLTEL and Cingular entered into a definitive agreement to exchange certain wireless assets and partnership interests. To complete this transaction, ALLTEL will pay Cingular $170.0 million in cash. Pursuant to the terms of the definitive merger agreement between ALLTEL and Western Wireless dated January 9, 2005, ALLTEL expects to issue approximately 60 million shares of its common stock and pay approximately $1.0 billion in cash to shareholders of Western Wireless. ALLTEL will also assume debt of approximately $2.2 billion, including $1.2 billion of term notes issued under Western Wireless' credit facility that, as a result of a change in control, will become due immediately upon the closing of the merger. Because these obligations did not exist as of December 31, 2004, the cash payment by ALLTEL to Western Wireless shareholders and the repayment of Western Wireless debt have not been included in the table above.

(c) Purchase obligations represent amounts payable under noncancellable contracts and include commitments for wireless handset purchases, network facilities and transport services, agreements for software licensing and long–term marketing programs.

(d) In connection with the leasing of 1,773 of the Company's cell site towers to American Tower, ALLTEL is obligated to pay American Tower a monthly fee per tower for management and maintenance services for the duration of the fifteen–year lease agreement, which expires in phases during 2016 and 2017.

(e) Other long–term liabilities primarily consist of deferred tax liabilities, minority interests, other postretirement benefit obligations, and deferred compensation. Deferred rental revenue of $375.3 million related to ALLTEL's agreement to lease cell site towers to American Tower was not included in the table above. The deferred rental revenue represents cash proceeds received in advance by ALLTEL under terms of the agreement and will be recognized as revenue ratably over the remaining lease term.

Under the Company's long–term debt borrowing agreements, acceleration of principal payments would occur upon payment default, violation of debt covenants not cured within 30 days or breach of certain other conditions set forth in the borrowing agreements. At December 31, 2004, the Company was in compliance with all of its debt covenants. There are no provisions within the Company's leasing agreements that would trigger acceleration of future lease payments. (See Notes 5, 14, 15 and 18 to the consolidated financial statements for additional information regarding certain of the obligations and commitments listed above.)

Market Risk

The Company is exposed to market risk from changes in marketable equity security prices, interest rates, and foreign exchange rates. The Company has estimated its market risk using sensitivity analysis. For marketable equity securities, market risk is defined as the potential change in fair value attributable to a hypothetical adverse change in market prices. For all other financial instruments, market risk is defined as the potential change in earnings resulting from a hypothetical adverse change in market prices or interest rates. The results of the sensitivity analysis used to estimate market risk are presented below, although the actual results may differ from these estimates.

Equity Price Risk

Changes in equity prices primarily affect the fair value of ALLTEL's investments in marketable equity securities. Fair value for investments was determined using quoted market prices, if available, or the carrying amount of the investment, if no quoted market price was available. At December 31, 2004, investments of the Company were recorded at fair value of $804.9 million, compared to $722.7 million at December 31, 2003. The increase in fair value primarily reflected the value of the Fidelity National common stock acquired by ALLTEL in connection with the April 1, 2003 sale of its financial services division, as previously discussed. Marketable equity securities amounted to $511.8 million at December 31, 2004 and included unrealized holding gains of $153.9 million. Comparatively, investments in marketable equity securities were $395.8 million at December 31, 2003 and included unrealized holding gains of $73.6 million. A hypothetical 10 percent decrease in quoted market prices would result in a $51.2 million decrease in the fair value of the Company's marketable equity securities at December 31, 2004.

Interest Rate Risk

The Company's earnings are affected by changes in variable interest rates related to ALLTEL's issuance of short–term commercial paper and interest rate swap agreements. The Company enters into interest rate swap agreements to obtain a targeted mixture of variable and fixed–interest–rate debt such that the portion of debt subject to variable rates does not exceed 30 percent of ALLTEL's total debt outstanding. The Company has established policies and procedures for risk assessment and the approval, reporting, and monitoring of interest rate swap activity. ALLTEL does not enter into interest rate swap agreements, or other derivative financial instruments, for trading or speculative purposes. Management periodically reviews ALLTEL's exposure to interest rate fluctuations and implements strategies to manage the exposure.

As of December 31, 2004 and 2003, the Company had no borrowings outstanding under its commercial paper program, compared to $25.0 million of outstanding commercial paper at December 31, 2002. As of December 31, 2004, 2003 and 2002, the Company has entered into six, pay variable/receive fixed, interest rate swap agreements on notional amounts totaling $1.0 billion to convert fixed–interest–rate payments to variable. The maturities of the six interest rate swaps range from March 1, 2006 to November 1, 2013. The weighted average fixed rate received by ALLTEL on these swaps is 5.5 percent, and the variable rate paid by ALLTEL is the three month LIBOR (London–Interbank Offered Rate). The weighted average variable rate paid by ALLTEL was 2.1 percent and 1.2 percent at December 31, 2004 and 2003, respectively. A hypothetical increase of 100 basis points in variable interest rates would have reduced annual pre–tax earnings in both 2004 and 2003 by approximately $10.0 million. Conversely, a hypothetical decrease of 100 basis points in variable interest rates would have increased annual pre–tax earnings in both 2004 and 2003 by approximately $10.0 million.

Foreign Exchange Risk

The Company's business operations in foreign countries are not material to the Company's consolidated operations, financial condition and liquidity. Foreign currency translation gains and losses were not material to the Company's consolidated results of operations for the years ended December 31, 2004, 2003 and 2002. Additionally, the Company is not currently subject to material foreign currency exchange rate risk from the effects that exchange rate movements of foreign currency would have on the Company's future costs or on future cash flows it would receive from its foreign subsidiaries. The Company has not entered into any significant foreign currency forward exchange contracts or other derivative financial instruments to hedge the effects of adverse fluctuations in foreign currency exchange rates.

Critical Accounting Policies

ALLTEL prepares its consolidated financial statements in accordance with accounting principles generally accepted in the United States. ALLTEL's significant accounting policies are discussed in detail in Note 1 to the consolidated financial statements. Certain of these accounting policies as discussed below require management to make estimates and assumptions about future events that could materially affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities. These critical accounting polices include the following:

Service revenues for the Company's communications business are recognized based upon minutes of use processed and contracted fees, net of any credits and adjustments. Due to varying customer billing cycle cut–off times, the Company must estimate service revenues earned but not yet billed at the end of each reporting period. These estimates are based

on historical minutes of use processed. Changes in estimates for revenues are recognized in the period in which they are determinable, and such changes could occur and have a material effect on the Company's consolidated operating results in the period of change.

In evaluating the collectibility of its trade receivables, ALLTEL assesses a number of factors including a specific customer's ability to meet its financial obligations to the Company, as well as general factors, such as the length of time the receivables are past due and historical collection experience. Based on these assessments, the Company records an allowance for doubtful accounts to reduce the related receivables to the amount the Company ultimately expects to collect from customers. If circumstances related to specific customers change or economic conditions worsen such that the Company's past collection experience is no longer relevant, ALLTEL's estimate of the recoverability of its trade receivables could be further reduced from the levels provided for in the consolidated financial statements. At December 31, 2004, the Company's allowance for doubtful accounts was $53.6 million. A 10 percent increase in this reserve would have increased the provision for doubtful accounts by $5.4 million for the year ended December 31, 2004.

The calculation of the annual costs of providing pension and postretirement benefits are based on certain key actuarial assumptions as disclosed in Note 8 to the consolidated financial statements. As previously discussed, the discount rate selected is based on a review of current market interest rates on high–quality, fixed–rate debt securities adjusted to reflect the Company's longer duration of expected future cash outflows for benefit payments. The expected return on plan assets reflects management's view of the long–term returns available in the investment market based on historical averages and consultation with investment advisors. The healthcare cost trend rate is based on the Company's actual medical claims experience and future projections of medical costs. See "Pension Plans" and "Other Postretirement Benefits" for the effects on the Company's future benefit costs resulting from changes in these key assumptions.

The calculation of depreciation and amortization expense is based on the estimated economic useful lives of the underlying property, plant and equipment and finite–lived intangible assets. Although ALLTEL believes it is unlikely that any significant changes to the useful lives of its tangible or finite–lived intangible assets will occur in the near term, rapid changes in technology or changes in market conditions could result in revisions to such estimates that could materially affect the carrying value of these assets and the Company's future consolidated operating results. Specifically, the previously discussed effects on customer churn rates due to competition and the FCC's number portability rules could adversely affect the useful lives of customer lists, resulting in a material increase in annual amortization expense or a write–down in the carrying value of these assets. An extension of the average useful life of the Company's property, plant and equipment and finite–lived intangible assets of one year would decrease depreciation and amortization expense by approximately $120.0 million per year, while a reduction in the average useful life of one year would increase depreciation and amortization expense by approximately $168.3 million per year.

In accordance with SFAS No. 142, ALLTEL tests its goodwill and other indefinite–lived intangible assets for impairment at least annually, which requires the Company to determine the fair value of these intangible assets, as well as the fair value of its reporting units. For purposes of testing goodwill, fair value of the reporting units is determined utilizing a combination of the discounted cash flows of the reporting units and calculated market values of comparable public companies. Fair value of the other indefinite–lived intangible assets is determined based on the discounted cash flows of the related business segment. During 2004 and 2003, no write–downs in the carrying values of either goodwill or indefinite–lived intangible assets were required based on their calculated fair values. In addition, reducing the calculated fair values of goodwill and the other indefinite–lived intangible assets by 10 percent would not have resulted in an impairment of the carrying value of the related assets in either 2004 or 2003. Changes in the key assumptions used in the discounted cash flow analysis due to changes in market conditions could adversely affect the calculated fair values of goodwill and other indefinite–lived intangible assets, materially affecting the carrying value of these assets and the Company's future consolidated operating results.

The Company's estimates of income taxes and the significant items resulting in the recognition of deferred tax assets and liabilities are disclosed in Note 11 to the consolidated financial statements and reflect ALLTEL's assessment of future tax consequences of transactions that have been reflected in the Company's financial statements or tax returns for each taxing authority in which it operates. Actual income taxes to be paid could vary from these estimates due to future changes in income tax law or the outcome of audits completed by federal, state and foreign taxing authorities. Included in the calculation of the Company's annual income tax expense are the effects of changes, if any, to ALLTEL's income tax contingency reserves. ALLTEL maintains income tax contingency reserves for potential assessments from the IRS or other taxing authorities. The reserves are determined based upon the Company's judgment of the probable outcome of the tax contingencies and are adjusted, from time to time, based upon changing facts and circumstances. Changes to the tax contingency reserves could materially affect the Company's future consolidated operating results in the period of change.

Legal Proceedings

ALLTEL is party to various legal proceedings arising in the ordinary course of business. Although the ultimate resolution of these various proceedings cannot be determined at this time, management of the Company does not believe that such proceedings, individually or in the aggregate, will have a material adverse effect on the future results of operations or financial condition of ALLTEL. In addition, management of the Company is currently not aware of any environmental matters that, individually or in the aggregate, would have a material adverse effect on the consolidated financial condition or results of operations of the Company.

Recently Issued Accounting Pronouncements

On December 16, 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 123(R), "Share–Based Payment", which is a revision of SFAS No. 123 and supersedes APB Opinion No. 25. SFAS No. 123(R) requires all share–based payments to employees, including grants of employee stock options, to be valued at fair value on the date of grant, and to be expensed over the applicable vesting period. Pro forma disclosure of the income statement effects of share–based payments is no longer an alternative. SFAS No. 123(R) is effective for all stock–based awards granted on or after July 1, 2005. In addition, companies must also recognize compensation expense related to any awards that are not fully vested as of the effective date. Compensation expense for the unvested awards will be measured based on the fair value of the awards previously calculated in developing the pro forma disclosures in accordance with the provisions of SFAS No. 123. ALLTEL is currently assessing the impact of adopting SFAS 123(R) to its consolidated results of operations.

Forward–Looking Statements

This Management's Discussion and Analysis of Financial Condition and Results of Operations includes, and future filings by the Company on Form 10–K, Form 10–Q and Form 8–K and future oral and written statements by ALLTEL and its management may include, certain "forward–looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward–looking statements are subject to uncertainties that could cause actual future events and results to differ materially from those expressed in the forward–looking statements. These forward–looking statements are based on estimates, projections, beliefs and assumptions and are not guarantees of future events and results. Words such as "expects", "anticipates", "intends", "plans", "believes", "seeks", "estimates", and "should", and variations of these words and similar expressions, are intended to identify these forward–looking statements. Examples of such forward–looking statements include statements regarding ALLTEL's future cash dividend policy, forecasts of segment capital requirements for 2005, and future contractual obligation and commitment payments. ALLTEL disclaims any obligation to update or revise any forward–looking statement based on the occurrence of future events, the receipt of new information, or otherwise.

Actual future events and results may differ materially from those expressed in these forward–looking statements as a result of a number of important factors. Representative examples of these factors include (without limitation) adverse changes in economic conditions in the markets served by ALLTEL; the extent, timing, and overall effects of competition in the communications business; material changes in the communications industry generally that could adversely affect vendor relationships with equipment and network suppliers and wholesale customers; changes in communications technology; the risks associated with the integration of acquired businesses; adverse changes in the terms and conditions of the company's wireless roaming agreements; the potential for adverse changes in the ratings given to ALLTEL's debt securities by nationally accredited ratings organizations; the availability and cost of financing in the corporate debt markets; the uncertainties related to ALLTEL's strategic investments; the effects of work stoppages; the effects of litigation; and the effects of federal and state legislation, rules, and regulations governing the communications industry.

In addition to these factors, actual future performance, outcomes and results may differ materially because of other, more general, factors including (without limitation) general industry and market conditions and growth rates, economic conditions, and governmental and public policy changes.

SELECTED FINANCIAL DATA

The following table presents certain selected consolidated financial data as of and for the years ended December 31:

(Millions, except per share amounts)	2004	2003	2002	2001	2000	1999
Revenues and sales	$ 8,246.1	$ 7,979.9	$ 7,112.4	$ 6,615.8	$ 6,308.9	$ 5,634.9
Operating expenses	6,273.6	6,062.9	5,322.8	4,990.8	4,757.4	4,157.8
Restructuring and other charges	50.9	19.0	69.9	76.3	15.3	88.2
Total costs and expenses	6,324.5	6,081.9	5,392.7	5,067.1	4,772.7	4,246.0
Operating income	1,921.6	1,898.0	1,719.7	1,548.7	1,536.2	1,388.9
Non-operating income (expense), net	22.9	(3.2)	(5.3)	(14.1)	27.6	(4.1)
Interest expense	(352.5)	(378.6)	(355.1)	(261.2)	(284.3)	(240.7)
Gain on disposal of assets, write-down of investments and other	–	17.9	1.0	357.6	1,928.5	43.1
Income from continuing operations before income taxes	1,592.0	1,534.1	1,360.3	1,631.0	3,208.0	1,187.2
Income taxes	565.3	580.6	510.2	653.0	1,325.3	487.5
Income from continuing operations	1,026.7	953.5	850.1	978.0	1,882.7	699.7
Discontinued operations, net of tax	19.5	361.0	74.2	69.5	82.7	83.9
Income before cumulative effect of accounting change	1,046.2	1,314.5	924.3	1,047.5	1,965.4	783.6
Cumulative effect of accounting change, net of tax	–	15.6	–	19.5	(36.6)	–
Net income	1,046.2	1,330.1	924.3	1,067.0	1,928.8	783.6
Preferred dividends	0.1	0.1	0.1	0.1	0.1	0.9
Net income applicable to common shares	$ 1,046.1	$ 1,330.0	$ 924.2	$ 1,066.9	$ 1,928.7	$ 782.7
Basic earnings per share:						
Income from continuing operations	$ 3.34	$ 3.06	$ 2.73	$ 3.14	$ 5.99	$ 2.23
Income from discontinued operations	.06	1.16	.24	.22	.26	.27
Cumulative effect of accounting change	–	.05	–	.06	(.12)	–
Net income	$ 3.40	$ 4.27	$ 2.97	$ 3.42	$ 6.13	$ 2.50
Diluted earnings per share:						
Income from continuing operations	$ 3.33	$ 3.05	$ 2.72	$ 3.12	$ 5.94	$ 2.21
Income from discontinued operations	.06	1.15	.24	.22	.26	.26
Cumulative effect of accounting change	–	.05	–	.06	(.12)	–
Net income	$ 3.39	$ 4.25	$ 2.96	$ 3.40	$ 6.08	$ 2.47
Dividends per common share	$ 1.49	$ 1.42	$ 1.37	$ 1.33	$ 1.29	$ 1.235
Weighted average common shares:						
Basic	307.3	311.8	311.0	311.4	314.4	312.8
Diluted	308.4	312.8	312.3	313.5	317.2	316.8
Pro forma amounts assuming accounting changes applied retroactively:						
Net income	$ 1,046.2	$ 1,314.5	$ 925.5	$ 1,047.9	$ 1,970.5	$ 768.3
Basic earnings per share	$3.40	$4.22	$2.98	$3.36	$6.27	$2.45
Diluted earnings per share	$3.39	$4.20	$2.96	$3.34	$6.21	$2.42
Total assets	$16,603.7	$16,661.1	$16,244.6	$12,500.7	$12,087.2	$10,774.2
Total shareholders' equity	$ 7,128.7	$ 7,022.2	$ 5,998.1	$ 5,565.8	$ 5,095.4	$ 4,205.7
Total redeemable preferred stock and long-term debt (including current maturities)	$ 5,578.3	$ 5,859.4	$ 6,641.1	$ 3,913.0	$ 4,673.3	$ 3,820.9

Notes to Selected Financial Information:

See Note 12 to the consolidated financial statements for a discussion of the Company's discontinued information services operations.

A. Net income for 2004 included pretax charges of $28.4 million related to a planned workforce reduction and the exit of its competitive local exchange carrier operations in the Jacksonville, Florida market. In addition, ALLTEL recorded a $2.3 million reduction in the liabilities associated with various restructuring activities initiated prior to 2003. ALLTEL also recorded a write-down in the carrying value of certain corporate and regional facilities to fair value in conjunction with the proposed leasing or sale of those facilities of $24.8 million. These transactions decreased net income $31.1 million or $.10 per share. (See Note 9 to the consolidated financial statements.) Net income for 2004 also reflected a reduction in income tax expense associated with continuing operations of $19.7 million, or $.06 per share, resulting from ALLTEL's adjustment of its income tax contingency reserves to reflect the results of audits of the Company's consolidated federal income tax returns for the fiscal years 1997 through 2001. (See Note 2 to the consolidated financial statements.)

B. Net income for 2003 included pretax charges of $8.5 million primarily related to the closing of certain call center locations and the write–off of $13.2 million of certain capitalized software development costs with no alternative future use or functionality. The Company also recorded a $2.7 million reduction in the liabilities associated with various restructuring activities initiated prior to 2003 to reflect differences between estimated and actual costs paid in completing the previous planned restructuring activities.

Notes to Selected Financial Information, Continued:

These transactions decreased net income $11.5 million or $.04 per share. (See Note 9 to the consolidated financial statements.) Net income for 2003 also included a pretax gain of $31.0 million realized from the sale of certain assets of the telecommunications information services operations, partially offset by pretax write-downs totaling $6.0 million to reflect other-than-temporary declines in the fair value of certain investments in unconsolidated limited partnerships. In addition, the Company incurred pretax termination fees of $7.1 million related to the early retirement of long-term debt. These transactions increased net income $10.7 million or $.04 per share. (See Note 10 to the consolidated financial statements.) Effective January 1, 2003, ALLTEL adopted SFAS No. 143 in accounting for asset retirement obligations. The cumulative effect of this accounting change resulted in a one-time non-cash credit of $15.6 million, net of income tax expense of $10.3 million, or $.05 per share. (See Note 2 to the consolidated financial statements.)

C. Net income for 2002 included pretax charges of $34.0 million incurred in connection with restructuring ALLTEL's competitive local exchange carrier, call center and retail store operations and with the closing of seven product distribution centers. The Company also incurred integration expenses of $28.8 million related to its acquisitions of wireline properties from Verizon Communications, Inc. and wireless properties from CenturyTel, Inc. ALLTEL also recorded write-downs in the carrying value of certain cell site equipment of $7.1 million. These charges decreased net income $42.3 million or $.14 per share. (See Note 9 to the consolidated financial statements.) Net income for 2002 included a pretax gain of $22.1 million realized from the sale of a wireless property, partially offset by pretax write-downs of $16.3 million related to investments in marketable securities. ALLTEL also recorded a pretax adjustment of $4.8 million to reduce the gain recognized from the dissolution of a wireless partnership that was initially recorded in 2001. These transactions increased net income $0.6 million or less than $.01 per share. (See Note 10 to the consolidated financial statements.)

Effective January 1, 2002, the Company changed its accounting for goodwill and other indefinite-lived intangible assets from an amortization method to an impairment-only approach in accordance with SFAS No. 142. Accordingly, the Company ceased amortization of goodwill and indefinite-lived intangible assets as of January 1, 2002. The adjusted after-tax income from continuing operations, income before cumulative effect of accounting change, net income and the related earnings per share effects, assuming that the change in accounting to eliminate the amortization of goodwill and other indefinite-lived intangible assets was applied retroactively were as follows for the years ended December 31:

(Millions, except per share amounts)	2001	2000	1999
Income from continuing operations	$1,068.9	$1,972.7	$751.9
Basic earnings per share	$3.43	$6.27	$2.40
Diluted earnings per share	$3.41	$6.22	$2.37
Income before cumulative effect of accounting change	$1,140.6	$2,057.0	$836.9
Basic earnings per share	$3.66	$6.55	$2.67
Diluted earnings per share	$3.64	$6.49	$2.64
Net income	$1,160.1	$2,020.4	$836.9
Basic earnings per share	$3.72	$6.43	$2.67
Diluted earnings per share	$3.70	$6.37	$2.64

D. Net income for 2001 included pretax gains of $347.8 million from the sale of PCS licenses, a pretax gain of $9.5 million from the dissolution of a wireless partnership and a pretax gain of $3.2 million from the sale of certain investments. Net income also included pretax termination fees of $2.9 million incurred due to the early retirement of debt. These transactions increased net income $212.7 million or $.68 per share. Net income also included pretax charges of $61.2 million incurred in connection with the restructuring of the Company's regional communications, product distribution and corporate operations. The Company also recorded write-downs in the carrying value of certain cell site equipment totaling $15.1 million. These charges decreased net income $45.3 million or $.14 per share. Effective January 1, 2001, the Company changed its method of accounting for a subsidiary's pension plan to conform to the Company's primary pension plan. The cumulative effect of this accounting change resulted in a non-cash credit of $19.5 million, net of income tax expense of $13.0 million, or $.06 per share.

E. Net income for 2000 included pretax gains of $1,345.5 million from the exchange of wireless properties with Bell Atlantic Corporation and GTE Corporation, pretax gains of $36.0 million from the sale of certain PCS assets and pretax gains of $562.0 million from the sale of investments, principally consisting of WorldCom, Inc. ("WorldCom") common stock. Net income also included a pretax write-down of $15.0 million in the Company's investment in an Internet access service provider. These transactions increased net income $1,124.3 million or $3.58 per share. Net income also included integration costs and other charges of $15.3 million primarily incurred in connection with the acquisition of wireless assets. The Company also incurred a pretax charge of $11.5 million in connection with a litigation settlement. These charges decreased net income $16.1 million or $.05 per share. Effective January 1, 2000, the Company changed its method of recognizing wireless access revenues and certain customer activation fees. The cumulative effect of this accounting change resulted in a non-cash charge of $36.6 million, net of income tax benefit of $23.3 million or $.12 per share.

F. Net income for 1999 included a pretax gain of $43.1 million from the sale of WorldCom common stock. The gain increased net income by $27.2 million or $.08 per share. Net income also included a pretax charge of $88.2 million in connection with the closing of the Company's mergers with Aliant Communications Inc., Liberty Cellular, Inc. and its affiliate KINI L.C. and with certain loss contingencies and other restructuring activities. These charges decreased net income $63.8 million or $.20 per share.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

ALLTEL Corporation's management is responsible for the integrity and objectivity of all financial information included in this Financial Supplement. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The financial statements include amounts that are based on the best estimates and judgments of management. All financial information in this Financial Supplement is consistent with that in the consolidated financial statements.

PricewaterhouseCoopers LLP, an independent registered public accounting firm, has audited these consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States) and have expressed herein their unqualified opinion on those financial statements.

The Audit Committee of the Board of Directors, which oversees ALLTEL's financial reporting process on behalf of the Board of Directors, is composed entirely of independent directors (as defined by the New York Stock Exchange). The Audit Committee meets periodically with management, the independent accountants, and the internal auditors to review matters relating to the Company's financial statements and financial reporting process, annual financial statement audit, engagement of independent accountants, internal audit function, system of internal controls, and legal compliance and ethics programs as established by ALLTEL management and the Board of Directors. The internal auditors and the independent accountants periodically meet alone with the Audit Committee and have access to the Audit Committee at any time.

Dated February 10, 2005

Scott T. Ford
President and
Chief Executive Officer

Jeffery R. Gardner
Executive Vice President–
Chief Financial Officer

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal control over financial reporting, and for performing an assessment of the effectiveness of internal control over financial reporting as of December 31, 2004. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company's system of internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Management performed an assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2004 based upon criteria in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on our assessment, management determined that the Company's internal control over financial reporting was effective as of December 31, 2004 based on the criteria in Internal Control–Integrated Framework issued by COSO.

Our management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2004 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

Dated February 10, 2005

Scott T. Ford President and Chief Executive Officer	Jeffery R. Gardner Executive Vice President– Chief Financial Officer

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of ALLTEL Corporation:

We have completed an integrated audit of ALLTEL Corporation's 2004 consolidated financial statements and of its internal control over financial reporting as of December 31, 2004 and audits of its 2003 and 2002 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, cash flows and shareholders' equity present fairly, in all material respects, the financial position of ALLTEL Corporation and its subsidiaries (the "Company") at December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 2 to the financial statements, the Company changed its method of accounting for asset retirement obligations as a result of adopting Statement of Financial Accounting Standards No. 143 ("SFAS No. 143"), "Accounting for Asset Retirement Obligations" as of January 1, 2003.

Internal control over financial reporting

Also, in our opinion, management's assessment, included in Management's Report on Internal Control Over Financial Reporting, that the Company maintained effective internal control over financial reporting as of December 31, 2004 based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on criteria established in *Internal Control – Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP
Little Rock, AR
February 10, 2005

CONSOLIDATED STATEMENTS OF INCOME
For the years ended December 31,

(Millions, except per share amounts)	2004	2003	2002
Revenues and sales:			
Service revenues	$7,374.3	$7,156.1	$6,428.9
Product sales	871.8	823.8	683.5
Total revenues and sales	8,246.1	7,979.9	7,112.4
Costs and expenses:			
Cost of services (excluding depreciation of $958.4, $906.3 and $791.7 in 2004, 2003 and 2002, respectively included below)	2,374.2	2,273.6	2,039.0
Cost of products sold	1,075.5	1,043.5	891.3
Selling, general, administrative and other	1,524.2	1,498.1	1,297.0
Depreciation and amortization	1,299.7	1,247.7	1,095.5
Restructuring and other charges	50.9	19.0	69.9
Total costs and expenses	6,324.5	6,081.9	5,392.7
Operating income	1,921.6	1,898.0	1,719.7
Equity earnings in unconsolidated partnerships	68.5	64.4	65.8
Minority interest in consolidated partnerships	(80.1)	(78.6)	(73.4)
Other income, net	34.5	11.0	2.3
Interest expense	(352.5)	(378.6)	(355.1)
Gain on disposal of assets, write–down of investments and other	–	17.9	1.0
Income from continuing operations before income taxes	1,592.0	1,534.1	1,360.3
Income taxes	565.3	580.6	510.2
Income from continuing operations	1,026.7	953.5	850.1
Discontinued operations			
Income tax benefit of $19.5 in 2004, net of income taxes of $256.2 and $31.0 in 2003 and 2002, respectively	19.5	361.0	74.2
Income before cumulative effect of accounting change	1,046.2	1,314.5	924.3
Cumulative effect of accounting change (net of income taxes of $10.3 in 2003)	–	15.6	–
Net income	1,046.2	1,330.1	924.3
Preferred dividends	0.1	0.1	0.1
Net income applicable to common shares	$1,046.1	$1,330.0	$ 924.2
Earnings per share:			
Basic:			
Income from continuing operations	$3.34	$3.06	$2.73
Income from discontinued operations	.06	1.16	.24
Cumulative effect of accounting change	–	.05	–
Net income	$3.40	$4.27	$2.97
Diluted:			
Income from continuing operations	$3.33	$3.05	$2.72
Income from discontinued operations	.06	1.15	.24
Cumulative effect of accounting change	–	.05	–
Net income	$3.39	$4.25	$2.96
Pro forma amounts assuming changes in accounting principles were applied retroactively:			
Net income as reported:	$1,046.2	$1,330.1	$ 924.3
Effect of change in recognition of asset retirement obligations	–	(15.6)	1.2
Net income as adjusted	$1,046.2	$1,314.5	$ 925.5
Earnings per share as adjusted:			
Basic	$3.40	$4.22	$2.98
Diluted	$3.39	$4.20	$2.96

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED BALANCE SHEETS
December 31,
(Dollars in millions, except per share amounts)

Assets	2004	2003
Current Assets:		
Cash and short-term investments	$ 484.9	$ 657.8
Accounts receivable (less allowance for doubtful accounts of $53.6 and $46.3, respectively)	912.7	890.0
Inventories	156.8	122.1
Prepaid expenses and other	62.4	59.2
Total current assets	1,616.8	1,729.1
Investments	804.9	722.7
Goodwill	4,875.7	4,854.2
Other intangibles	1,306.1	1,337.0
Property, Plant and Equipment:		
Land	278.1	259.2
Buildings and improvements	1,134.8	1,053.0
Wireline	6,735.8	6,514.7
Wireless	5,764.0	5,255.8
Information processing	1,048.4	946.7
Other	489.9	482.3
Under construction	385.3	398.2
Total property, plant and equipment	15,836.3	14,909.9
Less accumulated depreciation	8,288.2	7,289.1
Net property, plant and equipment	7,548.1	7,620.8
Other assets	452.1	397.3
Total Assets	$16,603.7	$16,661.1
Liabilities and Shareholders' Equity		
Current Liabilities:		
Current maturities of long-term debt	$ 225.0	$ 277.2
Accounts payable	448.2	479.8
Advance payments and customer deposits	219.3	205.3
Accrued taxes	158.2	114.6
Accrued dividends	105.9	116.2
Accrued interest	120.2	107.1
Other current liabilities	183.5	192.5
Total current liabilities	1,460.3	1,492.7
Long-term debt	5,352.4	5,581.2
Deferred income taxes	1,715.1	1,417.7
Other liabilities	947.2	1,147.3
Shareholders' Equity:		
Preferred stock, Series C, $2.06, no par value, 12,288 shares in 2004 and 13,928 shares in 2003 issued and outstanding	0.3	0.4
Common stock, par value $1 per share, 1.0 billion shares authorized, 302,267,959 shares in 2004 and 312,643,922 shares in 2003 issued and outstanding	302.3	312.6
Additional paid-in capital	197.9	750.1
Unrealized holding gain on investments	153.9	73.6
Foreign currency translation adjustment	0.5	0.6
Retained earnings	6,473.8	5,884.9
Total shareholders' equity	7,128.7	7,022.2
Total Liabilities and Shareholders' Equity	$16,603.7	$16,661.1

The accompanying notes are an integral part of these consolidated balance sheets.

CONSOLIDATED STATEMENTS OF CASH FLOWS
For the years ended December 31,

(Millions)	2004	2003	2002
Cash Provided from Operations:			
Net income	$ 1,046.2	$ 1,330.1	$ 924.3
Adjustments to reconcile net income to net cash provided from operations:			
Income from discontinued operations	(19.5)	(361.0)	(74.2)
Cumulative effect of accounting change	–	(15.6)	–
Depreciation and amortization	1,299.7	1,247.7	1,095.5
Provision for doubtful accounts	184.9	184.7	265.9
Non–cash portion of restructuring and other charges	25.6	13.2	12.6
Non–cash portion of gain on disposal of assets, write–down of investments and other	–	(25.0)	(1.0)
Increase in deferred income taxes	263.4	225.0	357.5
Reversal of income tax contingency reserves due to IRS audits	(19.7)	–	–
Other, net	(14.4)	(11.4)	(25.6)
Changes in operating assets and liabilities, net of effects of acquisitions and dispositions:			
Accounts receivable	(206.1)	(79.7)	(219.3)
Inventories	(33.9)	17.1	28.5
Accounts payable	(27.2)	21.8	80.1
Other current liabilities	70.6	30.2	(42.8)
Other, net	(102.8)	(102.4)	(9.3)
Net cash provided from operations	2,466.8	2,474.7	2,392.2
Cash Flows from Investing Activities:			
Additions to property, plant and equipment	(1,125.4)	(1,137.7)	(1,154.8)
Additions to capitalized software development costs	(32.3)	(56.7)	(58.4)
Additions to investments	(3.2)	(13.5)	(9.4)
Purchases of property, net of cash acquired	(185.1)	(160.6)	(3,365.5)
Proceeds from the lease of cell site towers	–	–	7.5
Proceeds from the sale of assets	–	46.1	24.1
Proceeds from the return on investments	88.6	48.3	51.9
Other, net	(1.0)	8.2	10.0
Net cash used in investing activities	(1,258.4)	(1,265.9)	(4,494.6)
Cash Flows from Financing Activities:			
Dividends on common and preferred stock	(467.6)	(436.4)	(423.1)
Reductions in long–term debt	(277.3)	(763.4)	(265.8)
Repurchases of common stock	(595.3)	–	–
Distributions to minority investors	(66.9)	(67.5)	(57.9)
Long–term debt issued, net of issuance costs	–	–	2,809.1
Common stock issued	25.9	49.1	17.2
Net cash provided from (used in) financing activities	(1,381.2)	(1,218.2)	2,079.5
Net cash provided from discontinued operations	–	531.8	91.3
Effect of exchange rate changes on cash and short–term investments	(0.1)	0.8	3.0
Increase (decrease) in cash and short–term investments	(172.9)	523.2	71.4
Cash and Short–term Investments:			
Beginning of the year	657.8	134.6	63.2
End of the year	$ 484.9	$ 657.8	$ 134.6
Supplemental Cash Flow Disclosures:			
Interest paid, net of amounts capitalized	$ 379.1	$ 425.7	$ 294.2
Income taxes paid	$ 285.9	$ 584.8	$ 268.2
Non–Cash Investing and Financing Activity:			
Change in fair value of investments in equity securities	$ 116.9	$ 120.5	$ (6.2)
Change in fair value of interest rate swap agreements	$ (12.6)	$ (25.5)	$ 99.2

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(Millions)

	Preferred Stock	Common Stock	Additional Paid–In Capital	Unrealized Holding Gain (Loss) On Investments	Foreign Currency Translation Adjustment	Retained Earnings	Total
Balance at December 31, 2001	$ 0.4	$310.5	$ 769.2	$ (4.5)	$ (9.9)	$4,500.1	$5,565.8
Net income	–	–	–	–	–	924.3	924.3
Other comprehensive income, net of tax: (See Note 13)							
Unrealized holding gains on investments, net of reclassification adjustments	–	–	–	4.5	–	–	4.5
Foreign currency translation adjustment	–	–	–	–	3.0	–	3.0
Comprehensive income	–	–	–	4.5	3.0	924.3	931.8
Employee plans, net	–	0.6	16.7	–	–	–	17.3
Tax benefit for non–qualified stock options	–	–	2.7	–	–	–	2.7
Conversion of preferred stock	–	0.1	0.2	–	–	–	0.3
Present value of contract adjustment liability	–	–	(93.1)	–	–	–	(93.1)
Dividends:							
Common – $1.37 per share	–	–	–	–	–	(426.6)	(426.6)
Preferred	–	–	–	–	–	(0.1)	(0.1)
Balance at December 31, 2002	$ 0.4	$311.2	$ 695.7	$ –	$ (6.9)	$4,997.7	$5,998.1
Net income	–	–	–	–	–	1,330.1	1,330.1
Other comprehensive income, net of tax: (See Note 13)							
Unrealized holding gains on investments, net of reclassification adjustments	–	–	–	73.6	–	–	73.6
Foreign currency translation adjustment, net of reclassification adjustments	–	–	–	–	7.5	–	7.5
Comprehensive income	–	–	–	73.6	7.5	1,330.1	1,411.2
Employee plans, net	–	1.4	47.7	–	–	–	49.1
Tax benefit for non–qualified stock options	–	–	6.7	–	–	–	6.7
Dividends:							
Common – $1.42 per share	–	–	–	–	–	(442.8)	(442.8)
Preferred	–	–	–	–	–	(0.1)	(0.1)
Balance at December 31, 2003	$ 0.4	$312.6	$ 750.1	$ 73.6	$ 0.6	$5,884.9	$7,022.2
Net income	–	–	–	–	–	1,046.2	1,046.2
Other comprehensive income, net of tax: (See Note 13)							
Unrealized holding gains on investments, net of reclassification adjustments	–	–	–	80.3	–	–	80.3
Foreign currency translation adjustment	–	–	–	–	(0.1)	–	(0.1)
Comprehensive income	–	–	–	80.3	(0.1)	1,046.2	1,126.4
Employee plans, net	–	0.6	25.2	–	–	–	25.8
Restricted stock, net of unearned compensation	–	0.2	2.8	–	–	–	3.0
Tax benefit for non–qualified stock options	–	–	3.9	–	–	–	3.9
Conversion of preferred stock	(0.1)	0.1	–	–	–	–	–
Repurchases of stock	–	(11.2)	(584.1)	–	–	–	(595.3)
Dividends:							
Common – $1.49 per share	–	–	–	–	–	(457.2)	(457.2)
Preferred	–	–	–	–	–	(0.1)	(0.1)
Balance at December 31, 2004	$ 0.3	$302.3	$ 197.9	$ 153.9	$ 0.5	$6,473.8	$7,128.7

The accompanying notes are an integral part of these consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies:

Description of Business – ALLTEL Corporation ("ALLTEL" or the "Company"), a Delaware corporation, is a customer–focused communications company. ALLTEL owns subsidiaries that provide wireless and wireline local, long–distance, network access, and Internet services. Telecommunications products are warehoused and sold by the Company's distribution subsidiary. A subsidiary also publishes telephone directories for affiliates and other independent telephone companies. In addition, a subsidiary provides billing, customer care and other data processing and outsourcing services to telecommunications companies. (See Note 16 for additional information regarding ALLTEL's business segments.)

Basis of Presentation – ALLTEL prepares its consolidated financial statements in accordance with accounting principles generally accepted in the United States, which require management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities. The estimates and assumptions used in the accompanying consolidated financial statements are based upon management's evaluation of the relevant facts and circumstances as of the date of the financial statements. Actual results may differ from the estimates and assumptions used in preparing the accompanying consolidated financial statements, and such differences could be material. The consolidated financial statements include the accounts of ALLTEL, its subsidiary companies, majority–owned partnerships and controlled business ventures. Investments in 20 percent to 50 percent owned entities and all unconsolidated partnerships are accounted for using the equity method. Investments in less than 20 percent owned entities and in which the Company does not exercise significant influence over operating and financial policies are accounted for under the cost method. All intercompany transactions, except those with certain affiliates described below, have been eliminated in the consolidated financial statements. Certain prior year amounts have been reclassified to conform with the 2004 financial statement presentation.

Service revenues consist of wireless access and network usage revenues, local service, network access, Internet access, long–distance and miscellaneous wireline operating revenues and telecommunications information services processing revenues. Product sales primarily consist of the product distribution and directory publishing operations and sales of communications equipment. Cost of services include the costs related to completing calls over the Company's telecommunications network, including access, interconnection, toll and roaming charges paid to other wireless providers, as well as the costs to operate and maintain the network. Additionally, cost of services includes the costs to provide telecommunications information services, bad debt expense and business taxes.

Regulatory Accounting – The Company's wireline subsidiaries, except for certain operations acquired in Kentucky in 2002 and Nebraska in 1999, 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 wireline subsidiaries to depreciate wireline plant over the useful lives approved by regulators, which could be different than the useful lives that would otherwise be determined by management. SFAS No. 71 also requires deferral of certain costs and obligations based upon approvals received from regulators to permit recovery of such amounts in future years. Criteria that would give rise to the discontinuance of SFAS No. 71 include (1) increasing competition restricting the wireline subsidiaries' ability to establish prices to recover specific costs and (2) significant changes in the manner in which rates are set by regulators from cost–based regulation to another form of regulation. The Company reviews these criteria on a quarterly basis to determine whether the continuing application of SFAS No. 71 is appropriate.

Transactions with Certain Affiliates – ALLTEL Communications Products, Inc. sells equipment to wireline subsidiaries of the Company ($85.9 million in 2004, $123.7 million in 2003 and $152.9 million in 2002) as well as to other affiliated and non–affiliated communications companies and other companies in related industries. The cost of equipment sold to the wireline subsidiaries is included, principally, in wireline plant in the consolidated financial statements. ALLTEL Publishing Corporation ("ALLTEL Publishing") provides directory publishing services to the wireline subsidiaries. Wireline revenues and sales include directory royalties received from ALLTEL Publishing ($40.1 million in 2004, $42.9 million in 2003 and $52.4 million in 2002) and amounts billed to other affiliates ($96.2 million in 2004, $92.7 million in 2003 and $87.3 million in 2002) for interconnection and toll services. These intercompany transactions have not been eliminated because the revenues received from the affiliates and the prices charged by the communications products and directory publishing subsidiaries are included in the wireline subsidiaries' (excluding the acquired operations in Kentucky and Nebraska) rate base and/or are recovered through the regulatory process.

Advertising – Advertising costs are expensed as incurred. Advertising expense totaled $202.5 million in 2004, $200.3 million in 2003 and $148.0 million in 2002.

1. Summary of Significant Accounting Policies, Continued:

Cash and Short-term Investments – Cash and short-term investments consist of highly liquid investments with original maturities of three months or less.

Accounts Receivable – Accounts receivable consist principally of trade receivables from customers and are generally unsecured and due within 30 days. Expected credit losses related to trade accounts receivable are recorded as an allowance for doubtful accounts in the consolidated balance sheets. In establishing the allowance for doubtful accounts, ALLTEL considers a number of factors, including historical collection experience, aging of the accounts receivable balances, current economic conditions, and a specific customer's ability to meet its financial obligations to the Company. When internal collection efforts on accounts have been exhausted, the accounts are written off by reducing the allowance for doubtful accounts.

Inventories – Inventories are stated at the lower of cost or market value. Cost is determined using either an average original cost or specific identification method of valuation. For wireless equipment, market is determined using replacement cost.

Goodwill and Other Intangible Assets – Goodwill represents the excess of cost over the fair value of net identifiable tangible and intangible assets acquired through various business combinations. The Company has acquired identifiable intangible assets through its acquisitions of interests in various wireless and wireline properties. The cost of acquired entities at the date of the acquisition is allocated to identifiable assets, and the excess of the total purchase price over the amounts assigned to identifiable assets is recorded as goodwill. In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets", goodwill is to be assigned to a company's reporting units and tested for impairment annually using a consistent measurement date, which for the Company is January 1st of each year. The impairment test for goodwill requires a two-step approach, which is performed at a reporting unit level. Step one of the test identifies potential impairments by comparing the fair value of a reporting unit to its carrying amount. Step two, which is only performed if the fair value of a reporting unit is less than its carrying value, calculates the impairment loss as the difference between the carrying amount of the reporting unit's goodwill and the implied fair value of that goodwill. ALLTEL completed step one of the annual impairment reviews of goodwill for both 2004 and 2003 and determined that no write-down in the carrying value of goodwill for any of its reporting units was required. For purposes of completing the annual impairment reviews, fair value of the reporting units was determined utilizing a combination of the discounted cash flows of the reporting units and calculated market values of comparable public companies.

The Company's indefinite-lived intangible assets consist of its cellular and Personal Communications Services ("PCS") licenses (the "wireless licenses") and the wireline franchise rights in Kentucky acquired in August 2002. (See Note 3). The Company determined that the wireless licenses and wireline franchise rights met the indefinite life criteria outlined in SFAS No. 142, because the Company expects both the renewal by the granting authorities and the cash flows generated from these intangible assets to continue indefinitely. The Company's intangible assets with finite lives are amortized over their estimated useful lives, which are 4 to 10 years for customer lists and 15 years for franchise rights. SFAS No. 142 also requires intangible assets with indefinite lives to be tested for impairment on an annual basis, by comparing the fair value of the assets to their carrying amounts. The wireless licenses are operated as a single asset supporting the Company's wireless business, and accordingly are aggregated for purposes of testing impairment. For purposes of completing the annual impairment reviews, the fair value of the wireless licenses was determined based on the discounted cash flows of the wireless business segment, while the fair value of the wireline franchise rights was determined based on the discounted cash flows of the acquired operations in Kentucky. Upon completing the annual impairment reviews of its wireless licenses and wireline franchise rights for both 2004 and 2003, the Company determined that no write-down in the carrying value of these assets was required.

Investments – Investments in unconsolidated partnerships are accounted for using the equity method. Investments in equity securities are classified as available for sale and are recorded at fair value in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities". All other investments are accounted for using the cost method. Investments are periodically reviewed for impairment. If the carrying value of the investment exceeds its fair value and the decline in value is determined to be other-than-temporary, an impairment loss would be recognized for the difference.

Investments were as follows at December 31:

(Millions)	2004	2003
Investments in unconsolidated partnerships	$257.8	$281.9
Equity securities	511.8	395.8
Other cost investments	35.3	45.0
	$804.9	$722.7

1. Summary of Significant Accounting Policies, Continued:
Investments in unconsolidated partnerships include the related excess of the purchase price paid over the underlying net book value of the wireless partnerships. The carrying value of excess cost included in investments was $19.5 million and $21.3 million at December 31, 2004 and 2003, respectively.

Property, Plant and Equipment – Property, plant and equipment are stated at original cost. Wireless plant consists of cell site towers, switching, controllers and other radio frequency equipment. Wireline plant consists of aerial and underground cable, conduit, poles, switches and other central office and transmission–related equipment. Information processing plant consists of data processing equipment, purchased software and internal use capitalized software development costs. Other plant consists of furniture, fixtures, vehicles, machinery and equipment. The costs of additions, replacements and substantial improvements, including related labor costs, are capitalized, while the costs of maintenance and repairs are expensed as incurred. For ALLTEL's non–regulated operations, when depreciable plant is retired or otherwise disposed of, the related cost and accumulated depreciation are deducted from the plant accounts, with the corresponding gain or loss reflected in operating results. The Company's wireline subsidiaries utilize group composite depreciation. Under this method, when plant is retired, the original cost, net of salvage value, is charged against accumulated depreciation, and no gain or loss is recognized on the disposition of the plant. Depreciation expense amounted to $1,239.0 million in 2004, $1,187.4 million in 2003 and $1,050.1 million in 2002. Depreciation for financial reporting purposes is computed using the straight–line method over the following estimated useful lives:

	Depreciable Lives
Buildings and improvements	5–50 years
Wireline	6–58 years
Wireless	4–20 years
Information processing	3–15 years
Other	3–25 years

The Company capitalizes interest in connection with the acquisition or construction of plant assets. Capitalized interest is included in the cost of the asset with a corresponding reduction in interest expense. Capitalized interest amounted to $16.7 million in 2004, $15.2 million in 2003 and $15.9 million in 2002.

Capitalized Software Development Costs – Software development costs incurred in the application development stage of internal use software are capitalized and recorded in information processing plant in the accompanying consolidated balance sheets. Modifications and upgrades to internal use software are capitalized to the extent such enhancements provide additional functionality. Software maintenance and training costs are expensed as incurred. Internal use software is amortized over periods ranging from three to ten years.

Impairment of Long–Lived Assets – Long–lived assets and intangible assets subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of the asset may not be recoverable from future, undiscounted net cash flows expected to be generated by the asset. If the asset is not fully recoverable, an impairment loss would be recognized for the difference between the carrying value of the asset and its estimated fair value based on discounted net future cash flows or quoted market prices. Assets to be disposed of that are not classified as discontinued operations are reported at the lower of their carrying amount or fair value less cost to sell.

Derivative Instruments – The Company uses derivative instruments to obtain a targeted mixture of variable and fixed–interest–rate long–term debt, such that the portion of debt subject to variable rates does not exceed 30 percent of the Company's total long–term debt outstanding. The Company has established policies and procedures for risk assessment and the approval, reporting and monitoring of derivative instrument activities. Derivative instruments are entered into for periods consistent with the related underlying exposure and are not entered into for trading or speculative purposes. The Company has entered into interest rate swap agreements and designated these derivatives as fair value hedges. In accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", the interest rate swaps are recorded as assets or liabilities in the consolidated balance sheets at fair value, with changes in the fair value of the derivative and of the underlying hedged item attributable to the hedged risk recognized in earnings. Net amounts due related to interest rate swap agreements are recorded as adjustments to interest expense in the consolidated statements of income when earned or payable. In the event a designated hedged item is sold, extinguished or matures prior to the termination of the related derivative instrument, the derivative instrument would be closed and the resulting gain or loss would be recognized in income.

1. Summary of Significant Accounting Policies, Continued:

Mandatorily Redeemable Financial Instruments – At December 31, 2003, twelve of the Company's consolidated non–wholly owned wireless partnerships had finite lives specified in their partnership agreements, and accordingly, were legally required to be dissolved and terminated at a specified future date, usually 50 or 99 years after formation, and the proceeds distributed to the partners. Under the provisions of SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity", the minority interests associated with these partnerships are considered mandatorily redeemable financial instruments, and as such, would be required to be reported as liabilities in ALLTEL's consolidated financial statements, initially measured at settlement value, and subsequently remeasured at each balance sheet date with changes in settlement values reported as a component of interest expense. On November 7, 2003, the FASB issued Staff Position No. 150–3, "Effective Date, Disclosures, and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests under FASB Statement No. 150" ("FSP No. 150–3"). FSP No. 150–3 deferred indefinitely the recognition and measurement provisions of SFAS No. 150 applicable to mandatorily redeemable noncontrolling interests, including the minority interests associated with the Company's consolidated non–wholly owned partnerships with finite lives. In accordance with FSP No. 150–3, the minority interests associated with the Company's finite–lived partnerships continue to be reported at book value. At December 31, 2003, the estimated settlement value of these minority interests was $46.6 million, of which $20.1 million was included in other liabilities in the accompanying consolidated balance sheet. During 2004, the partnership agreements for eight of the partnerships were amended so that the legal lives of the partnerships continue indefinitely. Accordingly, the minority interests associated with these eight partnerships are no longer mandatorily redeemable financial instruments within the scope of SFAS No. 150 and FSP No. 150–3. At December 31, 2004, the estimated settlement value of the minority interests for the four remaining partnerships still within the scope of SFAS No. 150 and FSP No. 150–3 was $27.5 million, of which $10.1 million was included in other liabilities in the accompanying consolidated balance sheet.

Preferred Stock – Cumulative preferred stock is issuable in series. The Board of Directors is authorized to designate the number of shares and fix the terms. There are 50.0 million shares of no par value cumulative non–voting preferred stock and 50.0 million shares of $25 par value voting cumulative preferred stock authorized. Two series of no par value preferred stock, Series C and Series D, were outstanding at December 31, 2004 and 2003. There were no shares of $25 par value preferred stock outstanding at December 31, 2004 and 2003. The Series C non–redeemable preferred shares are convertible at any time into 5.963 shares of ALLTEL common stock. The Series D redeemable preferred shares are convertible at any time prior to redemption into 5.486 shares of ALLTEL common stock. The Series D shares may be redeemed at the option of the Company or the holder at the $28 per share stated value. There were 32,190 shares and 35,558 shares of Series D stock outstanding at December 31, 2004 and 2003, respectively. The outstanding Series D stock of $0.9 million and $1.0 million at December 31, 2004 and 2003, respectively, is included in other liabilities in the accompanying consolidated balance sheets. During 2004, $94,000 of Series D stock was converted into ALLTEL common stock compared to $19,000 in 2003 and $243,000 in 2002.

Unrealized Holding Gain on Investments – Equity securities of certain publicly traded companies owned by ALLTEL have been classified as available–for–sale and are reported at fair value, with cumulative unrealized net gains reported, net of tax, as a separate component of shareholders' equity. The unrealized gains, including the related tax impact, are non–cash items, and accordingly, have been excluded from the accompanying consolidated statements of cash flows.

Foreign Currency Translation Adjustment – For the Company's foreign operations, assets and liabilities are translated from the applicable local currency to U.S. dollars using the current exchange rate as of the balance sheet date. Revenue and expense accounts are translated using the weighted average exchange rate in effect during the period. The resulting translation gains or losses are recorded as a separate component of shareholders' equity.

Revenue Recognition – Communications revenues are primarily derived from usage of the Company's networks and facilities. Wireless access and wireline local access revenues are recognized over the period that the corresponding services are rendered to customers. Revenues derived from other telecommunications services, including interconnection, long–distance and custom calling feature revenues are recognized monthly as services are provided. Sales of communications products including wireless handsets and accessories represent a separate earnings process and are recognized when products are delivered to and accepted by customers. Effective January 1, 2003, the Company adopted Emerging Issues Task Force ("EITF") Issue No. 00–21, "Accounting for Revenue Arrangements with Multiple Deliverables", for all new arrangements entered into on or after that date. Prior to the adoption of EITF 00–21, for transactions involving both the activation of service and the sale of equipment, the Company recognized revenues as follows: Fees assessed to communications customers to activate service were deferred and recognized over the expected life of the customer relationship, which was generally three years. Direct incremental customer acquisition costs incurred in the activation of service were deferred up to the amount of the related revenues.

1. Summary of Significant Accounting Policies, Continued:
Costs in excess of the deferred activation revenues were expensed as incurred. Upon adoption of EITF Issue No. 00–21, the Company ceased deferral of fees assessed to wireless communications customers to activate service and direct incremental customer acquisition costs incurred in the activation of service and instead began recognizing both at the point of sale. Wireless activation fees and related direct incremental customer acquisition costs deferred prior to the adoption of EITF Issue No. 00–21 continue to be recognized over the remaining expected life of the customer relationship.

ALLTEL Publishing recognizes directory publishing and advertising revenues and related directory costs when the directories are published and delivered. For directory contracts with a secondary delivery obligation, ALLTEL Publishing defers a portion of its revenues and related directory costs until secondary delivery occurs. The royalties paid by ALLTEL Publishing to the Company's regulated wireline subsidiaries (excluding the acquired operations in Kentucky and Nebraska) are recognized as revenue over the life of the corresponding contract, which is generally twelve months.

Telecommunications information services revenues are recognized in accordance with the American Institute of Certified Public Accountants' Statement of Position ("SOP") 97–2 "Software Revenue Recognition" and SOP 98–9 "Modification of SOP 97–2, Software Revenue Recognition, With Respect to Certain Transactions". Data processing revenues are recognized as services are performed. When the arrangement with the customer includes significant production, modification or customization of the software, the Company uses contract accounting, as required by SOP 97–2. For those arrangements accounted for under SOP 81–1 "Accounting for Performance of Construction–Type and Certain Production–Type Contracts", the Company uses the percentage–of–completion method. Under this method, revenue and profit are recognized throughout the term of the contract, based upon estimates of the total costs to be incurred and revenues to be generated throughout the term of the contract. Changes in estimates for revenues, costs and profits are recognized in the period in which they are determinable. When such estimates indicate that costs will exceed future revenues and a loss on the contract exists, a provision for the entire loss is then recognized.

For all other operations, revenue is recognized when products are delivered to and accepted by customers or when services are rendered to customers in accordance with contractual terms. Included in accounts receivable are unbilled receivables of $153.5 million and $169.4 million at December 31, 2004 and 2003, respectively.

Stock–Based Compensation – The Company's stock–based compensation plans are more fully discussed in Note 7. ALLTEL accounts for these plans under the recognition and measurement principles of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations. For fixed stock options granted under these plans, the exercise price of the option equals the market value of ALLTEL's common stock on the date of grant. Accordingly, ALLTEL does not record compensation expense for any of the fixed stock options granted, and no compensation expense related to stock options was recognized in 2004, 2003 or 2002. In 2004, the Company granted shares of restricted stock to certain senior management employees. Compensation expense related to these restricted shares amounted to $2.8 million in 2004. Unrecognized compensation expense for the restricted shares amounted to $5.7 million and was included in additional paid–in capital in the accompanying consolidated balance sheet and consolidated statement of shareholders' equity as of December 31, 2004. The following table illustrates the effects on net income and earnings per share had the Company applied the fair value recognition provisions of SFAS No. 123, "Accounting for Stock–Based Compensation", to its stock–based employee compensation plans for the years ended December 31:

(Millions, except per share amounts)		2004	2003	2002
Net income as reported		$1,046.2	$1,330.1	$ 924.3
Add stock–based compensation expense included in net income, net of related tax effects		1.8	–	–
Deduct stock–based employee compensation expense determined under fair value method for all awards, net of related tax effects		(26.3)	(24.6)	(31.1)
Pro forma net income		$1,021.7	$1,305.5	$ 893.2
Basic earnings per share:	As reported	$3.40	$4.27	$2.97
	Pro forma	$3.32	$4.19	$2.87
Diluted earnings per share:	As reported	$3.39	$4.25	$2.96
	Pro forma	$3.31	$4.17	$2.86

The pro forma amounts presented above may not be representative of the future effects on reported net income and earnings per share, since the pro forma compensation expense is allocated over the periods in which options become exercisable, and new option awards may be granted each year.

1. Summary of Significant Accounting Policies, Continued:

Income Taxes – Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax balances are adjusted to reflect tax rates, based on currently enacted tax laws, which will be in effect in the years in which the temporary differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the results of operations in the period that includes the enactment date. For the Company's regulated operations, the adjustment in deferred tax balances for the change in tax rates is reflected as regulatory assets or liabilities. These regulatory assets and liabilities are amortized over the lives of the related depreciable asset or liability concurrent with recovery in rates. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets unless it is more likely than not that such assets will be realized.

Earnings Per Share – Basic earnings per share of common stock was computed by dividing net income applicable to common shares by the weighted average number of common shares outstanding during each year. Diluted earnings per share reflects the potential dilution that could occur assuming conversion or exercise of all dilutive unexercised stock options and outstanding preferred stock. The dilutive effects of stock options and preferred stock were determined using the treasury stock method. Options to purchase approximately 9.7 million, 12.2 million and 13.8 million shares of common stock at December 31, 2004, 2003 and 2002, respectively, were excluded from the computation of diluted earnings per share because the effect of including them was anti–dilutive. A reconciliation of the net income and numbers of shares used in computing basic and diluted earnings per share was as follows for the years ended December 31:

(Millions, except per share amounts)	2004	2003	2002
Basic earnings per share:			
Income from continuing operations	$1,026.7	$ 953.5	$ 850.1
Income from discontinued operations	19.5	361.0	74.2
Cumulative effect of accounting change	–	15.6	–
Less preferred dividends	(0.1)	(0.1)	(0.1)
Net income applicable to common shares	$1,046.1	$1,330.0	$ 924.2
Weighted average common shares outstanding for the year	307.3	311.8	311.0
Basic earnings per share:			
Income from continuing operations	$ 3.34	$ 3.06	$ 2.73
Income from discontinued operations	.06	1.16	.24
Cumulative effect of accounting change	–	.05	–
Net income	$ 3.40	$ 4.27	$ 2.97
Diluted earnings per share:			
Net income applicable to common shares	$1,046.1	$1,330.0	$ 924.2
Adjustment for convertible preferred stock dividends	0.1	0.1	0.1
Net income applicable to common shares assuming conversion of preferred stock	$1,046.2	$1,330.1	$ 924.3
Weighted average common shares outstanding for the year	307.3	311.8	311.0
Increase in shares, which would result from the assumed:			
Exercise of stock options	0.8	0.7	1.0
Conversion of convertible preferred stock	0.3	0.3	0.3
Weighted average common shares, assuming conversion of the above securities	308.4	312.8	312.3
Diluted earnings per share:			
Income from continuing operations	$ 3.33	$ 3.05	$ 2.72
Income from discontinued operations	.06	1.15	.24
Cumulative effect of accounting change	–	.05	–
Net income	$ 3.39	$ 4.25	$ 2.96

As more fully discussed in Note 5, the Company issued equity units in 2002, which obligates the holder to purchase ALLTEL common stock on May 17, 2005. Prior to the issuance of shares of ALLTEL common stock upon settlement of the purchase contracts, the equity units will be reflected in the diluted earnings per share calculations using the treasury stock method. Under this method, the number of shares of common stock used in calculating diluted earnings per share is increased by the excess, if any, of the number of shares issuable upon settlement of the purchase contracts over the number of shares that could be purchased by ALLTEL in the market, at the average market price during the period, using the proceeds received upon settlement. The Company anticipates that there will be no dilutive effect on its earnings per share related to the equity units,

1. Summary of Significant Accounting Policies, Continued:
except during periods when the average market price of a share of ALLTEL common stock is above the threshold appreciation price of $60.39. Because the average market price of ALLTEL's common stock during the years ended December 31, 2004 and 2003 was below this threshold appreciation price, the shares issuable under the purchase contract component of the equity units were excluded from the diluted earnings per share calculation in 2004, 2003 and 2002.

Recently Issued Accounting Pronouncements – On December 16, 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 123(R), "Share–Based Payment", which is a revision of SFAS No. 123 and supersedes APB Opinion No. 25. SFAS No. 123(R) requires all share–based payments to employees, including grants of employee stock options, to be valued at fair value on the date of grant, and to be expensed over the applicable vesting period. Pro forma disclosure of the income statement effects of share–based payments is no longer an alternative. SFAS No. 123(R) is effective for all stock–based awards granted on or after July 1, 2005. In addition, companies must also recognize compensation expense related to any awards that are not fully vested as of the effective date. Compensation expense for the unvested awards will be measured based on the fair value of the awards previously calculated in developing the pro forma disclosures in accordance with the provisions of SFAS No. 123. ALLTEL is currently assessing the impact of adopting SFAS 123(R) to its consolidated results of operations.

2. Accounting Changes:
Change in Accounting Estimate – The Company is routinely audited by federal, state and foreign taxing authorities. The outcome of these audits may result in the Company being assessed taxes in addition to amounts previously paid. Accordingly, ALLTEL maintains tax contingency reserves for such potential assessments. The reserves are determined based upon the Company's best estimate of possible assessments by the Internal Revenue Service ("IRS") or other taxing authorities and are adjusted, from time to time, based upon changing facts and circumstances. During the third quarter of 2004, the IRS completed its fieldwork related to the audits of the Company's consolidated federal income tax returns for the fiscal years 1997 through 2001. As a result of the IRS issuing its proposed audit adjustments related to the periods under examination, ALLTEL reassessed its income tax contingency reserves to reflect the IRS findings. Based upon this reassessment, ALLTEL recorded a $129.3 million reduction in these reserves in the third quarter of 2004. The reserve adjustments primarily related to acquisition–related issues and included interest charges on potential assessments. The corresponding effects of the adjustments to the tax contingency reserves resulted in a reduction in goodwill of $94.5 million (see Note 4) and a reduction in income tax expense associated with continuing operations of $19.7 million. In addition, $15.1 million of the adjustments to the tax contingency reserves related to the financial services division of ALLTEL's information services subsidiary, ALLTEL Information Services, Inc., that was sold to Fidelity National Financial Inc. ("Fidelity National") on April 1, 2003. (See Note 12.) Pursuant to the terms of the sale agreement, ALLTEL retained, as of the date of sale, all income tax liabilities related to the sold operations and agreed to indemnify Fidelity National from any future tax liability imposed on the financial services division for periods prior to the date of sale. The adjustment of the tax contingency reserves related to the disposed financial services division has been reported as "discontinued operations".

Change in Accounting Principle – Except for certain wireline subsidiaries as further discussed below, ALLTEL adopted SFAS No. 143, "Accounting for Asset Retirement Obligations", effective January 1, 2003. SFAS No. 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long–lived assets and the associated asset retirement costs. This standard applies to legal obligations associated with the retirement of long–lived assets that result from the acquisition, construction, development, or normal use of the assets. SFAS No. 143 requires that a liability for an asset retirement obligation be recognized when incurred and reasonably estimable, recorded at fair value, and classified as a liability in the balance sheet. When the liability is initially recorded, the entity capitalizes the cost and increases the carrying value of the related long–lived asset. The liability is then accreted to its present value each period, and the capitalized cost is depreciated over the estimated useful life of the related asset. At the settlement date, the entity will settle the obligation for its recorded amount and recognize a gain or loss upon settlement. ALLTEL has evaluated the effects of SFAS No. 143 on its operations and has determined that, for telecommunications and other operating facilities in which the Company owns the underlying land, ALLTEL has no contractual or legal obligation to remediate the property if the Company were to abandon, sell or otherwise dispose of the property. Certain of the Company's cell site and switch site operating lease agreements contain clauses requiring restoration of the leased site at the end of the lease term. Similarly, certain of the Company's lease agreements for office and retail locations require restoration of the leased site upon expiration of the lease term. Accordingly, ALLTEL is subject to asset retirement obligations associated with these leased facilities under the provisions of SFAS No. 143. The application of SFAS No. 143 to the Company's cell site and switch site leases and leased office and retail locations did not have a material impact on ALLTEL's consolidated results of operations, financial position, or cash flows as of and for the year ended December 31, 2003.

In accordance with federal and state regulations, depreciation expense for ALLTEL's wireline operations has historically included an additional provision for cost of removal. The additional cost of removal provision does not meet the recognition

2. Accounting Changes, Continued:
and measurement principles of an asset retirement obligation under SFAS No. 143. In December 2002, the Federal Communications Commission ("FCC") notified wireline carriers that they should not adopt the provisions of SFAS No. 143 unless specifically required by the FCC in the future. As a result of the FCC ruling, ALLTEL continues to record a regulatory liability for cost of removal for its wireline subsidiaries that follow the accounting prescribed by SFAS No. 71. The regulatory liability for cost of removal included in accumulated depreciation amounted to $171.7 million and $160.6 million at December 31, 2004 and 2003, respectively. For the acquired Kentucky and Nebraska wireline operations not subject to SFAS No. 71, effective January 1, 2003, the Company ceased recognition of the cost of removal provision in depreciation expense and eliminated the cumulative cost of removal included in accumulated depreciation. The effect of these changes in 2003 was to decrease depreciation expense by $6.4 million and increase income before cumulative effect of accounting change by $4.0 million. The cumulative effect of retroactively applying these changes to periods prior to January 1, 2003, resulted in a non–cash credit of $15.6 million, net of income tax expense of $10.3 million, and was included in net income for the year ended December 31, 2003.

3. Acquisitions:
On December 1, 2004, ALLTEL completed the purchase of certain wireless assets from United States Cellular Corporation ("U.S. Cellular") and TDS Telecommunications Corporation ("TDS Telecom") for $148.2 million in cash, acquiring wireless properties with a potential service area covering approximately 584,000 potential customers ("POPs") in Florida and Ohio. In addition, the Company also added partnership interests in seven ALLTEL–operated markets in Georgia, Mississippi, North Carolina, Ohio and Wisconsin. Prior to this acquisition, ALLTEL owned an approximate 42 percent interest in the Georgia market, which has a potential service area covering approximately 229,000 POPs, and ALLTEL owned a majority interest in the Mississippi, North Carolina, Ohio and Wisconsin markets. On November 2, 2004, the Company purchased for $35.6 million in cash wireless properties with a potential service area covering approximately 275,000 POPs in south Louisiana from SJI, a privately held company. During the fourth quarter of 2004, ALLTEL also acquired additional ownership interests in wireless properties in Louisiana and Wisconsin in which the Company owned a majority interest in exchange for $1.4 million in cash and a portion of the Company's ownership interest in a wireless partnership serving the St. Louis, Missouri market.

The accompanying consolidated financial statements include the accounts and results of operations of the acquired wireless properties from the dates of acquisition. During the fourth quarter of 2004, ALLTEL completed the purchase price allocation for each of these acquisitions based upon a fair value analysis of the tangible and identifiable intangible assets acquired. The excess of the aggregate purchase price over the fair market value of the tangible net assets acquired of $145.2 million was assigned to customer list, cellular licenses and goodwill. The customer lists recorded in connection with these transactions are being amortized on a straight–line basis over their estimated useful lives of four years. The cellular licenses are classified as indefinite–lived intangible assets and are not subject to amortization. The majority of the goodwill recorded in connection with the 2004 acquisitions was deductible for income tax purposes. The following table summarizes the fair value of the assets acquired and liabilities assumed for the various business combinations completed during 2004:

	Acquired from			
(Millions)	U.S. Cellular	TDS Telecom	SJI and Other	Combined Totals
Assets acquired:				
Current assets	$ 2.0	$ 9.7	$ 2.2	$ 13.9
Property, plant and equipment	5.2	23.7	3.4	32.3
Goodwill	55.8	33.4	26.8	116.0
Cellular licenses	3.8	6.3	3.9	14.0
PCS licenses	–	–	0.6	0.6
Customer list	4.1	6.9	4.2	15.2
Other assets	0.7	0.3	–	1.0
Less investments in unconsolidated partnerships	–	(14.9)	(2.8)	(17.7)
Total assets acquired	71.6	65.4	38.3	175.3
Liabilities assumed:				
Current liabilities	(1.8)	(2.4)	(1.4)	(5.6)
Other liabilities	(1.6)	–	(4.6)	(6.2)
Total liabilities assumed	(3.4)	(2.4)	(6.0)	(11.8)
Minority interest liability acquired	16.8	0.2	4.6	21.6
Net cash paid	$85.0	$ 63.2	$36.9	$185.1

3. Acquisitions, Continued:
On August 29, 2003, the Company purchased for $22.8 million in cash a wireless property with a potential service area covering approximately 205,000 POPs in an Arizona Rural Service Area ("RSA"). During the third quarter of 2003, the Company also purchased for $5.7 million in cash additional ownership interests in wireless properties in Mississippi, New Mexico and Virginia in which the Company owned a majority interest. The Company completed the purchase price allocation for these acquisitions based upon a fair value analysis of the tangible and identifiable intangible assets acquired. The excess of the aggregate purchase price over the fair market value of the tangible net assets acquired of $25.4 million was assigned to cellular licenses and goodwill.

On April 1, 2003, the Company paid $7.5 million in cash to increase its ownership interest from 43 percent to approximately 86 percent in a wireless property with a potential service area covering approximately 145,000 POPs in a Wisconsin RSA. During the second quarter of 2003, ALLTEL completed the purchase price allocation of this acquisition based upon a fair value analysis of the tangible and identifiable intangible assets acquired. The excess of the aggregate purchase price over the fair market value of the tangible net assets acquired of $3.0 million was assigned to customer list, cellular licenses and goodwill.

On February 28, 2003, ALLTEL purchased for $72.0 million in cash wireless properties with a potential service area covering approximately 370,000 POPs in southern Mississippi, from Cellular XL Associates ("Cellular XL"), a privately held company. Of the total purchase price, ALLTEL paid $64.6 million to Cellular XL at the date of purchase with the remaining cash payment, subject to adjustments as specified in the purchase agreement, payable with interest, 12 months after the closing date. The remaining cash payment, as adjusted, of $7.5 million was paid on February 29, 2004. ALLTEL completed the purchase price allocation of this acquisition based upon a fair value analysis of the tangible and identifiable intangible assets acquired. The excess of the aggregate purchase price over the fair market value of the tangible net assets acquired of $67.0 million was assigned to customer list, cellular licenses and goodwill. On February 28, 2003, the Company also purchased for $60.0 million in cash the remaining ownership interest in wireless properties with a potential service area covering approximately 355,000 POPs in two Michigan RSAs. Prior to this acquisition, ALLTEL owned approximately 49 percent of the Michigan properties. The Company completed the purchase price allocation of this acquisition based upon a fair value analysis of the tangible and identifiable intangible assets acquired. The excess of the aggregate purchase price over the fair market value of the tangible net assets acquired of $46.8 million was assigned to customer list, cellular licenses and goodwill.

The accompanying consolidated financial statements include the accounts and results of operations of the acquired wireless properties from the dates of acquisition. The customer lists recorded in connection with these transactions are being amortized on a straight–line basis over their estimated useful lives of six years. The cellular licenses are classified as indefinite–lived intangible assets and are not subject to amortization. Substantially all of the goodwill recorded in connection with the 2003 acquisitions was deductible for income tax purposes. The following table summarizes the fair value of the assets acquired and liabilities assumed for the various business combinations completed during 2003:

	Acquired from			
(Millions)	Cellular XL	Michigan Minority Partners	Other	Combined Totals
Assets acquired:				
Current assets	$ 0.4	$ 4.9	$ 4.2	$ 9.5
Property, plant and equipment	5.4	22.5	8.2	36.1
Goodwill	53.4	35.4	4.2	93.0
Cellular licenses	9.6	8.0	23.8	41.4
Customer list	4.0	3.4	0.4	7.8
Less investments in unconsolidated partnerships	–	(12.5)	(4.5)	(17.0)
Total assets acquired	72.8	61.7	36.3	170.8
Liabilities assumed:				
Current liabilities	(8.2)	(1.7)	(1.9)	(11.8)
Total liabilities assumed	(8.2)	(1.7)	(1.9)	(11.8)
Minority interest liability acquired	–	–	1.6	1.6
Net cash paid	$64.6	$ 60.0	$36.0	$ 160.6

3. Acquisitions, Continued:

On August 1, 2002, ALLTEL purchased substantially all of the wireless assets owned by CenturyTel, Inc. ("CenturyTel") for approximately $1.59 billion in cash. In this transaction, ALLTEL added properties representing approximately 8.3 million POPs, and acquired approximately 762,000 wireless customers, minority partnership interests in cellular operations representing approximately 1.8 million proportionate POPs and PCS licenses covering 1.3 million POPs in Wisconsin and Iowa. The accompanying consolidated financial statements include the accounts and results of operations of the acquired wireless properties from the date of acquisition. During the third quarter of 2002, the Company completed the purchase price allocation of this acquisition based upon the appraised fair values of the property, plant and equipment and identifiable intangible assets acquired. The excess of the aggregate purchase price over the fair market value of the tangible net assets acquired of $1.38 billion was assigned to customer list, cellular licenses and goodwill. The customer list recorded in connection with this transaction is being amortized on a straight-line basis over its estimated useful life of six years. The cellular licenses are classified as indefinite-lived intangible assets and are not subject to amortization. Of the total amount assigned to goodwill, approximately $481.0 million is expected to be deductible for income tax purposes.

On August 1, 2002, ALLTEL also completed the purchase of local telephone properties serving approximately 589,000 wireline customers in Kentucky from Verizon Communications, Inc. ("Verizon") for approximately $1.93 billion in cash. Upon signing of the purchase agreement in October 2001, ALLTEL paid Verizon a deposit equal to 10 percent of the total purchase price, or $190.7 million, with the balance of the cash payment (net of accrued interest on the deposit) due at the time the transaction was completed. The accompanying consolidated financial statements include the accounts and results of operations of the acquired wireline properties from the date of acquisition. During the fourth quarter of 2002, the Company completed the purchase price allocation of this acquisition based upon the appraised fair values of the property, plant and equipment and identifiable intangible assets acquired. The excess of the aggregate purchase price over the fair market value of the tangible net assets acquired of $1.34 billion was assigned to customer list, franchise rights and goodwill. The customer list recorded in connection with this transaction is being amortized on a straight-line basis over its estimated useful life of ten years. The franchise rights are classified as indefinite-lived intangible assets and are not subject to amortization. Of the total amount assigned to goodwill, approximately $1.0 billion is expected to be deductible for income tax purposes.

During 2002, ALLTEL also purchased a wireline property in Georgia and acquired additional ownership interests in wireless properties in Arkansas, Louisiana and Texas. In connection with these acquisitions, the Company paid $35.0 million in cash and assigned the excess of the aggregate purchase price over the fair market value of the tangible net assets acquired of $31.0 million to goodwill. In connection with the CenturyTel and Verizon acquisitions discussed above, the Company recorded integration expenses and other charges in 2002. (See Note 9.)

The following table summarizes the fair value of the assets acquired and liabilities assumed for the various business combinations completed during 2002:

	Acquired from			
(Millions)	Century Tel	Verizon	Other	Combined Totals
Assets acquired:				
Current assets	$ 57.2	$ 38.0	$ 1.2	$ 96.4
Investments	77.9	–	–	77.9
Property, plant and equipment	192.9	608.6	10.7	812.2
Goodwill	1,075.5	1,003.1	31.0	2,109.6
Cellular licenses	214.0	–	–	214.0
PCS licenses	1.6	–	–	1.6
Franchise rights	–	265.0	–	265.0
Customer list	89.0	67.6	–	156.6
Other assets	0.4	–	2.9	3.3
Total assets acquired	1,708.5	1,982.3	45.8	3,736.6
Liabilities assumed:				
Current liabilities	(55.6)	(44.6)	(1.7)	(101.9)
Long-term debt	–	–	(9.1)	(9.1)
Other liabilities	(57.6)	(9.0)	–	(66.6)
Total liabilities assumed	(113.2)	(53.6)	(10.8)	(177.6)
Net cash paid	$1,595.3	$1,928.7	$ 35.0	$ 3,559.0

3. Acquisitions, Continued:

The purchase prices paid for each of the transactions discussed above were based on estimates of future cash flows of the properties acquired. ALLTEL paid a premium (i.e., goodwill) over the fair value of the net tangible and identified intangible assets acquired for a number of reasons, including but not limited to the following: the 2004 acquisitions expanded the Company's wireless operations into new markets in Florida, Louisiana and Ohio and added a combined 92,000 new wireless customers to ALLTEL's communications customer base. The 2003 acquisitions expanded the Company's wireless footprint into new markets across Arizona, Michigan, Mississippi and Wisconsin and added a combined 147,000 new wireless customers to ALLTEL's communications customer base. The 2002 purchase of wireless properties from CenturyTel expanded the Company's wireless footprint into new markets across Arkansas, Louisiana, Michigan, Mississippi, Texas and Wisconsin. Similarly, the wireline properties acquired from Verizon overlap ALLTEL's existing wireless service in northeastern Kentucky. The scale and scope of ALLTEL's entire communications business was enhanced by the CenturyTel and Verizon acquisitions through the combined addition of 1,351,000 geographically clustered communications customers. As a result, fixed operating costs can be spread over a larger base with very little incremental overhead added. Additionally, in the wireless properties acquired in 2004, 2003 and 2002, ALLTEL should realize, over time, accelerated customer growth and higher average revenue per customer as a result of the Company's higher revenue national rate plans. Finally, the wireline operations in Kentucky generated a lower operating margin than ALLTEL's wireline business primarily due to cost structure differences. ALLTEL believes, over time, that the Company can improve the margins in the acquired Kentucky operations to be more in line with the margins in its existing wireline operations.

Unaudited pro forma financial information related to the Company's 2004 and 2003 acquisitions has not been presented because these acquisitions, individually or in the aggregate were not material to the Company's consolidated results of operations for the years ended December 31, 2004 and 2003.

The following unaudited pro forma consolidated results of operations of the Company for the year ended December 31, 2002 assumes that the acquisition of wireless properties from CenturyTel and the acquisition of wireline properties from Verizon were completed as of January 1, 2002:

(Millions, except per share amounts)	2002
Revenues and sales	$7,602.7
Income from continuing operations	$ 923.5
Earnings per share from continuing operations:	
Basic	$2.97
Diluted	$2.96
Income before cumulative effect of accounting change	$ 997.7
Earnings per share before cumulative effect of accounting change:	
Basic	$3.21
Diluted	$3.19
Net income	$ 997.7
Earnings per share:	
Basic	$3.21
Diluted	$3.19

The pro forma amounts represent the historical operating results of the properties acquired from CenturyTel and Verizon with appropriate adjustments that give effect to depreciation and amortization and interest expense. The effects of the other non–acquisition related items discussed in Notes 9 and 10 are included in the pro forma amounts presented above. The pro forma amounts are not necessarily indicative of the operating results that would have occurred if the acquired properties had been operated by ALLTEL during the periods presented. In addition, the pro forma amounts do not reflect potential cost savings related to full network optimization and the redundant effect of selling, general and administrative expenses.

4. Goodwill and Other Intangible Assets:

The changes in the carrying amount of goodwill by business segment were as follows:

(Millions)	Wireless	Wireline	Communications Support Services	Total
Balance at December 31, 2002	$3,519.7	$1,247.7	$ 2.3	$4,769.7
Acquired during the period	93.0	–	–	93.0
Other adjustments	(8.4)	(0.1)	–	(8.5)
Balance at December 31, 2003	3,604.3	1,247.6	2.3	4,854.2
Acquired during the period	116.0	–	–	116.0
Other – reversal of income tax contingency reserves	(94.5)	–	–	(94.5)
Balance at December 31, 2004	$3,625.8	$1,247.6	$ 2.3	$4,875.7

The carrying value of indefinite–lived intangible assets other than goodwill were as follows at December 31:

(Millions)	2004	2003
Cellular licenses	$ 775.6	$ 761.6
PCS licenses	79.1	78.5
Franchise rights – wireline	265.0	265.0
	$1,119.7	$1,105.1

Intangible assets subject to amortization were as follows at December 31:

	2004		
(Millions)	Gross Cost	Accumulated Amortization	Net Carrying Value
Customer lists	$ 397.6	$ (218.8)	$ 178.8
Franchise rights	22.5	(14.9)	7.6
	$ 420.1	$ (233.7)	$ 186.4

	2003		
(Millions)	Gross Cost	Accumulated Amortization	Net Carrying Value
Customer lists	$ 382.4	$ (159.6)	$ 222.8
Franchise rights	22.5	(13.4)	9.1
	$ 404.9	$ (173.0)	$ 231.9

Intangible assets subject to amortization are amortized on a straight–line basis over their estimated useful lives, which are 4 to 10 years for customer lists and 15 years for franchise rights. Amortization expense for intangible assets subject to amortization was $60.7 million in 2004, $60.3 million in 2003 and $45.4 million in 2002. Amortization expense for intangible assets subject to amortization is estimated to be $63.4 million in 2005, $44.8 million in 2006, $28.1 million in 2007, $21.5 million in 2008 and $8.5 million in 2009. See Note 3 for a discussion of the acquisitions completed during 2004 and 2003 that resulted in the recognition of goodwill and other intangible assets.

5. Debt:

Long–term debt was as follows at December 31:

(Millions)	2004	2003
Issued by ALLTEL Corporation:		
Equity unit notes, 6.25%, due 2007(a)	$1,385.0	$1,385.0
Debentures and notes, without collateral:		
7.25%, due 2004	–	250.0
6.75%, due 2005	200.0	200.0
7.00%, due 2012	800.0	800.0
6.50%, due 2013	200.0	200.0
7.00%, due 2016	300.0	300.0
6.80%, due 2029	300.0	300.0
7.875%, due 2032	700.0	700.0
Collateralized notes, 10.00%, due 2005 and 2010	0.4	0.4
Industrial revenue bonds, 2.83% and 3.00%, due 2008	2.6	3.3
Issued by subsidiaries of ALLTEL Corporation:		
Debentures and notes, without collateral:		
ALLTEL Communications Inc. – 9.00%, due 2006	174.3	166.7
ALLTEL Communications Inc. – 7.50%, due 2006(b)	450.0	450.0
ALLTEL Communications Inc. – 6.65%, due 2008(b)	100.0	100.0
ALLTEL Communications Inc. – 7.60%, due 2009(b)	200.0	200.0
ALLTEL Ohio Limited Partnership – 8.00%, due 2010(b)	425.0	425.0
ALLTEL Georgia Communications Corp. – 6.50%, due 2004 to 2013	90.0	100.0
ALLTEL Communications Holdings of the Midwest, Inc. – 6.75%, due 2028	100.0	100.0
Other subsidiaries – 7.00% to 9.55%, due 2009 to 2018	94.0	106.1
First mortgage bonds – 6.00%, due 2005	2.1	6.5
Market value of interest rate swaps	67.1	79.7
Discount on long–term debt	(13.1)	(14.3)
	5,577.4	5,858.4
Less current maturities	(225.0)	(277.2)
Total long–term debt	$5,352.4	$5,581.2
Weighted rate	7.1%	7.1%
Weighted maturity	9 years	10 years

Notes:
(a) Interest rate will be reset on or after February 17, 2005.
(b) Repayment of subsidiary's debt obligation guaranteed by ALLTEL Corporation.

Commercial Paper – The Company has established a commercial paper program with a maximum borrowing capacity of $1.5 billion. Commercial paper borrowings consist of discounted notes that are exempt from registration under the Securities Act of 1933. Commercial paper borrowings are classified as long–term debt, because borrowings under this program are intended to be maintained on a long–term basis and are supported by the revolving credit agreement.

Revolving Credit Agreement – The Company has a five–year $1.5 billion unsecured line of credit under a revolving credit agreement with an expiration date of July 28, 2009. Commercial paper borrowings are deducted in determining the total amount available for borrowing under the revolving credit agreement. Accordingly, the total amount outstanding under the commercial paper program and the indebtedness incurred under the revolving credit agreement may not exceed $1.5 billion. At December 31, 2004, the amount available for borrowing under the revolving credit agreement was $1.5 billion. The revolving credit agreement contains various covenants and restrictions including a requirement that, at the end of each calendar quarter, ALLTEL maintain a total debt–to–capitalization ratio of less than 65 percent. For purposes of calculating this ratio under the agreement, total debt would include amounts classified as long–term debt (excluding mark–to–market adjustments for interest rate swaps), current maturities of long–term debt outstanding, short–term debt and any letters of credit or other guarantee obligations. As of December 31, 2004, the Company's long–term debt to capitalization ratio was 43.7 percent. In addition, the indentures and borrowing agreements, as amended, provide, among other things, for various restrictions on the payment of dividends by the Company. Retained earnings unrestricted as to the payment of dividends by the Company amounted to $6,142.2 million at December 31, 2004.

5. Debt, Continued:

Equity Units – During 2002, the Company issued and sold 27.7 million equity units in an underwritten public offering and received net proceeds of $1.34 billion. Each equity unit consists of a corporate unit, with a $50 stated amount, comprised of a purchase contract and $50 principal amount of senior notes. The corporate unit may be converted by the holder into a treasury unit consisting of the purchase contract and a treasury portfolio of zero–coupon U.S. Government treasury securities by substituting the treasury securities for the senior notes. The holder of an equity unit owns the underlying senior notes or treasury portfolio but has pledged the senior notes or treasury portfolio to ALLTEL to secure the holder's obligations under the purchase contract. The purchase contract obligates the holder to purchase, and obligates ALLTEL to sell, on May 17, 2005, for $50, a variable number of newly issued common shares of ALLTEL. The number of ALLTEL shares issued will be determined at the time the purchase contracts are settled based upon the then current price of ALLTEL's common stock. If the price of ALLTEL's common stock is equal to or less than $49.50, then ALLTEL will deliver 1.0101 shares to the holder of the equity unit. If the price of ALLTEL's common stock is greater than $49.50 but less than $60.39, then ALLTEL will deliver a fraction of shares equal to $50 divided by the then current price of ALLTEL's common stock. Finally, if the price of ALLTEL's common stock is equal to or greater than $60.39, then ALLTEL will deliver 0.8280 shares to the holder. Accordingly, upon settlement of the purchase contracts on May 17, 2005, ALLTEL will receive proceeds of approximately $1.4 billion and will deliver between 22.9 million and 28.0 million common shares in the aggregate. The proceeds will be credited to shareholders' equity and allocated between the common stock and additional paid–in–capital accounts. ALLTEL will make quarterly contract adjustment payments to the equity unit holders at a rate of 1.50 percent of the stated amount per year until the purchase contract is settled, although the Company has the right to defer these payments until no later than May 17, 2005.

Each corporate unit also included $50 principal amount of senior notes that will mature on May 17, 2007. The notes are pledged by the holders to secure their obligations under the purchase contracts. ALLTEL will make quarterly interest payments to the holders of the notes initially at an annual rate of 6.25 percent. On or after February 17, 2005, the notes will be remarketed. At that time, ALLTEL's remarketing agent will be entitled to reset the interest rate on the notes in order to generate sufficient remarketing proceeds to satisfy the holder's obligation under the purchase contract. In the event of a successful initial remarketing, the interest rate on the senior notes will be reset on February 14, 2005. If the intial remarketing of the senior notes fails, a final remarketing will be attempted on May 12, 2005. In the event of an unsuccessful final remarketing, the Company will exercise its rights as a secured party to obtain and extinguish the notes. The total distributions payable on the equity units are at an annual rate of 7.75 percent, consisting of interest (6.25 percent) and contract adjustment payments (1.50 percent). The corporate units are listed on the New York Stock Exchange under the symbol "AYZ".

The present value of the contract adjustment payments of $57.1 million was accrued upon the issuance of the equity units as a charge to additional paid–in capital with the related liability included in other liabilities in the accompanying consolidated balance sheets. Subsequent contract adjustment payments are allocated between this liability account and interest expense based on a constant rate calculation over the life of the transaction. Additional paid–in capital for 2002 also included a charge of $36.0 million representing a portion of the equity unit issuance costs that were allocated to the purchase contracts.

Interest expense was as follows for the years ended December 31:

(Millions)	2004	2003	2002
Interest expense related to long–term debt	$ 408.5	$ 434.4	$ 397.5
Other interest	0.9	1.7	1.8
Effects of interest rate swaps	(40.2)	(42.3)	(28.3)
Less capitalized interest	(16.7)	(15.2)	(15.9)
	$ 352.5	$ 378.6	$ 355.1

Maturities and sinking fund requirements for the four years after 2005 for long–term debt outstanding as of December 31, 2004, were $647.1 million, $1,407.8 million, $124.2 million and $223.6 million, respectively.

6. Financial Instruments and Investments:

The carrying amount of cash and short–term investments approximates fair value due to the short term nature of the instruments. The fair values of the Company's investments, long–term debt, redeemable preferred stock and interest rate swaps were as follows at December 31:

(Millions)	2004		2003	
	Fair Value	Carrying Amount	Fair Value	Carrying Amount
Investments	$ 804.9	$ 804.9	$ 722.7	$ 722.7
Long–term debt, including current maturities	$6,111.7	$5,577.4	$6,650.9	$5,858.4
Redeemable preferred stock	$ 10.4	$ 0.9	$ 9.1	$ 1.0
Interest rate swaps	$ 67.1	$ 67.1	$ 79.7	$ 79.7

The fair value of investments was based on quoted market prices and the carrying value of investments for which there were no quoted market prices. The fair value of long–term debt, including current maturities, was estimated based on the overall weighted rates and maturities of the Company's long–term debt compared to rates and terms currently available in the long–term financing markets. The fair value of the redeemable preferred stock was estimated based on the conversion of the Series D convertible redeemable preferred stock to common stock of the Company. Fair values of the interest rate swaps were based on quoted market prices. There was no impact to earnings due to hedge ineffectiveness for the interest rate swaps designated as fair value hedges. The fair value of all other financial instruments was estimated by management to approximate carrying value.

7. Stock–Based Compensation Plans:

Under the Company's stock–based compensation plans, ALLTEL may grant fixed and performance–based incentive and non–qualified stock options, restricted stock, and other equity securities to officers and other management employees. The maximum number of shares of the Company's common stock that may be issued to officers and other management employees under all stock option plans in effect at December 31, 2004 was 31.7 million shares. Fixed options granted under the stock option plans generally become exercisable over a period of one to five years after the date of grant. Certain fixed options granted in 2000 become exercisable in increments of 50%, 25% and 25% over a five–year period beginning three years after the date of grant. Certain fixed options granted in 1997 become exercisable in equal increments over a six–year period beginning three years after the date of grant. During 2004, the Company granted 170,996 shares of restricted stock to certain senior management employees. The restricted shares vest in equal increments over a three–year period from the date of grant.

Under the Company's stock option plan for non–employee directors (the "Directors' Plan"), the Company grants fixed, non–qualified stock options to directors for up to 1.0 million shares of common stock. Under the Directors' Plan, directors receive a one–time option grant to purchase 10,000 shares of common stock when they join the Board. Directors are also granted each year, on the date of the annual meeting of stockholders, an option to purchase a specified number of shares of common stock (currently 6,500 shares). Options granted under the Directors' Plan become exercisable the day immediately preceding the date of the first annual meeting of stockholders following the date of grant.

For all plans, the exercise price of the option equals the market value of ALLTEL's common stock on the date of grant. For fixed stock options, the maximum term for each option granted is 10 years. The fair value of each stock option granted as identified below was calculated using the Black–Scholes option–pricing model and the following weighted average assumptions:

	2004	2003	2002
Expected life	4.9 years	4.9 years	5.0 years
Expected volatility	30.7%	32.4%	29.7%
Dividend yield	2.9%	2.9%	2.5%
Risk–free interest rate	3.2%	3.0%	4.6%

7. Stock–Based Compensation Plans, Continued:
Set forth below is certain information related to stock options outstanding under ALLTEL's stock–based compensation plans:

	(Thousands) Shares			Weighted Average Price Per Share		
	2004	2003	2002	2004	2003	2002
Outstanding at beginning of period	15,912.3	18,317.5	16,254.5	$ 55.32	$ 55.24	$ 54.45
Granted	1,351.3	2,097.2	3,146.3	50.78	48.87	54.72
Exercised	(690.3)	(1,462.8)	(610.6)	38.57	34.09	28.03
Forfeited	(651.0)	(3,039.6)	(472.7)	57.86	60.56	59.76
Expired	–	–	–	–	–	–
Outstanding at end of period	15,922.3	15,912.3	18,317.5	$ 55.56	$ 55.32	$ 55.24
Exercisable at end of period	10,075.3	8,267.1	7,180.7	$ 55.66	$ 53.04	$ 48.02
Non–vested at end of period	5,847.0	7,645.2	11,136.8			
Weighted average fair value of stock options granted during the year	$ 13.52	$ 13.72	$ 14.19			

The following is a summary of stock options outstanding as of December 31, 2004:

	Options Outstanding			Options Exercisable	
Range of Exercise Price	Number of Shares	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price Per Share	Number of Shares	Weighted Average Exercise Price Per Share
$20.24 – $26.95	101.1	1.8 years	$ 26.23	101.1	$ 26.23
$29.47 – $37.75	2,050.1	2.5 years	33.46	2,048.0	33.45
$39.19 – $47.30	925.4	6.3 years	45.16	504.3	44.18
$50.22 – $58.46	5,640.1	3.8 years	52.78	1,716.5	53.83
$61.77 – $68.25	7,053.1	5.3 years	65.63	5,552.9	65.53
$70.75 – $73.13	152.5	4.6 years	72.31	152.5	72.31
	15,922.3	4.4 years	$ 55.56	10,075.3	$ 55.66

8. Employee Benefit Plans and Postretirement Benefits Other Than Pensions:
The Company maintains a qualified defined benefit pension plan, which covers substantially all employees other than employees of ALLTEL's directory publishing subsidiary. The Company also maintains a supplemental executive retirement plan that provides unfunded, non–qualified supplemental retirement benefits to a select group of management employees. In addition, the Company has entered into individual retirement agreements with certain retired executives providing for unfunded supplemental pension benefits. The Company provides postretirement healthcare and life insurance benefits for eligible employees. Employees share in the cost of these benefits. The Company funds the accrued costs of these plans as benefits are paid.

The components of pension expense, including provision for executive retirement agreements, and postretirement expense were as follows for the years ended December 31:

	Pension Benefits			Postretirement Benefits		
(Millions)	2004	2003	2002	2004	2003	2002
Benefits earned during the year	$ 30.5	$ 26.6	$ 27.1	$ 0.5	$ 0.6	$ 0.6
Interest cost on benefit obligation	51.9	52.2	48.2	16.5	14.8	13.3
Amortization of transition (asset) obligation	–	(1.2)	(2.2)	0.9	0.8	0.8
Amortization of prior service (credit) cost	0.2	(0.1)	(3.7)	1.6	1.5	1.6
Recognized net actuarial loss	19.9	20.7	0.2	9.3	7.3	5.2
Effects of Medicare subsidy	–	–	–	(2.9)	–	–
Expected return on plan assets	(70.5)	(57.2)	(60.8)	–	–	–
Total net periodic benefit expense	$ 32.0	$ 41.0	$ 8.8	$ 25.9	$ 25.0	$ 21.5

8. Employee Benefit Plans and Postretirement Benefits Other Than Pensions, Continued:

As a component of determining its annual pension cost, ALLTEL amortizes unrecognized gains or losses that exceed 17.5 percent of the greater of the projected benefit obligation or market-related value of plan assets on a straight-line basis over five years. Unrecognized actuarial gains and losses below the 17.5 percent corridor are amortized over the average remaining service life of active employees (approximately 14 years). The Company uses a December 31 measurement date for its employee benefit plans. Actuarial assumptions used to calculate the pension and postretirement expense were as follows for the years ended December 31:

	Pension Benefits			Postretirement Benefits		
	2004	2003	2002	2004	2003	2002
Discount rate	6.40%	6.85%	7.25%	6.40%	6.85%	7.25%
Expected return on plan assets	8.50%	8.50%	8.50%	–	–	–
Rate of compensation increase	3.50%	3.50%	4.50%	–	–	–

A summary of plan assets, projected benefit obligation and funded status of the plans were as follows at December 31:

	Pension Benefits		Postretirement Benefits	
(Millions)	2004	2003	2004	2003
Fair value of plan assets at beginning of year	$ 862.8	$ 692.9	$ –	$ –
Employer contributions	104.9	104.9	15.7	14.1
Participant contributions	–	–	5.7	4.4
Actual return on plan assets	90.1	136.8	–	–
Benefits paid	(56.6)	(71.8)	(21.4)	(18.5)
Fair value of plan assets at end of year	1,001.2	862.8	–	–
Projected benefit obligation at beginning of year	889.5	802.5	254.6	202.2
Benefits earned	30.5	26.6	0.5	0.6
Interest cost on projected benefit obligation	51.9	52.2	16.5	14.8
Participant contributions	–	–	5.7	4.4
Plan amendments	2.0	7.9	2.3	–
Effects of Medicare subsidy	–	–	(18.3)	–
Actuarial loss	85.6	72.1	2.2	51.1
Benefits paid	(56.6)	(71.8)	(21.4)	(18.5)
Projected benefit obligation at end of year	1,002.9	889.5	242.1	254.6
Plan assets less than projected benefit obligation	(1.7)	(26.7)	(242.1)	(254.6)
Unrecognized actuarial loss	226.9	181.7	92.2	114.8
Unrecognized prior service cost	10.2	7.5	15.4	14.7
Unrecognized net transition obligation	–	–	6.6	7.5
Net amount recognized	$ 235.4	$ 162.5	$ (127.9)	$ (117.6)
Amounts recognized in the consolidated balance sheet:				
Prepaid benefit cost	$ 284.8	$ 210.6	$ –	$ –
Accrued benefit cost liability	(49.4)	(48.1)	(127.9)	(117.6)
Net amount recognized	$ 235.4	$ 162.5	$ (127.9)	$ (117.6)

Employer contributions and benefits paid in the above table included amounts contributed directly to or paid directly from both the retirement plans and from Company assets.

The accumulated benefit obligation for all defined benefit pension plans was $916.2 million and $802.0 million at December 31, 2004 and 2003, respectively. For the supplemental retirement pension plans with accumulated benefit obligations in excess of plan assets, the projected benefit obligation and accumulated benefit obligation were $61.3 million and $55.4 million at December 31, 2004, respectively, and $63.5 million and $57.0 million at December 31, 2003, respectively. There are no assets held in these supplemental retirement pension plans, as the Company funds the accrued costs of the plans as benefits are paid.

8. Employee Benefit Plans and Postretirement Benefits Other Than Pensions, Continued:

Actuarial assumptions used to calculate the projected benefit obligations were as follows for the years ended December 31:

	Pension Benefits		Postretirement Benefits	
	2004	2003	2004	2003
Discount rate	6.00%	6.40%	6.00%	6.40%
Expected return on plan assets	8.50%	8.50%	–	–
Rate of compensation increase	3.50%	3.50%	–	–

In developing the expected long–term rate of return assumption, ALLTEL evaluated historical investment performance and input from its investment advisors. Projected returns by such advisors were based on broad equity and bond indices. The Company also considered the pension plan's historical returns since 1975 of 11.1 percent. The expected long–term rate of return on qualified pension plan assets is based on a targeted asset allocation of 70 percent to equities, with an expected long–term rate of return of 10 percent, and 30 percent to fixed income assets, with an expected long–term rate of return of 5 percent.

The asset allocation at December 31, 2004 and 2003 and target allocation for 2005 for the Company's qualified defined benefit pension plan by asset category were as follows:

	Target Allocation	Percentage of Plan Assets At December 31:	
Asset Category	2005	2004	2003
Equity securities	62.5% – 77.5%	65.6%	66.1%
Fixed income securities	15.0% – 35.0%	23.3%	19.9%
Money market and other short–term interest bearing securities	0.0% – 7.5%	11.1%	14.0%
		100.0%	100.0%

Primarily due to cash contributions funded to the qualified pension plan by ALLTEL in late December of each year that had not yet been reinvested, the actual asset allocations at December 31, 2004 and 2003 differed from the plan's target allocation. During 2004, the qualified pension plan liquidated its investment in ALLTEL common stock. Equity securities at December 31, 2003 included ALLTEL common stock of $33.2 million, or 4 percent of total plan assets. The Company's investment strategy is to maintain a diversified asset portfolio expected to provide long–term asset growth. Investments are generally restricted to marketable securities, with investments in real estate, venture capital, leveraged or other high–risk derivatives not permitted. Equity securities include stocks of both large and small capitalization domestic and international companies. Fixed income securities include securities issued by the U.S. Government and other governmental agencies, asset–backed securities and debt securities issued by domestic and international companies. Investments in money market and other short–term interest bearing securities are maintained to provide liquidity for benefit payments with protection of principal being the primary objective.

Information regarding the healthcare cost trend rate was as follows for the years ended December 31:

	2004	2003
Healthcare cost trend rate assumed for next year	10.00%	11.00%
Rate that the cost trend rate ultimately declines to	5.00%	5.00%
Year that the rate reaches the rate it is assumed to remain at	2010	2010

For the year ended December 31, 2004, a one percent increase in the assumed healthcare cost trend rate would increase the postretirement benefit cost by approximately $1.6 million, while a one percent decrease in the rate would reduce the postretirement benefit cost by approximately $1.3 million. As of December 31, 2004, a one percent increase in the assumed healthcare cost trend rate would increase the postretirement benefit obligation by approximately $20.8 million, while a one percent decrease in the rate would reduce the postretirement benefit obligation by approximately $17.6 million.

8. Employee Benefit Plans and Postretirement Benefits Other Than Pensions, Continued:

Estimated future employer contributions and benefit payments were as follows as of December 31, 2004:

(Millions)	Pension Benefits	Postretirement Benefits
Expected employer contributions for		
2005	$ 5.2	$ 17.2
Expected benefit payments:		
2005	$ 49.9	$ 17.2
2006	49.0	15.8
2007	50.3	16.7
2008	52.1	17.6
2009	54.4	18.2
2010 – 2014	324.7	93.0

The expected employer contribution for pension benefits consists solely of amounts necessary to fund the expected benefit payments related to the unfunded supplemental retirement pension plans. ALLTEL does not expect that any contribution to the qualified defined pension plan calculated in accordance with the minimum funding requirements of the Employee Retirement Income Security Act of 1974 will be required in 2005. Future discretionary contributions to the plan will depend on various factors, including future investment performance, changes in future discount rates and changes in the demographics of the population participating in the Company's qualified pension plan. Expected benefit payments include amounts to be paid from the plans or directly from Company assets, and exclude amounts that will be funded by participant contributions to the plans.

Under the Medicare Prescription Drug, Improvement and Modernization Act of 2003, (the "Act") beginning in 2006, the Act will provide a prescription drug benefit under Medicare Part D, as well as a federal subsidy to plan sponsors of retiree healthcare plans that provide a prescription drug benefit to their participants that is at least actuarially equivalent to the benefit that will be available under Medicare. The amount of the federal subsidy will be based on 28 percent of an individual beneficiary's annual eligible prescription drug costs ranging between $250 and $5,000. On May 19, 2004, the Financial Accounting Standards Board issued Staff Position No. 106–2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" ("FSP No. 106–2"). FSP No. 106–2 clarified that the federal subsidy provided under the Act should be accounted for as an actuarial gain in calculating the accumulated postretirement benefit obligation and annual postretirement expense. As of December 31, 2004, the Department of Health and Human Services had yet to issue final regulations on the determination of actuarial equivalence and the federal subsidy. Based on its current understanding of the Act, ALLTEL determined that a substantial portion of the prescription drug benefits provided under its postretirement benefit plan would be deemed actuarially equivalent to the benefits provided under Medicare Part D. Effective July 1, 2004, ALLTEL prospectively adopted FSP No. 106–2 and remeasured its accumulated postretirement benefit obligation as of that date to account for the federal subsidy, the effects of which resulted in an $18.3 million reduction in the Company's accumulated postretirement benefit obligation and a $2.9 million reduction in the Company's 2004 postretirement expense. On January 21, 2005, the Department of Health and Human Services issued final federal regulations related to the federal subsidy. ALLTEL is currently evaluating the effects, if any, that these final rules may have on its future benefit costs and accumulated postretirement benefit obligation.

ALLTEL has a non–contributory defined contribution plan in the form of profit–sharing arrangements for eligible employees. The amount of profit–sharing contributions to the plan is determined annually by ALLTEL's Board of Directors. Profit–sharing expense amounted to $21.3 million in 2004, $21.9 million in 2003 and $32.3 million in 2002. The Company also sponsors employee savings plans under section 401(k) of the Internal Revenue Code, which cover substantially all full–time employees, except bargaining unit employees. Employees may elect to contribute to the plans a portion of their eligible pretax compensation up to certain limits as specified by the plans. ALLTEL also makes annual contributions to the plans. Expense recorded by ALLTEL related to these plans amounted to $7.1 million in 2004, $7.3 million in 2003 and $10.9 million in 2002.

9. Restructuring and Other Charges:

A summary of the restructuring and other charges recorded in 2004 was as follows:

(Millions)	Wireless	Wireline	Communications Support Services	Corporate Operations	Total
Severance and employee benefit costs	$ 8.6	$ 11.2	$ 0.5	$ 2.1	$ 22.4
Relocation costs	2.7	1.2	0.1	0.1	4.1
Lease and contract termination costs	0.5	(1.9)	–	(0.1)	(1.5)
Write–down in carrying value of certain facilities	0.7	–	–	24.1	24.8
Other exit costs	0.4	0.7	–	–	1.1
Total restructuring and other charges	$ 12.9	$ 11.2	$ 0.6	$ 26.2	$ 50.9

In January 2004, the Company announced its plans to reorganize its operations and support teams. Also, during February 2004, the Company announced its plans to exit its Competitive Local Exchange Carrier ("CLEC") operations in the Jacksonville, Florida market due to the continued unprofitability of these operations. In connection with these activities, the Company recorded a restructuring charge of $29.3 million consisting of $22.9 million in severance and employee benefit costs related to a planned workforce reduction, $4.8 million of employee relocation expenses, $0.5 million in lease termination costs and $1.1 million of other exit costs. The severance and employee benefit costs included a $1.2 million payment to a former employee of the Company's sold financial services division that became payable in the first quarter of 2004 pursuant to the terms of a change in control agreement between the employee and ALLTEL. During the fourth quarter of 2004, the Company recorded a $0.9 million reduction in the liabilities associated with the restructuring efforts initiated in the first quarter of 2004, consisting of $0.7 million in employee relocation expenses and $0.2 million in severance and employee benefit costs. The reductions primarily reflected differences between estimated and actual costs paid in completing the employee relocations and terminations. As of December 31, 2004, the Company had paid $22.5 million in severance and employee–related expenses, and all of the employee reductions and relocations had been completed.

During the first quarter of 2004, ALLTEL also recorded a $2.3 million reduction in the liabilities associated with various restructuring activities initiated prior to 2003, consisting of $2.0 million in lease and contract termination costs and $0.3 million in severance and employee benefit costs. The reductions primarily reflected differences between estimated and actual costs paid in completing the previous planned workforce reductions and lease and contract terminations. During the first quarter of 2004, the Company also recorded a write–down in the carrying value of certain corporate and regional facilities to fair value in conjunction with the 2004 organizational changes and the 2003 sale of the Company's financial services division to Fidelity National Financial Inc. ("Fidelity National"), as further discussed in Note 12 to the consolidated financial statements.

A summary of the restructuring and other charges recorded in 2003 was as follows:

(Millions)	Wireless	Wireline	Communications Support Services	Corporate Operations	Total
Severance and employee benefit costs	$ 1.3	$ 7.0	$ –	$ (2.0)	$ 6.3
Lease and contract termination costs	–	–	(0.5)	–	(0.5)
Write–down of software development costs	7.6	1.8	3.8	–	13.2
Total restructuring and other charges	$ 8.9	$ 8.8	$ 3.3	$ (2.0)	$ 19.0

During the second quarter of 2003, the Company recorded a restructuring charge of $8.5 million consisting of severance and employee benefit costs related to a planned workforce reduction, primarily resulting from the closing of certain call center locations. As of December 31, 2004, the Company had paid $8.5 million in severance and employee–related expenses, and all of the employee reductions had been completed. The Company also recorded a $2.7 million reduction in the liabilities associated with various restructuring activities initiated prior to 2003, consisting of $2.2 million in severance and employee benefit costs and $0.5 million in lease termination costs. The reduction primarily reflected differences between estimated and actual costs paid in completing the previous planned workforce reductions and lease terminations. During the second quarter of 2003, ALLTEL also wrote off certain capitalized software development costs that had no alternative future use or functionality.

9. Restructuring and Other Charges, Continued:

A summary of the restructuring and other charges recorded in 2002 was as follows:

(Millions)	Wireless	Wireline	Communications Support Services	Total
Severance and employee benefit costs	$ 6.4	$ 6.6	$ 1.8	$ 14.8
Lease and contract termination costs	5.2	3.8	3.6	12.6
Computer system conversion and other integration costs	4.0	17.0	–	21.0
Write–down of cell site equipment	7.1	–	–	7.1
Write–down of software development costs	0.3	4.1	–	4.4
Branding and signage costs	4.1	3.7	–	7.8
Equipment removal and other disposal costs	–	2.2	–	2.2
Total restructuring and other charges	$ 27.1	$ 37.4	$ 5.4	$ 69.9

During the evaluation of its existing CLEC operations, ALLTEL determined that a business model that relied heavily on interconnection with other carriers had limited potential for profitably acquiring market share. Accordingly, in January 2002, the Company announced its plans to exit its CLEC operations in seven states representing less than 20 percent of its CLEC access lines. In the course of exiting these markets, ALLTEL honored all existing customer contracts, licenses and other obligations and worked to minimize the inconvenience to affected customers by migrating these customers to other service providers. During 2002, the Company also consolidated its call center, retail store and product distribution operations. In connection with these activities, the Company recorded restructuring charges totaling $27.4 million consisting of $14.8 million in severance and employee benefit costs related to planned workforce reductions and $12.6 million of costs associated with terminating certain CLEC transport agreements and lease termination fees incurred with the closing of certain retail, call center and product distribution locations. In exiting the CLEC operations, the Company also incurred costs to disconnect and remove switching and other transmission equipment from central office facilities and expenses to notify and migrate customers to other service providers. ALLTEL also wrote off certain capitalized software development costs that had no alternative future use or functionality. The restructuring plans were completed in 2002 and resulted in the elimination of 1,040 employees primarily in the Company's sales, customer service and network operations support functions and ALLTEL's product distribution operations. As of December 31, 2004, the Company had paid $14.3 million in severance and employee–related expenses, and all of the employee reductions had been completed.

The $12.6 million in lease and contract termination costs recorded in 2002 consisted of $6.2 million, representing the estimated minimum contractual commitments over the next one to five years for 38 operating locations that the Company abandoned, net of anticipated sublease income. The lease and contract termination costs also included $1.6 million of costs to terminate transport agreements with six interexchange carriers. The Company also recorded an additional $3.8 million to reflect the revised estimated costs, net of anticipated sublease income, to terminate leases associated with four operating locations. ALLTEL had previously recorded $6.3 million in lease termination costs related to these four locations in 1999. The additional charge reflected a reduction in expected sublease income primarily due to softening demand in the commercial real estate market and the bankruptcy filings by two sublessees. The lease termination costs also included $1.0 million of unamortized leasehold improvements related to the abandoned locations.

In connection with the purchase of wireline properties in Kentucky from Verizon and wireless properties from CenturyTel, the Company incurred branding and signage costs of $7.8 million. In connection with these acquisitions, the Company also incurred $21.0 million of computer system conversion and other integration costs. These expenses included internal payroll and employee benefit costs, contracted services, and other computer programming costs incurred in connection with expanding ALLTEL's customer service and operations support functions to handle increased customer volumes resulting from the acquisitions and to convert Verizon's customer billing and operations support systems to ALLTEL's internal systems.

In conjunction with a product replacement program initiated by a vendor in 2001, the Company exchanged certain used cell site equipment for new equipment. The exchange of cell site equipment began during the third quarter of 2001 and continued through the first quarter of 2002. As the equipment exchanges were completed, the Company recorded write–downs in the carrying value of the used cell site equipment to fair value.

9. Restructuring and Other Charges, Continued:

The following is a summary of activity related to the liabilities associated with the Company's restructuring and other charges at December 31:

(Millions)	2004	2003
Balance, beginning of year	$ 3.8	$ 13.1
Restructuring and other charges	54.1	21.7
Reversal of accrued liabilities	(3.2)	(2.7)
Non–cash write–down of assets	(25.6)	(15.2)
Cash outlays	(28.4)	(13.1)
Balance, end of year	$ 0.7	$ 3.8

As of December 31, 2004, the remaining unpaid liability related to the Company's restructuring activities consisted of severance and employee–related expenses of $0.2 million, relocation expenses of $0.2 million and lease and contract termination costs of $0.3 million and is included in other current liabilities in the accompanying consolidated balance sheets. The restructuring and other charges decreased net income $31.1 million, $11.5 million and $42.3 million for the years ended December 31, 2004, 2003 and 2002, respectively.

10. Gain on Disposal of Assets, Write–Down of Investments and Other:

In December 2003, the Company sold to Convergys Information Management Group, Inc. ("Convergys") certain assets and related liabilities, including selected customer contracts and capitalized software development costs, associated with the Company's telecommunications information services operations. In connection with this sale, the Company recorded a pretax gain of $31.0 million. In the second quarter of 2003, ALLTEL recorded pretax write–downs totaling $6.0 million to reflect other–than–temporary declines in the fair value of certain investments in unconsolidated limited partnerships. In addition, during the second quarter of 2003, the Company retired, prior to stated maturity dates, $249.1 million of long–term debt, representing all of the long–term debt outstanding under the Rural Utilities Services, Rural Telephone Bank and Federal Financing Bank programs. In connection with the early retirement of the debt, the Company incurred pretax termination fees of $7.1 million. These transactions increased net income $10.7 million.

In 2002, the Company recorded a pretax gain of $22.1 million from the sale of a wireless property in Pennsylvania to Verizon Wireless. The Company also recorded pretax write–downs totaling $15.1 million related to its investment in Hughes Tele.com Limited ("HTCL"). The initial write–down of $12.5 million was recorded in connection with HTCL's agreement to merge with a major Indian telecommunications company and an other–than–temporary decline in the fair value of HTCL's common stock. In December 2002, ALLTEL exchanged its shares of HTCL for non–voting, mandatory redeemable convertible preferred shares of Tata Teleservices Limited ("Tata"), a privately held Indian company. Subsequently, ALLTEL decided to liquidate this investment by selling the Tata preferred shares. The additional $2.6 million write–down of the Tata investment reflected the difference between the carrying amount of the Tata preferred shares and the estimated sales proceeds to be realized by ALLTEL upon completion of the sale, which occurred in February 2003. During 2002, the Company recorded a pretax adjustment of $4.8 million to reduce the gain recognized from the dissolution of a wireless partnership with BellSouth Mobility, Inc. ("BellSouth") initially recorded in 2001. The adjustment reflected a true up for cash distributions payable to BellSouth in conjunction with the dissolution of the partnership. In 2002, the Company also recorded a pretax write–down of $1.2 million related to an other–than–temporary decline in ALLTEL's investment in Airspan Networks, Inc., a provider of wireless telecommunications equipment. The effect of these transactions increased net income $0.6 million in 2002.

11. Income Taxes:

Income tax expense was as follows for the years ended December 31:

(Millions)	2004	2003	2002
Current:			
Federal	$ 257.5	$ 251.2	$ 169.4
State and other	40.2	37.1	(2.4)
	297.7	288.3	167.0
Deferred:			
Federal	230.6	244.3	288.5
State and other	37.0	48.0	54.7
	267.6	292.3	343.2
	$ 565.3	$ 580.6	$ 510.2

11. Income Taxes, Continued:

Deferred income tax expense for all three years primarily resulted from temporary differences between depreciation expense for income tax purposes and depreciation expense recorded in the financial statements. Deferred income tax expense for 2004, 2003 and 2002 also included the effects of no longer amortizing indefinite–lived intangible assets for financial statement purposes in accordance with SFAS No. 142, as previously discussed. These intangible assets continue to be amortized for income tax purposes.

Differences between the federal income tax statutory rates and effective income tax rates, which include both federal and state income taxes, were as follows for the years ended December 31:

	2004	2003	2002
Statutory federal income tax rates	35.0%	35.0%	35.0%
Increase (decrease):			
State income taxes, net of federal benefit	3.1	3.6	2.6
Reversal of income tax contingency reserves due to IRS audits	(1.2)	–	–
Allowance of prior year loss on disposal of a subsidiary	(1.1)	–	–
Other items, net	(0.3)	(0.8)	(0.1)
Effective income tax rates	35.5%	37.8%	37.5%

As more fully discussed in Note 2 to the consolidated financial statements, during the third quarter of 2004, the IRS completed its fieldwork related to the audits of ALLTEL's consolidated federal income tax returns for the fiscal years 1997 through 2001. As a result of the IRS issuing its proposed audit adjustments related to the periods under examination, ALLTEL reassessed its income tax contingency reserves to reflect the IRS findings and recorded a reduction in income tax expense associated with continuing operations of $19.7 million. During 2004, the Company also reached an agreement with the IRS allowing for the deduction of a previously realized loss associated with ALLTEL's 1997 disposition of a subsidiary. The Company remains subject to ongoing tax examinations and assessments in various jurisdictions. ALLTEL does not believe that the outcome of these examinations will have a material adverse effect on its consolidated results of operations, cash flows or financial position.

The significant components of the net deferred income tax liability were as follows at December 31:

(Millions)	2004	2003
Property, plant and equipment	$ 958.3	$ 914.0
Goodwill and other intangibles	635.5	611.3
Capitalized software development costs	32.4	34.4
Pension and other employee benefits	82.7	59.6
Unrealized holding gain on investments	82.9	46.9
Partnership investments	(66.0)	(218.5)
Deferred compensation	(37.1)	(37.1)
Operating loss carryforwards	(22.2)	(18.7)
Other, net	32.4	12.3
	1,698.9	1,404.2
Valuation allowance	16.2	13.5
Deferred income taxes	$1,715.1	$1,417.7

At December 31, 2004 and 2003, total deferred tax assets were $202.7 million and $381.3 million, respectively, and total deferred tax liabilities were $1,917.8 million and $1,799.0 million, respectively. As of December 31, 2004 and 2003, the Company had available tax benefits associated with state operating loss carryforwards of $22.2 million and $18.7 million, respectively, which expire annually in varying amounts to 2023. The Company establishes valuation allowances when necessary to reduce deferred tax assets to amounts expected to be realized. The valuation allowance relates to certain state operating loss carryforwards, which may expire and not be utilized. The valuation allowance increased by $2.7 million in 2004 and was reflected in income tax from continuing operations.

12. Discontinued Operations:

Pursuant to a definitive agreement dated January 28, 2003, on April 1, 2003, ALLTEL sold the financial services division of its information services subsidiary, ALLTEL Information Services, Inc., to Fidelity National for $1.05 billion, received as $775.0 million in cash and $275.0 million in Fidelity National common stock. Approximately 5,500 employees of the Company transitioned to Fidelity National as part of the transaction. As a result of this transaction, ALLTEL recorded an after tax gain

12. Discontinued Operations, Continued:

of $323.9 million. The after–tax proceeds from the sale were used primarily to reduce borrowings outstanding under the Company's commercial paper program and to retire all long–term debt outstanding under the Rural Utilities Services, Rural Telephone Bank and Federal Financing Bank programs. The Fidelity National common stock acquired in this transaction currently represents an approximate six percent interest in Fidelity National. The depreciation of long–lived assets related to the financial services division ceased as of January 28, 2003, the date of the agreement to sell such operations. In January 2003, ALLTEL also completed the termination of its business venture with Bradford & Bingley Group. The business venture, ALLTEL Mortgage Solutions, Ltd., a majority–owned consolidated subsidiary of ALLTEL, was created in 2000 to provide mortgage administration and information technology products in the United Kingdom. Unfortunately, the business climate in the United Kingdom limited the venture's ability to leverage the business across a broad base of customers. As a result of these transactions, the operations of the financial services division and ALLTEL Mortgage Solutions, Ltd. have been reflected as discontinued operations in the Company's consolidated financial statements for all periods presented.

The following table includes certain summary income statement information related to the financial services operations reflected as discontinued operations for the years ended December 31:

(Millions)	2004	2003	2002
Revenues and sales	$ –	$ 210.3	$ 871.0
Operating expenses (a)	–	148.1	775.1
Operating income	–	62.2	95.9
Minority interest in consolidated partnerships	–	–	3.5
Other income (expense), net (b)	–	(0.1)	5.8
Gain on sale of discontinued operations (c)	–	555.1	–
Pretax income from discontinued operations	–	617.2	105.2
Income tax expense (benefit) (d)	(19.5)	256.2	31.0
Income from discontinued operations	$ 19.5	$ 361.0	$ 74.2

Notes:

(a) Included in operating expenses for 2002 was a $42.3 million charge associated with discontinuing the Company's business venture with Bradford & Bingley Group. The charge primarily consisted of the write–off of capitalized software development costs that had no alternative use or functionality. The charge also included the write–off of unamortized leasehold improvements and other costs to unwind the business venture.

(b) The Company had no outstanding indebtedness directly related to the financial services operations, and accordingly, no interest expense was allocated to discontinued operations.

(c) Goodwill associated with the sold financial services division amounted to $25.8 million and was included in the computation of the gain on the sale of discontinued operations.

(d) The income tax benefit recorded in the third quarter of 2004 included the reversal of $15.1 million of federal income tax contingency reserves attributable to the sold financial services division, as previously discussed in Note 2. In connection with the IRS audits of the Company's consolidated federal income tax returns for the fiscal years 1997 through 2001, the Company also recorded a foreign tax credit carryback benefit of $4.4 million.

The following table includes certain summary cash flow statement information related to the financial services operations reflected as discontinued operations for the years ended December 31:

(Millions)	2003	2002
Net cash provided by (used in) operating activities	$(231.5)(a)	$ 203.9
Net cash provided by (used in) investing activities	763.4 (b)	(112.0)
Net cash used in financing activities	(0.1)	(0.6)
Net cash provided by discontinued operations	$ 531.8	$ 91.3

Notes:

(a) Included $260.9 million in estimated tax payments related to sale of the financial services operations.

(b) Included cash proceeds of $784.9 million received from the sale of the financial services division to Fidelity National. The cash proceeds included working capital adjustments of $9.9 million.

13. Other Comprehensive Income:

Other comprehensive income consists of unrealized holding gains (losses) on investments in equity securities and foreign currency translation adjustments. Other comprehensive income was as follows for the years ended December 31:

(Millions)	2004	2003	2002
Unrealized holding gains (losses) on investments:			
Unrealized holding gains (losses) arising in the period	$ 116.9	$ 120.5	$ (6.2)
Income tax expense (benefit)	36.2	46.9	(2.3)
	80.7	73.6	(3.9)
Reclassification adjustments for (gains) losses included in net income for the period	(0.7)	–	13.7
Income tax expense (benefit)	0.3	–	(5.3)
	(0.4)	–	8.4
Net unrealized gains in the period	116.2	120.5	7.5
Income tax expense	35.9	46.9	3.0
	80.3	73.6	4.5
Foreign currency translation adjustment:			
Translation adjustment for the period	(0.1)	0.8	3.0
Reclassification adjustments for losses included in net income for the period	–	6.7	–
	(0.1)	7.5	3.0
Other comprehensive income before tax	116.1	128.0	10.5
Income tax expense	35.9	46.9	3.0
Other comprehensive income	$ 80.2	$ 81.1	$ 7.5

14. Commitments and Contingencies:

Litigation – The Company is party to various legal proceedings arising from the ordinary course of business. Although the ultimate resolution of these various proceedings cannot be determined at this time, management of the Company does not believe that such proceedings, individually or in the aggregate, will have a material adverse effect on the future consolidated results of operations, cash flows or financial condition of the Company.

Guarantees – Effective January 1, 2003, ALLTEL adopted the recognition and measurement provisions of FASB Interpretation ("FIN") No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," for all arrangements entered into on or after that date. The Company currently has outstanding various indemnifications related either to the sale of the financial services division to Fidelity National or the sale of certain assets and related liabilities of the telecommunications information services operations to Convergys. (See Notes 10 and 12.)

In conjunction with the sale of the financial services division, ALLTEL agreed to indemnify Fidelity National for any damages resulting from ALLTEL's breach of warranty or non–fulfillment of certain covenants under the sales agreement, that exceed 1.5 percent of the purchase price, or $15.75 million, up to a maximum of 15 percent of the purchase price, or $157.5 million. The Company believes, because of the low probability of being required to pay any amount under this indemnification, the fair value of this obligation is immaterial to the consolidated results of operations, cash flows and financial condition of the Company. Accordingly, the Company has not recorded a liability related to it. ALLTEL also agreed to indemnify Fidelity National from any future tax liability imposed on the financial services division related to periods prior to the date of sale. ALLTEL's obligation to Fidelity National under this indemnification is not subject to a maximum amount. At December 31, 2004, the Company has recorded a liability for tax contingencies of approximately $8.3 million related to the operations of the financial services division for periods prior to the date of sale that management has assessed as probable and estimable, which should adequately cover any obligation under this indemnification.

In connection with the sale of assets to Convergys, ALLTEL agreed to indemnify Convergys for any damages resulting from ALLTEL's breach of warranty under the sales agreement that exceed $500,000, up to a maximum of $10.0 million. In addition, the Company agreed to indemnify Convergys for any damages resulting from non–fulfillment of certain covenants or liabilities arising from the ownership, operation or use of the assets included in the sale. This indemnification is not subject to a maximum obligation. The Company believes because of the low probability of being required to pay any amount under these indemnifications, the fair value of these obligations is immaterial to the consolidated results of operations, cash flows and financial condition of the Company. Accordingly, the Company has not recorded a liability related to these indemnifications.

14. Commitments and Contingencies, Continued:

Lease Commitments – Minimum rental commitments for all non–cancelable operating leases, consisting principally of leases for cell site tower space, network facilities, real estate, office space, and office equipment were as follows as of December 31, 2004:

Year	(Millions)
2005	$ 147.4
2006	112.7
2007	81.0
2008	59.8
2009	32.3
Thereafter	74.8
Total	$ 508.0

Rental expense totaled $184.8 million in 2004, $139.3 million in 2003 and $115.7 million in 2002.

15. Agreement to Lease Cell Site Towers:

In 2000, ALLTEL signed a definitive agreement with American Tower Corporation ("American Tower") to lease to American Tower certain of the Company's cell site towers in exchange for cash paid in advance. Under terms of the fifteen–year lease agreement, American Tower assumed responsibility to manage, maintain and remarket the remaining space on the towers, while ALLTEL maintained ownership of the cell site facilities. ALLTEL is obligated to pay American Tower a monthly fee for management and maintenance services for the duration of the agreement amounting to $1,200 per tower per month, subject to escalation not to exceed five percent annually. American Tower has the option to purchase the towers for additional consideration at the end of the lease term. Upon completion of this transaction, the Company had leased 1,773 cell site towers to American Tower and received proceeds of $531.9 million. Proceeds from this leasing transaction were recorded by ALLTEL as deferred rental income and are recognized as service revenues on a straight–line basis over the fifteen–year lease term. Deferred rental income was as follows at December 31:

(Millions)	2004	2003
Deferred rental income – current (included in other current liabilities)	$ 35.6	$ 35.3
Deferred rental income -- long–term (included in other liabilities)	375.3	411.2
Total deferred rental income	$ 410.9	$ 446.5

16. Business Segments:

ALLTEL disaggregates its business operations based upon differences in products and services. Wireless operations include cellular, PCS and paging services and are provided in 24 states. The Company's wireline subsidiaries provide local service and network access in 15 states. Wireline operations also include ALLTEL's local competitive access and Internet access operations. Local competitive access services are currently provided in select markets. Communications support services consist of the Company's long–distance, network management, product distribution, telecommunications information services and directory publishing operations. Long–distance and Internet access services are currently marketed in 25 and 17 states, respectively. Telecommunications information services provide application software, data processing and outsourcing services to telecommunications companies in the United States and select international markets. Corporate items include general corporate expenses, headquarters facilities and equipment, investments, and other items not allocated to the segments.

The accounting policies used in measuring segment assets and operating results are the same as those described in Note 1. The Company accounts for intercompany sales at current market prices or in accordance with regulatory requirements. The Company evaluates performance of the segments based on segment income, which is computed as revenues and sales less operating expenses, excluding the effects of the restructuring and other charges discussed in Note 9. These items are not allocated to the segments and are included in corporate operations. In addition, none of the non–operating items such as equity earnings in unconsolidated partnerships, minority interest expense, other income, net, gain on disposal of assets, write–down of investments, debt prepayment penalties, interest expense and income taxes have been allocated to the segments.

16. Business Segments, Continued:

(Millions)	For the year ended December 31, 2004			
	Wireless	Wireline	Communications Support Services	Total Segments
Revenues and sales from unaffiliated customers:				
Domestic	$5,078.1	$2,256.0	$ 690.3	$ 8,024.4
International	–	–	1.9	1.9
	5,078.1	2,256.0	692.2	8,026.3
Intercompany revenues and sales	–	163.8	231.6	395.4
Total revenues and sales	5,078.1	2,419.8	923.8	8,421.7
Operating expenses	3,319.1	977.3	826.8	5,123.2
Depreciation and amortization	738.8	516.5	34.3	1,289.6
Total costs and expenses	4,057.9	1,493.8	861.1	6,412.8
Segment income	$1,020.2	$ 926.0	$ 62.7	$ 2,008.9
Assets	$9,881.5	$5,042.8	$ 495.8	$15,420.1
Investments in unconsolidated partnerships	$ 257.8	$ –	$ –	$ 257.8
Capital expenditures	$ 769.3	$ 332.0	$ 15.1	$ 1,116.4

	For the year ended December 31, 2003			
	Wireless	Wireline	Communications Support Services	Total Segments
Revenues and sales from unaffiliated customers:				
Domestic	$4,728.4	$2,286.9	$ 700.9	$ 7,716.2
International	–	–	4.4	4.4
	4,728.4	2,286.9	705.3	7,720.6
Intercompany revenues and sales	–	149.2	253.7	402.9
Total revenues and sales	4,728.4	2,436.1	959.0	8,123.5
Operating expenses	3,059.4	1,025.7	846.4	4,931.5
Depreciation and amortization	671.0	526.5	36.2	1,233.7
Total costs and expenses	3,730.4	1,552.2	882.6	6,165.2
Segment income	$ 998.0	$ 883.9	$ 76.4	$ 1,958.3
Assets	$9,673.9	$5,212.9	$ 518.6	$15,405.4
Investments in unconsolidated partnerships	$ 281.9	$ –	$ –	$ 281.9
Capital expenditures	$ 739.4	$ 378.6	$ 19.0	$ 1,137.0

	For the year ended December 31, 2002			
	Wireless	Wireline	Communications Support Services	Total Segments
Revenues and sales from unaffiliated customers:				
Domestic	$4,160.2	$2,027.2	$ 628.6	$ 6,816.0
International	–	–	3.8	3.8
	4,160.2	2,027.2	632.4	6,819.8
Intercompany revenues and sales	–	152.5	293.3	445.8
Total revenues and sales	4,160.2	2,179.7	925.7	7,265.6
Operating expenses	2,634.7	921.1	803.7	4,359.5
Depreciation and amortization	577.6	465.6	37.8	1,081.0
Total costs and expenses	3,212.3	1,386.7	841.5	5,440.5
Segment income	$ 947.9	$ 793.0	$ 84.2	$ 1,825.1
Assets	$9,418.7	$5,340.4	$ 535.6	$15,294.7
Investments in unconsolidated partnerships	$ 273.5	$ –	$ –	$ 273.5
Capital expenditures	$ 717.1	$ 399.6	$ 32.9	$ 1,149.6

16. Business Segments, Continued:

A reconciliation of the total business segments to the applicable amounts in the Company's consolidated financial statements was as follows as of and for the years ended December 31:

(Millions)	2004	2003	2002
Revenues and sales:			
Total business segments	$ 8,421.7	$ 8,123.5	$ 7,265.6
Less: intercompany eliminations(1)	(175.6)	(143.6)	(153.2)
Total revenues and sales	$ 8,246.1	$ 7,979.9	$ 7,112.4
Income from continuing operations before income taxes:			
Total business segment income	$ 2,008.9	$ 1,958.3	$ 1,825.1
Corporate operations	(36.4)	(41.3)	(35.5)
Restructuring and other charges	(50.9)	(19.0)	(69.9)
Equity earnings in unconsolidated partnerships	68.5	64.4	65.8
Minority interest expense in consolidated partnerships	(80.1)	(78.6)	(73.4)
Other income, net	34.5	11.0	2.3
Interest expense	(352.5)	(378.6)	(355.1)
Gain on disposal of assets, write–down of investments and other	–	17.9	1.0
Total income from continuing operations before income taxes	$ 1,592.0	$ 1,534.1	$ 1,360.3
Depreciation and amortization expense:			
Total business segments	$ 1,289.6	$ 1,233.7	$ 1,081.0
Corporate operations	10.1	14.0	14.5
Total depreciation and amortization expense	$ 1,299.7	$ 1,247.7	$ 1,095.5
Assets:			
Total business segments	$15,420.1	$15,405.4	$15,294.7
Corporate assets(2)	1,201.2	1,319.3	458.2
Assets held for sale	–	–	538.3
Less: elimination of intercompany receivables	(17.6)	(63.6)	(46.6)
Total assets	$16,603.7	$16,661.1	$16,244.6
Capital expenditures:			
Total business segments	$ 1,116.4	$ 1,137.0	$ 1,149.6
Corporate operations	9.0	0.7	5.2
Total capital expenditures	$ 1,125.4	$ 1,137.7	$ 1,154.8

Notes:

(1) See "Transactions with Certain Affiliates" in Note 1 for a discussion of intercompany revenues and sales not eliminated in preparing the consolidated financial statements.

(2) Corporate assets consist of cash and short–term investments, fixed assets, investments in equity securities and other assets not allocated to the segments.

16. Business Segments, Continued:

Supplemental information pertaining to the Communications Support Services segment was as follows for the years ended December 31:

(Millions)	2004	2003	2002
Revenues and sales from unaffiliated customers:			
Product distribution	$ 306.5	$ 275.1	$ 215.2
Long–distance and network management services	188.0	198.7	179.0
Directory publishing	155.9	122.6	119.1
Telecommunications information services	41.8	108.9	119.1
	$ 692.2	$ 705.3	$ 632.4
Intercompany revenues and sales:			
Product distribution	$ 114.7	$ 132.3	$ 156.1
Long–distance and network management services	116.9	121.4	137.2
Directory publishing	–	–	–
Telecommunications information services	–	–	–
	$ 231.6	$ 253.7	$ 293.3
Total revenues and sales:			
Product distribution	$ 421.2	$ 407.4	$ 371.3
Long–distance and network management services	304.9	320.1	316.2
Directory publishing	155.9	122.6	119.1
Telecommunications information services	41.8	108.9	119.1
Total communications support services revenues and sales	$ 923.8	$ 959.0	$ 925.7

17. Quarterly Financial Information – (Unaudited):

	For the year ended December 31, 2004				
(Millions, except per share amounts)	Total	4th	3rd	2nd	1st
Revenues and sales	$8,246.1	$2,139.7	$2,103.1	$2,042.1	$1,961.2
Operating income	$1,921.6	$ 501.2	$ 517.8	$ 507.8	$ 394.8
Income from continuing operations	$1,026.7	$ 270.6	$ 303.7	$ 262.6	$ 189.8
Discontinued operations	19.5	–	19.5	–	–
Income before cumulative effect of accounting change	$1,046.2	$ 270.6	$ 323.2	$ 262.6	$ 189.8
Cumulative effect of accounting change	–	–	–	–	–
Net income	$1,046.2	$ 270.6	$ 323.2	$ 262.6	$ 189.8
Preferred dividends	0.1	–	–	0.1	–
Net income applicable to common shares	$1,046.1	$ 270.6	$ 323.2	$ 262.5	$ 189.8
Basic earnings per share:					
Income from continuing operations	$ 3.34	$ .89	$ .99	$ .85	$ .61
Income from discontinued operations	.06	–	.06	–	–
Cumulative effect of accounting change	–	–	–	–	–
Net income	$ 3.40	$ .89	$ 1.05	$ .85	$ .61
Diluted earnings per share:					
Income from continuing operations	$ 3.33	$ .89	$ .99	$ .85	$ .61
Income from discontinued operations	.06	–	.06	–	–
Cumulative effect of accounting change	–	–	–	–	–
Net income	$ 3.39	$ .89	$ 1.05	$ .85	$ .61

17. Quarterly Financial Information – (Unaudited), Continued:

(Millions, except per share amounts)	For the year ended December 31, 2003				
	Total	4th	3rd	2nd	1st
Revenues and sales	$7,979.9	$2,013.7	$2,050.2	$2,010.2	$1,905.8
Operating income	$1,898.0	$ 474.1	$ 486.7	$ 471.1	$ 466.1
Income from continuing operations	$ 953.5	$ 258.9	$ 242.8	$ 224.2	$ 227.6
Discontinued operations	361.0	–	–	323.9	37.1
Income before cumulative effect of accounting change	$1,314.5	$ 258.9	$ 242.8	$ 548.1	$ 264.7
Cumulative effect of accounting change	15.6	–	–	–	15.6
Net income	$1,330.1	$ 258.9	$ 242.8	$ 548.1	$ 280.3
Preferred dividends	0.1	–	–	0.1	–
Net income applicable to common shares	$1,330.0	$ 258.9	$ 242.8	$ 548.0	$ 280.3
Basic earnings per share:					
Income from continuing operations	$ 3.06	$ .83	$ .78	$ .72	$ .73
Income from discontinued operations	1.16	–	–	1.04	.12
Cumulative effect of accounting change	.05	–	–	–	.05
Net income	$ 4.27	$ .83	$ .78	$ 1.76	$ .90
Diluted earnings per share:					
Income from continuing operations	$ 3.05	$ .83	$ .78	$ .72	$ .73
Income from discontinued operations	1.15	–	–	1.03	.12
Cumulative effect of accounting change	.05	–	–	–	.05
Net income	$ 4.25	$ .83	$ .78	$ 1.75	$ .90

Notes to Quarterly Financial Information:

A. During the fourth quarter of 2004, the Company recorded a $0.9 million reduction in the liabilities associated with the restructuring efforts initiated in the first quarter of 2004 (see Note C below), consisting of $0.7 million in employee relocation expenses and $0.2 million in severance and employee benefit costs. (See Note 9).

B. During the third quarter of 2004, the IRS completed its fieldwork related to the audits of the Company's consolidated federal income tax returns for the fiscal years 1997 through 2001 and issued its proposed audit adjustments related to the periods under examination. As a result, ALLTEL adjusted its income tax contingency reserves to reflect the IRS findings, the effects of which resulted in a reduction in income tax expense associated with continuing operations of $19.7 million or $.06 per share. (See Note 2).

C. In the first quarter of 2004, ALLTEL recorded a restructuring charge of $29.3 million related to a planned workforce reduction and the exit of its CLEC operations in the Jacksonville, Florida market. In addition, ALLTEL recorded a $2.3 million reduction in the liabilities associated with various restructuring activities initiated prior to 2003. ALLTEL also recorded a write–down in the carrying value of certain corporate and regional facilities to fair value in conjunction with the proposed leasing or sale of those facilities. These transactions decreased net income $31.6 million or $.10 per share. (See Note 9).

D. In the fourth quarter of 2003, the Company recorded a pretax gain of $31.0 million from the sale of certain assets and related liabilities, including customer contracts and capitalized software development costs, associated with the Company's telecommunications information services operations. This transaction increased net income $18.9 million or $.06 per share. (See Note 10.)

E. In the second quarter of 2003, the Company recorded a restructuring charge of $8.5 million related to a planned workforce reduction, primarily resulting from the closing of certain call center locations, and recorded a $2.7 million reduction in the liabilities associated with various restructuring activities initiated prior to 2003. The Company also wrote off $13.2 million of certain capitalized software development costs that had no alternative future use or functionality. (See Note 9.) In the second quarter of 2003, ALLTEL also recorded pretax write–downs totaling $6.0 million to reflect other–than–temporary declines in the fair value of certain investments in unconsolidated limited partnerships. In addition, the Company incurred pretax termination fees of $7.1 million related to the early retirement of long–term debt. These transactions decreased net income $19.8 million or $.06 per share. (See Note 10.)

F. Effective January 1, 2003, ALLTEL adopted the measurement and recognition provisions of SFAS No. 143 in accounting for asset retirement obligations. The cumulative effect of this accounting change resulted in a one–time non–cash credit of $15.6 million, net of income tax expense of $10.3 million, or $.05 per share. (See Note 2.)

18. Subsequent Event – Pending Merger With Western Wireless Corporation:
On January 9, 2005, ALLTEL entered into an Agreement and Plan of Merger (the "Merger Agreement") with Western Wireless Corporation ("Western Wireless") providing for the merger of Western Wireless with and into a wholly–owned subsidiary of ALLTEL (the "Merger"). In the Merger, each share of Western Wireless common stock will be exchanged for .535 shares of ALLTEL common stock and $9.25 in cash unless the shareholder makes an all–cash or all–stock election. Western Wireless shareholders making an all–stock or all–cash election may be subject to proration depending on the number of shareholders making such elections. In the aggregate, ALLTEL will issue approximately 60 million shares of stock and pay approximately $1.0 billion in cash. A subsidiary of ALLTEL will also assume debt of approximately $2.2 billion, including $1.2 billion of term notes issued under Western Wireless' credit facility that, as a result of a change in control, will become due immediately upon the closing of the Merger. The transaction is valued at approximately $6 billion.

Upon completion of the Merger, ALLTEL will add approximately 1.3 million domestic wireless customers (excluding reseller customers) in 19 midwestern and western states that are contiguous to the Company's existing wireless properties, increasing the number of wireless customers served by ALLTEL to approximately 10 million. Through this transaction, ALLTEL will add wireless operations in nine new states, including California, Idaho, Minnesota, Montana, Nevada, North Dakota, South Dakota, Utah and Wyoming, and the Company will also significantly expand its wireless operations in Arizona, Colorado, New Mexico and Texas. In addition, ALLTEL will add approximately 1.6 million international customers in six countries.

Consummation of the Merger is subject to certain conditions, including the approval of the Merger by the stockholders of Western Wireless and the receipt of regulatory approvals, including, without limitation, the approval of the FCC and the expiration of the applicable waiting period under the Hart–Scott–Rodino Antitrust Improvements Act of 1976, as amended. The transaction is expected to close by mid–year 2005. The Merger Agreement contains certain termination rights for each of ALLTEL and Western Wireless and further provides that, upon termination of the Merger Agreement under specified circumstances involving an alternative transaction, Western Wireless may be required to pay ALLTEL a termination fee of $120.0 million.

Exhibit 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statement on Form S–3 (No. 33–85142) and Forms S–8 (No. 33–48476, 33–54175, 33–56291, 33–65199, 333–88907, 333–88923, 333–90167 and 333–116053) of ALLTEL Corporation of our reports dated February 10, 2005 relating to the consolidated financial statements, management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting, which appear in this Form 10–K/A (Amendment No. 1). We also consent to the incorporation by reference of our report dated February 10, 2005 relating to the financial statement schedule, which appears in this Form 10–K/A (Amendment No. 1).

/s/ PricewaterhouseCoopers LLP

Little Rock, Arkansas
June 20, 2005

Exhibit 31(a)

CERTIFICATION

I, Scott T. Ford, Chief Executive Officer and President of ALLTEL Corporation, certify that:

1. I have reviewed this annual report on Form 10-K/A of ALLTEL Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on the most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: June 21, 2005

/s/ Scott T. Ford
Scott T. Ford
Chief Executive Officer and President

Exhibit 31(b)

CERTIFICATION

I, Jeffery R. Gardner, Executive Vice President – Chief Financial Officer of ALLTEL Corporation, certify that:

1. I have reviewed this annual report on Form 10-K/A of ALLTEL Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a–15(e) and 15d–15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a–15(f) and 15d–15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on the most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: June 21, 2005

/s/ Jeffery R. Gardner
Jeffery R. Gardner
Executive Vice President – Chief Financial Officer

Exhibit 32(a)

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES–OXLEY ACT OF 2002

In connection with the accompanying Annual Report of ALLTEL Corporation (the Company) on Form 10–K/A for the period ending December 31, 2004 as filed with the Securities and Exchange Commission on the date hereof (the Report), I, Scott T. Ford, Chief Executive Officer and President of the Company, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to 906 of the Sarbanes–Oxley Act of 2002, to the best of my knowledge, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Scott T. Ford
Scott T. Ford
Chief Executive Officer and President
June 21, 2005

A signed original of this written statement required by Section 906 has been provided to ALLTEL Corporation and will be retained by ALLTEL Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

Exhibit 32(b)

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES–OXLEY ACT OF 2002

In connection with the accompanying Annual Report of ALLTEL Corporation (the Company) on Form 10–K/A for the period ending December 31, 2004 as filed with the Securities and Exchange Commission on the date hereof (the Report), I, Jeffery R. Gardner, Executive Vice President – Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to 906 of the Sarbanes–Oxley Act of 2002, to the best of my knowledge, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Jeffery R. Gardner
Jeffery R. Gardner
Executive Vice President – Chief Financial Officer
June 21, 2005

A signed original of this written statement required by Section 906 has been provided to ALLTEL Corporation and will be retained by ALLTEL Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

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FORM 10-Q

VALOR COMMUNICATIONS GROUP INC - VCG

Filed: November 08, 2005 (period: September 30, 2005)

Quarterly report which provides a continuing view of a company's financial position

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PART I

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

☑ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2005
or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ___to___
Commission file number: 001-32422

VALOR COMMUNICATIONS GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	20-0792300
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
201 E. John Carpenter Freeway, Suite 200, Irving, Texas	75062
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (972) 373-1000
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☑ No ☐
Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☑
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☑
As of November 2, 2005, 71,130,634 shares of common stock, par value $0.0001 per share, were outstanding.

VALOR COMMUNICATIONS GROUP, INC.
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PART I — FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS.

Valor Communications Group, Inc.

Condensed Consolidated Balance Sheets
(Dollars in thousands, except par value)
(unaudited)

	December 31, 2004	September 30, 2005
ASSETS		
Current assets		
Cash and cash equivalents	$ 17,034	$ 46,721
Accounts receivable:		
Customers, net of allowance for doubtful accounts of $1,833 and $1,825, respectively	26,602	25,850
Carriers and other, net of allowance for doubtful accounts of $881 and $873, respectively	36,155	33,653
Materials and supplies, at average cost	1,400	1,356
Other current assets	8,821	7,701
Total current assets	90,012	115,281
Net property, plant and equipment	749,984	727,315
Investments and other assets		
Goodwill	1,058,235	1,058,215
Other	72,936	51,289
Total investments and other assets	1,131,171	1,109,504
TOTAL ASSETS	$ 1,971,167	$ 1,952,100
LIABILITIES AND EQUITY		
Current liabilities		
Current maturities of long-term debt	$ 1,801	$ 123
Accounts payable	5,847	10,904
Notes payable	1,893	—
Accrued expenses and other current liabilities:		
Taxes	13,505	11,577
Salaries and benefits	15,135	12,619
Interest	5,471	5,819
Other	15,564	40,198
Advance billings and customer deposits	15,700	15,129
Total current liabilities	74,916	96,369
Long-term debt	1,599,177	1,180,555
Deferred credits and other liabilities	38,698	99,245
Redeemable preferred interests	236,129	—
Redeemable preferred interests of subsidiary	15,776	—
Total liabilities	1,964,696	1,376,169
Minority interests	—	—
Commitments and contingencies (see Note 9)		
Stockholders' equity		
Class A common interests, no par or stated value, 500,000,000 interests authorized, 65,568,694 issued and 65,534,944 outstanding at December 31, 2004	64,633	—
Class B common interests, no par or stated value, 5,184,255 interests authorized, 5,056,755 issued and outstanding at December 31, 2004	—	—
Class C interests, no par or stated value, 50,000,000 interests authorized, 46,000,000 issued and outstanding at December 31, 2004	29,542	—
	—	

Common stock, $0.0001 par value per share, 200,000,000 shares authorized, 70,868,777 shares issued and 70,767,501 shares outstanding at September 30, 2005		
Additional paid–in capital	—	921,891
Treasury stock, 33,750 Class A common interests at December 31, 2004 and 101,276 shares of common stock at September 30, 2005, at cost	(34)	(1,461)
Accumulated other comprehensive loss	(7,894)	(7,432)
Deferred equity compensation	—	(15,841)
Accumulated deficit	(79,776)	(321,233)
Total stockholders' equity	6,471	575,931
TOTAL LIABILITIES AND EQUITY	$ 1,971,167	$ 1,952,100

See accompanying notes to condensed consolidated financial statements.

Valor Communications Group, Inc.

Condensed Consolidated Statements of Income and Comprehensive Income
(Dollars in thousands, except owner unit and per share amounts)
(unaudited)

	Three months ended September 30, 2004	Three months ended September 30, 2005	Nine months ended September 30, 2004	Nine months ended September 30, 2005
Operating revenues	$ 126,631	$ 127,960	$ 379,279	$ 379,954
Operating expenses				
Cost of service (exclusive of depreciation and amortization shown separately below)	26,674	29,092	78,704	81,163
Selling, general and administrative	31,915	32,395	100,098	96,737
Non–cash stock compensation	—	2,069	—	10,412
Asset impairment	—	614	—	614
Depreciation and amortization	22,022	22,460	63,993	67,184
Total operating expenses	80,611	86,630	242,795	256,110
Operating income	46,020	41,330	136,484	123,844
Other income (expense)				
Interest expense	(28,289)	(19,814)	(83,384)	(64,726)
Gain (loss) on interest rate hedging arrangements	(85)	178	(122)	(378)
Earnings from unconsolidated cellular partnerships	339	146	1,007	207
Loss on debt extinguishment	—	—	—	(29,262)
Impairment on investment in cellular partnerships	(6,678)	(2,339)	(6,678)	(2,339)
Other income and (expense), net	(6,703)	300	(25,060)	901
Total other income (expense)	(41,416)	(21,529)	(114,237)	(95,597)
Income before income taxes and minority interest	4,604	19,801	22,247	28,247
Income tax expense (benefit)	(2,029)	6,480	(6,095)	8,852
Income before minority interest	6,633	13,321	28,342	19,395
Minority interest	(367)	—	(3,171)	(468)
Net income	6,266	13,321	25,171	18,927
Other comprehensive income				
Interest rate hedging arrangements, net of tax	—	3,135	—	462
Comprehensive income	$ 6,266	$ 16,456	$ 25,171	$ 19,389
Earnings (loss) per owners' unit:				
Basic and diluted net income (loss) (see Note 11):				
Class A and B common interests	$ 0.13	$ —	$ 0.54	$ 0.09
Class C interests	$ (0.07)	$ —	$ (0.29)	$ 0.01
Earnings per common share (see Note 11):				
Basic	$ —	$ 0.19	$ —	$ 0.18
Diluted	$ —	$ 0.19	$ —	$ 0.18
Cash dividends declared per share:	$ —	$ 0.36	$ —	$ 0.90

See accompanying notes to condensed consolidated financial statements.

Valor Communications Group, Inc.
Condensed Consolidated Statements of Cash Flows
(Dollars in thousands)
(unaudited)

	Nine months ended September 30, 2004	2005
Operating activities		
Net income	$ 25,171	$ 18,927
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	63,993	67,184
Deferred income taxes	(6,756)	8,852
Expense incurred related to cash payment to minority shareholders in connection with reorganization	17,988	—
Loss on debt extinguishment	—	29,262
Amortization of debt issuance costs	6,192	2,773
Non–cash unrealized (gain) loss on interest rate hedging arrangements	(7,813)	378
Asset impairment	—	614
Impairment on investment in cellular partnerships	6,678	2,339
Earnings from unconsolidated cellular partnerships	(1,007)	(207)
Provision for doubtful accounts receivable	3,159	4,246
Non–cash stock compensation expense	—	10,412
Minority interest	3,171	468
Changes in current assets and current liabilities:		
Accounts receivable	(1,048)	(981)
Accounts payable	(1,943)	5,057
Accrued interest	6,925	348
Other current assets and current liabilities, net	7,170	(4,191)
Other, net	3,414	(9,462)
Net cash provided by operating activities from continuing operations	125,294	136,019
Investing activities		
Additions to property, plant and equipment	(51,520)	(45,044)
Redemption of RTFC capital certificates	—	24,445
Other, net	(476)	225
Net cash used in investing activities from continuing operations	(51,996)	(20,374)
Financing activities		
Proceeds from issuance of debt	59,000	400,000
Repayments of debt	(118,347)	(820,300)
Notes payable, net	4,063	(1,893)
Prepayment fees paid in connection with the repayment of debt	—	(19,393)
Proceeds from issuance of common stock, net of offering costs	—	411,322
Cash dividends paid	—	(37,459)
Cash payment to preferred and common minority shareholders in connection with reorganization	(18,646)	—
Payments of debt issuance costs	(124)	(17,381)
Other, net	—	(854)
Net cash used in financing activities from continuing operations	(74,054)	(85,958)
Net (decrease) increase in cash and cash equivalents from continuing operations	(756)	29,687
Net operating cash used in discontinued operations	(17)	—
Net (decrease) increase in cash and cash equivalents	(773)	29,687
Cash and cash equivalents at beginning of period	1,414	17,034
Cash and cash equivalents at end of period	$ 641	$ 46,721

See Note 12 for supplemental cash flow information.
See accompanying notes to condensed consolidated financial statements.

Valor Communications Group, Inc.
Notes to Condensed Consolidated Financial Statements
(Dollars in thousands except owner unit and common share amounts)
(unaudited)

(1) Background and Basis of Presentation

The consolidated financial statements include the accounts of Valor Communications Group, Inc. ("Valor") and its wholly owned subsidiaries (collectively, the "Company"). All significant intercompany transactions have been eliminated. Valor is a holding company and has no direct operations. Valor was formed for the sole purpose of reorganizing our corporate structure and consummating the Company's initial public offering, both of which occurred in February 2005. Valor's principal assets are the direct and indirect equity interests of its subsidiaries, Valor Telecommunications, LLC ("VTC"), Valor Telecommunications Southwest, LLC ("VTS") and Valor Telecommunications Southwest II, LLC ("VTS II"). The historical consolidated financial statements prior to the initial public offering represent those of VTC.

The consolidated financial statements included herein have been prepared by the Company pursuant to the rules and regulations of the U.S. Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted pursuant to such rules and regulations. However, in the opinion of our management, the consolidated financial statements include all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the financial information in accordance with GAAP. The financial information for the three and nine months ended September 30, 2004 and 2005 has not been audited by an independent registered public accounting firm. The results of operations for the first nine months of the year are not necessarily indicative of the results of operations that might be expected for the entire year. The consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in our Annual Report on Form 10–K for the fiscal year ended December 31, 2004.

Initial Public Offering and Senior Notes Offering — On February 9, 2005, the Company completed its initial public offering ("Offering") registering 29,375,000 shares of common stock at an offering price of $15 per share. Concurrent with the Offering, the Company issued $400,000 principal amount of 7 3/4% senior notes due in 2015. The proceeds from the Offering and the issuance of the senior notes were used to repay the second lien loan of $265,000, senior subordinated loan of $135,000, a portion of the existing credit facility in the amount of $373,400 and associated fees and expenses of approximately $65,400. In connection with the Offering, certain of the Company's stockholders granted an option to the underwriters to purchase up to 4,406,250 additional shares in the aggregate at the Offering price, less the underwriting discount. On March 16, 2005, the underwriters exercised their over–allotment option in full. The Company received no proceeds from the over–allotment exercise.

In August 2005, the Company completed the exchange of all outstanding 7 3/4% senior notes in aggregate principal amount of $400,000 due 2015 for substantially identical 7 3/4% senior notes that have been registered under the Securities Act of 1933. The new notes will mature on February 15, 2015 and will pay interest semi–annually on February 15 and August 15, starting on August 15, 2005.

Reorganization — Immediately prior to and in connection with the Offering, the Company consummated a reorganization pursuant to which the existing equity holders contributed all their equity interests, including Class A common, Class B common, Class C, redeemable preferred interests, redeemable preferred interests of subsidiary and minority interests, in VTC and VTS to Valor in exchange for 39,537,574 shares of Valor common stock in the aggregate. Following the reorganization, Valor exists as a holding company with no direct operations, and each of VTC, VTS and VTS II is either a direct or an indirect wholly owned subsidiary of Valor.

As a result of the reorganization, all partnership operations of Valor became wholly owned (directly or indirectly) by the Company, and the operations of the Company and all wholly owned subsidiaries and affiliates became included in a consolidated federal corporate tax return.

Amendment to Senior Credit Facility — In connection with the Offering, the Company amended its senior credit facility. The amended senior credit facility resulted in the reduction of the commitment amount of

Tranche B Term Loan to $750,000, Tranche C Term Loan to $50,000 and Tranche D Term Loan to $5,556. Under the amended credit facility, the entire principal balances on the Tranches B, C and D Term Loans are due at maturity, which is February 2012.
As a result of the repayment of existing indebtedness, the Company recorded a loss on extinguishment of debt of $29,262 primarily due to prepayment premiums, breakage costs and the write–off of deferred debt costs in the first quarter of 2005.
Stock Compensation — Concurrent with the Offering, the Company terminated the Valor Telecom Executive Incentive Plan and cancelled all equity incentive non–qualifying stock options in Class B common interests. The Company finalized the 2005 Long–Term Incentive Plan ("LTIP") resulting in the issuance of restricted stock. Since the Offering, the Company has granted 1,989,659 shares of restricted stock to management and our board of directors under the LTIP plan. The Company has recorded $10,412 of non–cash stock compensation expense for the nine months ended September 30, 2005 as a result of the issuance of the restricted stock.

(2) Stock–Based Compensation

The Company accounts for its employee stock compensation plans using the intrinsic value based method in accordance with APB Opinion No. 25 as allowed by SFAS No. 123, "Accounting for Stock–Based Compensation." In connection with and following the Offering, the Company grants shares of restricted stock to employees. The Company has recorded $10,412 of non–cash stock compensation expense in the nine months ended September 30, 2005 related to the difference between the exercise price and the Company's common stock price at the measurement date. For the periods in which the Company had outstanding options, no stock–based employee compensation cost is reflected in net income, since options granted under the plan had an exercise price equal to the market value of the underlying common stock on the measurement date. If compensation cost for the restricted stock and options had been determined in accordance with SFAS No. 123, the Company's net income and per owner unit amounts for the three and nine months ended September 30, 2004 and 2005 would have been as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2004	2005	2004	2005
Net income as reported:	$ 6,266	$ 13,321	$ 25,171	$ 18,927
Deduct: Total stock–based employee compensation expense determined under fair value based method, net of tax	(100)	(1,418)	(300)	(7,136)
Add: Total stock–based employee compensation expense determined under intrinsic value based method, net of tax	—	1,418	—	7,136
Pro forma net income	$ 6,166	$ 13,321	$ 24,871	$ 18,927
Earnings (loss) per owners' unit:				
Basic and diluted net income (loss) as reported:				
Class A and B common interests	$ 0.13	$ —	$ 0.54	$ 0.09
Class C interests	$ (0.07)	$ —	$ (0.29)	$ 0.01
Common stock	$ —	$ 0.19	$ —	$ 0.18
Basic and diluted net income (loss) pro forma:				
Class A and B common interests	$ 0.13	$ —	$ 0.54	$ 0.09
Class C interests	$ (0.07)	$ —	$ (0.29)	$ 0.01
Common stock	$ —	$ 0.19	$ —	$ 0.18

As discussed in Note 1, the Company cancelled all equity incentive non–qualifying stock options in Class B common interests in connection with the Offering in February 2005.

(3) Net Property, Plant and Equipment

Net property, plant and equipment consists of the following:

	December 31, 2004	September 30, 2005
Gross property, plant and equipment	$ 1,048,527	$ 1,093,750
Accumulated depreciation	(298,543)	(366,435)
Net property, plant and equipment	$ 749,984	$ 727,315

In late September 2005, Hurricane Rita made landfall in the Gulf Coast region of the United States. The effects of Hurricane Rita, including high winds and rain, impacted our east Texas market. As a result of the hurricane, the Company incurred damage on certain of its property, plant, and equipment. The Company has assessed the recoverability of these assets based on the authoritative accounting literature and determined that the carrying value of certain of its property, plant, and equipment in the affected areas was impaired. As such, the Company recorded an impairment loss of $614 net of insurance recoveries of $344 that the Company has concluded are probable from its covered losses in the accompanying condensed consolidated statements of income and comprehensive income.

(4) Investments and Other Assets

Investments and other assets consist of the following:

	December 31, 2004	September 30, 2005
Goodwill	$ 1,058,235	$ 1,058,215
RTFC equity certificates	31,718	7,384
Unamortized debt issuance costs	26,696	31,435
Investments in cellular partnerships	10,518	7,570
Other	4,004	4,900
Total	$ 1,131,171	$ 1,109,504

In 2004, a wireless competitor began constructing facilities in areas serviced by the Company's unconsolidated cellular partnerships. This has resulted in a significant decrease in roaming revenue further decreasing the Company's earnings from the unconsolidated cellular partnerships. In light of the financial results of the cellular partnership through September 30, 2004, the Company assessed the recoverability of the investments in the unconsolidated cellular partnerships, which resulted in an impairment charge of $6,678 to the statement of income. One of the cellular partnerships continued to experience a significant decline in roaming revenues in 2005. Due to the financial results of this cellular partnership through September 30, 2005, the Company recorded an additional impairment charge of $2,339 to the statement of income.

(5) Long-Term Debt

As a result of the amendments to the credit facility in February 2005, the Company is required to reduce the risk of interest rate volatility with at least 50% of its indebtedness. To manage interest rate risk exposure and fulfill requirements under the credit facility, the Company has entered into nine agreements, three interest rate caps and six interest rate swaps, with investment grade financial institutions in 2005 (collectively, "Agreements"). While the Company may be exposed to credit losses due to non-performance of the counterparties, the Company considers the risk to be remote. In connection with entering the interest rate cap agreements, the Company paid $854.

The following represents a summary of the Agreements:

Instrument	Effective Date	Maturity Date	Notional Amount	Cap Rate or Pay Rate	September 30, 2005 Fair Value Asset (Liability)
Interest rate cap	03/31/05	03/31/06	$450,000	5.0%	$ 2
	03/31/06	03/30/07	50,000	5.0	58
	03/31/06	03/31/08	100,000	5.0	416
Interest rate swap	03/31/06	03/31/08	75,000	4.5	60
	03/31/06	03/31/08	75,000	4.6	34
	03/31/06	03/31/09	50,000	4.2	569
	03/31/06	03/31/10	100,000	4.7	(489)
	03/30/07	03/31/08	30,000	4.7	(35)
	03/31/08	03/31/09	180,000	4.3	522

The Company's interest rate caps are not treated as hedges as prescribed by the accounting literature. Therefore, the fair value of the instruments is recorded each reporting period on the Condensed Consolidated Balance Sheets with the change in fair value recorded in the Condensed Consolidated Statements of Income in "Gain (loss) on interest rate hedging arrangements." The interest rate swaps effectively convert the Company's variable rate debt to fixed rate debt. The swap agreements qualify for hedge accounting under SFAS No. 133; therefore, they are carried at fair market value on the Condensed Consolidated Balance Sheets, with changes in fair value recorded as "Other comprehensive income" in the accompanying Condensed Consolidated Statements of Income and Comprehensive Income. The Company does not hold or issue derivative financial instruments for trading or speculative purposes.

(6) Deferred Credits and Other Liabilities

Deferred credits and other liabilities consist of the following:

	December 31, 2004	September 30, 2005
Accrued pension costs	$ 16,908	$ 6,343
Accrued postretirement medical and life benefit costs	12,207	12,873
Deferred revenue	2,555	2,237
Deferred income taxes	6,319	76,995
Deferred investment tax credit	215	181
Other	494	616
Total	$ 38,698	$ 99,245

(7) Income Taxes

In connection with the Offering, the Company completed a reorganization, which resulted in the operations of all entities within Valor and VTC becoming reportable in a consolidated corporate federal tax return. As a result of the reorganization, the Company's previous owners contributed approximately $308,000 of net operating losses ("NOLs") that the Company will be able to use, subject to certain limitations, to reduce future taxable income. Furthermore, the Company, as of the Offering date, had cumulative book/tax differences of approximately $519,000 resulting from items such as goodwill amortization and accelerated tax depreciation that the Company has deducted faster for tax purposes under the tax code than for financial reporting purposes.

The tax effect of the NOLs and the cumulative differences were recorded on the Company's balance sheet at the reorganization and resulted in an initial net deferred tax liability of approximately $79,000.

The Company also had other items totaling $826,000, which consist of $713,000 related to unamortized goodwill and $113,000 related to the step–up in tax basis of assets as a result of the reorganization that occurred in connection with the Offering. Unamortized goodwill represents tax deductions through 2015 that will result in a future deferred tax liability for financial reporting purposes due to the book/tax basis difference related to the goodwill.

In the third quarter of 2005, the Company completed a tax valuation related to the $113,000 step–up in tax basis of assets. Based on the valuation, it was determined the $113,000 step–up in tax basis of assets, as determined by the applicable tax code, will be allocated in part to tangible assets and in part to tax goodwill based upon relative fair market values. As a result, the portion allocated to tangible assets will be treated as a temporary difference that will reverse upon the disposition of certain Company assets. Concurrent with completion of the valuation, the Company recorded a non–current deferred tax asset of approximately $18,000, which was netted against non–current deferred tax liability, with the offset to additional paid–in capital. The deferred tax asset is an estimate and is subject to change upon completion of the partners' tax returns related to the period prior to the Offering. The portion attributable to tax goodwill will continue to be treated as a permanent difference in accordance with SFAS No. 109, "Accounting for Income Taxes," since there is no corresponding book goodwill.

Prior to the reorganization in February 2005, only VTS II had elected to be taxed as a corporation for federal income tax purposes. Each legal operating entity owned directly or indirectly by VTS II is legally formed either as a limited liability company, a limited partnership, or a corporation. However, each of these entities was treated for federal income tax purposes either as a corporation or a disregarded entity (a division of a corporation). Operations for all entities directly or indirectly owned by VTS II were included in a consolidated federal income tax return filed by VTS II. Since VTS II had elected to be treated as a corporation for tax purposes, the income tax expense and the deferred tax assets and liabilities reported in the consolidated results of operations are reported under this entity's name and are computed based upon the consolidated VTS II operations.

The Company accounts for income taxes under SFAS No. 109. The Company records its net deferred income tax asset and liability for all temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

Income tax expense (benefit) was as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2004	2005	2004	2005
Current expense (benefit)	$ 43	$ (38)	$ 661	$ —
Deferred expense (benefit)	(2,072)	6,518	(6,756)	8,852
Total income tax expense (benefit)	$ (2,029)	$ 6,480	$ (6,095)	$ 8,852

The differences between the federal income tax statutory rate and the Company's effective income tax rate for the three and nine months ended September 30, 2004 is primarily related to consolidated entities not subject to income taxes. The effective tax rate for the nine months ended September 30, 2004 was further impacted by permanent differences associated with the purchase of minority interests. The differences between the federal income tax statutory rate and the Company's effective income tax rate for the nine months ended September 30, 2005 is primarily related to consolidated entities not subject to income taxes prior to the effective date of the Offering and permanent difference related to the step–up in tax basis of assets that is attributable to goodwill that occurred in connection with the Company's reorganization. The Company's expected effective tax rate for fiscal year 2005 is approximately 32%.

(8) Pension and Postretirement Benefits

The Company sponsors a qualified pension plan and a postretirement benefit plan for its union employees. The pension plan is noncontributory. The Company's postretirement health care plans are generally contributory and include a limit on the Company's share of the cost for recent and future retirees. The Company accrues the costs, as determined by an actuary, of the pension and the postretirement benefits over the period from the date of hire until the date the employee becomes fully eligible for benefits.
The following tables provide the components of net periodic benefit cost:

	Pension Benefits			
	Three months ended September 30,		Nine months ended September 30,	
	2004	2005	2004	2005
Service cost	$ 1,006	$ 1,002	$ 3,019	$ 2,971
Interest cost	958	985	2,876	2,921
Expected return on plan assets	(718)	(678)	(2,154)	(2,010)
Amortization of loss	245	391	736	1,158
Net periodic benefit cost	$ 1,491	$ 1,700	$ 4,477	$ 5,040

In September 2005, the Company made its required $6,500 cash contribution related to the 2004 plan year and made an optional cash contribution of $6,000. As a result of the optional contribution, the Company will have no required cash contributions for the remainder of 2005 or for 2006. The next required cash contribution will be due in 2007; however, the Company may elect to make optional contributions prior to that date.

	Postretirement Benefits			
	Three months ended September 30,		Nine months ended September 30,	
	2004	2005	2004	2005
Service cost	$ 97	$ 92	$ 291	$ 300
Interest cost	217	219	651	716
Amortization of loss	38	36	114	120
Net periodic benefit cost	$ 352	$ 347	$ 1,056	$ 1,136

(9) Commitments and Contingencies

In the normal course of business, there are various legal proceedings outstanding, including both commercial and regulatory litigation. In the opinion of management, these proceedings will not have a material adverse effect on the results of operations or financial condition of the Company. On July 13, 2005, four former employees served the Company with a Demand for Arbitration, claiming that the Company and its subsidiary, VTS, had breached the terms of the former employees' VTS stock option agreements in the Company's valuation of those options in the reorganization that preceded the Offering. The American Arbitration Association arbitrator has established a procedural schedule for resolution of this dispute, including the scheduling of an arbitration hearing in April 2006. The Company believes that it has meritorious defenses and intends to continue to vigorously defend this matter. Even though litigation is inherently uncertain and it is possible that an adverse decision could be rendered, the Company believes an unfavorable outcome in this case is remote and anticipates resolution of this matter will not have a material effect on its consolidated financial statements.

(10) Related Party Transactions

The Company had the following transactions with related parties:

	Three months ended September 30,		Nine months ended September 30,	
	2004	2005	2004	2005
Interest expense to the sponsors for subordinated debt	$ 7,856	$ —	$ 23,569	$ —
Payments to certain individual investors for ownership and other expenses	18,646	—	18,646	—
Management fee expense to the sponsors for advisory services	250	—	750	—
Various professional fees paid to certain sponsors and individual investors	9	10	96	29
Revenue earned from wireless affiliates	122	121	364	382

The Company had the following balances with related parties:

	December 31, 2004	September 30, 2005
Receivable from wireless affiliates for management services and facility leases	$ 1,096	$ 1,196
Payable to the sponsors for management fees	500	—

Under the terms of the CGKC&H (wireless affiliate) partnership agreement, the general partners have designated the Company to act as the operating partner of CGKC&H. The agreement provides that the Company is to be reimbursed for all reasonable and necessary expenses incurred on behalf of CGKC&H. During the nine months ended September 30, 2004 and 2005, the Company was reimbursed approximately $764 and $863, respectively, from CGKC&H for these services.

Effective January 1, 2005, the Company terminated the management agreement, whereby, the Company paid its sponsors management fees for advisory services.

(11) Earnings Per Share

On February 9, 2005, the Company completed its Offering, registering 29,375,000 shares of common stock. Concurrent with the Offering, the Company issued 41,458,333 shares of common stock in exchange for all outstanding ownership interests in VTC and its subsidiaries outstanding prior to the Offering and issuance of shares to management under the LTIP. As of September 30, 2005, the Company had 70,868,777 shares of common stock issued and 70,767,501 outstanding (net of treasury shares), including restricted shares issued to management and to the board of directors.

The following tables set forth the computation of earnings per share:

	Earnings Per Share	
	Three months ended September 30, 2005	For the period from February 9 – September 30, 2005
	(dollars in thousands, except per share data)	
Numerator:		
Net income	$ 13,321	$ 12,376
Denominator:		
Weighted average common shares outstanding for purposes of computing basic EPS	69,370,344	69,366,739
Effect of unvested restricted stock	182,632	319,803
Total weighted average shares outstanding for purposes of computing diluted EPS	69,552,976	69,686,542
Basic EPS:		
Net income per common share	$ 0.19	$ 0.18
Diluted EPS:		
Net income per common share	$ 0.19	$ 0.18

	Three months ended September 30, 2004		Nine months ended September 30, 2004		For the Period from January 1– February 8, 2005	
	Class A and B Common Interests	Class C Interests	Class A and B Common Interests	Class C Interests	Class A and B Common Interests	Class C Interests
	(dollars in thousands, except per unit data)					
Numerator:						
Net income (loss)	$ 9,358	$ (3,092)	$ 38,297	$ (13,126)	$ 6,234	$ 317
Denominator:						
Weighted average common interests outstanding	70,591,699	46,000,000	70,591,699	46,000,000	70,591,699	46,000,000
Basic and Diluted:						
Net income (loss) per owners' unit	$ 0.13	$ (0.07)	$ 0.54	$ (0.29)	$ 0.09	$ 0.01

(12) Supplemental Cash Flow Information

Cash payments for interest were $79,040 and $62,277 for the nine months ended September 30, 2004 and 2005, respectively.
Cash payments for income taxes were $1,000 for the nine months ended September 30, 2004.
A note payable for $3,015 was issued during the nine months ended September 30, 2004 for insurance policies.
The Company entered into long–term capital leases of $846 for the purchase of vehicles for the nine months ended September 30, 2004.
In connection with the Offering, the Company redeemed all outstanding interests for 39,537,574 shares of Valor common stock and recorded a net deferred tax liability from the existing equity owners of VTC prior to becoming a federal corporate taxpayer as follows:

	DR (CR)
Class A common interests	$ 64,633
Class B common interests	—
Class C interests	29,542
Redeemable preferred interests	236,129
Redeemable preferred interests in subsidiary	15,776
Deferred tax liability, net	(61,592)
Minority interest	468
Common stock	(4)
Additional paid–in capital	(531,468)
Treasury stock	(34)
Accumulated deficit	246,550

The Company issued 1,989,659 shares of restricted stock in the nine months ended September 30, 2005. The Company recorded $29,606 to deferred equity compensation with a corresponding offset to either common stock, additional paid–in capital or treasury stock (if issued from treasury stock). The Company recorded $10,412 of non–cash stock based compensation expense related to the issuance of restricted stock to management and the board of directors for the nine months ended September 30, 2005.
Concurrent with the Offering, the Company exchanged shares of Valor common stock with a value of $1,351 for all outstanding units under the Valor Telecom Executive Incentive Plan.
In the nine months ended September 30, 2005, certain unvested shares of restricted stock were forfeited. Restricted stock forfeitures of $3,372 were recorded as a reduction to deferred equity compensation with a corresponding offset to paid–in capital and treasury stock.
In connection with the amendment of the credit facility in February 2005, the Company wrote–off $9,869 of unamortized debt issuance costs.
In September 2005, the Company declared a cash dividend of $24,974 that was payable in October 2005. This amount is included in "Other" in current liabilities on the Condensed Consolidated Balance Sheets.

(13) Guarantor Subsidiaries

The Company's senior notes issued are guaranteed jointly and severally by all of Valor's existing subsidiaries ("the guarantor subsidiaries") and such guarantees are full and unconditional. Existing guarantor subsidiaries include VTC, VTS, including its operating entities, and VTS II, including its operating entities. Valor has no independent assets or operations. Separate financial information has not been presented for the guarantor subsidiaries because the guarantor subsidiaries effectively comprise all of Valor's assets and operations.

Provisions of the senior credit agreement that the Company entered into in conjunction with the Offering restrict the ability of all of the guarantor subsidiaries to transfer funds to the Company. The senior credit agreement also precludes the guarantor subsidiaries from transferring funds to Valor:

i. to pay dividends on common stock during a dividend suspension period, as defined in the senior credit agreement;

ii. when an event of default has occurred, as defined in the senior credit agreement; or

iii. for the purpose of paying dividends that would exceed available distributable cash, as defined in the senior credit agreement.

(14) Recently Issued Accounting Pronouncements

In January 2004, FASB Staff Position ("FSP") No. 106–1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" was issued. FSP No. 106–1 permits the deferral of recognizing the effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") in the accounting for post–retirement health care plans under SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," and in providing disclosures related to the plan required by SFAS No. 132 (revised 2003), "Employers' Disclosures about Pensions and Other Postretirement Benefits." In May 2004, FSP 106–2, "Accounting and Disclosure Requirement Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" was issued. FSP 106–2 provides guidance that measures the accumulated post–retirement benefit obligation ("APBO") and net periodic postretirement benefit cost on or after the date of enactment shall reflect the effects of the Act. FSP 106–2 is effective for the first interim or annual period beginning after June 15, 2004. Upon the effective date, FSP 106–2 will supersede FSP 106–1. The deferral of the accounting for the Act will continue until FSP 106–2 is effective. We have elected the deferral provided by FSP 106–1 and are evaluating the magnitude of the potential favorable impact on our results of operations and financial position. The effects of the Act have not been reflected for interim disclosure purposes. The Company is currently evaluating the options available under the Act and has yet to determine if the plan is actuarially equivalent to the standard Medicare Part D benefit. Therefore, any measures of APBO or Net Periodic Postretirement Benefit Cost do not reflect the effects of the Act on the plan.

In March 2005, the FASB issued FASB Interpretation ("FIN") No. 47, "Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143," which clarifies the term *conditional asset retirement obligation* as used in FASB Statement No. 143, "Accounting for Asset Retirement Obligations." The term *conditional asset retirement obligation* refers to an obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. An obligation exists when a law, regulation or contract requires an entity to perform an asset retirement activity. The interpretation requires an entity to recognize a liability— generally upon acquisition, construction or development— for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. In circumstances where sufficient information is not available, the liability should be recognized in the period in which sufficient information becomes available to estimate its fair value. The interpretation is effective no later than the end of fiscal years ending after December 15, 2005. The Company is currently evaluating the effect that adoption of this interpretation will have on its financial position and results of operations.

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(15) Subsequent Events

Effective October 1, 2005, the Company granted 361,533 shares of restricted stock, for an aggregate purchase price of $0.0001 per share, to its recently appointed Senior Vice President and Chief Financial Officer, Jerry E. Vaughn. The shares of restricted stock will vest 6.25% on January 1, 2006, 25% on January 1, 2007, 25% on January 1, 2008, 25% on January 1, 2009, and the remaining 18.75% on October 1, 2009. As of October 1, 2005, the value of the restricted stock grant was approximately $4,900.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Three and nine months ended September 30, 2005 compared to three and nine months ended September 30, 2004

Forward–Looking Statements

As provided by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, we caution that the statements in this quarterly report on Form 10–Q relating to matters that are not historical facts, including, but not limited to, statements found in this Item 2 — "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Item 3 — "Quantitative and Qualitative Disclosures About Market Risk," are forward–looking statements that represent management's beliefs and assumptions based on currently available information. Forward–looking statements can be identified by the use of words such as "believes," "intends," "may," "should," "anticipates," "expects" or comparable terminology or by discussions of strategies or trends. Although we believe that the expectations reflected in such forward–looking statements are reasonable, we cannot give any assurances that these expectations will prove to be correct. Such statements by their nature involve substantial risks and uncertainties that could significantly impact expected results, and actual future results could differ materially from those described in such forward–looking statements. Among the factors that could cause actual future results to differ materially are the risks and uncertainties discussed in this quarterly report and those described from time to time in materials filed with our other filings with the SEC. While it is not possible to identify all factors, we continue to face many risks and uncertainties including, but not limited to, the following:

- our high degree of leverage and significant debt service obligations;
- our ability to refinance our existing indebtedness on terms acceptable to us, or at all;
- any adverse changes in law or government regulation, including possible changes to cash funding requirements for our defined benefit pension plan;
- 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 possibility of labor disruptions;
- the risk of increased competition in the markets we serve;
- the impact of pricing decisions;
- the risk of weaker economic conditions within the United States;
- potential difficulties in integrating completed or future acquisitions;
- uncertainties associated with new product development;
- environmental matters;
- potential outcome of future income tax audits;
- possible future litigation or regulatory proceedings;
- potential increasing costs of providing healthcare and postretirement benefits to our existing and former employees;

- changes in accounting policies or practices adopted voluntarily or as required by accounting principles generally accepted in the United States;
- changes in laws or regulations governing telecommunications providers or the provision of telecommunications services; and
- other risks and uncertainties.

Should one or more of these risks materialize (or the consequences of such a development worsen) or should the underlying assumptions prove incorrect, actual results could differ materially from those forecasted or expected. We disclaim any intention or obligation to update publicly or revise such statements whether as a result of new information, future events or otherwise, except as required by law.

Overview

We provide telecommunications services in primarily rural areas of Texas, Oklahoma, New Mexico and Arkansas serving approximately 525,000 access lines as of September 30, 2005. 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. In January 2002, we 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. In the markets we serve, we provide a full range of voice and data services, including integrated packages of local, long distance, high–speed data and Internet access, as well as a variety of enhanced services such as voicemail and caller identification. We provide reliable, personalized customer care through three call centers, and we have automated many of our customer service functions to enable our customers to interact with our company 24 hours a day, 365 days a year.

The competitive landscape and customer preferences for communications services continue to evolve in the telecommunications industry in general, as well as in the markets we serve. We have taken numerous steps to position ourselves to meet the competitive pressures that we face, including: (i) expanding the coverage of our DSL product to provide greater broadband opportunities, including increased DSL speeds, to our customers in rural America; (ii) aggressively pricing and bundling services such as DSL, Internet access, long distance and second lines with our basic service to create more appealing product offerings at more attractive prices to our customers; (iii) offering discounts to customers who make commitments to purchase service from us for a one–year period; and (iv) improving customer service. We added over 7,100 DSL subscribers in the three month period ended September 30, 2005 and we have expanded our DSL footprint to make DSL service available to approximately 71% of our customer base. We have also focused intently on increasing the efficiency of our business by investing in our infrastructure to improve our underlying business processes and increase the quality of our customer service, maintaining tight expense controls and utilizing a disciplined approach to our capital spending.

We experience competition from wireless service providers in many of our markets and wireline local carriers and cable companies in a limited number of our markets. The number of access lines we serve is one of the fundamental drivers of our business, and competition has been a significant factor in the recent decline in our access lines. While the number of access lines we serve has been declining gradually for the last several years, we have been able to increase our revenues in prior years as a result of our strategy to sell additional services to our existing customers to increase our average revenue per line. We lost 5,552 access lines in the three month period ended September 30, 2005 and 15,635 access lines year–to–date as of September 30, 2005. We had previously anticipated that our decline in access lines in 2005 would be approximately equal to the 2.9% decline we experienced in 2004. We continue to expect our rate of line losses for the full year will exceed that of last year. Revenues for the three and nine month periods ended September 30, 2005 were essentially flat compared to the same periods in prior year.

Competition continues in Broken Arrow, OK, a suburb of Tulsa, OK. The cable provider serving that market began offering a cable telephony product late in 2004. We have defined active cable telephony

markets as those markets where we have processed request(s) by the cable competitor to port customer telephone numbers to the cable provider. "Porting" is an industry term used to describe the process that allows a customer to retain his or her existing phone number when switching his or her telephone service to a competitor. As of September 30, 2005, approximately 12% of our access lines were in active cable telephony markets, consisting essentially of the lines we serve in Broken Arrow and a bordering community along with three of our West Texas markets. Our active cable telephony markets have contributed more than 70% of our year to date access line losses. In non–active cable telephony markets, representing approximately 88% of our access lines, our year to date line losses are less than 1%.

In May 2005, the Defense Base Closure and Realignment (BRAC) Commission announced that the Red River Army Depot, which is located in Texarkana, TX, was included on the list of military bases BRAC recommended that Congress close over the next several years. On September 8, 2005, BRAC presented its final report to the President of the United States. The final report elected to realign certain functions of the Red River Army Depot rather than close the facility. As a result, we do not anticipate any material impact on our financial operations.

We are subject to regulation primarily by federal and state government agencies. At the federal level, the Federal Communications Commission ("FCC") has jurisdiction over interstate and international telecommunications services. State telecommunications regulators exercise jurisdiction over intrastate telecommunications services.

Significant transactions

On February 9, 2005, we completed the Offering, registering 29,375,000 shares of Valor common stock at a price of $15 per share. The net proceeds from the Offering were used to repay certain existing indebtedness. In conjunction with the Offering, we completed a reorganization of our company. In connection with the Offering, certain of the company's stockholders granted an option to the underwriters to purchase up to 4,406,250 additional shares in the aggregate at the Offering price less the underwriting discount. On March 16, 2005, the underwriters exercised their over–allotment option in full. We received no proceeds from the over–allotment exercise.

Concurrently with the Offering, our subsidiary, Valor Telecommunications Enterprises, LLC, and its direct wholly owned subsidiary, Valor Telecommunications Enterprises Finance Corp., as co–issuers, issued $400 million aggregate principal amount of 7^3/4% ten –year senior notes in a private offering pursuant to Rule 144A of the Securities Act of 1933. We used the net proceeds from such issuance to repay certain existing indebtedness. In August 2005, we completed the exchange of all outstanding 7^3/4% senior notes in aggregate principal amount of $400 million due 2015 for substantially identical 7^3/4% senior notes that have been registered under the Securities Act of 1933. The new notes will mature on February 15, 2015 and will pay interest semi–annually on February 15 and August 15, starting on August 15, 2005.

Significant expenses that have been recorded in the nine months ended September 30, 2005 include the following:

- $29.3 million in fees and expenses associated with our repayment of existing indebtedness, including write–off of certain deferred debt costs, prepayment premiums and breakage fees;
- $2.3 million in compensation expense for the portion of cash transaction bonuses that were paid and accrued to members of our management team in connection with the Offering; and
- $10.4 million in non–cash stock compensation expense for restricted shares issued to members of our management team and our board of directors.

Regulatory Matters

We operate in a regulated industry, and the majority of our revenues come from the provision of regulated telecommunications services, including state and federal support for the provision of telephone services in high–cost 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. 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. In September 2005, the Texas legislature adopted significant telecommunications legislation. This legislation created, among other provisions, a statewide video franchise for telecommunications carriers, established a framework for deregulation of the retail telecommunications services offered by incumbent local telecommunications carriers and directed the Texas Public Utility Commission (TPUC) to initiate a study of the Texas Universal Service Fund. We expect to participate in numerous TPUC proceedings in the coming months related to this new legislation, and we expect that the Texas Legislature may further address issues of importance to rural telecommunications carriers in Texas, including the Texas Universal Service Fund, in the 2007 Legislative session.

In New Mexico, we operate under an Alternative Form of Regulation Plan that is specific to our company. We recently played an instrumental role in the development and passage of access reform legislation. The New Mexico Public Regulation Commission adopted rules on November 1, 2005 to implement the access reform legislation. The rules generally require: 1) the reduction of access rates to interstate levels according to prescribed criteria; 2) the increase of business and residence basic local services prices to a statewide benchmark; 3) creation of a state USF to ensure revenue neutrality after taking into account revenues from the retail price increases. Also, the New Mexico Public Regulation Commission has pending a rules proceeding that will implement the mid–sized carrier legislation adopted by the New Mexico Legislature in 2004. These rules will govern the Company's retail prices and service quality when its Alternative Form of Regulation Plan expires in March 2006.

In Oklahoma, legislation was enacted in May 2004 that regulates us as 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 Texarkana, Arkansas, 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.

Universal Service Fund ("USF")

In furtherance of public policy, we receive 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 USF supports eligible telecommunications providers that serve high cost markets.

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.

Results of Operations

We have two operating segments, rural local exchange carrier, or RLEC, and Other.

As an RLEC, we provide regulated telecommunications services to customers in our service areas. These services include local calling services to residential and business customers, as well as providing interexchange carriers (IXC) with call origination and termination services, on both a flat–rate and usage–sensitive basis, allowing them to complete long distance calls for their customers who reside in our service areas.

In Other, we provide unregulated telecommunications services to customers throughout our RLEC service areas. These services include long distance and Internet services. Long distance is provided through resale agreements with national long distance carriers.

We have considered the aggregation criteria in SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" and determined the operating segments are considered one reportable segment as further described in Note 2 to the "Consolidated Financial Statements" in our Annual Report on Form 10–K for the year ended December 31, 2004.

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We generated revenues of $128.0 million and $380.0 million in the three and nine months ended September 30, 2005, respectively, compared to $126.6 million and $379.3 million in the comparable 2004 periods. Operating income for the three and nine months ended September 30, 2005 was $41.3 million and $123.8 million, respectively, compared to $46.0 million and $136.5 million in the comparable 2004 periods. Net income for the quarter ended September 30, 2005 was $13.3 million compared to net income of $6.3 million for the quarter ended September 30, 2004. Net income for the nine months ended September 30, 2005 was $18.9 million compared to net income of $25.2 million for the comparable period in 2004.

Consolidated Operating Revenues

The following table provides the detail of revenues for the three and nine months ended September 30:

	Three months ended September 30,				Nine months ended September 30,			
	2004	2005	Change	% Change	2004	2005	Change	% Change
	(dollars in thousands)							
Local service	$ 38,783	$ 37,594	$ (1,189)	−3%	$116,305	$114,378	$ (1,927)	−2%
Data services	6,492	8,656	2,164	33%	18,592	24,054	5,462	29%
Long distance services	10,018	10,572	554	6%	28,173	31,088	2,915	10%
Access services	30,625	30,842	217	1%	96,301	91,232	(5,069)	−5%
Universal Service Fund	30,444	28,241	(2,203)	−7%	90,759	86,862	(3,897)	−4%
Other services	10,269	12,055	1,786	17%	29,149	32,340	3,191	11%
	$126,631	$127,960	$ 1,329	1%	$379,279	$379,954	$ 675	0%

The following table sets forth several key metrics for the three and nine months ended September 30:

	Three months ended September 30,		Nine months ended September 30,	
	2004	2005	2004	2005
Total revenue (in thousands)	$ 126,631	$ 127,960	$ 379,279	$ 379,954
Ending access lines (1)	547,925	524,702	547,925	524,702
Average access lines	550,621	527,478	552,335	532,520
Total connections (2)	564,446	572,011	564,446	572,011
Average revenue per access line per month	$ 76.66	$ 80.86	$ 76.30	$ 79.28
Long distance subscribers	214,048	229,530	214,048	229,530
Penetration rate of total access lines	39%	44%	39%	44%
DSL subscribers	16,521	47,309	16,521	47,309
Penetration rate of total access lines	3%	9%	3%	9%

(1) 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 customer's premises. Non−revenue producing lines provisioned for company official use and for test purposes are included in our total access line counts. There were 13,744 and 14,699 non−revenue producing lines

included in our total access line count at September 30, 2004 and 2005, respectively, which represented 2.5% and 2.8%, respectively, of our total access line counts.

(2) Total connections are defined as total access lines plus DSL subscribers.

Three months ended September 30, 2005 compared to the three months ended September 30, 2004

Our consolidated revenues increased $1.3 million for the quarter ended September 30, 2005 compared to the same period in 2004. Our revenues were impacted by the following items:

Increase of DSL subscribers to 47,309 and the addition of an average 19,870 long distance subscribers for the three months ended September 30, 2005 compared to 2004.	$ 2.7
Favorable resolution of a regulatory proceeding we had pending before the Texas Public Utility Commission ("TPUC") related to an expanded local calling surcharge that was approved by the TPUC in the fourth quarter of 2004. Our ability to bill and collect this surcharge will expire on December 31, 2005.	0.6
Increase in other services due to equipment sales, directory advertising, and services provided to wholesale carriers.	1.6
Loss of access lines, lower access rates, and reduction in minutes of use.	(2.1)
Decrease in USF revenues due to lower access line counts.	(1.4)

Nine months ended September 30, 2005 compared to the nine months ended September 30, 2004

Our consolidated revenues remained essentially flat for the nine month period ended September 30, 2005 compared to 2004. Our revenues were affected by the following items:

Increase of DSL subscribers to 47,309 and the addition of an average 21,697 long distance subscribers for the nine months ended September 30, 2005 compared to 2004.	$ 8.4
Favorable resolution of a regulatory proceeding we had pending before the Texas Public Utility Commission ("TPUC") related to an expanded local calling surcharge that was approved by the TPUC in the fourth quarter of 2004. Our ability to bill and collect this surcharge will expire on December 31, 2005.	1.9
Increase in other services due to equipment sales, directory advertising, and services provided to wholesale carriers.	3.6
Loss of access lines, lower access rates, and reduction in minutes of use.	(8.2)
Decrease in USF revenues due to lower access line counts and reduction in Federal USF high cost support, effective January 1, 2005, due to increases in the national average loop cost by the FCC.	(3.8)

Operating Expenses

The following table sets forth operating expenses for the three and nine months ended September 30:

	Three months ended September 30,				Nine months ended September 30,			
	2004	2005	Change	% Change	2004	2005	Change	% Change
	(dollars in thousands)							
Cost of service	$26,674	$29,092	$ 2,418	9%	$ 78,704	$ 81,163	$ 2,459	3%
Selling, general and administrative	31,915	32,395	480	2%	100,098	96,737	(3,361)	−3%
Non–cash stock compensation	—	2,069	2,069	n/a	—	10,412	10,412	n/a
Asset impairment	—	614	614	n/a	—	614	614	n/a
Depreciation and amortization	22,022	22,460	438	2%	63,993	67,184	3,191	5%
	$80,611	$86,630	$ 6,019	7%	$242,795	$256,110	$13,315	5%

Three months ended September 30, 2005 compared to the three months ended September 30, 2004

Our operating expenses for the quarter ended September 30, 2005 increased $6.0 million from the comparable period in 2004. The increase is attributable to the following items:

Non–cash stock compensation associated with the issuance of restricted stock to our management and board of directors that vests on various percentages through 2009.	$2.1
Management incentive compensation incurred related to our Offering.	0.3
Increase in sales and marketing as a result of our continuing efforts position ourselves to meet the ongoing competitive pressures that we are facing.	0.8
Change in various accounting estimates in 2004 and 2005.	1.0
Asset impairment charge and increase in operating costs associated with clean–up and repair efforts from Hurricane Rita.	0.9
Depreciation and amortization increase as a result of our investment property, plant and equipment to improve our network infrastructure	0.4

Nine months ended September 30, 2005 compared to the nine months ended September 30, 2004

Our operating expenses for the quarter ended September 30, 2005 increased $13.3 million from the comparable period in 2004. The increase is attributable to the following items:

Non–cash stock compensation associated with the issuance of restricted stock to our management and board of directors that vests based on various percentages through 2009. We expect to incur approximately $8.1 million of non–cash stock compensation expense in both 2006 and 2007 and $1.3 and $0.9 in 2008 and 2009, respectively.	$10.4
Management incentive compensation incurred related to our Offering. We expect to incur $1.0 million of cash bonuses related to our Offering in 2006.	2.3
Increase in sales and marketing as a result of our continuing efforts to position ourselves to meet the ongoing competitive pressures that we are facing. $0.8 million of these costs are specifically related to DSL modem promotions.	1.6
Public company costs as a result of our Offering in February 2005.	0.7
Asset impairment charge and increase in operating costs associated with clean–up and repair efforts from Hurricane Rita. We expect to incur approximately $0.6 million of additional operating costs in the fourth quarter.	0.9
Depreciation and amortization increase as a result of our investment in property, plant and equipment to improve our network infrastructure.	3.2
Former Chief Executive Officer transition payment made in the second quarter of 2004.	(5.0)
Reduction of employee salary and benefit costs related to a reduction in headcount.	(2.1)

Not included in the analysis above were approximately $1.6 million of variable costs related to equipment sales and providing Internet access service that were offset by a decrease in long distance network costs as a result of a rate reduction in the fourth quarter of 2004.

In late September 2005, Hurricane Rita made landfall in the Gulf Coast region of the United States. The effects of Hurricane Rita, including high winds and rain, impacted our east Texas market. As a result of the hurricane, we have incurred damage on certain of our property, plant, and equipment. We have assessed the recoverability of these assets based on the authoritative accounting literature and determined that the carrying value of certain of its property, plant, and equipment in the affected areas was impaired. As such, we recorded an impairment loss of $0.6 million net of insurance recoveries of $0.3 million that we concluded are probable from our covered losses in the accompanying condensed consolidated statements of income and comprehensive income.

Interest Expense

The following table sets forth interest expense for the three and nine months ended September 30:

	Three months ended September 30,				Nine months ended September 30,			
	2004	2005	Change	% Change	2004	2005	Change	% Change
	(dollars in thousands)							
Interest expense	$(28,289)	$(19,814)	$ 8,475	–30%	$(83,384)	$(64,726)	$18,658	–22%

The decrease in interest expense was primarily due to an approximately $400 million lower average principal outstanding primarily as a result of repayment of debt from the net proceeds of the Offering and lower average interest rates on our debt.

Gain (Loss) on Interest Rate Hedging Arrangements

The following table sets forth gain (loss) on interest rate hedging arrangements for the three and nine months ended September 30:

	Three months ended September 30,				Nine months ended September 30,			
	2004	2005	Change	% Change	2004	2005	Change	% Change
	(dollars in thousands)							
Gain (loss) on interest rate hedging arrangements	$ (85)	$ 178	$ 263	–309%	$ (122)	$ (378)	$ (256)	210%

The adjustment to mark our hedging arrangements to market value resulted in non–cash income of $2.5 million and $7.8 million for the three and nine months ended September 30, 2004, respectively. Offsetting the non–cash income for the three and nine months ended September 30, 2004 are cash settlements of $2.6 million and $7.9 million, respectively. We entered into new arrangements to limit our interest rate risk under the terms of our existing credit facility in 2005 as further described under "Item 3: Quantitative and Qualitative Disclosures About Market Risk." The amount recorded in the three and nine months ended September 30, 2005, represents the change in fair value of the instruments that are not accounted for utilizing hedge accounting.

Earnings from Unconsolidated Cellular Partnerships, Loss on Debt Extinguishment, Impairment on Investments in Cellular Partnerships and Other Income and Expense

The following table provides the detail of other income and expense for the three and nine months ended September 30:

	Three months ended September 30,				Nine months ended September 30,			
	2004	2005	Change	% Change	2004	2005	Change	% Change
	(dollars in thousands)							
Earnings from unconsolidated cellular partnerships	$ 339	$ 146	$ (193)	–57%	$ 1,007	$ 207	$ (800)	–79%
Loss on debt extinguishment	—	—	—	n/a	—	(29,262)	(29,262)	n/a
Impairment on investments in cellular partnerships	(6,678)	(2,339)	4,339	–65%	(6,678)	(2,339)	4,339	–65%
Other income and (expense), net	(6,703)	300	7,003	–104%	(25,060)	901	25,961	–104%

Earnings from unconsolidated cellular partnerships represent our share of the earnings in the equity interest of our two cellular partnerships. 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 income. One of our cellular partnerships continued to experience a significant decline in roaming revenues in 2005. Due to the financial results of this cellular partnership through September 30, 2005, we recorded an impairment charge of $2.3 million to the statement of income.

In connection with the Offering and amendment of our credit facility, we recorded a $29.3 million loss on extinguishment of debt. The loss on extinguishment of debt relates to prepayment fees and premiums and write–off of debt issuance costs related to our existing indebtedness and transaction fees and costs related to our new facility that were included in the calculation of the loss on extinguishment of debt under the provisions of EITF 96–19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments."

Other income and (expense), net includes various miscellaneous income and expense items, including interest income on our cash balances held at financial institutions. The change in the respective periods ended September 30, 2005 is primarily attributable to the purchase of substantially all outstanding equity interests from a group of individual investors associated with our reorganization in April 2004, which resulted in $18.0 million of expense and offering costs of $6.8 million that were expensed in September 2004 as a result of our decision to not pursue the previously planned public offering of income deposit securities in 2004.

Income Taxes

The following table sets forth income taxes for the three and nine months ended September 30:

	Three months ended September 30,				Nine months ended September 30,			
	2004	2005	Change	% Change	2004	2005	Change	% Change
	(dollars in thousands)							
Income tax expense (benefit)	$ (2,029)	$ 6,480	$ 8,509	–419%	$ (6,095)	$ 8,852	$14,947	–245%

The income taxes for the periods ended September 30, 2004 only represent those of VTS II, which has elected to be taxed as a corporation for federal income tax purposes.

In February 2005, we completed a reorganization concurrent with the Offering. Prior to our reorganization, substantially all of the operations of Valor elected partnership treatment for income tax purposes. Following the completion of the Offering and the related reorganization, the operations of our company and all wholly owned subsidiaries became reportable in a consolidated corporate federal tax return. As such, for the period from January 1, 2005 through the Offering date, we recorded income tax expense directly attributable to the operations of VTS II. Following the Offering date, we recorded income taxes on the operations of Valor. Additionally, we recorded deferred tax positions related to differences between financial reporting and the tax basis of our assets and liabilities and net operating losses incurred prior to becoming a taxable entity.

The differences between the federal income tax statutory rate and our effective income tax rate for the three and nine months ended September 30, 2004 is primarily related to consolidated entities not subject to income taxes prior to our reorganization. The nine months ended September 2004 effective tax rate was further impacted by permanent differences associated with the purchase of minority interests. We expect our overall effective income tax rate will approximate 32% for fiscal year 2005. The differences between the federal income tax statutory rate and our effective income tax rate for the respective periods ended September 30, 2005 is primarily related to consolidated entities not subject to income taxes prior the effective date of the Offering and a permanent difference related to the step–up in our tax basis of assets attributable to goodwill that occurred in connection with our reorganization.

Minority Interest

The following table sets forth the minority interest for the three and nine months ended September 30:

	Three months ended September 30,				Nine months ended September 30,			
	2004	2005	Change	% Change	2004	2005	Change	% Change
	(dollars in thousands)							
Minority interest	$ (367)	$ —	$ 367	−100%	$ (3,171)	$ (468)	$ 2,703	−85%

Minority interest reflects the share of income of minority shareholders who held common interests in VTS and VTS II. In connection with the Offering, we completed a reorganization, whereby we redeemed all outstanding minority interests. For the nine months ended September 30, 2005, minority interest reflects the share of income of minority shareholders from January 1, 2005 through the Offering date.

Financial Condition and Liquidity

Financial Condition. As of September 30, 2005, we had total debt, net of cash and cash equivalents, of $1.1 billion and $575.9 million of stockholders' equity, compared to net debt of $1.6 billion and $6.5 million of common owners' equity at December 31, 2004. Prior to the completion of our reorganization and the Offering, we used excess cash generated through operations to pay down long−term debt. At September 30, 2005 and December 31, 2004, we had a positive working capital balance of $18.9 million and $15.1 million, respectively.

As previously disclosed, we were required to make our estimated 2005 cash pension contributions of $6.5 million in quarterly increments beginning in April 2005. As of September 30, 2005, we have paid $3.2 million of our estimated 2005 cash pension contribution. Also, in September 2005, we made our required $6.5 million cash contribution related to the 2004 plan year and made an optional payment of $6.0 million into our qualified pension plan. Due to our total 2005 payments, our defined benefit pension plan is estimated to be fully funded on a current liability basis as of January 1, 2005 for the 2005 plan year. Accordingly, our previously required quarterly payments of $1.6 million due in October 2005 and January 2006 will not be necessary. Our next required cash contribution is estimated to be due in 2007. However, we may elect to make optional contributions prior to that date.

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

In accordance with our dividend policy, we intend to distribute, as dividends, a substantial portion of cash generated by our business in excess of operating needs, interest and principal payments on indebtedness and capital expenditures.

In connection with our reorganization, our previous owners contributed approximately $308.2 million of net operating losses ("NOLs") that we will be able to use, subject to certain limitations, to reduce our future taxable income. Furthermore, we have cumulative differences of approximately $519.4 million resulting from items such as goodwill amortization and accelerated tax depreciation that we have deducted faster for tax purposes under the Internal Revenue Code than we have for financial reporting purposes. We also have other items totaling $826.0 million, the most significant being goodwill, that we will deduct from our future taxable income. The tax effect of the NOLs and cumulative differences were recorded on our balance sheet due to the reorganization and resulted in a net deferred tax liability of approximately $61.6 million. We expect that we will generate a net operating loss in 2005 for federal income tax purposes without utilizing

any previously generated NOLs. The loss generated during 2005 will serve to increase the total NOLs available for use in future years.

	Nine months ended September 30,			
	2004	2005	Change	% Change
	(dollars in thousands)			
Net cash provided by operating activities	$125,294	$136,019	$ 10,725	9%
Net cash used in investing activities	(51,996)	(20,374)	31,622	–61%
Net cash used in financing activities	(74,054)	(85,958)	(11,904)	16%
Net operating cash used in discontinued operations	(17)	—	17	–100%
Net (decrease) increase in cash and cash equivalents	$ (773)	$ 29,687	$ 30,460	–3940%

Cash Flows

Operating Activities. Net cash provided by continuing operations of $136.0 million in 2005, was generated primarily by adjustments to our income from continuing operations of $18.9 million to exclude non–cash items and loss on debt extinguishment totaling $126.3 million. The most significant non–cash item in 2005 was depreciation and amortization expense of $67.2 million. We also recognized a loss on debt extinguishment of $29.3 million as a result of the repayment of existing indebtedness. Net cash provided by continuing operations of $125.3 million in 2004 was generated primarily by $25.2 million of income from continuing operations, adjusted to exclude reorganization related and non–cash items totaling $85.6 million. The most significant non–cash item in 2004 was 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.

Investing Activities. Cash used in investing activities was $20.4 million for the first nine months of 2005 compared to cash used in investing activities of $52.0 million in 2004. Our investing activities consist 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 nine months ended September 30, 2005 and 2004 were $45.0 million and $51.5 million, respectively. We anticipate that capital spending for fiscal year 2005 will be approximately $58.8 million.

The investing activities during 2005 include proceeds from the redemption of our RTFC capital certificate of $24.4 million that occurred in connection with amendment of our credit facility.

Financing Activities. Cash used by financing activities was $86.0 million in 2005 and $74.1 million in 2004. These changes are principally due to the net incremental payments of long–term debt of $420.3 million and $59.3 million in 2005 and 2004, respectively. Cash used in financing activities in 2005 also includes $411.3 million of net proceeds from the issuance of common stock in connection with the Offering and payment of dividends, prepayment fees and debt issuance costs of $37.5 million, $19.4 million, and $17.4 million, respectively. Cash used in financing activities in 2004 also includes our purchase of ownership interests from certain individual investors.

Prior to the completion of our reorganization and the Offering, we managed our cash on hand through the use of revolving credit facilities to maximize the amount of debt repayment.

Outstanding Debt and Existing Financing Arrangements

As of September 30, 2005, we had various financing arrangements outstanding. Under these financing arrangements, we have $1.2 billion of outstanding debt and $99.8 million of available borrowing capacity under our revolving credit facility.

Amended Credit Facility and Issuance of Senior Notes

In connection with the Offering, we issued $400.0 million principal amount 7¾% senior notes due in 2015 for net proceeds of approximately $390.0 million. The proceeds from the issuance of the senior notes were used to repay certain existing indebtedness. Also, in connection with the Offering, we amended our senior credit facility. The amended senior credit facility resulted in the reduction of the commitment amount of Tranche B Term Loan to $750.0 million, Tranche C Term Loan to $50.0 million and Tranche D Term Loan to $5.6 million. The reduction of the amended credit facility was primarily funded from the net proceeds of the Offering. Under the amended credit facility, the entire principal balances on Tranches B, C and D are due at maturity, February 2012.

Recently Issued Accounting Pronouncements

In January 2004, FASB Staff Position ("FSP") No. 106–1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" was issued. FSP No. 106–1 permits the deferral of recognizing the effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") in the accounting for post–retirement health care plans under SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," and in providing disclosures related to the plan required by SFAS No. 132 (revised 2003), "Employers' Disclosures about Pensions and Other Postretirement Benefits." In May 2004, FSP 106–2, "Accounting and Disclosure Requirement Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" was issued. FSP 106–2 provides guidance that measures the accumulated post–retirement benefit obligation ("APBO") and net periodic postretirement benefit cost on or after the date of enactment shall reflect the effects of the Act. FSP 106–2 is effective for the first interim or annual period beginning after June 15, 2004. Upon the effective date FSP 106–2 will supersede FSP 106–1. The deferral of the accounting for the Act will continue until FSP 106–2 is effective. We have elected the deferral provided by FSP 106–1 and are evaluating the magnitude of the potential favorable impact on our results of operations and financial position. The effects of the Act have not been reflected for interim disclosure purposes. We are currently evaluating the options available under the Act and have yet to determine if the plan is actuarially equivalent to the standard Medicare Part D benefit. Therefore, any measures of APBO or Net Periodic Postretirement Benefit Cost do not reflect the effects of the Act on the plan.

In March 2005, the FASB issued FASB Interpretation ("FIN") No. 47, "Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143", which clarifies the term *conditional asset retirement obligation* as used in FASB Statement No. 143, "Accounting for Asset Retirement Obligations." The term *conditional asset retirement obligation* refers to an obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. An obligation exists when a law, regulation or contract requires an entity to perform an asset retirement activity. The interpretation requires an entity to recognize a liability— generally upon acquisition, construction or development — for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. In circumstances where sufficient information is not available, the liability should be recognized in the period in which sufficient information becomes available to estimate its fair value. The interpretation is effective no later than the end of fiscal years ending after December 15, 2005. We are currently evaluating the effect that adoption of this interpretation will have on our financial position and results of operations.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

We are exposed to market risk from changes in interest rates on our long–term debt obligations. We estimate our market risk using sensitivity analysis. Market risk is defined as the potential change in the fair value of a fixed–rate debt obligation due to a hypothetical adverse change in interest rates and the potential change in interest expense on variable rate long–term debt obligations due to changes in market interest rates. Fair value on long–term debt obligations is determined based on quoted market prices and a discounted cash flow analysis, using the rates and maturities of these obligations, compared to terms and rates currently available in the long–term markets. The potential change in interest expense is determined by calculating the effect of the hypothetical rate increase on our variable rate debt for the year and does not assume changes in our financial structure.

The results of the sensitivity analysis used to estimate market risk are presented below, although the actual results may differ from these estimates.

At December 31, 2004, we had total debt of $1.6 billion consisting of both fixed and variable debt with weighted average interest rate of 7.3%. Substantially all of our debt balance was scheduled to mature 2011 through 2012. As a result of the debt recapitalization that occurred November 10, 2004, the fair value of our debt approximated its carrying value at December 31, 2004.

At September 30, 2005, we had total debt of $1.2 billion consisting of both fixed and variable debt with weighted average interest rates ranging from 5.8% to 7.8%. Approximately $800.0 million of our debt matures in 2012 and $400.0 million matures in 2015. In February 2005, we completed the Offering and issuance of 7¾% senior notes for net proceeds of approximately $801.5 million. We used the proceeds from the Offering and the issuance of senior notes to repay certain indebtedness that was outstanding at December 31, 2004 and related transaction costs. The fair value of our debt based on current prevailing rates and quoted market prices is $1.2 billion at September 30, 2005.

At September 30, 2005, we had approximately $725.0 million of variable rate debt. If market interest rates increase 100 basis points within the next year over the rates in effect at September 30, 2005, annual interest expense would increase $5.8 million. The increase in interest rates is impacted by our interest rate caps and swaps that are currently in effect or will be in effect over the next year. We are charged interest on our variable rate debt, as defined in our Amended and Restated Credit Agreement, based on LIBOR plus 1.75% or an applicable base rate plus 0.75%. The three–month LIBOR rate for the nine months ended September 30, 2005 ranged from 2.6% to 4.1%.

Pursuant to our credit facility, we are required to reduce the risk of interest rate volatility with at least 50% of our indebtedness. To manage our interest rate risk exposure and fulfill our requirement under our credit facility, we entered into nine agreements, three interest rate caps and six interest rate swaps, with investment grade financial institutions in March and September of 2005 (collectively, the "Agreements"). In connection with entering the interest rate cap agreements, we paid $0.9 million.

The following represents a summary of the Agreements (dollars in thousands):

Instrument	Effective Date	Maturity Date	Notional Amount	Cap Rate or Pay Rate	September 30, 2005 Fair Value Asset (Liability)
Interest rate cap	03/31/05	03/31/06	$450,000	5.0%	$ 2
	03/31/06	03/30/07	50,000	5.0	58
	03/31/06	03/31/08	100,000	5.0	416
Interest rate swap	03/31/06	03/31/08	75,000	4.5	60
	03/31/06	03/31/08	75,000	4.6	34
	03/31/06	03/31/09	50,000	4.2	569
	03/31/06	03/31/10	100,000	4.7	(489)
	03/30/07	03/31/08	30,000	4.7	(35)
	03/31/08	03/31/09	180,000	4.3	522

Our interest rate caps are not treated as hedges as prescribed by the accounting literature; therefore, the fair value of the instruments is recorded each reporting period on the Condensed Consolidated Balance Sheets with the change in fair value recorded in the Condensed Consolidated Statements of Income in "Gain (loss) on interest rate hedging arrangements." The interest rate swaps effectively convert our variable rate debt to fixed rate debt. Our interest rate swap agreements qualify for hedge accounting under SFAS No. 133; therefore, they are carried at fair market value and are included on the Condensed Consolidated Balance Sheets with changes in fair value recorded as "Other comprehensive income" in the accompanying Condensed Consolidated Statements of Income. We do not hold or issue derivative financial instruments for trading or speculative purposes.

ITEM 4. CONTROLS AND PROCEDURES.

The Company, under the supervision and with the participation of its management, including the Chief Executive Officer and Principal Financial Officer, evaluated the effectiveness of the design and operation of the Company's "disclosure controls and procedures" (as defined in Rule 13a–15(e) and 15d–15(e) under the Securities Exchange Act) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and the Principal Financial Officer concluded that the Company's disclosure controls and procedures were effective as of September 30, 2005 to ensure that information relating to the Company and the Company's consolidated subsidiaries required to be disclosed in the Company's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Principal Financial Officer, as appropriate to allow timely discussions regarding required disclosure. It should be noted, however, that the design of any system of controls is limited in its ability to detect errors, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote. There has been no change in the Company's internal control over financial reporting during the quarter ended September 30, 2005 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II — OTHER INFORMATION

ITEM 6. EXHIBITS.

31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes–Oxley Act of 2002

31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes–Oxley Act of 2002

32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes–Oxley Act of 2002

32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes–Oxley Act of 2002

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: November 4, 2005

VALOR COMMUNICATIONS GROUP, INC.

By: /s/ John J. Mueller
John J. Mueller
President and Chief Executive Officer
(Principal Executive Officer)

Dated: November 4, 2005

By: /s/ Jerry E. Vaughn
Jerry E. Vaughn
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

Exhibit 31.1

CERTIFICATION

I, John J. Mueller, certify that:

1) I have reviewed this quarterly report on Form 10–Q of Valor Communications Group, Inc.;

2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a–15(e) and 15d — 15(e)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 4, 2005

/s/ John J. Mueller

John J. Mueller
President and Chief Executive
Officer

Exhibit 31.2

CERTIFICATION

I, Jerry E. Vaughn, certify that:

1) I have reviewed this quarterly report on Form 10–Q of Valor Communications Group, Inc.;

2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a–15(e) and 15d — 15(e)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 4, 2005

/s/ Jerry E. Vaughn

Jerry E. Vaughn
Senior Vice President and Chief
Financial Officer

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES–OXLEY ACT OF 2002

In connection with the Quarterly Report of Valor Communications Group, Inc. (the Company) on Form 10–Q for the quarter ending September 30, 2005 as filed with the Securities and Exchange Commission on the date hereof (the Report), I, John J. Mueller, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes–Oxley Act of 2002, that to my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ John J. Mueller

John J. Mueller
President and Chief Executive
Officer
November 4, 2005

Note: The certification the registrant furnishes in this exhibit is not deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities of that Section. Registration Statements or other documents filed with the Securities and Exchange Commission shall not incorporate this exhibit by reference, except as otherwise expressly stated in such filing.

Exhibit 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES–OXLEY ACT OF 2002

In connection with the Quarterly Report of Valor Communications Group, Inc. (the Company) on Form 10–Q for the period ending September 30, 2005 as filed with the Securities and Exchange Commission on the date hereof (the Report), I, Jerry E. Vaughn, Senior Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes–Oxley Act of 2002, that to my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Jerry E. Vaughn

Jerry E. Vaughn
Senior Vice President and Chief
Financial Officer
November 4, 2005

Note: The certification the registrant furnishes in this exhibit is not deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities of that Section. Registration Statements or other documents filed with the Securities and Exchange Commission shall not incorporate this exhibit by reference, except as otherwise expressly stated in such filing.

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

☑ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2005

Or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission file number 001-32422

Valor Communications Group, Inc.
(Exact name of registrant as specified in its charter)

Delaware *(State or other jurisdiction of incorporation or organization)*	**20-0792300** *(IRS Employer Identification No.)*
201 E. John Carpenter Freeway, Suite 200, Irving, Texas *(Address of principal executive offices)*	**75062** *(Zip Code)*

Registrant's telephone number, including area code:
(972) 373-1000

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common stock ($.0001 par value per share)	New York Stock Exchange

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined by rule 405 of the Securities Act. Yes ☐ No ☑

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☑

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

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

Indicate by check mark whether the registrant is a large accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☑

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☑

The aggregate market value of the common equity held by non-affiliates of the registrant as of June 30, 2005, the last business day of the registrant's most recently completed second fiscal quarter (based on the last reported closing price of $13.80 per share of common stock as reported by the New York Stock Exchange on such date) was approximately $590 million.

As of February 1, 2006, 71,063,265 shares of common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Certain of the Information required by Part III is incorporated by reference from the Registrant's definitive proxy statement to be filed with the Commission pursuant to Regulation 14A not later than 120 days after end of the fiscal year covered by this report.

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Certification of CFO Pursuant to Section 302
Certification of CEO Pursuant to Section 906
Certification of CFO Pursuant to Section 906

PART I

Item 1. *Business.*

General

Valor Communications Group, Inc. (NYSE: VCG) is 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 local telephone company in the country. We operate approximately 518,000 telephone access lines in primarily rural areas of Texas, Oklahoma, New Mexico and Arkansas. We operate our business through telephone company subsidiaries that qualify as rural local exchange carriers under the Telecommunications Act of 1996.

We offer a wide range of telecommunications services to residential, business and government customers. Our services include: local exchange telephone services, which covers basic dial-tone service as well as enhanced services, such as caller identification, voicemail and call waiting; long distance services; and data services, such as providing digital subscriber lines. We also provide access services that enable inter-exchange carriers to complete interstate and intrastate long distance calls. In addition to the services we provide, we receive revenues from Universal Service Fund ("USF") payments from the State of Texas and the federal government to support the high cost of providing local telephone service in rural areas.

We formed our company in 2000 in connection with the acquisition of select telephone assets from GTE Southwest Corporation ("GTE"), which is now part of Verizon. In January 2002, we 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. We completed our initial public offering on February 9, 2005 and our shares began trading on the NYSE under the symbol "VCG."

As previously announced on December 9, 2005, the board of directors of Valor Communications Group, Inc. ("Valor") unanimously approved a strategic merger that will combine Valor and the wireline telecommunications business of Alltel Corporation ("Alltel"). Pursuant to the Agreement and Plan of Merger Valor entered into on December 8, 2005 with Alltel and Alltel Holding Corp. (which we refer to as "Spinco"), Spinco will merge with and into Valor and Valor will survive as a stand-alone company and will hold and conduct the combined business operations of Valor and Spinco. The merger will take place immediately after Alltel contributes the assets making up its wireline telecommunications business to Spinco and distributes the common stock of Spinco to its stockholders. In the merger, each share of Spinco common stock will be converted into the right to receive approximately 1.04 shares of Valor common stock. Existing shares of Valor common stock will remain outstanding. Following completion of the merger, the separate existence of Spinco will cease. Valor expects to issue approximately 403 million shares of common stock to Alltel stockholders in the merger. However, this amount is subject to change as a result of compensatory equity grants and other issuances of Valor common stock. Valor also expects to assume approximately $4 billion in outstanding debt in the merger. Immediately following the merger, Valor expects to change its name and that its common stock will be quoted on the New York Stock Exchange under that new name and with a new ticker symbol, each of which has yet to be determined. When the merger is completed, Alltel stockholders will together own approximately 85%, and Valor's stockholders will own approximately 15%, of the shares of common stock in that entity on a fully diluted basis. The composition of the senior management and board of directors of the combined business will be largely determined by Alltel. While we are the legal acquirer and the surviving entity in this transaction, Alltel's wireline business will be deemed to be the accounting acquirer in a transaction treated for accounting purposes as a reverse acquisition. The historical financial statements of Valor after the close of the merger will be those of Alltel's wireline business. The merger is subject to both regulatory and shareholder approval and is expected to close in mid-2006.

Initial Public Offering and Reorganization

On February 9, 2005, we completed our initial public offering (the "Offering") registering 29,375,000 shares of common stock at an offering price of $15 per share. In conjunction with the Offering, we issued $400 million aggregate principal senior notes. In August 2005, we exchanged all of the senior notes

with substantially identical senior notes that were registered under the Securities Act of 1933. The proceeds from the Offering and the issuance of the senior notes were used to repay the second lien loan of $265 million, senior subordinated loan of $135 million, and a portion of the existing credit facility of $373.4 million and associated fees and expenses of $66.3. Immediately following the Offering, we amended our senior credit facility. The amended senior credit facility resulted in the reduction of the commitment amount, excluding the senior secured revolving facility, to $805.6 million. In connection with the Offering, certain of our stockholders granted an option to the underwriters to purchase up to 4,406,250 additional shares at the Offering price less the underwriting discount. On March 16, 2005, the underwriters exercised their over-allotment option in full. We received no proceeds from the over-allotment exercise.

Immediately prior to and in connection with the Offering, we consummated a reorganization pursuant to which our existing equity holders contributed all their equity interests in Valor Telecommunications, LLC, ("VTC") and Valor Telecommunications Southwest, LLC, ("VTS") to Valor in exchange for 39,537,574 shares of common stock in the aggregate. Following the reorganization, Valor exists as a holding company with no direct operations and each of VTC, VTS and Valor Telecommunications Southwest II, LLC, ("VTS II") is either a direct or an indirect wholly-owned subsidiary of Valor. Valor's principal assets consist of the direct and indirect equity interests of its subsidiaries.

Industry Overview

The U.S. local telephone industry is comprised of a few large, well-known companies, including the regional Bell operating companies and numerous small and mid-sized independent rural telephone companies that typically operate in sparsely populated rural areas where competition has been limited due to the generally unfavorable economics of constructing and operating competitive systems. To ensure that affordable universal telephone service is available in these remote areas, rural telephone companies may receive various support mechanisms provided by both state and federal government regulation.

Federal and state laws and regulations promoting the widespread availability of telephone service have allowed rural telephone companies to invest in their networks while keeping prices affordable for customers. This policy commitment was reaffirmed and expanded by the universal service provisions of the Telecommunications Act of 1996. In light of the high cost per access line of installing lines and switches and providing telephone service in sparsely populated areas, a system of cost recovery mechanisms has been established to, among other things, keep customer telephone charges at a reasonable level and yet allow owners of such telephone companies to earn a fair return on their investment. These cost recovery mechanisms, which are less available to larger telephone companies, have resulted in robust telecommunications networks in many rural areas.

The passage of the Telecommunications Act of 1996 substantially changed the regulatory structure applicable to the telecommunications industry, with a stated goal of stimulating competition for telecommunications services, including local telephone service, long distance service and enhanced services. In recent years, the telecommunications industry has undergone significant structural change. Many of the largest service providers have achieved growth through acquisitions and mergers while an increasing number of competitive providers have restructured or entered bankruptcy to obtain protection from their creditors. Since 2001, capital in the form of public financing has been generally difficult to obtain for new entrants and competitive providers. Capital constraints have caused a number of competitive providers to change their business plans, resulting in industry consolidation. Despite these changes, the demand for all types of telecommunications services, particularly data services, has not diminished, and companies increasingly bundle services and provide integrated offerings for end-user customers.

The most common measure of the relative size of a local telephone company is the number of access lines it operates. An "access line" is the telephone line connecting a person's home or business to the public switched telephone network. A local telephone company can acquire access lines either through normal growth or through a transaction with another local telephone company. The net increase or decrease in access lines realized by a local telephone company on an annual basis is a relevant measure because the access line is the foundation for a large majority of local telephone company revenues and it is also an indicator of customer

growth or contraction. A local telephone company experiences normal growth when it sells additional access lines in a particular market due to increased demand for telephone service by current customers or from new customers, such as from the construction of new residential or commercial buildings. Growth in access lines through transactions with other local telephone companies occurs less frequently. Typically, one local telephone company purchases access lines from another local telephone company. Such purchases usually provide the acquiring local telephone company with the opportunity to expand the geographic areas it serves, rather than increasing its access lines in markets that it already serves.

Services

We locally manage our service offerings to serve effectively and efficiently the needs of each community. We are committed to a high standard of service and have dedicated sales and customer service representatives with local market knowledge positioned in each of the states in which we operate. Based on our understanding of our local customers' needs, we offer bundled services that are designed to simplify the customer's selection and use of our services. Offering bundled services allows us to capitalize on our network infrastructure by offering a full suite of integrated communications services in voice, high-speed data, Internet access and long distance services, as well as enhanced services, such as voicemail and caller identification, all on one bill.

We also generate revenue through the provision of network access to long distance carriers for origination and termination of interstate and intrastate long distance phone calls, the receipt of government-sponsored USF support, and from the sale of other services, such as customer premises equipment and directory advertising.

The following summarizes each component of our revenue sources (percentages are based on revenues for the year ended December 31):

Revenue Sources	Percent of Revenue		
	2003	2004	2005
Local services	31.4%	31.2%	30.0%
Data services	4.2	5.0	6.6
Long distance services	6.2	7.5	8.1
Access services	26.6	25.0	23.8
Universal Service Fund:			
Texas	20.7	20.1	19.8
Federal	3.4	3.6	3.0
Other services	7.5	7.6	8.7

You should refer to the section "Management's Discussion and Analysis of Financial Condition and Results of Operation" for more information.

Local Services. Local calling services include basic local lines and private lines, as well as enhanced services such as voicemail and caller identification. We provide local calling services to residential, business and government customers, generally for a fixed monthly charge. In the markets we serve, the amount that we can charge a customer for local service is generally determined by the appropriate state regulatory authorities pursuant to the laws and regulations of the particular state. We also generate revenue from non-recurring services, such as service activation and reconnection of service.

Data Services. We provide high-speed Internet access with our DSL products for a monthly fee. We also provide Internet access services to dial-up Internet subscribers. Our dial-up Internet service provides customers, primarily residential customers, with a local dial-up number they can use to establish a connection to the Internet over their existing phone lines for a flat, monthly fee. Our Internet access services also enable customers to establish an email account and to send and receive email.

Long Distance Services. We generate revenue from the provision of long distance calling services either based on usage or pursuant to flat-rate calling plans. These services include traditional switched and dedicated long distance, toll free calling, international, calling card and operator services.

Access Services. Long distance carriers pay us network access charges when our local customers make or receive long distance telephone calls. Since these calls are generally billed to the customer originating the call, a mechanism is required to compensate each rural telephone company, regional Bell operating company or long distance carrier providing services relating to the call. Access services include switched access, charges that depend on call volume, and special access, involving dedicated circuits for which long distance telephone companies pay a flat fee. We bill access charges to long distance companies and other customers for the use of our facilities to access the customer, as described below. In addition, per Federal Communications Commission ("FCC") rule, end users are charged a monthly flat-rate fee assessed on access lines.

Intrastate Access. We generate intrastate access revenue when an intrastate long distance call involving a long distance carrier is originated by or terminated with a customer in our exchange to or from a customer in another exchange in the same state. The long distance carrier pays us an intrastate access payment for either terminating or originating the call. We record the details of the call through our carrier access billing system and receive the access payment from the long distance carrier. When one of our customers originates the call, we sometimes provide billing and collection for the long distance carrier through a billing and collection agreement. The access charge for our intrastate service is regulated and approved by the state regulatory authority.

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

Universal Service Fund

Texas USF. The Texas USF supports eligible telecommunications carriers that serve high cost markets. See further discussion of Texas USF within this Item under the caption "State Regulation."

Federal USF. The federal USF supplements the amount of local service revenue that we receive to ensure that basic local service rates for customers in high cost rural areas are comparable to rates charged in lower cost urban and suburban areas. The federal USF, which is funded by monthly fees paid by long distance carriers and local telephone companies, distributes funds to us on a monthly basis based upon our embedded costs for providing local service. This mostly reflects the changes in the universal service support as a result of the Coalition for Affordable Local and Long Distance Service ("CALLS") plan that moved the implicit support from access charges and made it explicit.

Other Services. Our other services consist primarily of the sale of customer premises equipment, directory advertising, wholesale services such as unbundled network elements, billing and collection fees, and other ancillary services.

Sales and Marketing

Our marketing approach emphasizes customer-oriented sales, marketing and service with a local presence. We market our products primarily through our customer service representatives, direct sales representatives, local retail stores and outsourced telemarketing supported by direct mail, bill inserts, newspaper advertising, website promotions, public relations activities and sponsorship of community events. We have established relationships with local government officials and business leaders. In our largest operating areas, we maintain retail business offices that allow our customers the opportunity to pay their bills directly or meet personally with our customer service and sales representatives to purchase additional services or, in some locations, customer premises equipment. Our customer service and sales representatives earn incentive compensation to promote sales of services that meet the unique needs of our customers.

Our sales force makes direct calls to prospective and existing business customers and conducts analyses of business customers' usage histories and service needs, and demonstrates how our service package may improve a customer's communications capabilities and costs. Our network engineers work closely with our various sales groups to design service products and applications, such as high-speed data and wholesale

transport services, for our customers. Our technicians survey customer premises to assess building entry, power and space requirements and coordinate delivery, installation and testing of equipment.

To foster long-term relationships with our subscribers, we have undertaken many initiatives to provide superior customer service. We operate three call centers located in the rural areas that we serve with customer service representatives who are knowledgeable about the local market. In addition, we have automated many of our customer service functions so our customers can receive answers to many frequently asked questions regarding their telecommunications services 24 hours a day without speaking to a customer service representative.

Network Architecture and Technology

Our network consists of central office hosts and remote sites with advanced digital switches, primarily manufactured by Nortel, Lucent and Siemens, generally operating with the most current software. The outside plant consists of transport and distribution delivery networks connecting our host central office with remote central offices and ultimately with our customers. We own fiber optic cable, which has been deployed throughout our current network and is the primary transport technology between our host and remote central offices and interconnection points with other incumbent carriers. We also lease fiber optic capacity from other major carriers.

In our markets, DSL-enabled integrated access technology is being deployed to provide significant broadband capabilities to our customers. We continue to remove any network impediments so we can offer DSL service to more customers. Based on current technical limitations and the cost characteristics in certain of our rural markets, DSL is available to many, but not to all, of our customers.

Rapid and significant changes in technology are expected in the communications industry. Our future success will depend, in part, on our ability to anticipate and adapt to technological changes. We believe that our network architecture enables us to respond efficiently to these technological changes.

We offer facilities-based services in each of our markets. Our fully integrated telecommunications network is comprised primarily of asynchronous transport mode ("ATM") core switches, capable of handling both voice and data, and time digital multiplex ("TDM") digital central office switches in our four divisions of operation. We currently own or lease all of our network facilities and have not booked any revenues from swaps of indefeasible rights to use ("IRUs").

Our SS7 network consists of six Signal Transfer Points ("STP") and two Signal Control Points ("SCP") nodes which provide 800 Number Routing, Caller Name delivery, CLASS, and Message Waiting Indicator service for all of our class 5 TDM digital central office switches. Our Voice Mail network consists of 11 voice mail servers which leverage the ATM Core transport network to reach 100% of our customer base.

Our network operations center located in Texarkana, Texas monitors all our networks, transport and ATM elements, digital switching systems and Internet services infrastructure devices 24 hours a day, seven days a week.

Competition

We experience competition from wireless service providers in many of our markets. We also experience competition from wireline local carriers and cable companies in a limited number of our markets. In addition, future technological changes could negatively impact our competitive position. For example, as Voice over Internet Protocol ("VoIP") emerges, some wholesale customers may be able to bypass network access charges. See further discussion at Item 1A. "Risk Factors."

Regulation

The following summary of the regulatory environment in which our business operates does not describe all present and proposed federal, state and local legislation and regulations affecting the telecommunications industry. Some legislation and regulations are currently the subject of judicial proceedings, legislative hearings

and administrative proposals that could change the manner in which this industry operates. We cannot predict the outcome of any of these matters or their potential impact on our business. Regulation in the telecommunications industry is subject to rapid change, and any such change may have an adverse effect on us in the future.

Overview

The telecommunications services we provide and from which we derive a large majority of our revenue are subject to federal, state and local regulation. We hold various authorizations for our service offerings. At the federal level, the FCC has jurisdiction over common carriers, such as us, to the extent that their facilities are used to originate, terminate or provide interstate and international telecommunications services. State regulators in Texas, Oklahoma, New Mexico and Arkansas ("State PUCs") exercise jurisdiction over our facilities and services used to provide, originate or terminate intrastate communications. State and federal regulators share responsibility for implementing and enforcing the policies of the Telecommunications Act of 1996 intended to foster competition in local telecommunications services. Municipalities and other local government agencies regulate certain aspects of our business, such as our use of public rights-of-way, and by requiring that we obtain construction permits and comply with building codes.

The following discussions outline some of the major telecommunications-related regulations that affect us, but numerous other substantive areas of regulation not discussed here may also influence our business.

Federal Regulation

We are subject to, and must comply with, the federal Communications Act of 1934, as amended (the "Communications Act"). The Telecommunications Act of 1996, which amended the Communications Act, changed and will continue to change the regulatory and competitive landscape in which we operate. The most important of these changes removed most legal barriers to market entry into local telephone services; required that incumbent local exchange carriers interconnect with competitors and offer unbundled network elements; established procedures for the Regional Bell Operating Companies to provide long distance services within their home regions; and created greater opportunities for competitive providers to compete with other incumbent local exchange carriers.

Access Charges

The FCC regulates the prices that incumbent local exchange carriers charge for the use of their local networks in originating or terminating interstate and international transmissions. State PUCs regulate prices for access provided in connection with the origination and termination of intrastate transmissions. The prices that we and other incumbent local exchange carriers charge for use of local telephone networks to complete long distance calls are called "access charges."

We provide two types of access services, special access and switched access. The rates for special access, which is provided via dedicated circuits connecting long distance carriers to our network, are structured as flat-rate monthly charges. The rates for switched access are structured as per-minute traffic sensitive charges, which are paid by long distance carriers. In addition, we bill end-users a flat rate, monthly recurring subscriber line charge. These charges are also deemed to be a component of access charges under the FCC's regulatory framework. A significant amount of our revenues comes from access charges derived from intrastate, interstate and international transmissions.

Since July 1, 2000, most of our interstate access charges have been established in accordance with an order adopted in response to a proposal put forth by members of the CALLS Order. The CALLS Order reformed interstate access charge regulation for carriers subject to price caps. It implemented a system for reducing per-minute traffic sensitive rates for switched access services to specific target levels that the FCC believed more closely approximated the cost of providing those services. The CALLS Order also permitted us to recover a greater proportion of our local costs by increasing the subscriber line charge levied on end users. In June 2002, the FCC adopted an order that permitted all price cap regulated carriers, including us, to increase further the subscriber line charge. We are required annually to file tariffs for our interstate access

charges with the FCC. By its terms, the CALLS Order was to expire on June 30, 2005, but the FCC ruled that the CALLS Order will remain in effect until the FCC adopts a replacement plan.

In April 2001, the FCC released a Notice of Proposed Rulemaking to determine whether to adopt a unified regime that would apply to all of these intercarrier compensation arrangements; such a regime could be a successor to the five-year transitional access charge system established by the CALLS Order. The FCC's Notice sought comment on various possible reforms, including an alternative to the current "calling-party's-network-pays" system known as "bill-and-keep." Under "bill-and-keep" arrangements, each carrier would be required to recover the costs of terminating (and originating) calls from its end users. We are actively participating in discussions with other industry parties aimed at developing a consensus proposal on intercarrier compensation for this FCC proceeding and other FCC proceedings relating to the issue. In October 2004, we joined with eight other carriers, collectively known as the Intercarrier Compensation Forum ("ICF"), to file a specific reform proposal in that FCC proceeding. On March 3, 2005, the FCC issued a Notice of Proposed Rulemaking on intercarrier compensation, and the FCC has received comment on the various plans and proposals for intercarrier compensation reform that have been advanced by various industry groups and state regulators. This matter remains pending at the FCC and the outcome of the proceeding at this point is uncertain, but it could result in significant changes to the way in which we receive compensation from other carriers and our end users. At this time, we cannot estimate whether the FCC or Congress will reform the current system and, if so, whether and to what extent any changes will affect our access charge revenues, reciprocal compensation revenues or other revenues and expenses.

The FCC has also initiated a proceeding in January 2005 to examine the appropriate regulatory framework for special access services and has solicited comment broadly on the manner in which price cap carriers can provide special access services. The FCC is considering reforms to modify or eliminate pricing flexibility policies and additional reforms to the price cap rules affecting special access pricing. The outcome of the FCC's proceedings is uncertain, but it could result in significant changes to the way in which we receive compensation from other carriers and our end users for special access services. At this time, we cannot estimate whether the FCC will reform the current special access rules and, if so, whether and to what extent any changes will affect our special access revenues or business.

Interconnection with Local Telephone Companies and Access to Other Facilities

The Telecommunications Act of 1996 imposes several requirements on all local exchange carriers with additional requirements imposed on incumbent local exchange carriers. These requirements are intended to promote competition in the local exchange market by, in part, ensuring that a carrier seeking interconnection will have access to the interconnecting carrier's network functionalities under reasonable rates, terms and conditions. As of December 31, 2005, we had 27 comprehensive (interconnection, unbundling and resale) agreements with 18 competitive local exchange carriers, 58 interconnection only agreements with 33 local carriers and 24 resale agreements with 15 resellers. Many of these competitors have agreements in more than one of our states, and not all of these competitors currently offer competitive local services in our markets.

The Telecommunications Act of 1996 prescribes different regulatory requirements for local exchange carriers that meet the definition of a rural telephone company. We have been certified as a rural telephone company in each of the states in which we operate. A wireless carrier has challenged our certification at the FCC on two occasions, and these challenges have been pending since 2000 and 2003. We cannot predict the outcome of the challenges or whether the FCC will rule on the wireless carrier's petition.

As a rural telephone company, we may rely on a statutory exemption from these additional interconnection requirements until we receive a bona fide request for interconnection and the applicable state regulator lifts the exemption. To lift the exemption, the state regulator must find that competitive entry would not impose an undue economic burden on us, is technically feasible and will not harm universal service.

We have agreed not to exercise the rural exemption in Oklahoma, where we were classified as a non-rural carrier prior to July 1, 2003. In Texas and New Mexico, we agreed to continue providing interconnection to those competitive carriers that had interconnections agreements with GTE at the time we acquired the GTE properties and we continue to provide interconnection to these carriers today. Notwithstanding these

agreements, we may request suspension or modification of certain interconnection requirements in all states, including Oklahoma, by petition to the state regulator and upon the demonstration of certain statutory factors.

On July 18, 2004, the FCC adopted an "all or nothing" rule, which requires competitive local exchange carriers that wish to obtain interconnection with an incumbent local exchange carrier by adopting the terms of existing interconnection agreements between the incumbent and another competitive local exchange carrier to adopt all of the terms and conditions of such agreement. The new rule restricts a competitive local exchange carrier's ability to "pick and choose" the most favorable terms from all existing interconnection agreements.

Unbundling of Network Elements

To implement the interconnection requirements of the Telecommunications Act of 1996, incumbent local exchange carriers that do not have a currently effective rural exemption are required to provide unbundled network elements to competitors based on forward-looking economic costs.

In February 2003, in its Triennial Review Order, the FCC revised its rules requiring the unbundling of network elements by incumbent local exchange carriers. These rules were appealed, and were vacated in part by the United States Court of Appeals for the District of Columbia Circuit.

The FCC released final rules in February 2005. The rules eliminate incumbent local exchange carriers' unbundling requirement for mass market switching, although a 12-month transition period was provided for competitive carriers to move existing mass-market customers to new arrangements. A wire center test was adopted for high-capacity circuits that is likely to eliminate unbundling for those circuits in less than 1 percent of wire centers nationwide. We cannot predict what impact, if any, this action taken by the FCC, or subsequent court challenges of the FCC's final rules, may have on our operations.

Local Number Portability

In 2003, the FCC ruled that we and other local exchange carriers must port our telephone numbers to requesting wireless carriers, so-called wireline-to-wireless local number portability ("LNP"). Local exchange carriers operating in the country's largest urban areas were required to make LNP capability available to wireless carriers by November 24, 2003. Rural telephone companies serving rural areas had to make LNP available to wireless carriers on May 24, 2004 or six months after a bona fide request from a wireless carrier.

The FCC still has under consideration a number of technical and cost recovery issues associated with deployment of LNP. We have received bona fide requests for LNP in some of our exchanges, and we are now LNP capable in all New Mexico, Texas and Oklahoma exchanges for which we have received bona fide requests for LNP.

On March 11, 2005, the United States Court of Appeals for the District of Columbia Circuit stayed the FCC's wireless LNP rules as they apply to "small entities" (with less than 1,500 employees) and remanded the wireless LNP rules to the FCC with instructions to conduct a regulatory flexibility analysis. The Court's order would stay new porting requests from wireless carriers while this matter is pending at the FCC. We qualify as a "small entity," and we have suspended our provisioning of new porting requests to wireless carriers pursuant to the Court's stay while the FCC considers this matter.

Federal Universal Service

The FCC is required to establish a universal service program, to ensure that affordable, quality telecommunications services are available to all Americans. The program at the federal level has several components, including one that pays support to "high cost" areas, including certain areas served by rural local exchange carriers for which the costs of providing basic telephone service are significantly higher than the national average.

Eligibility. Universal service funds are only available to carriers designated as eligible telecommunications carriers by state regulators or the FCC. We are an eligible telecommunication carrier in each state in which we operate. Competitive providers that have been granted eligible telephone carrier status are eligible to

receive the same amount of universal service support per line as the local exchange carrier serving the same area. Under current federal rules, the payment of federal universal service funds to a competitor qualifying as an eligible telephone carrier in an area served by a local exchange carrier is not intended to reduce significantly any federal universal support payable to the local exchange carrier. Currently, six competitive carriers have received eligible telephone carrier designation in our markets in Texas, Oklahoma and New Mexico and draw support.

In late 2004, Congress passed Appropriations legislation that prevented the FCC from "modify[ing] amend[ing], or chang[ing] its rules or regulations for universal service payments to implement the ... [Joint Board recommendation] ... regarding single connection[s]." On February 25, 2005, the FCC adopted additional mandatory requirements for designation of competitive carriers as eligible to receive universal service support. These requirements will apply to all eligible telecommunications carriers on a prospective basis, including those previously certified, starting on October 1, 2006. We cannot predict at this time how the outcome of these proceedings or other legislative or regulatory changes could affect our business, revenue or profitability.

Support Mechanisms. The high-cost program consists of a number of individual support mechanisms. The CALLS Order provided for a phase-out of implicit universal service support mechanisms (which had, in part, relied on setting rates for interstate access above cost), to be replaced with more explicit subsidy mechanisms. In particular, the CALLS Order created an interstate access support ("IAS") fund as part of the USF. Additional support mechanisms offset high fixed switching costs in areas with fewer than 50,000 access lines, yet another high-cost loop program provides support to rural carriers where our average cost per line exceeds 115 percent of the national average cost per line. The national cap on the high-cost loop program may limit the amount of high-cost loop support we receive.

Contribution Obligation. We are required to make contributions to the federal universal service program based on methodologies and procedures established by the FCC. Contributions to the federal USF are based on end-user revenues from interstate and international services. In accordance with FCC rules, we recover our contributions from our customers through a surcharge on interstate and international revenues. The surcharge is adjusted each quarter. The FCC has an open proceeding dating back to December 2002 addressing comprehensive reform of the universal service contribution methodology, including transitioning from the current revenue-based mechanism to a connection-based or number-based methodology. We cannot predict the outcome of this proceeding or its effect on us.

Internet and Broadband Services

In connection with our Internet access offerings, we could become subject to laws and regulations as they are adopted or applied to the Internet. To date, the FCC has treated ISPs, as enhanced service providers, rather than common carriers, and therefore ISPs are exempt from most federal and state regulation, including the requirement to pay access charges or contribute to the federal USF. As Internet services expand, federal, state and local governments may adopt rules and regulations, or apply existing laws and regulations to the Internet.

In its September 23, 2005 Order, the FCC adopted a comprehensive regulatory framework for facilities-based providers of wireline broadband Internet access service. The FCC determined that facilities-based wireline broadband Internet access service is an information service. This decision places the federal regulatory treatment of DSL service in parity with the federal regulatory treatment of cable modem service. Facilities-based wireline carriers are permitted to offer broadband Internet access transmission arrangements for wireline broadband Internet access services on a common carrier basis or a non-common carrier basis, but they must continue to provide existing wireline broadband Internet access transmission offerings, on a grandfathered basis, to unaffiliated ISPs for a one-year transition period. Wireline broadband Internet access providers must maintain their current universal service contribution levels attributable to the provision of wireline broadband Internet access service for a period of 270 days from the date of the FCC Order. If the FCC is unable to complete new contribution rules within the 270-day period, the FCC will take whatever action is necessary to preserve existing funding levels, including extending the 270-day period discussed above or expanding the contribution base.

The emerging technology application known as 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. In 2004, the FCC ruled that certain VoIP services are jurisdictionally interstate, and it preempted the ability of the states to regulate some VoIP applications or providers. A number of state regulators have filed judicial challenges to that preemption decision. The FCC has pending a proceeding that will address the applicability of various regulatory requirements to VoIP providers, including the payment of access charges and the support of programs such as Universal Service and E-911. Expanded use of VoIP technology could reduce the access revenues received by local exchange carriers like us. We cannot predict whether or when VoIP providers may be required to pay or be entitled to receive access charges or USF support, the extent to which users will substitute VoIP calls for traditional wireline communications or the impact of the growth of VoIP on our revenues.

Communications Assistance for Law Enforcement Act

Under the Communications Assistance for Law Enforcement Act ("CALEA") and related federal statutes, we are required to provide law enforcement officials with call content and call identifying information under a valid electronic surveillance warrant and to reserve a sufficient number of circuits for use by law enforcement officials in executing court-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 and managed VoIP services, 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.

State Regulation

We operate in Texas, Oklahoma, New Mexico and Arkansas, and we are certified in those states to provide local telecommunications services.

Intrastate Rate Regulation. State regulators in the states in which we operate regulate the prices we charge for intrastate services, including our prices for local, intrastate long distance and intrastate access services paid by providers of intrastate long distance services. In Texas, most of our intrastate operations are subject to price caps. In September 2005, the Texas Legislature adopted significant telecommunications legislation. This legislation created, among other provisions, a statewide video franchise for telecommunications carriers, established a framework for deregulation of the retail telecommunications services offered by incumbent local telecommunications carriers, created requirements for incumbent local telecommunications carriers to reduce intrastate access charges upon the deregulation of markets and directed the Texas Public Utility Commission ("TPUC") to initiate a study of the Texas Universal Service Fund. We expect to participate in numerous TPUC proceedings in the coming months related to this new legislation, and we expect that the Texas Legislature may further address issues of importance to rural telecommunications carriers in Texas, including the Texas Universal Service Fund, in the 2007 Legislative session.

Our subsidiaries in New Mexico will operate under an alternative regulation plan until March 31, 2006. We do not expect to have to renegotiate and renew our current alternative regulation plan because legislation enacted in 2004 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 in New Mexico. After April 1, 2006, the New Mexico Public Regulation Commission will regulate us pursuant to rules that will govern our retail prices and service quality. These rules, adopted in January 2006, will allow us pricing freedom on retail services. The rules also mandate the streamlining of rules governing the introduction and withdrawal of tariffs and the packaging and bundling of services. We also recently played an instrumental role in the development and passage of access reform legislation. The New Mexico Public Regulation Commission adopted rules on November 1, 2005 to implement the access reform legislation, and later in December 2005, adopted several modifications to those rules. The rules generally require: 1) the reduction of access rates to interstate levels according to prescribed criteria; 2) the

increase of business and residence basic local services prices to prescribed benchmark prices; and 3) creation of a state USF to ensure revenue neutrality after taking into account revenues from the retail price increases.

In Oklahoma, legislation was enacted in May 2004 that regulates us as a rural telephone company, thereby allowing us significant pricing freedom for our basic services and reducing our costs of regulation. On January 25, 2006, we filed a letter with the Arkansas Public Service Commission in which we elected to be regulated pursuant to the Telecommunications Regulatory Reform Act of 1997. In accordance with the provisions of the Act, on the effective date of our election our tariffed rates were deemed just and reasonable. Any increase in basic local service rates cannot exceed $2.00 per year, but we have pricing freedom over discretionary services. The Act also provides that mergers, acquisitions, and asset purchases and sales involving an electing company are not subject to Public Service Commission approval.

Service Quality. State regulators impose service quality reporting obligations on us and require us to adhere to prescribed service quality standards. These standards measure the performance of various parts of our business. If we fail to meet these standards, regulators may impose fines or penalties, require us to issue credits to customers, require incremental capital investment, impose stricter reporting and oversight standards, subject us to third-party audits or take other actions that may impact our revenues or increase our costs.

Compliance. State regulators also have the authority to condition, modify, cancel, terminate or revoke operating authority for failure to comply with applicable laws or rules, regulations, and policies of the state regulatory agency. Fines or other penalties may be imposed for such violations.

Texas USF. The Universal Service Fund payments we receive from the Texas USF are intended to support the high cost of our operations in rural markets.

The purpose of the Texas USF is to implement a competitively neutral mechanism to assist telecommunications providers in providing basic local telecommunications services at reasonable prices to customers in high cost rural areas and to qualifying low-income and disabled customers. By order of the TPUC, the Texas USF pays eligible carriers serving areas identified as high cost, on a per-line basis. Texas USF support payments are based on actual lines in service and therefore are subject to reduction if customers discontinue service or migrate from our lines to a competitive carrier. All customers of telecommunications services in Texas fund the Texas USF through the payment of a monthly surcharge on their bills. In addition, the Texas USF rules provide that the TPUC must open an investigation within 90 days after any changes are made to the federal USF.

The rules governing the Texas USF provide for a review of the Texas USF every three years starting in 1999. In September 2002, the TPUC undertook its first review. Interested parties provided the TPUC with comments on whether there should be changes made to the Texas USF. In September 2003, the TPUC recommended no changes be made to the Texas USF at that time. In September 2005, the Texas Legislature adopted significant telecommunications legislation. Part of that legislation directed the TPUC to initiate a study of the Texas USF and to make a report to the Texas Legislature. The TPUC has underway a proceeding to obtain information necessary to make its report to the Legislature prior to the start of the 2007 legislative session. In addition, the 2005 legislation precludes the TPUC from undertaking any proceeding to reduce Texas USF support until after September 1, 2007. We do not expect that the action taken by the Texas Legislature during the 2005 session or the pending TPUC proceeding will change materially the Texas USF support we receive under the current regulatory structure. However, such changes may be possible in the future if legislation adopted in 2007 changes the future structure of the Texas USF or if the TPUC initiates a proceeding on or after September 1, 2007 that addresses the methodology or funding levels for our Texas USF support. If such changes occur in the future, those changes may be adverse to our revenues.

Environmental Matters

Our operations are subject to federal, state and local laws and regulations governing the use, storage, disposal of, and exposure to hazardous materials, the release of pollutants into the environment and the remediation of contamination. As an owner or operator of property, we could be subject to environmental laws that impose liability for the entire cost of cleanup at contaminated sites, regardless of fault or the lawfulness

of the activity that resulted in contamination. We believe, however, that our operations are in substantial compliance with applicable environmental laws and regulations.

Employees

As of December 31, 2005, our work force consisted of 1,232 full time employees and 56 part time employees. Approximately 832 of our employees are subject to collective bargaining agreements with the Communications Workers of America ("CWA"). Most of our union employees work in our call centers and in technical positions related to the operation of our network and provision of service to our customers. On May 2, 2005, the CWA informed us that the union membership ratified the three-year, tentative collective bargaining agreement reached between us and the CWA on April 5, 2005. The new agreement will cover the period March 1, 2005 through February 28, 2008. Our labor agreement with the CWA relating to employees of our Kerrville operations was renegotiated in February 2006 and, when ratified, will expire March 1, 2008. There is no material impact to our results of operations or liquidity as a result of the new agreement.

Available Information

We maintain a website on the Internet with the address of *www.valortelecom.com* (this and any other reference to valortelecom.com in this annual report on Form 10-K is solely a reference to a uniform resource locator ("URL"), only and is not intended to incorporate the website into this annual report on Form 10-K). Copies of our Form 10-K, quarterly reports on Form 10-Q and any current reports on Form 8-K, and any amendments thereto, are or will be available free of charge as soon as reasonably practical after they are filed with the Securities and Exchange Commission ("SEC") at such website. The general public may also read and copy any materials we file with the SEC at the SEC's Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549, and may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. We are an electronic filer, and the SEC maintains an Internet website at www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

Forward-Looking Statements

As provided by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, we caution that the statements in this Annual Report on Form 10-K relating to matters that are not historical facts, including, but not limited to, statements found in this Item 1 — "Business," Item 1A — "Risk Factors," Item 3 — "Legal Proceedings," Item 7 — "Management's Discussion and Analysis of Financial Condition and Results of Operation" and Item 7A — "Quantitative and Qualitative Disclosures About Market Risk," are forward-looking statements that represent management's beliefs and assumptions based on currently available information. Forward-looking statements can be identified by the use of words such as "believes," "intends," "may," "should," "anticipates," "expects" or comparable terminology or by discussions of strategies or trends. Although we believe that the expectations reflected in such forward-looking statements are reasonable, we cannot give any assurances that these expectations will prove to be correct. Such statements by their nature involve substantial risks and uncertainties that could significantly impact expected results, and actual future results could differ materially from those described in such forward-looking statements. Among the factors that could cause actual future results to differ materially are the risks and uncertainties discussed in this Annual Report and those described from time to time in materials filed with our other filings with the SEC.

While it is not possible to identify all factors, we continue to face many risks and uncertainties including, but not limited to, the following:

- our high degree of leverage and significant debt service obligations;
- our ability to refinance our existing indebtedness on terms acceptable to us, or at all;
- any adverse changes in law or government regulation, including possible changes to cash funding requirements for our defined benefit pension plan;
- 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 possibility of labor disruptions;
- the risk of increased competition in the markets we serve;
- the impact of pricing decisions;
- the risk of weaker economic conditions within the United States;
- uncertainties associated with new product development;
- environmental matters;
- potential outcome of income tax audits;
- possible future litigation or regulatory proceedings;
- changes in accounting policies or practices adopted voluntarily or as required by accounting principles generally accepted in the United States;
- changes in laws or regulations governing telecommunications providers or the provision of telecommunications services; and
- other risks and uncertainties.

Should one or more of these risks materialize (or the consequences of such a development worsen) or should the underlying assumptions prove incorrect, actual results could differ materially from those forecasted or expected. We disclaim any intention or obligation to update publicly or revise such statements whether as a result of new information, future events or otherwise.

Executive Officers of the Registrant

The following table sets forth information with respect to our executive officers.

Name	Age	Position
John J. Mueller	49	Chief Executive Officer and President, Director
Jerry E. Vaughn	61	Senior Vice President — Chief Financial Officer
William M. Ojile, Jr.	45	Senior Vice President — Chief Legal Officer and Secretary
W. Grant Raney	45	Senior Vice President — Chief Operating Officer
Cynthia B. Nash	41	Senior Vice President — Chief Information Officer

John J. Mueller has served as our Chief Executive Officer and President since April 2004 and was previously our President and Chief Operating Officer since November 2002. Mr. Mueller was appointed to our board of directors following the consummation of our Offering. Mr. Mueller joined us in April 2002 as Executive Vice President and Chief Operating Officer. Prior to joining our company, Mr. Mueller spent 23 years at Cincinnati Bell Inc. including serving as General Manager — Consumer Markets from February

1999 to May 1999, President — Business Units from May 1999 to November 1999 and President of the Cincinnati Bell Telephone Company from November 1999 to October 2001.

Jerry E. Vaughn has served as Senior Vice President — Chief Financial Officer since October 2005. Most recently, from June 1999 until August 2005, Mr. Vaughn was Chief Financial Officer for Louisiana-based U.S. Unwired, Inc. where he led the company's finance and accounting activities. Mr. Vaughn has more than 25 years of diversified financial management experience.

William M. Ojile, Jr. has served as our Senior Vice President, Chief Legal Officer and Secretary since November 2000. Before joining our company, Mr. Ojile worked at US WEST, Inc. for approximately 12 years, serving as Regional Executive Director — Public Policy from January 1998 to July 2000 and, after the merger between US WEST and Qwest Communications International in July 2000, as Corporate Counsel for Qwest Communications International from July 2000 to November 2000.

W. Grant Raney has served as our Chief Operating Officer since September 2005 and Senior Vice President — Operations, Sales and Marketing since August 2004. Prior to then, Mr. Raney had served as our Senior Vice President — Operations and Engineering since January 2001. In February 2000, Mr. Raney joined our company as Vice President — Operations. Prior to joining our company, from March 1999 to February 2000, Mr. Raney was Division Vice President at Spectra Communications Group, a partnership of CenturyTel, Inc. Starting in March 1979 at CenturyTel, Mr. Raney has 26 years of experience in the telecommunications industry in a variety of roles of increasing responsibility.

Cynthia B. Nash has served as our Senior Vice President and Chief Information Officer since January 2004. In April 2002, Ms. Nash joined our company as our Vice President and Chief Technology Officer. Before joining our company, Ms. Nash held various positions of increasing responsibility with CenturyTel, Inc., including Vice President of Information Technology from January 2001 to April 2002, Director of the Program Management Office and Customer Care from September 2000 to January 2001, Director of Applications Development from December 1999 to September 2000 and Director of Telco Applications from September 1997 to December 1999. Ms. Nash has over 17 years of experience in the telecommunications industry.

Item 1A. *Risk Factors.*

Risks Relating to Our Business

We provide services to our customers over access lines and if we lose access lines our revenues, earnings and cash flow from operations may decrease.

Our business generates revenue by delivering voice and data services over access lines. We have experienced net access line losses since 2002, and during the year ended December 31, 2005, the number of access lines we serve declined by 4.0% due to the competitive landscape and changes in customer preferences for communications services in the markets we serve. We may continue to experience net access line losses in our markets for an unforeseen period of time.

A significant portion of our access line losses have come from markets where we experience cable telephony competition. We have defined active cable telephony markets as those markets where we have processed request(s) by the cable competitor to port customer telephone numbers to the cable provider. "Porting" is an industry term used to describe the process that allows a customer to retain its existing phone number when switching its telephone service to a competitor. Beginning in November 2004 in Broken Arrow, Oklahoma, the incumbent local cable television operator, began offering cable telephony. For the year ended December 31, 2005, approximately 12% of our access lines were in active cable telephony markets, consisting essentially of the lines we serve in Broken Arrow, Oklahoma and bordering communities, along with three of our West Texas markets. Our active cable telephony markets contributed more than 65% of our 2005 access line losses. In non-active cable telephony markets, representing approximately 88% of our access lines, our 2005 line losses are approximately 1.5%.

In addition, we experience access line losses due to wireless substitution and competition from subsidiaries of rural local telephony companies that have extended their facilities into some of our adjacent

rural markets. Future technological changes could also negatively impact our competitive position. For example, as VoIP develops, some wholesale customers may be able to bypass network access charges. Our inability to retain access lines could adversely affect our revenues, earnings and cash flow from operations.

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 which we provide. 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.

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 intense, 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, VoIP, high-speed fiber optic networks or satellite telecommunications services and with companies that might provide traditional telephone services over nontraditional network infrastructures, like electric utilities.

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 systems. Transitioning these support services to another provider could take a significant period of time and involve substantial costs. In addition, we have a resale agreement with Sprint to provide our long distance transmission services. Replacing this resale agreement 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 years ended December 31, 2003, 2004 and 2005, we generated 17.5%, 16.3% and 15.7%, respectively, of our total revenues from originating and terminating phone calls for interexchange carriers. Bankruptcies or disruptions in the businesses of these interexchange carriers could have an adverse effect on our financial results and cash flows.

Regulatory Risks

We receive 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 USF revenues to support the high cost of providing affordable telecommunications services in rural markets. Such support payments constituted 24.1%, 23.7% and 22.8% of our revenues for the years ended December 31, 2003, 2004 and 2005, respectively. Of these support payments, in the years ended December 31, 2003, 2004 and 2005, 20.7%, 20.1% and 19.8%, respectively, 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 and cash flow from operations would be directly and adversely affected.

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, in September 2005, the Texas Legislature adopted significant telecommunications legislation. Part of that legislation directed the TPUC to initiate a study of the Texas Universal Service Fund and to make a report to the Legislature. As a result, either the Texas Legislature or the TPUC could make future changes to the Texas USF that may impact our support from the Texas USF. 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 TPUC 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 years ended December 31, 2003, 2004 and 2005, we derived $132.0 million, $126.8 million and $120.7 million, respectively, of our revenues from network access charges. Our network access revenue consists of (i) 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, (ii) fees charged for use of dedicated circuits and (iii) 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 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. The FCC has 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 USF 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 market;
- 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. On remand from the United States Court of Appeals for the District of Columbia Circuit, the FCC is examining the impact of the rules on "small entities," which by definition includes Valor. Pending completion of this review, the court stayed the impact of the wireline-to-wireless porting rules on small entities. 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 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.

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

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 their approval allowing us to 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, our revenues, earnings and cash flow from operations 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 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.

Risks Relating to Our Common Stock and Senior Debt

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

Upon the completion of our Offering in February 2005, our board of directors adopted 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. In addition, because a significant portion of cash available to pay dividends is 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, depends 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 on terms acceptable to us or at all.

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 in our loan agreements, 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 senior 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 of directors 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 senior credit facility contains, and any agreement we enter into in the future to refinance this indebtedness may contain, limitations on our ability to pay dividends.

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

As of December 31, 2005, we had approximately $1,180.6 million 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;
- our ability to obtain additional financing in the future for working capital, capital expenditures or acquisitions may be limited;
- a significant portion of our cash flow from operations is likely to be dedicated to the payment of interest on our indebtedness, thereby reducing funds available for other corporate purposes;
- our substantial indebtedness may make us more vulnerable to economic downturns and limit our ability to withstand competitive pressures; and
- all principal amounts owed under our existing indebtedness are due in full at maturity. Our debt service in the meantime consists of interest payments. It is highly likely that we will be required to refinance our existing debt obligations at maturity. We may be unable to do so on terms acceptable to us, or at all.

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.

Covenants in our senior credit facility 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, our senior credit facility requires 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.

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

The terms of our senior credit facility include several restrictive covenants that prohibit us from prepaying our other indebtedness while indebtedness under the facility is outstanding. Our senior 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.

A breach of any of these covenants, ratios or tests could result in a default under our senior credit facility. Upon the occurrence of an event of default, the lenders could elect to declare all amounts outstanding under our senior 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 we 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 our senior 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.

Our interest expense may increase significantly and could cause our results of operations and distributable cash to decline significantly.

Our senior credit facility is subject to periodic renewal or must otherwise be refinanced. We may not be able to renew or refinance the credit facility, or if renewed or refinanced, the renewal or refinancing may occur on less favorable terms, including higher interest rates. Borrowings under the facility are 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 senior 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.

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

Because certain of our subsidiaries may have had an "ownership change" for purposes of Section 382 of the Internal Revenue Code as a result of our reorganization that occurred immediately prior to the consummation of our Offering, the use of our current net operating losses to offset our taxable income for taxable periods (or portions thereof) beginning after the ownership change 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 the 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.

Risks Related to Our Pending Merger with Alltel's Wireline Business

As a result of our pending merger with Alltel's wireline business, certain agreements or events could have a significant impact on our stock price, operations and liquidity. We refer to the company that will be created as a result of the merger with Alltel's wireline business as Newco in the following discussion of risks related to the pending merger.

Failure to complete the merger could adversely impact the market price of Valor's common stock.

If the merger is not completed for any reason, the price of our common stock may decline to the extent that the market price of our common stock reflects positive market assumptions that the spin-off and the merger will be completed and the related benefits will be realized.

After the close of the transaction, sales of Newco common stock may negatively affect its market price.

The market price of Newco common stock could decline as a result of sales of a large number of shares of Newco common stock in the market after the completion of the merger or the perception that these sales could occur. These sales, or the possibility that these sales may occur, also might make it more difficult for Newco to obtain additional capital by selling equity securities in the future at a time and at a price that Newco deems appropriate.

The merger agreement will create a new management team and new Board of Directors.

If the merger is completed, the composition of Newco's senior management team and board of directors will be determined almost exclusively by Alltel upon completion of the merger in accordance with the terms of the merger agreement. Most of our present management and board of directors, except for the one

appointment we will make to the board of directors of Newco, will not have significant input on the strategic and operating decisions of the surviving company upon completion of the merger.

Present Valor shareholders will have a reduced ownership and voting interest after the merger and will exercise less influence over management.

After the merger's completion, Valor stockholders will own a significantly smaller percentage of Newco than they currently own of Valor. Following completion of the merger, Valor's stockholders will own approximately 15% of Newco on a diluted basis. Consequently, Valor stockholders, as a group, will be able to exercise less influence over the management and policies of Newco than they currently exercise over the management and policies of Valor.

The merger agreement contains provisions that may discourage a third party from submitting a business combination proposal to us that might result in greater value to our stockholders than the merger.

The merger agreement generally prohibits us from soliciting any acquisition proposal. In addition, if the merger agreement is terminated by Valor or Alltel in circumstances that obligate us to pay a termination fee and to reimburse transaction expenses to Alltel, our financial condition may be adversely affected as a result of the payment of the termination fee and transaction expenses, which might deter third parties from proposing alternative business combination proposals.

We may also be subject to additional risks if the merger is not completed.

We expect to incur substantial costs related to the merger, such as legal, accounting, filing, financial advisory and financial printing fees, which must be paid regardless of whether the merger is completed.

Depending on the reasons for termination of the merger agreement, Valor is required to pay Alltel a termination fee of $35 million plus costs incurred by Alltel and Alltel's wireline business in connection with the transaction.

We may experience potential disruption to our businesses and distraction of our workforce and management team, including our ability to retain and motivate qualified personnel, including executive officers and other key management personnel. A significant number of employees at our corporate headquarters in Irving may be displaced as a result of the merger when headquarters for Newco becomes located in Central Arkansas, and thus those affected employees may choose to end their employment with us sooner. The loss of key management personnel or other key employees or our inability to attract such personnel may adversely affect our ability to manage our overall operations, particularly if the loss of personnel was to occur and the merger is not completed.

Newco may not realize the anticipated benefits from the merger.

The success of the merger will depend, in part, on the ability of Newco to realize the anticipated synergies, cost savings and growth opportunities from integrating the businesses of Valor with those of Alltel's wireline business. The companies' success in realizing these synergies, cost savings and growth opportunities, and the timing of this realization, depends on the successful integration of Alltel's wireline business and Valor's operations. Even if the companies are able to integrate their business operations successfully, there can be no assurance that this integration will result in the realization of the full benefits of synergies, cost savings and growth opportunities that Newco currently expects from this integration or that these benefits will be achieved within the anticipated time frame. For example, the elimination of duplicative costs may not be possible or may take longer than anticipated, the benefits from the merger may be offset by costs incurred in integrating the companies and regulatory authorities may impose adverse conditions on the combined business in connection with granting approval for the merger.

Item 1B. ***Unresolved Staff Comments.***

None.

Item 2. *Properties.*

Our corporate headquarters are located in Irving, Texas. We lease over 60,000 square feet of office space for our headquarters in Irving pursuant to a lease that will expire in August 2010. In addition, we lease an aggregate of over 100,000 square feet with respect to three call centers in New Mexico and Texas and retail phone stores located in Texas, New Mexico and Oklahoma pursuant to leases that expire at various times between 2006 and 2010. We own all of the other properties that are material to our business. Our other properties include maintenance facilities, rolling stock, central office and remote switching platforms and transport and distribution network facilities in the states in which we operate our business. Our administrative and maintenance facilities are generally located in or near the rural communities we serve and our central offices are often within the administrative building and outlying customer service centers. Auxiliary battery or other non-utility power sources are at each central office to provide uninterrupted service in the event of an electrical power failure. Mobile generators are located near our central offices in the event of a major power outage that continues for a long period of time. Transport and distribution network facilities include fiber optic backbone, copper wire distribution facilities and some digital loop carriers ("DLC") which connect customers to remote switch locations or to the central office and to points of presence or interconnection with the incumbent long distance carrier. These facilities are located on land pursuant to permits, easements, rights of way or other agreements.

Item 3. *Legal Proceedings.*

On July 13, 2005, four former employees served us with a Demand for Arbitration, claiming that we had breached the terms of the former employees' VTS stock option agreements in our valuation of those options in the reorganization that preceded the Offering. In this action, the former employees seek to exercise their VTS options to receive, on a one-for-one basis, shares of Valor common stock or, alternatively, the cash value of the Valor common stock they would have received had such exercise been permitted. The American Arbitration Association established arbitration to be held in April 2006. We believe that we have meritorious defenses and we intend to continue to vigorously defend this matter. Even though litigation is inherently uncertain and it is possible that an adverse decision could be rendered, we anticipate resolution of this matter will not have a material effect on our consolidated financial statements.

We are involved, from time to time, in various other claims, legal actions and regulatory proceedings arising in the ordinary course of our business. Currently no material litigation is pending or, to our knowledge, threatened against us that will have a material adverse effect, either individually or in the aggregate, on our consolidated financial condition, results of operations or liquidity.

Item 4. *Submission of Matters to a Vote of Security Holders.*

No matters were submitted to a vote of security holders during the quarter ended December 31, 2005.

PART II

Item 5. *Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.*

On February 9, 2005, we completed our Offering, registering 29,375,000 shares of common stock at an offering price of $15 per share. The proceeds from the Offering of $411.3 million, net of underwriting discounts and other expenses, were used to repay existing indebtedness and related transaction costs. In connection with the Offering, certain of our stockholders granted an option to the underwriters to purchase up to 4,406,250 additional shares in the aggregate at the offering price less the underwriting discount. On March 16, 2005, the underwriters exercised their over-allotment option in full. We received no proceeds from the over-allotment exercise.

Immediately prior to and in connection with the Offering, we consummated a reorganization pursuant to which our existing equity holders contributed all their ownership interests in VTC and VTS to Valor in

exchange for 39,537,574 shares of common stock in the aggregate, in a private offering pursuant to Section 4(2) of the Securities Act of 1933, as amended (the "Act"). In addition, in connection with our reorganization, we issued restricted shares of our common stock pursuant to Rule 701 promulgated under the Act. Following the reorganization, Valor exists as a holding company with no direct operations and each of VTC, VTS and VTS II is either a direct or an indirect wholly-owned subsidiary of Valor. Valor's principal assets consist of the direct and indirect equity interests of its subsidiaries, all of which are pledged to the creditors under our new credit facility.

Beginning on February 9, 2005, our common stock was listed and traded on the New York Stock Exchange (symbol: VCG). Prior to February 9, 2005, there was no established public trading market. As of February 1, 2006, there were approximately 127 holders of record of our common stock. Because many of our shares of existing common stock are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders. On February 1, 2006 the closing price per share of our common stock was $11.70.

The following table sets forth the high and low closing sales prices per share of common stock since our Offering according to the New York Stock Exchange, and dividends declared per share during such periods:

Year Ended December 31, 2005 Quarter Ended:	High	Low	Dividends Declared
March 31(1)	$16.00	$14.47	$ 0.18(2)
June 30	14.67	12.84	0.36
September 30	14.19	13.53	0.36
December 31	13.62	11.40	0.36

(1) Represents the period from our Offering, February 9, 2005 through March 31, 2005.

(2) Represents a partial, prorated dividend for the first quarter of 2005.

We intend to continue to pay quarterly dividends at an annual rate of $1.44 per share for the year through the date when the merger with Alltel's wireline business is consummated. Thereafter, as provided in the merger agreement, the initial dividend policy, subject to applicable law, of the combined business will be to pay quarterly dividends at an annual rate of $1.00 per share, at the discretion of the newly appointed board of directors and subject to covenant restrictions under the new company's then existing indebtedness. The declaration and payment of future dividends and the amount thereof, if any, will be dependent upon our results of operations, financial condition, cash requirements for our business, contractual requirements, restrictions and other factors deemed relevant by the board of directors and the pending merger with Alltel's wireline business. Furthermore, covenants in our amended credit facility impose restrictions as to our ability to pay dividends. See further discussion within "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation."

Item 6. ***Selected Financial Data.***

Valor is a holding company and has no direct operations. Valor was formed for the sole purpose of reorganizing our corporate structure and consummating the Offering in February 2005. 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.

We derived the selected financial data presented below at December 31, 2004 and 2005 and for each of the three years in the period ended December 31, 2005 from our consolidated financial statements included elsewhere herein. We derived the selected financial data presented below for the years ended December 31, 2001 and 2002 and at December 31, 2001, 2002 and 2003 from our audited consolidated financial statements not included herein. The information in the following table should be read together with our audited consolidated financial statements and the related notes and Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operation," as included elsewhere in this annual report.

	Year Ended December 31,				
	2001	2002(1)	2003	2004	2005
Statement of operations data:					
Operating revenues	$424,916	$479,883	$497,334	$507,310	$505,894
Operating expenses	321,618	320,632	315,061	330,189	338,850
Operating income	103,298	159,251	182,273	177,121	167,044
Income (loss) from continuing operations	(44,912)	19,763	58,125	(27,755)	35,347
Earnings (loss) per owner's unit and per share:					
Basis and diluted (loss) income from continuing operations					
Class A and B common interests	$ (0.58)	$ 0.22	$ 0.73	$ (0.09)	$ 0.09
Class C interests	—	0.09	0.15	(0.46)	0.01
Common share — basic(2)	—	—	—	—	0.42
Common share — diluted(2)	—	—	—	—	0.41
Basic and diluted net (loss) income					
Class A and B common interests	$ (0.77)	$ 0.17	$ 0.73	$ (0.09)	$ 0.09
Class C interests	—	0.09	0.15	(0.46)	0.01
Common share — basic(2)	—	—	—	—	0.42
Common share — diluted(2)	—	—	—	—	0.41
Cash dividends declared(2):	$ —	$ —	$ —	$ —	$ 1.26

	Year Ended December 31,				
	2001	2002	2003	2004	2005
Cash flow data from continuing operations:					
Net cash provided by operating activities	$ 100,301	$ 150,383	$ 166,065	$ 143,716	$ 191,091
Net cash used in investing activities	(106,614)	(216,773)	(66,299)	(34,858)	(32,737)
Net cash provided by (used in) financing activities	8,117	71,015	(99,465)	(93,225)	(111,210)
Other data:					
Capital expenditures	$ 107,869	$ 89,527	$ 69,850	$ 65,525	$ 57,385
Acquisitions	—	128,135	—	1,500	—
Depreciation and amortization(3)	110,843	73,273	81,638	86,451	89,928
Balance sheet data:					
Total assets	$1,913,057	$2,062,404	$2,039,043	$1,971,167	$1,962,781
Long-term debt (including current maturities)	1,469,420	1,544,285	1,463,973	1,600,978	1,180,614
Notes payable	10,197	1,175	6,687	1,893	—
Redeemable preferred interests	370,231	370,231	370,231	236,129	—
Redeemable preferred interests of subsidiary	20,559	21,161	24,475	15,776	—

(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. Amount reflects the purchase price, net of cash acquired.

(2) Represents the period following February 9, 2005, the closing date of our Offering.

(3) 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.

Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operation.*

The following discussion and analysis of financial condition and results of operation should be read in conjunction with Item 6. "Selected Financial Data" and the Consolidated Financial Statements and related Notes thereto included elsewhere in this annual report on Form 10-K. This discussion includes forward-looking statements. Please see the "Cautionary Statement" above and Item 1A. "Risk Factors" for a discussion of the uncertainties, risks and assumptions associate with these 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 December 31, 2005, we operated approximately 518,000 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 $505.9 million in the year ended December 31, 2005 compared to $507.3 million and $497.3 million in the years ended December 31, 2004 and 2003, respectively. Operating income in the year ended December 31, 2005 was $167.0 million compared to $177.1 million and $182.3 million in the years ended December 31, 2004 and 2003, respectively. Net income for the year ended December 31, 2005 was

$35.3 million compared to a net loss for the year ended December 31, 2004 of $27.8 million and to net income of $58.2 million for the year ended December 31, 2003.

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. In January 2002, we 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. In the markets we serve, we provide a full range of voice and data services, including integrated packages of local, long distance, high-speed data and Internet access, as well as a variety of enhanced services such as voicemail and caller identification. We provide reliable, personalized customer care through three call centers, and we have automated many of our customer service functions to enable our customers to interact with our company 24 hours a day, 365 days a year.

The competitive landscape and customer preferences for communications services continue to evolve in the telecommunications industry in general, as well as in the markets we serve. We have taken numerous steps to position ourselves to meet the competitive pressures that we face, including: (i) expanding the coverage of our DSL product to provide greater broadband opportunities, including increased DSL speeds, to our customers in rural America; (ii) aggressively pricing and bundling services such as DSL, Internet access, long distance and second lines with our basic service to create more appealing product offerings at more attractive prices to our customers; (iii) offering discounts to customers who make commitments to purchase service from us for a one-year period; and (iv) improving customer service. We added approximately 30,000 DSL subscribers for the year ended December 31, 2005 and we have expanded our DSL footprint to make DSL service available to approximately 71% of our access lines. We have also focused intently on increasing the efficiency of our business by investing in our infrastructure to improve our underlying business processes and increase the quality of our customer service, maintaining tight expense controls and utilizing a disciplined approach to our capital spending.

We experience competition from wireless service providers in many of our markets and wireline local carriers and cable companies in a limited number of our markets. The number of access lines we serve is one of the fundamental drivers of our business, and competition has been a significant factor in the recent decline in our access lines. While the number of access lines we serve has been declining for the last several years, we have been able to increase our revenues in prior years as a result of our strategy to sell additional services to our existing customers to increase our average revenue per line. We lost 21,881 access lines for the year ended December 31, 2005. Revenues for the year ended December 31, 2005 were essentially flat compared to the prior year.

Competition continues in Broken Arrow, Oklahoma, a suburb of Tulsa, Oklahoma. The cable provider serving that market began offering a cable telephony product late in 2004. We have defined active cable telephony markets as those markets where we have processed request(s) by the cable competitor to port customer telephone numbers to the cable provider. "Porting" is an industry term used to describe the process that allows a customer to retain his or her existing phone number when switching his or her telephone service to a competitor. For the year ended December 31, 2005, approximately 12% of our access lines were in active cable telephony markets, consisting essentially of the lines we serve in Broken Arrow and bordering communities along with three of our West Texas markets. Our active cable telephony markets have contributed more than 65% of our year to date access line losses. In non-active cable telephony markets, representing approximately 88% of our access lines, our 2005 line losses are approximately 1.5%.

We are subject to regulation primarily by federal and state government agencies. At the federal level, the FCC has jurisdiction over interstate and international telecommunications services. State telecommunications regulators exercise jurisdiction over intrastate telecommunications services.

Significant transactions

As previously announced on December 9, 2005, the board of directors of Valor unanimously approved a strategic merger that will combine Valor and the wireline telecommunications business of Alltel. Pursuant to the Agreement and Plan of Merger Valor entered into on December 8, 2005 with Alltel and Alltel Holding Corp.

(which we refer to as "Spinco"), Spinco will merge with and into Valor and Valor will survive as a stand-alone company and will hold and conduct the combined business operations of Valor and Spinco. The merger will take place immediately after Alltel contributes the assets making up its wireline telecommunications business to Spinco and distributes the common stock of Spinco to its stockholders. In the merger, each share of Spinco common stock will be converted into the right to receive approximately 1.04 shares of Valor common stock. Existing shares of Valor common stock will remain outstanding. Following completion of the merger, the separate existence of Spinco will cease. Valor expects to issue approximately 403 million shares of common stock to Alltel stockholders in the merger. However, this amount is subject to change as a result of compensatory equity grants and other issuances of Valor common stock. Valor also expects to assume approximately $4 billion in outstanding debt in the merger. Immediately following the merger, Valor expects to change its name and that its common stock will be quoted on the New York Stock Exchange under that new name and with a new ticker symbol, each of which has yet to be determined. When the merger is completed, Alltel stockholders will together own approximately 85%, and Valor's stockholders will own approximately 15%, of the shares of common stock in that entity on a fully diluted basis. The composition of the senior management and board of directors of the combined business will be largely determined by Alltel. While we are the legal acquirer and the surviving entity in this transaction, Alltel's wireline business will be deemed to be the accounting acquirer in a transaction treated for accounting purposes as a reverse acquisition. The historical financial statements of Valor Communications Group, Inc. after the close of the merger will be those of Alltel's wireline business. The merger is subject to both regulatory and shareholder approval and is expected to close in mid-2006.

On February 9, 2005, we completed the Offering, registering 29,375,000 shares of Valor common stock at a price of $15 per share. The net proceeds from the Offering were used to repay certain existing indebtedness. In conjunction with the Offering, we completed a reorganization of our company. In connection with the Offering, certain of the company's stockholders granted an option to the underwriters to purchase up to 4,406,250 additional shares in the aggregate at the Offering price less the underwriting discount. On March 16, 2005, the underwriters exercised their over-allotment option in full. We received no proceeds from the over-allotment exercise.

Concurrent with the Offering, our subsidiary, Valor Telecommunications Enterprises, LLC, and its direct wholly owned subsidiary, Valor Telecommunications Enterprises Finance Corp., as co-issuers, issued $400 million aggregate principal amount of 7¾% ten-year senior notes in a private offering pursuant to Rule 144A of the Securities Act of 1933. We used the net proceeds from such issuance to repay certain existing indebtedness. In August 2005, we completed the exchange of all outstanding 7¾% senior notes in aggregate principal amount of $400 million due 2015 for substantially identical 7¾% senior notes that have been registered under the Securities Act of 1933. The new notes will mature on February 15, 2015 and will pay interest semi-annually on February 15 and August 15, starting on August 15, 2005. The senior notes contain restrictions on our ability to pay dividends that are no more restrictive than those contained in our credit facility as discussed in Item 7 "Amended Credit Facility and Issuance of Senior Notes."

Significant expenses that have been recorded for the year ended December, 31, 2005 include the following:

- $3.3 million in advisory fees and other related costs associated with the Alltel wireline business merger;
- $29.3 million in fees and expenses associated with our repayment of existing indebtedness, including write-off of certain deferred debt costs, prepayment premiums and breakage fees;
- $2.5 million in compensation expense for the portion of cash transaction bonuses that were paid and accrued to members of our management team in connection with the Offering; and
- $12.7 million in non-cash stock compensation expense for restricted shares issued to members of our management team and our board of directors.

Regulatory Matters

We operate in a regulated industry, and the majority of our revenues come from the provision of regulated telecommunications services, including state and federal support for the provision of telephone services in high-cost 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. For a detailed discussion of our state and federal regulation, see Item 1. "Regulation" of this annual report on Form 10-K.

State Regulation. We operate in Texas, Oklahoma, New Mexico and Arkansas and each state has its own regulatory framework for intrastate telecommunications 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. In September 2005, the Texas legislature adopted significant telecommunications legislation. This legislation created, among other provisions, a statewide video franchise for telecommunications carriers, established a framework for deregulation of the retail telecommunications services offered by incumbent local telecommunications carriers and directed the TPUC to initiate a study of the Texas USF. We expect to participate in numerous TPUC proceedings in the coming months related to this new legislation, and we expect that the Texas Legislature may further address issues of importance to rural telecommunications carriers in Texas, including the Texas USF, in the 2007 Legislative session.

Our subsidiaries in New Mexico will operate under an alternative regulation plan until March 31, 2006. We do not expect to have to renegotiate and renew our current alternative regulation plan because legislation enacted in 2004 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 in New Mexico. After April 1, 2006, the New Mexico Public Regulation Commission will regulate the Company pursuant to rules that will govern the Company's retail prices and service quality. These rules, adopted in January 2006, will allow the Company pricing freedom on retail services. The rules also mandate the streamlining of rules governing the introduction and withdrawal of tariffs and the packaging and bundling of services. We also recently played an instrumental role in the development and passage of access reform legislation. The New Mexico Public Regulation Commission adopted rules on November 1, 2005 to implement the access reform legislation, and later in December 2005, adopted several modifications to those rules. The rules generally require: 1) the reduction of access rates to interstate levels according to prescribed criteria; 2) the increase of business and residence basic local services prices to prescribed benchmark prices; and 3) creation of a state USF to ensure revenue neutrality after taking into account revenues from the retail price increases.

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

On January 25, 2006, we filed a letter with the Arkansas Public Service Commission in which we elected to be regulated pursuant to the Telecommunications Regulatory Reform Act of 1997. 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.

Universal Service Fund

In furtherance of public policy, we receive 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 USF supports eligible telecommunications carriers that serve high cost markets.

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.

Critical Accounting Policies and Estimates

Our financial statements are prepared in accordance with accounting principles that are generally accepted in the United States of America. 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, equity method investments 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 of the Notes to the Consolidated Financial Statements for a 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 our 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 provided. The portion of revenues that is earned but unbilled at the end of an accounting period is accrued as accounts receivable.

USF 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. Revenues are recognized in the month in which the service is provided.

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 their 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 our Consolidated Balance Sheets.

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 2005, 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 2006. 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.

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 and coupon payments corresponding to the expected benefit payments from the plan. As of December 31, 2005, we lowered our discount rate 20 basis points to 5.70%. The impact of the change in discount rate increased our obligation by approximately $1 million as of December 31, 2005.

We made cash contributions of $15.7 million to our defined benefit pension plan in 2005 consisting of: (i) our required 2004 plan year contribution of $6.5 million, (ii) our required quarterly contributions for the 2005 plan year of $1.6 million each in April and July and (iii) a $6.0 million optional cash contribution in September 2005. The optional cash contribution in September 2005 made our plan fully funded on a current liability basis as of January 1, 2005 for the 2005 plan year. Had we not made this optional contribution, we would have been required to continue making our quarterly contributions in October 2005 and in January 2006. Also, as a result of our optional contribution and the funded status of our plan, we do not anticipate that we will be required to make cash contributions in 2006 for the 2005 or 2006 plan years. Our earliest required cash contribution will be in 2007. We may, however, elect to make optional contributions prior to that date.

Goodwill and Intangible Assets. The Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," ("SFAS 142"). 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.

Equity Method Investments — We have investments in companies in which we own 20 percent to 50 percent of the voting common stock or have the ability to exercise influence over operating and financial policies. We account for these investments under the equity method. We periodically assess our investments to determine if other than a temporary decline in the value of the investment has occurred. If such a decline has occurred and the carrying value is less than the fair value, we will adjust the carrying value to fair value.

In the third quarters of 2004 and 2005, we assessed the recoverability of our investments and determined that an other than temporary decline had occurred. As a result, we recorded impairment charges of $6.7 million and $2.3 million in the third quarters of 2004 and 2005, respectively.

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 are 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 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," ("SFAS 144"), utilizing cash flows which take into account management's estimates of future operations.

Redeemable Preferred Interests. With respect to reporting periods ending prior to the consummation of our reorganization, we were required to make an estimate of the fair value of our redeemable preferred interests that had been previously outstanding in order to determine the carrying value of the liability at each reporting date. The redeemable preferred interests were not entitled to dividends and had no voting rights. The redeemable preferred interests did, however, include a provision that entitled the holder, upon the occurrence of a liquidation event or redemption, to a return equal to the sum of (i) the initial contribution per interest, or $1.00 for Class A Preferred interests and $0 for Class B Preferred interests and (ii) an appreciation amount calculated as interest on $1.00 per interest, at a rate of 20% per year, compounded quarterly. The appreciation amount defined in (ii) above was payable only after all holders of Class A common interests had received a return of their initial $1.00 capital investment. The fair value of this liability was determined based upon our enterprise value, since the return to be paid to preferred interest holders upon redemption would vary based upon the total value of the enterprise available to be distributed to holders of the redeemable preferred interests. As such, we did not record accretion on the redeemable preferred interests of VTC or on the redeemable preferred interests of our subsidiary, VTS. We measured this liability at each reporting date as the amount of cash that would be paid if settlement occurred at the reporting date in accordance with paragraph 22 of SFAS 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." Any change in the estimated value of preferred interests in a reporting period would have been recorded as interest expense. This treatment required us to make an estimate of our enterprise value at each reporting date to properly measure this liability. We concluded that this liability was fairly stated at an amount equal to the initial contribution of $1.00 per interest for all of the outstanding redeemable preferred interests. We recognized no changes in the fair value of the liability since inception.

As discussed above, we were required to estimate our enterprise value to determine the carrying value of this liability at each reporting date. Members of our management possessing the requisite valuation experience estimated our enterprise value for purposes of determining the carrying value of the redeemable preferred interests. Determining the fair value of our redeemable preferred interests required us to make complex and subjective judgments. We used the income approach to estimate the value of our enterprise at each reporting date. The income approach involves applying the appropriate discount rate to estimated cash flows that are based on our forecasts of revenues, costs, and capital expenditures. Our revenue forecasts were based on expected annual overall growth rates ranging from 0% to 2%. We assumed that we would continue to gain efficiencies in our business that will allow us to reduce our expenses in certain areas and control the increase in others. There is inherent uncertainty in these estimates. The assumptions underlying the estimates were consistent with our business plan. For this analysis, we used our weighted-average cost of capital to discount

the estimated cash flows. Our weighted-average cost of capital was calculated as the weighted-average return implied in each class of debt and equity that were issued and outstanding at the time. We used an annual rate of return of 20%, compounded quarterly, for the redeemable preferred interests in our weighted-average cost of capital calculation. We believe this methodology gave appropriate consideration to the inherent risks and uncertainties involved with making these estimates. If we used a different weighted-average cost of capital, it could have produced a different estimate of our enterprise value and a different carrying value for this liability.

In light of our recent reorganization, we are no longer required to make an estimate of fair value of the redeemable preferred interests because all of the outstanding redeemable preferred interests have been exchanged for shares of our common stock. Our weighted average cost of capital declined following our reorganization. As a result, the fair value of the shares granted to holders of these redeemable preferred interests exceeded the carrying value of the liability. The redeemable preferred interests were held by our equity sponsors. Our equity sponsors also controlled the voting rights of our existing common equity. As such, we concluded that the difference between the carrying value of this liability and the fair value of the shares issued resulting from the reorganization was, in essence, a capital transaction and we recorded this difference to accumulated deficit as provided for in footnote 1 to paragraph 20 of Accounting Principles Board ("APB") Opinion 26, "Early Extinguishment of Debt."

Stock Compensation. As described in more detail in Notes 2 and 15 of the Notes to the Consolidated Financial Statements, we had issued Equity Incentive Non-Qualifying Stock Options to employees to purchase Class B common interests in our subsidiary, VTS. Following our Offering in February 2005, we issued restricted stock under the terms of the 2005 Long-term Incentive Plan ("LTIP"). We account for the Equity Incentive Non-Qualifying Stock Options and the restricted stock grants in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees" as allowed by SFAS No. 123, "Accounting for Stock Based Compensation." We measure compensation expense for these plans using the intrinsic value method as prescribed by APB Opinion No. 25. Under the intrinsic value method, compensation is measured as the amount the market value of the underlying equity instrument on the grant date exceeds the exercise price. This amount, if any, is then charged to compensation expense over the vesting period. During each of the years ended December 31, 2003 and 2004, we recorded no compensation expense. For the year ended December 31, 2005, we recorded $12.7 million of compensation expense associated with issuance of restricted stock.

Additionally, the Valor Telecom Executive Incentive Plan was implemented on April 1, 2002 whereby certain executives were granted phantom stock units that allowed them to participate, on a pro-rata basis, in the appreciation of the Class A preferred interests and Class A common interests of VTC. We account for the Valor Telecom Executive Incentive Plan in accordance with FASB Interpretation No. 28, "Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans." Under this method, the amount by which the unit market value exceeds the unit value specified under the plan when the instruments are granted is charged to compensation expense over the appropriate vesting period.

In each of these plans, the underlying equity instruments were not equivalent in value to the common stock that was sold in the Offering. As a result of our reorganization, the holders of options to purchase Class B common interests in VTS did not receive the right to purchase an equal number of shares of our common stock for the $1.00 exercise price. The terms and conditions set forth in the VTS LLC agreement governed the conversion of the outstanding Class B common interests in VTS. The value of these Class B common interests did not exceed the exercise price. Accordingly, holders of options under VTS Equity Incentive Non-Qualifying Stock Option Plan received no cash and none of our shares in exchange for the options that vested at the date of completion of our Offering. Accordingly, based on the Offering price of $15.00 per share, the intrinsic value of the options to purchase Class B interests in VTS is $0. The interests held in the Valor Telecom Executive Incentive Plan were converted into our common shares pursuant to the terms and conditions set forth in the VTC LLC agreement.

Significant Factors, Assumptions, and Methodologies Used in Determining our Fair Value. Members of our management possessing the requisite valuation experience estimated the fair value of the options granted under the VTS Equity Incentive Non-Qualifying Stock Option Plan. Additionally, we have estimated the fair value of our redeemable preferred interests in order to determine the amount of compensation we are required

to record associated with the phantom stock units issued under the Valor Telecom Executive Incentive Plan at each reporting date. We did not obtain contemporaneous valuations by an unrelated valuation specialist because, at the time of the issuances of stock options during this period, we believed that our management possessed the requisite valuation expertise to prepare a reasonable estimate of the fair value of the interests.

Determining the fair value of our common and preferred equity interests requires us to make complex and subjective judgments. We used the income approach to estimate the value of our enterprise at each date options were granted and at each reporting date for purposes of valuing the interests held in the Valor Telecom Executive Incentive Plan. The income approach involves applying the appropriate discount rate to estimated cash flows that are based on our forecasts of revenues, costs, and capital expenditures. Our revenue forecasts are based on expected annual overall growth rates ranging from 0% to 2%. We have assumed that we will continue to gain efficiencies in our business that will allow us reduce our expenses in certain areas and control the increase of our expenses in other areas. There is inherent uncertainty in these estimates. The assumptions underlying the estimates are consistent with our business plan. For this analysis, we used our weighted-average cost of capital to discount the estimated cash flows; however, if a different weighted-average cost of capital had been used, the valuation would have been different. We believe this methodology gives appropriate consideration to the inherent risks and uncertainties involved with making these estimates.

The enterprise value was then allocated to preferred and common interests pursuant to the terms and conditions set forth in the limited liability company agreement. After first allocating the value to the secured and unsecured obligations of the company, the remaining value was allocated as follows:

- Class A preferred interests up to the "Class A Preferred Capital Amount," defined as $1.00 per interest;
- Class A common interests up to the "Class A Common Capital Amount," defined as $1.00 per interest;
- ratably among Class A and Class B preferred interests up to the "Preferred Appreciation Amount," defined as an appreciation amount equal to interest on the "Class A Preferred Capital Amount" on each interest at a rate of 20% per year, compounded quarterly; and
- ratably among the holders of the Class A common interests.

We assessed our estimates for reasonableness by comparing our estimated enterprise value to that of other publicly traded companies in our industry. This assessment confirmed to us that our estimates of our enterprise value were reasonable.

As disclosed more fully in Note 15 of the Notes to the Consolidated Financial Statements, we determined that the phantom stock units issued under the Valor Telecom Executive Incentive Plan had no value for the year ended December 31, 2003. The reasons for the difference in our estimate of fair value of the phantom stock units held in the Valor Telecom Executive Incentive Plan on each of the previous reporting dates and the fair value based on the Offering price of $15.00 per share are attributed to the following events, all of which occurred in the fourth quarter of 2004:

- we completed our debt recapitalization, which substantially lowered our cost of debt;
- we committed to complete our reorganization that simplified our capital structure and lowered our overall cost of capital primarily due to the anticipated exchange of preferred interests for common interests;
- we committed to amend our credit agreement to permit the payment of dividends;
- we amended the terms of the Offering covered by the registration statement on file with the commission to reflect a structure that would allow us to pay a $1.44 per share dividend on our common stock we sold in the Offering; and
- an increasing trend towards higher valuations for public companies that offer shareholders the opportunity to receive dividends such as we intend to pay.

As a result, for the year ended December 31, 2004, we recorded $1.3 million of compensation expense to reflect the impact of the Offering on the fair value of the phantom stock units.

Results of Operations

We have two operating segments, rural local exchange carrier ("RLEC") and Other.

As an RLEC, we provide regulated telecommunications services to customers in our service areas. These services include local calling services to residential and business customers, as well as providing interexchange carriers ("IXC") with call origination and termination services, on both a flat-rate and usage-sensitive basis, allowing them to complete long distance calls for their customers who reside in our service areas.

In Other, we provide unregulated telecommunications services to customers throughout our RLEC service areas. These services include long distance and Internet services. Long distance is provided through resale agreements with national long distance carriers.

We have considered the aggregation criteria in SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" and determined the operating segments are considered one reportable segment as further described in Note 2 to the Consolidated Financial Statements in the F-pages of this annual report on Form 10-K.

The following table sets forth several key metrics:

	Year Ended December 31,		
	2003	2004	2005
Total revenue (in thousands)	$497,334	$507,310	$505,894
Ending access lines(1)	556,745	540,337	518,456
Average access lines	564,027	548,541	529,397
Total connections(2)	565,524	563,221	571,215
Average revenue per access line per month	$ 73.48	$ 77.07	$ 79.63
Long distance subscribers	188,526	216,437	232,031
Penetration rate of total access lines	34%	40%	45%
Average long distance subscribers	159,574	202,482	224,234
DSL subscribers	8,779	22,884	52,759
Penetration rate of total access lines	2%	4%	10%

(1) 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 customer's premises. Non-revenue producing lines provisioned for company official use and for test purposes are included in our total access line counts. There were 13,248, 14,344 and 14,704 non-revenue producing lines included in our total access line count at December 31, 2003, 2004 and 2005, which represented 2.4%, 2.7% and 2.8% of our total access line counts, respectively.

(2) Total connections are defined as total access lines plus DSL subscribers.

Operating Revenues

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 usage 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 — 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 premises equipment, or CPE, directory advertising, unbundled network elements and billing and collection fees.

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

	Year Ended December 31,			% Change	
	2003	2004	2005	2003-2004	2004-2005
	(Dollars in thousands)				
Local service	$156,369	$158,404	$151,549	1%	(4)%
Data services	20,990	25,239	33,209	20	32
Long distance services	30,816	38,350	41,109	24	7
Access services	132,047	126,838	120,682	(4)	(5)
Universal Service Fund	119,727	120,045	115,540	0	(4)
Other ancillary services	37,385	38,434	43,805	3	14
	$497,334	$507,310	$505,894	2%	(0)%

We have been able to maintain our revenue levels, despite access line losses, 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. To date, the revenue related to this strategy has been able to 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 cause our revenue to significantly decline, either of which could have an adverse effect on our results of operations, financial condition and liquidity.

Year Ended December 31, 2005 Compared to Year Ended December 31, 2004

Local Service Revenues. Local service revenues decreased $6.9 million to $151.5 million in 2005 from $158.4 million in 2004. Revenues from the provision of basic service decreased $4.0 million primarily as a result of access line loss. In 2004, we recorded $4.1 million of revenue from the favorable resolution of a regulatory proceeding related to an expanded local calling surcharge as further described below. In 2005, we billed and recorded $2.4 million related to the expanded local calling surcharge. Beginning in 2006, we will no longer be allowed to assess this quarterly charge of $0.6 million to our customers.

Data Services Revenues. Data services revenues increased $8.0 million to $33.2 million in 2005 from $25.2 million in 2004. Data services revenues increased primarily due to the growth in DSL subscribers to 52,759 at December 31, 2005. This represents a 131% increase compared to the number of DSL subscribers at December 31, 2004.

Long Distance Services Revenues. Long distance services revenues increased $2.7 million to $41.1 million in 2005 from $38.4 million in 2004. Direct-dialed and flat rate plan revenues increased $2.5 million due to adding an average of 21,752 subscribers.

Access Services Revenues. Access services revenues decreased $6.1 million to $120.7 million in 2005 from $126.8 million in 2004 primarily due to access lines loss, lower access rates and reduction in minutes in 2005 compared to 2004.

USF Revenues. USF revenues decreased $4.5 million to $115.5 million in 2005 from $120.0 in 2004. Decrease of $4.0 million was primarily attributable to access line loss and the related effect on our revenues received from both Federal USF CALLS support and the Texas USF. We also experienced a $0.8 million

decrease related to a reduction in Federal USF high cost support, effective January 1, 2005, due to increases in the national average loop cost by the FCC.

Other Services Revenues. Other services revenues increased $5.4 million to $43.8 million in 2005 from $38.4 million in 2004. Increase of equipment sales, directory advertising and services provided to wholesale carriers accounted for $4.1 million of the increase in revenues.

Year ended December 31, 2004 compared to year ended December 31, 2003

Local Service Revenues. Local service revenues increased $2.0 million to $158.4 million in 2004 from $156.4 million in 2003. Revenues from extended area services decreased by $1.5 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. Revenues from the provision of basic service decreased $1.6 million primarily as a result of access line loss. The decrease is offset by an increase of $4.1 million of revenue from the favorable resolution of a regulatory proceeding we had pending before the TPUC related to an expanded local calling surcharge. The petition we had pending with the TPUC requested authorization for us to bill this surcharge. The TPUC granted us interim approval to bill the surcharge in April 2003, but stipulated that all amounts billed were subject to refund pending the ultimate resolution of our petition. In November 2004, the TPUC ruled in our favor and granted our petition. Upon receiving this ruling, we recorded all amounts that we had billed and previously deferred under the interim order as revenue. The $4.1 million represents $0.6 million per quarter dating back to the 2nd quarter of 2003 when we began billing the surcharge. We will continue to bill and record $0.6 million per quarter through the end of 2005, at which time we will no longer be allowed to assess this charge to our customers per the terms of the ruling from the TPUC. Enhanced services sales increased $0.9 million. The remaining $0.1 million increase is due to various other items.

Data Services Revenues. Data services revenues increased $4.2 million to $25.2 million in 2004 from $21.0 million in 2003. DSL revenues increased $3.1 million as the number of DSL subscribers grew to 22,884 at December 31, 2004. This represents a 161% increase compared to the number of DSL subscribers at December 31, 2003. Revenues for providing dial-up internet access increased $0.9 million as a result of an increase in the subscriber base. The remaining $0.2 million increase is due to various other items.

Long Distance Services Revenues. Long distance services revenues increased $7.6 million to $38.4 million in 2004 from $30.8 million in 2003. Direct-dialed and flat rate plan revenues increased $4.3 million due to adding an average of 43,000 subscribers and monthly recurring revenue increased $3.8 million due to a rate increase. These increases were partially offset by $0.5 million in other various items such as Calling Card revenue.

Access Services Revenues. Access services revenues decreased $5.2 million to $126.8 million in 2004 from $132.0 million in 2003. Switched access revenues decreased $3.7 million, which was primarily attributable to lower interstate access rates that went into effect on July 1, 2003. Revenues decreased $0.8 million as a result of the termination of a contract under which we provided dedicated facilities on one of our microwave towers. These two decreases were partially offset by a $0.5 million increase in special access revenue as special circuits ordered by long distance carriers continued to increase. The remaining decrease is due to various other items including loss of access line counts.

USF Revenues. There were no meaningful changes in USF revenues.

Other Services Revenues. Other services revenues increased $1.0 million to $38.4 million in 2004 from $37.4 million in 2003. $2.0 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 and compensation related to cellular traffic that crosses our networks. This increase was offset by a decrease of $0.8 million in sales of customer premises equipment.

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 premises 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.

Non-cash Stock Compensation. Non-cash stock compensation represents the amount the market value of our underlying equity instruments on the grant date exceeds the exercise price recognized over the applicable vesting period.

Depreciation and Amortization. Depreciation and amortization includes depreciation of our communications network and equipment.

The following table sets forth operating expenses for the periods shown:

	Year Ended December 31,			% Change	
	2003	2004	2005	2003-2004	2004-2005
	(Dollars in thousands)				
Cost of service	$106,527	$104,934	$107,581	(1)%	3%
Selling, general and administrative	126,896	137,459	126,946	8	(8)
Non-cash stock compensation	—	1,345	12,699	n/a	n/m
Asset impairment	—	—	1,696	—	n/a
Depreciation and amortization	81,638	86,451	89,928	6	4
	$315,061	$330,189	$338,850	5%	3%

n/m — not meaningful

Year ended December 31, 2005 compared to year ended December 31, 2004

Cost of Service. Cost of service increased $2.7 million to $107.6 million in 2005 from $104.9 million in 2004. Contributing to the increase was a $1.7 million increase in variable costs associated with fees we pay competing carriers (both wireless and wireline) for carrying and terminating calls that originate on our network and terminate on their networks. We incurred $0.6 million of operating costs associated with clean-up and repair efforts from Hurricane Rita. Finally, we experienced increases in variable costs related to equipment sales and providing Internet access services, which were virtually offset in their entirety by long distance network variable costs as a result of a rate reduction in the fourth quarter of 2004.

Selling, General and Administrative. Selling, general and administrative decreased $10.6 million to $126.9 million in 2005 from $137.5 million in 2004. The decrease was primarily attributable to a $5.0 million one-time transition payment made to our former CEO and $5.1 million in bonuses to management related to the debt recapitalization, all of which occurred in 2004. Also, $4.0 million is due to decreases in salary and benefit costs related to reduced headcount and decrease in incentive compensation that is tied to the company's performance. Offsetting the above decreases were 2005 cash bonuses of $2.5 million paid and accrued to management in connection with our Offering.

In 2005, non-cash stock compensation expense relates to the issuance of restricted stock to our management and board of directors that vests based on various percentages through January 1, 2010. In 2005, the $12.7 million of non-cash stock compensation expense consisted of $5.5 million of restricted stock that vested upon the Offering date and $7.2 million of restricted stock which vests on January 1, 2006. We expect to incur approximately $8.1 million of non-cash stock compensation expense in both 2006 and 2007 and $1.4 million and $0.9 million in 2008 and 2009, respectively. Upon completion of the merger with Alltel's wireline business, we expect to accelerate recognition of certain deferred equity compensation as non-cash

stock compensation expense. In 2004, non-cash stock compensation expense related to the increase in fair value of the Valor Telecom Executive Incentive Plan phantom stock units.

Asset Impairment. In late September 2005, Hurricane Rita made landfall in the Gulf Coast region of the United States. The effects of Hurricane Rita, including high winds and rain, impacted our east Texas market. As a result of the hurricane, we incurred damage on certain of our property, plant, and equipment. We assessed the recoverability of these assets based on the authoritative accounting literature and determined that the carrying value of certain of our property, plant, and equipment in the affected areas was impaired. As such, we recorded an impairment loss of $0.6 million, net of insurance recoveries of $0.3 million, in the accompanying Consolidated Statements of Operations and Comprehensive Income (Loss). In the fourth quarter of 2005, we assessed the recoverability of our goodwill carrying value associated with our Other reporting unit. Based on this analysis, we determined the value of the goodwill would not be recoverable and recorded an impairment charge of $1.1 million.

Depreciation and Amortization. Depreciation and amortization increased $3.4 million to $89.9 million in 2005 from $86.5 million in 2004. 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, 2004 compared to year ended December 31, 2003

Cost of Service. Cost of service decreased $1.6 million to $104.9 million in 2004 from $106.5 million in 2003. The decrease was attributable to, among other factors, costs for external circuits and network capacity, which declined $2.1 million as a result of efficiencies gained from upgrades we made to our network. In addition, costs to maintain and operate our network declined $1.1 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 $0.8 million and there was a $0.7 million decrease in the amounts that we paid to cellular carriers for traffic settlements.

Offsetting the above noted decreases was a $2.0 million increase in access charges paid to third parties related to the increase in usage from our increasing long distance subscriber base and a $1.4 million increase in employee related benefit costs.

Selling, General and Administrative. Selling, general and administrative increased $10.6 million to $137.5 million in 2004 from $126.9 million in 2003. The increase was primarily attributable to a $5.0 million one-time transition payment made to our former CEO, $5.1 million in bonuses to management related to the debt recapitalization and $1.5 million charge for probable losses associated with certain legal and tax contingencies. Additionally, we recorded a $3.4 million one-time benefit in 2003 upon recovering amounts that we had previously written off as a result of MCI WorldCom's 2002 bankruptcy. We have also increased sales and marketing $1.4 million due to increased DSL promotions, telemarketing and other back office support costs. Finally, there was a $0.3 million increase in employee related benefit costs.

Offsetting the above noted increases were decreases of $3.5 million due to vendor price reductions associated with certain back-office functions we have outsourced to a third party service provider and $2.3 million in bad debt expense as a result of improvements we made to our collections processes.

Non-cash compensation expense related to the increase in fair value of the Valor Telecom Executive Incentive Plan phantom stock units.

Depreciation and Amortization. Depreciation and amortization increased $4.9 million to $86.5 million in 2004 from $81.6 million 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.

Interest Expense

The following table sets forth interest expense:

	Year Ended December 31,		
	2003	2004	2005
	(Dollars in thousands)		
Interest expense	$119,185	$110,287	$83,154

In each case, our decrease in interest expense was due to lower average principal outstanding due to repayments, including repayments from net proceeds from our Offering, and lower average rates on our debt.

Loss on Interest Rate Hedging Arrangements

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

	Year Ended December 31,		
	2003	2004	2005
	(Dollars in thousands)		
Loss on interest rate hedging arrangements	$(2,113)	$(126)	$(399)

The adjustment to mark our hedging arrangements to market value resulted in a non-cash income of $8.9 million and $8.5 million for the years ended December 31, 2004 and 2003, respectively. Offsetting the non-cash income for the years ended December 31, 2004 and 2003 are cash settlements of $9.0 million and $10.6 million, respectively. We entered into new arrangements to limit our interest rate risk under the terms of our existing credit facility in 2005 as further described under "Item 7A: Quantitative and Qualitative Disclosures About Market Risk." The amount recorded in 2005 represents the change in fair value of the instruments that are not accounted for utilizing hedge accounting.

Earnings from Unconsolidated Cellular Partnerships, Impairment on Investment in Cellular Partnerships, Loss on Debt Extinguishment and Other Income and (Expense), net

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

	Year Ended December 31,		
	2003	2004	2005
	(Dollars in thousands)		
Earnings from unconsolidated cellular partnerships	$ 3,258	$ 1,113	$ 421
Impairment on investment in cellular partnerships	—	(6,678)	(2,339)
Loss on extinguishment of debt	—	(62,975)	(29,262)
Other income and (expense), net	(3,376)	(25,116)	(1,898)

Earnings from unconsolidated cellular partnerships represent our share of the earnings in the equity interest of two cellular partnerships. 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 partnerships in 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 Consolidated Statements of Operations and Comprehensive Income (Loss). One of our cellular partnerships continued to experience a significant decline in roaming revenues in 2005. Due to the financial results of this cellular partnership through September 30, 2005, we recorded an impairment charge of $2.3 million to the Consolidated Statements of Operations and Comprehensive Income (Loss).

In connection with our debt recapitalization on November 10, 2004 and amendment of our credit facility completed in conjunction with our Offering on February 9, 2005, we recorded a $63.0 million and $29.3 million loss on extinguishment of debt, respectively. The loss on extinguishment of debt was determined under the provisions of Emerging Issues Task Force 96-19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments."

Other income and expense, net includes the portion of income and loss allocated to shareholders who held redeemable preferred interests in VTS prior to our reorganization and various other miscellaneous income and expense items, including interest income on our cash balances held at financial institutions. Other income and expense, net in 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 $7.0 million that were expensed as a result of our decision not to pursue the previously planned public offering of income deposit securities. In 2005, we recognized approximately $3.3 million of costs related to the pending merger with Alltel's wireline business.

Income Taxes

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

	Year Ended December 31,		
	2003	2004	2005
	(Dollars in thousands)		
Income tax expense	$2,478	$665	$14,329

The income taxes for 2004 and 2003 represent those of VTS II, which had elected to be taxed as a corporation for federal income tax purposes. (See Note 2, "Summary of Significant Accounting Policies" and Note 8, "Income Taxes" of the Notes to the Consolidated Financial Statements for an expanded discussion of income taxes.) In February 2005, we completed a reorganization concurrent with our Offering. Prior to our reorganization, substantially all of the operations of Valor elected partnership treatment for income tax purposes. Following the completion of our Offering and the related reorganization, the operations of our company and all wholly owned subsidiaries became reportable in a consolidated corporate federal tax return. As such, for the period from January 1, 2005 through the Offering date, we recorded income tax expense directly attributable to the operations of VTS II. Following the Offering date, we recorded income taxes on the operations of Valor. Additionally, we recorded deferred tax assets and liabilities related to the differences between financial reporting and the tax basis of our assets and liabilities and net operating losses incurred prior to becoming a taxable entity.

The differences between the federal income tax statutory rate and our effective income tax rate for the years ended December 31, 2004 and 2003 are primarily related to consolidated entities not subject to income taxes prior to our reorganization. Fiscal year ended December 31, 2004 was further impacted by permanent differences associated with the purchase of minority interests and our impairment charge on our investment in cellular partnerships. The differences between the federal income tax statutory rate and our effective income tax rate for the year ended December 31, 2005 is primarily related to consolidated entities not subject to income taxes prior to the effective date of the Offering, a permanent difference related to the step-up in our tax basis of assets attributable to goodwill that occurred in connection with our reorganization and an impairment charge on our investment in cellular partnerships.

Minority Interest

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

	Year Ended December 31,		
	2003	2004	2005
	(Dollars in thousands)		
Minority interest	$(254)	$(142)	$(468)

Minority interest reflects the share of income of minority shareholders who held common interests in VTS and VTSII. In connection with the Offering, we completed a reorganization, whereby we redeemed all outstanding minority interests. For the year ended December 31, 2005, minority interest reflects the share of income of minority shareholders from January 1, 2005 through the Offering date.

Discontinued Operations

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

	Year Ended December 31,		
	2003	2004	2005
	(Dollars in thousands)		
Discontinued operations	$108	$ —	$ —

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 related to the sale of our competitive local exchange carrier in Texas.

Cumulative Effect of Change in Accounting Principle

The following table sets forth cumulative effect of accounting change for the periods shown:

	Year Ended December 31,		
	2003	2004	2005
	(Dollars in thousands)		
Cumulative effect of change in accounting principle, net of tax	$ —	$ —	$(269)

The cumulative effect of change in accounting principle represents our adoption of FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143." See Note 21 of Notes to Consolidated Financial Statements for more discussion.

Financial Condition and Liquidity

Financial Condition. As of December 31, 2005, we had total debt, net of cash and cash equivalents, of $1,116.4 million and $571.8 million of stockholders' equity, compared to $1,585.8 million and $6.5 million of stockholders' equity at December 31, 2004. Prior to the completion of our reorganization and Offering, we had used excess cash generated through operations to pay down long-term debt. At December 31, 2004 and 2005, we had positive working capital balances of $15.1 million and $35.6 million, respectively.

We made cash contributions of $15.7 million to our defined benefit pension plan in 2005 consisting of; (i) our required 2004 plan year contribution of $6.5 million, (ii) our required quarterly contributions for the 2005 plan year of $1.6 million each in April and July and (iii) a $6.0 million optional cash contribution in September 2005. The optional cash contribution in September 2005 made our plan fully funded on a current liability basis as of January 1, 2005 for the 2005 plan year. Had we not made this optional contribution, we would have been required to continue making our quarterly contributions in October 2005 and in January 2006. Also, as a result of our optional contribution and the funded status of our plan, we do not anticipate that we will be required to make cash contributions in 2006 for the 2005 or 2006 plan years. Our earliest required cash contribution will be in 2007. We may, however, elect to make optional contributions prior to that date.

In accordance with our dividend policy, we intend to distribute, as dividends, a substantial portion of cash generated by our business in excess of operating needs, interest and principal payments on indebtedness and capital expenditures.

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

In connection with our reorganization, our previous owners contributed approximately $307.3 million of federal net operating losses ("NOLs") we anticipate that we will be able to use, subject to certain limitations, to reduce our future taxable income. We expect that we will generate a net operating loss in 2005 of approximately $12.8 million for federal income tax purposes without utilizing any previously generated NOLs. The loss generated during 2005 will serve to increase the total NOLs available for use in future years to approximately $320.1 million. Furthermore, as of December 31, 2005, we have cumulative differences of approximately $533.3 million resulting from items such as goodwill amortization and accelerated tax

depreciation that we have deducted faster for tax purposes under the Internal Revenue Code than we have for financial reporting purposes. We also have other items totaling $818.0 million, the most significant being goodwill, that we will deduct from our future taxable income. The tax effect of the NOLs and cumulative differences were recorded on our balance sheet due to the reorganization and resulted in a net deferred tax liability of approximately $59.4 million.

Cash Flows

	Year Ended December 31,		
	2003	2004	2005
	(Dollars in thousands)		
Net cash provided by operating activities	$166,065	$143,716	$ 191,091
Net cash used in investing activities	(66,299)	(34,858)	(32,737)
Net cash used in financing activities	(99,465)	(93,225)	(111,210)
Net operating cash used in discontinued operations	(176)	(13)	—
Net increase in cash and cash equivalents	$ 125	$ 15,620	$ 47,144

Operating Activities. Net cash provided by continuing operations of $191.1 million in 2005 was generated primarily by adjustments to our income from continuing operations of $35.3 million to exclude non-cash items and loss on debt extinguishment of $160.6 million. The most significant non-cash items in 2005 were depreciation and amortization expense of $89.9 million and deferred income taxes of $14.2 million. In connection with our Offering, we recognized a $29.3 million of a loss on debt extinguishment. Net cash provided by continuing operations of $143.7 million in 2004 was generated primarily by adjustments to our loss from continuing operations of $27.8 million to exclude non-cash items, loss on debt extinguishment and reorganization items of $177.9 million. The most significant non-cash item in 2004 was depreciation and amortization expense of $86.5 million. In connection with our debt recapitalization, we recognized a $63.0 million of a loss on debt extinguishment. 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 $103.1 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.

Investing Activities. Cash used in investing activities was $32.7 million in 2005, $34.9 million in 2004 and $66.3 million in 2003. Our investing activities consist 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 December 31, 2003, 2004 and 2005 were $69.9 million, $65.5 million and $57.4 million, respectively. Since the beginning of 2001, our capital expenditures have been utilized to replace and upgrade many facets of our infrastructure, including:

- modernizing our networks with the latest technology to allow us to offer new and innovative products;
- replacing outside plant in areas that generated abnormally high maintenance costs;
- implementing operational support systems to enhance our productivity in the areas of customer service and network monitoring;
- upgrading our fleet with newer and more reliable vehicles; and
- implementing financial systems.

The initiatives outlined above have been completed, and we believe they have provided us with an infrastructure that can support our current growth prospects and can be maintained with less capital spending

than in the past. Therefore, we anticipate that capital spending for 2006 will decline to approximately $50.0 million.

Investing activities during 2004 and 2005 include proceeds from the redemption of our RTFC capital certificate of $31.1 million and $24.4 million that occurred in connection with our debt recapitalization and our Offering, respectively.

Financing Activities. Cash used in financing activities was $111.2 million in 2005, $93.2 million in 2004 and $99.5 million in 2003. These changes are principally due to the net incremental payments of long-term debt of $420.4 million and $100.0 million in 2005 and 2003, respectively, and net incremental borrowings of $135.8 million in 2004. Cash used in financing activities in 2005 also includes $411.3 million of net proceeds from the issuance of common stock in connection with our Offering and payment of dividends, prepayment fees and debt issuance costs of $62.4 million, $19.4 million and $17.5 million, respectively. Cash used in financing activities in 2004 includes our $18.6 million purchase of ownership interests from certain individual investors, redemption of certain redeemable preferred, common and minority interests totaling $159.4 million and payment of prepayment fees and transaction costs of $11.4 million and $31.3 million, respectively.

Prior to the completion of our reorganization and offering, we have managed our cash on hand through the use of revolving credit facilities to maximize the amount of debt repayment.

Outstanding Debt and Existing Financing Arrangements

As of December 31, 2005, we had various financing arrangements outstanding. Under these financing arrangements, we have $1,180.6 million of outstanding debt and $99.8 million of available borrowing capacity under our revolving credit facility (refer to Note 6 of the Notes to the Consolidated Financial Statements for more details on outstanding debt).

Amended Credit Facility and Issuance of Senior Notes

In connection with our Offering, we issued 7¾% senior notes due in 2015 for net proceeds of approximately $389.7 million. The proceeds from the issuance of the senior notes were used to repay existing indebtedness.

In connection with the Offering, we amended our senior credit facility. The amended senior credit facility resulted in the reduction of the commitment amount of Tranche B Term Loan to $750.0 million, Tranche C Term Loan to $50.0 million and Tranche D Term Loan to $5.6 million. The reduction of the amended credit facility was primarily funded from the net proceeds of the Offering. Under the amended credit facility, the entire principal balances on Tranches B, C and D are due at maturity, February 2012.

Interest on Tranche B bears interest based on LIBOR, plus 1.75%, and is payable no less than monthly. Interest on Tranches C and D is fixed at 6.38% through April 2007 and is payable quarterly. We entered into nine agreements to reduce the risk of interest rate volatility of our indebtedness in 2005.

Covenants. Our amended credit facility contains negative covenants that, among other things, limit or restrict our ability (as well as those of our subsidiaries) to: create liens and encumbrances; make investments, incur debt, enter into loans, merge, dissolve, liquidate or consolidate our business; make acquisitions, make dispositions or transfers; declare dividends or distributions; amend material documents; change the nature of our business; make certain restricted payments (other than certain permitted restricted payments); engage in certain transactions with affiliates; enter into sale/leaseback or off-balance sheet transactions; or become general or limited partners or joint venturers with any party other than with certain of our subsidiaries and make changes to our fiscal year.

In addition, the financial covenants under our credit facility require us to maintain certain financial ratios. Our ratio of Adjusted EBITDA to net interest expense for any measurement period of four fiscal quarters ending during any such period set forth below must be above the ratio set forth for such period:

Period	Ratio
Closing of new credit facility, to end of financial quarter ending March 31, 2006; and	2.50 to 1.0
Thereafter	2.75 to 1.0

We may not permit our ratio of total debt (defined as total debt minus the sum of debt incurred to maintain our investment in RTFC subordinated capital certificates, and minus, to the extent no amounts are outstanding on the new revolver, cash and cash equivalents) to Adjusted EBITDA on any date of determination to exceed 5.25 to 1.0. As of December 31, 2005, we are in compliance with all of the covenants included in the credit facility.

Adjusted EBITDA is 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 adjusted net income: (a) interest expense; (b) provision for income taxes; (c) depreciation and amortization; (d) nonrecurring expenses related to the Offering, issuance of senior notes, our recent recapitalization and the other transactions; (e) other nonrecurring or unusual costs or losses incurred after the debt recapitalization 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 adjusted 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.

Under our senior credit facility, dividends are 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. "Available cash" is defined in the 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 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 and prepayments 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.

- 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 5.0 to 1.0.
- We are prohibited from paying dividends if an event of default under the new credit facility has occurred and is continuing. In particular, it will be an event of default if:

  (a) our total leverage ratio, as defined above, exceeds 5.25 to 1.0; or

  (b) our interest coverage ratio for the four-quarter period ended on the last day of any fiscal quarter on or prior to March 31, 2006, is less than 2.50 to 1.0, and thereafter 2.75 to 1.0.

Senior Notes

The indenture that governs the senior notes we issued simultaneously with the closing of the Offering contains restrictions on the payment of dividends that are no more restrictive than those contained in our new credit facility.

Dividends

In connection with the Offering, our board of directors adopted 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. Since the Offering, our board of directors approved dividends of $1.26 per share to shareholders. This dividend consisted of a partial, prorated dividend for the first quarter of 2005. In accordance with this dividend policy, we intend to continue to pay quarterly dividends at an annual rate of $1.44 per share. We expect the aggregate annual impact of this dividend policy to be approximately $102.0 million. The cash requirements of the dividend policy are in addition to the debt service requirements discussed in "Outstanding Debt and Existing Financing Arrangements." We expect that the cash requirements discussed here and in "Outstanding Debt and Existing Financing Arrangements" will be funded through cash flow generated from the operations of our business.

Recent Accounting Pronouncements

In January 2004, FASB Staff Position ("FSP") No. 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" was issued. FSP No. 106-1 permits the deferral of recognizing the effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 ("the Act") in the accounting for post-retirement health care plans under SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," and in providing disclosures related to plans required by SFAS No. 132 (revised 2003), "Employers' Disclosures about Pensions and Other Postretirement Benefits." In May 2004, FSP 106-2, "Accounting and Disclosure Requirement Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" was issued. FSP 106-2 provides guidance that measures the accumulated post-retirement benefit obligation ("APBO") and net periodic postretirement benefit cost on or after the date of enactment. FSP 106-2 is effective for the first interim or annual period beginning after June 15, 2004. The Act introduces a prescription drug benefit beginning in 2006 under Medicare ("Medicare Part D"), as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. Due to the levels of benefits provided under our health care plans, we have concluded that our health care plans are at least "actuarially equivalent" to Medicare Part D. We have elected not to apply for the federal subsidy, as the benefit to our results of operations would be minimal. See Note 9 of the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report for further discussion of postretirement benefits.

In December 2004, the FASB issued a revision to SFAS No. 123, "Accounting for Stock-Based Compensation." This revision will require us to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. The cost will be recognized over the period during which an employee is required to provide service in exchange for the award. This

revised Statement is effective as of the beginning of the first interim or annual reporting period that begins after December 15, 2005. This revised Statement will apply to all awards granted after the required effective date and to awards modified, repurchased or canceled after that date. As of the required effective date, we will apply this revised Statement using a modified version of prospective application. Under that transition method, compensation cost is recognized on or after the required effective date for the portion of outstanding awards for which the requisite service has not yet been rendered, based on the grant-date fair value of those awards calculated under SFAS No. 123 for either recognition or pro forma disclosures. We will adopt the provisions of SFAS No. 123 revision in the first quarter of 2006. We do not expect the adoption will have a material impact on our financial position or results of operation.

In June 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections — a replacement of APB Opinion No. 20 and FASB Statement No. 3" ("SFAS 154"). SFAS 154 replaces APB Opinion No. 20, "Accounting Changes" ("APB 20"), and SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements." SFAS 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impracticable to determine either the period-specific effects or the cumulative effects of the change. APB 20 previously required that most voluntary changes in accounting principles be recognized by including in net income in the period of the change the cumulative effect of changing to the new accounting principle. This standard generally will not apply with respect to the adoption of new accounting standards, as new accounting standards usually include specific transition provisions, and will not override transition provisions contained in new or existing accounting literature. SFAS 154 is effective for fiscal years beginning after December 15, 2005, and early adoption is permitted for accounting changes and error corrections made in years beginning after the date that SFAS 154 was issued. We do not expect that SFAS 154 will have a significant effect on our financial condition or results of operations upon its adoption.

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 Sheets. The following table summarizes our contractual and other obligations at December 31, 2005, and the effect such obligations are expected to have on liquidity and cash flow in future periods:

	Payment Due by Period(1)				
	2006	2007-2008	2009-2010	Thereafter	Total
			(Dollars in thousands)		
Contractual obligations(2)	$ 48,289	$ 56,076	$ 2,210	$ 972	$ 107,547
Long-term debt obligations(3)	78,769	157,418	157,418	1,358,324	1,751,929
Operating lease obligations(4)	2,336	3,744	2,927	228	9,235
Total contractual cash obligations	$129,394	$217,238	$162,555	$ 1,359,524	$ 1,868,711

(1) Does not include an estimate for income taxes, cash contributions to our pension plan and cash contributions to our post-retirement medical plan which we are required or may be required to make but not required to include in the table above.

(2) Our contractual obligations represent our required capital investment in New Mexico, officers' salaries under employment agreements, $2.0 million of Offering bonuses under employment agreements, capital expenditure commitments and payments to third party service providers.

(3) The long-term debt obligations represent our cash debt service obligations, including both principal and estimated interest. In determining the interest portion on our variable interest rate debt, we used the weighted average interest rate as of the end of the applicable period.

(4) Operating lease obligations represent the future minimum rental payments required under the operating leases that have initial or remaining non-cancelable lease terms in excess of one year as of December 31, 2005.

There have been no material changes outside of the ordinary course of business to our contractual and other obligations since December 31, 2005.

Off-Balance Sheet Arrangements

Except as noted in the table above under "Contractual and Other Obligations," we have no material off-balance sheet obligations.

Inflation

Historically, we have mitigated the effects of increased costs by recovering certain costs applicable to our regulated telephone operations through the ratemaking process over time. Possible future regulatory changes may alter our ability to recover increased costs in our regulated operations. As inflation raises the operating expenses in our non-regulated lines of business, we will attempt to recover rising costs by raising prices for our services.

Item 7A. *Quantitative and Qualitative Disclosures About Market Risk.*

We are exposed to market risk from changes in interest rates on our long-term debt obligations. We estimate our market risk using sensitivity analysis. Market risk is defined as the potential change in the fair value of a fixed-rate debt obligation due to a hypothetical adverse change in interest rates and the potential change in interest expense on variable rate long-term debt obligations due to changes in market interest rates. Fair value on long-term debt obligations is determined based on quoted market prices and a discounted cash flow analysis, using the rates and maturities of these obligations compared to terms and rates currently available in the long-term markets. The potential change in interest expense is determined by calculating the effect of the hypothetical rate increase on our variable rate debt for the year and does not assume changes in our financial structure.

The results of the sensitivity analysis used to estimate market risk are presented below, although the actual results may differ from these estimates.

At December 31, 2004, we had total debt of $1,601.0 million, consisting of both fixed and variable debt with weighted average interest rates of 7.3%. Substantially all of our debt balances were scheduled to mature 2011 through 2012. As a result of the debt recapitalization that occurred November 10, 2004, the fair value of our debt approximated its carrying value.

At December 31, 2005, we had total debt of $1,180.6 million, consisting of both fixed and variable debt with weighted interest rates ranging from 5.8% to 7.8%. Approximately $780.6 million of our debt matures in 2012 and $400.0 million matures in 2015. In February 2005, we completed the Offering and issuance of 7¾% senior notes for net proceeds of approximately $801.0 million. We used the proceeds from the Offering and the issuance of senior notes to repay certain indebtedness that was outstanding at December 31, 2004 and related transaction costs. The fair value of our debt based on current prevailing rates and quoted market prices is $1,196.6 million at December 31, 2005.

At December 31, 2005, we had approximately $725.0 million of variable rate debt. If market interest rates increase 100 basis points within the next year over the rates in effect at December 31, 2005, annual interest expense would increase $3.9 million. The increase in interest expense is impacted by our interest rate caps and swaps that are currently in effect or will be in effect over the next year. We are charged interest on our variable rate debt, as defined in our Amended and Restated Credit Agreement, based on LIBOR, plus

1.75%, or an applicable base rate plus 0.75%. The three-month LIBOR rate for the year ended December 31, 2005 ranged from 2.6% to 4.5%.

Pursuant to our credit facility, we are required to reduce the risk of interest rate volatility with at least 50% of our indebtedness. To manage our interest rate risk exposure and fulfill our requirement under our credit facility, we entered into nine agreements, three interest rate caps and six interest rate swaps, with investment grade financial institutions in March and September of 2005 (collectively, the "Agreements"). In connection with entering the interest rate cap agreements, we paid $0.9 million.

The following represents a summary of the Agreements (dollars in thousands):

Instrument	Effective Date	Maturity Date	Notional Amount	Cap Rate or Pay Rate	December 31, 2005 Fair Value Asset (Liability)
Interest rate cap	03/31/05	03/31/06	$450,000	5.0%	$ —
	03/31/06	03/30/07	50,000	5.0	53
	03/31/06	03/31/08	100,000	5.0	403
Interest rate swap	03/31/06	03/31/08	75,000	4.5	345
	03/31/06	03/31/08	75,000	4.6	310
	03/31/06	03/31/09	50,000	4.2	844
	03/31/06	03/31/10	100,000	4.7	177
	03/30/07	03/31/08	30,000	4.7	13
	03/31/08	03/31/09	180,000	4.3	816

Our interest rate caps are not treated as hedges as prescribed by the accounting literature; therefore, the fair value of the instruments is recorded each reporting period on the Consolidated Balance Sheets with the change in fair value recorded in the Consolidated Statements of Operations in "Gain (loss) on interest rate hedging arrangements." The interest rate swaps effectively convert our variable rate debt to fixed rate debt. Our interest rate swap agreements qualify for hedge accounting under SFAS No. 133; therefore, they are carried at fair market value and are included on the Consolidated Balance Sheets with changes in fair value recorded as "Other comprehensive income (loss)" in the accompanying Consolidated Statements of Operations. We do not hold or issue derivative financial instruments for trading or speculative purposes.

Item 8. *Financial Statements and Supplementary Data.*

The information called for by this Item is contained in a separate section of this annual report on Form 10-K. See "Index of Financial Statements and Schedule" (page F-1).

Item 9. *Changes In and Disagreements with Accountants on Accounting and Financial Disclosure.*

None.

Item 9A. *Controls and Procedures.*

The company, under the supervision and with the participation of its management, including the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of the company's "disclosure controls and procedures" (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the company's disclosure controls and procedures were effective as of December 31, 2005 to ensure that information relating to the Company and the company's consolidated subsidiaries required to be disclosed in the company's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to the company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely discussions regarding required disclosure. It should be noted, however, that the design of any system of controls is limited in its ability to detect errors, and there can be no assurance

that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote. There has been no change in the company's internal control over financial reporting during the quarter ended December 31, 2005 that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting.

Item 9B. ***Other Information.***

None.

PART III

Item 10. ***Directors and Executive Officers of the Registrant.***

A list of our executive officers and biographical information appears in Part I, Item I of this annual report on Form 10-K.

The Company has adopted a code of business conduct and ethics applicable to the Company's Directors, officers (including the Company's principal executive, principal financial officer and principal accounting officer) and employees known as the Code of Business Conduct. The Code of Business Conduct is available on the Company's website. In the event that we amend or waive any of the provisions of the Code of Business Conduct applicable to our principal executive officer, principal financial officer or principal accounting officer, we intend to disclose the same on the Company's website at *www.valortelecom.com*.

The remaining information required by this Item is incorporated by reference to Valor's definitive Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A within 120 days after the end of the fiscal year covered by this report (the "Valor Proxy Statement").

Item 11. ***Executive Compensation.***

The information required by this Item is incorporated by reference to the Valor Proxy Statement.

Item 12. ***Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.***

The information required by this Item is incorporated by reference to the Valor Proxy Statement.

Item 13. ***Certain Relationships and Related Transactions.***

The information required by this Item is incorporated by reference to the Valor Proxy Statement. See also Note 18 to the Consolidated Financial Statements.

Item 14. ***Principal Accounting Fees and Services.***

The information required by this Item is incorporated by reference to the Valor Proxy Statement.

PART IV

Item 15. ***Exhibits, Financial Statement Schedule.***

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3. Exhibits:

2.1	Agreement and Plan of Merger, dated as of December 8, 2005, among Alltel, Alltel Holding Corp. ("Spinco") and Valor Communications Group, Inc.†
4.1	Indenture, dated February 14, 2005, among Valor Communications Group, Inc., the guarantors thereto and The Bank of New York, as Trustee.††
4.2	Form of Senior Subordinated Note (included in Exhibit 4.1).††
4.3	Registration Rights Agreement, dated February 14, 2005, by and among Valor Telecommunications Enterprises, LLC, Valor Telecommunications Enterprises Finance Corp., the Guarantors named therein and the Initial Purchasers (as defined therein).††
10.1	Amended and Restated Credit Agreement, dated as of February 14, 2004, among Valor Telecommunications Enterprises, LLC as Borrower, Valor Communications Group, Inc. and certain of its subsidiaries, as Guarantors, Bank of America, N.A. as Administrative Agent, Swing Line Lender and L/C Issuer, J.P. Morgan Chase Bank, National Association and Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Syndication Agents, CIBC World Markets Corp. and Wachovia Bank, N.A., as Documentation Agents and the Lenders party thereto.††
10.2	Amendment No. 1, dated August 9, 2005, to the Amended and Restated Credit Agreement dated February 14, 2005.*
10.3	Valor Communications Group, Inc. 2005 Incentive Compensation Plan.††
10.4	Amended & Restated AT&T Master Carrier Agreement, dated as of March 29, 2005, between Valor Telecommunications of Texas L.P. and AT&T Corp.††
10.5	Collective Bargaining Agreement made as of March 1, 2005 between Valor Telecommunications of Texas, LP, or their successors and Communications Workers of America and the employees of the Company in the Bargaining Unit.*
10.6	Form of Employment Agreement by and between Valor Communications Group, Inc., Valor Telecommunications, LLC and Jerry E. Vaughn.**
10.7	Third Amendment to Wholesale Solutions Switched Services Agreement, dated November 8, 2005, by and between Sprint Communications Company L.P. and Valor Telecommunications Enterprises, LLC.****
10.8	Voting Agreement, dated as of December 8, 2005, by and among Alltel Holding Corp. and certain shareholders of Valor Communications Group, Inc.†
10.9	Amendment No. 15 to the Telecommunications Services Agreement, dated as of November 15, 2004, by and between Valor Telecommunications Enterprises, LLC and MCI Worldcom Network Services, Inc.****
10.10	Amendment No. 16 to the Telecommunications Services Agreement, dated as of April 6, 2005, by and between Valor Telecommunications Enterprises, LLC and MCI Worldcom Network Services, Inc.****

10.11 Eleventh Amendment, dated as of March 31, 2005 to the Sprint Wholesale Services Data and Private Line Agreement between Sprint Communications Company L.P. and Valor Telecommunications Enterprises, LLC.****
21.1 Subsidiaries of the registrant.***
31.1 Certification Statement of Chief Executive Officer of Valor Communications Group, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2 Certification Statement of Chief Financial Officer of Valor Communications Group, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1 Certification Statement of Chief Executive Officer of Valor Communications Group, Inc. pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2 Certification Statement of Chief Financial Officer of Valor Communications Group, Inc. pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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† Incorporated by reference to Form 8-K of ALLTEL Corporation filed with the Securities and Exchange Commission on December 9, 2005

†† Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2005

* Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2005

** Incorporated by reference to the Registrant's Report on Form 8-K filed on September 19, 2005

*** Incorporated by reference to the Registrant's Registration Statement on Form S-4, filed on May 13, 2005 (Reg. No. 333-124917)

**** A request for confidential treatment was filed for portions of this document. Confidential portions have been omitted and filed separately with the Securities and Exchange Commission as required by Rule 406.

SIGNATURES

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

VALOR COMMUNICATIONS GROUP, INC.

By: /s/ John J. Mueller
John J. Mueller
President and Chief Executive Officer
(Principal Executive Officer)

Date: February 27, 2006

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Anthony J. de Nicola Anthony J. de Nicola	Chairman of the Board	February 27, 2006
/s/ Kenneth R. Cole Kenneth R. Cole	Vice Chairman of the Board	February 27, 2006
/s/ John J. Mueller John J. Mueller	President and Chief Executive Officer (Principal Executive Officer) and Director	February 27, 2006
/s/ Jerry E. Vaughn Jerry E. Vaughn	Senior Vice President and Chief Financial Officer (Principal Financial Officer)	February 27, 2006
/s/ Randal S. Dumas Randal S. Dumas	Vice President and Controller (Principal Accounting Officer)	February 27, 2006
/s/ Sanjay Swani Sanjay Swani	Director	February 27, 2006
/s/ Edward J. Heffernan Edward J. Heffernan	Director	February 27, 2006
/s/ Stephen Brodeur Stephen Brodeur	Director	February 27, 2006
/s/ M. Ann Padilla M. Ann Padilla	Director	February 27, 2006

Signature	Title	Date
/s/ Edward L. Lujan Edward L. Lujan	Director	February 27, 2006
/s/ Federico F. Peña Federico F. Peña	Director	February 27, 2006
/s/ Michael E. Donovan Michael E. Donovan	Director	February 27, 2006
/s/ Norman W. Alpert Norman W. Alpert	Director	February 27, 2006

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Schedules I, III, IV and V are omitted because they are not applicable.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Valor Communications Group, Inc.
Irving, Texas

We have audited the accompanying consolidated balance sheets of Valor Communications Group, Inc. and subsidiaries (the "Company") as of December 31, 2004 and 2005, and the related consolidated statements of operations and comprehensive income (loss), changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2005. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Valor Communications Group, Inc. and subsidiaries at December 31, 2004 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 21 to the financial statements, in 2005 the Company changed its method of accounting for conditional asset retirement obligations to conform to Financial Accounting Standards Board Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations, an Interpretation of FASB Statement No. 143."

/s/ Deloitte & Touche LLP

Dallas, Texas
February 24, 2006

Valor Communications Group, Inc.

Consolidated Balance Sheets

	December 31, 2004	December 31, 2005
	(Dollars in thousands, except par value)	
ASSETS		
Current assets		
Cash and cash equivalents	$ 17,034	$ 64,178
Accounts receivable:		
Customers, net of allowance for doubtful accounts of $1,833 and $2,062, respectively	26,602	25,333
Carriers and other, net of allowance for doubtful accounts of $881 and $954, respectively	36,155	34,640
Materials and supplies, at average cost	1,400	1,418
Other current assets	8,821	10,306
Total current assets	90,012	135,875
Net property, plant and equipment	749,984	717,529
Investments and other assets		
Goodwill	1,058,235	1,057,007
Other	72,936	52,370
Total investments and other assets	1,131,171	1,109,377
TOTAL ASSETS	$1,971,167	$1,962,781
LIABILITIES AND EQUITY		
Current liabilities		
Current maturities of long-term debt	$ 1,801	$ 59
Accounts payable	5,847	6,621
Notes payable	1,893	—
Accrued expenses and other current liabilities:		
Taxes	13,505	10,760
Salaries and benefits	15,135	13,679
Interest	5,471	13,705
Dividend payable	—	25,138
Other	15,564	15,405
Advance billings and customer deposits	15,700	14,892
Total current liabilities	74,916	100,259
Long-term debt	1,599,177	1,180,555
Deferred credits and other liabilities	38,698	110,199
Redeemable preferred interests	236,129	—
Redeemable preferred interests of subsidiary	15,776	—
Total liabilities	1,964,696	1,391,013
Commitments and contingencies (see Note 10)		
Stockholders' equity		
Class A common interests, no par or stated value, 500,000,000 interests authorized, 65,568,694 issued and 65,534,944 outstanding at December 31, 2004	64,633	—
Class B common interests, no par or stated value, 5,184,255 interests authorized, 5,056,755 issued and outstanding at December 31, 2004	—	—
Class C interests, no par or stated value, 50,000,000 interests authorized, 46,000,000 issued and outstanding at December 31, 2004	29,542	—
Common stock, $0.0001 par value per share, 200,000,000 shares authorized, 71,134,034 shares issued and 71,130,634 shares outstanding at December 31, 2005	—	7
Additional paid-in capital	—	918,929
Treasury stock, 33,750 Class A common interests at December 31, 2004 and 3,400 shares of common stock at December 31, 2005, at cost	(34)	(46)
Accumulated other comprehensive loss	(7,894)	(7,304)
Deferred equity compensation	—	(18,502)
Accumulated deficit	(79,776)	(321,316)
Total stockholders' equity	6,471	571,768
TOTAL LIABILITIES AND EQUITY	$1,971,167	$1,962,781

See accompanying notes to consolidated financial statements.

Valor Communications Group, Inc.

Consolidated Statements of Operations and Comprehensive Income (Loss)

	Year Ended December 31,		
	2003	2004	2005
	(Dollars in thousands, except per owner unit and per share amounts)		
Operating revenues	$ 497,334	$ 507,310	$ 505,894
Operating expenses			
Cost of service (exclusive of depreciation and amortization shown separately below)	106,527	104,934	107,581
Selling, general and administrative (exclusive of non-cash stock compensation shown separately below)	126,896	137,459	126,946
Non-cash stock compensation	—	1,345	12,699
Asset impairment	—	—	1,696
Depreciation and amortization	81,638	86,451	89,928
Total operating expenses	315,061	330,189	338,850
Operating income	182,273	177,121	167,044
Other income (expense)			
Interest expense	(119,185)	(110,287)	(83,154)
Loss on interest rate hedging arrangements	(2,113)	(126)	(399)
Earnings from unconsolidated cellular partnerships	3,258	1,113	421
Impairment on investment in cellular partnerships	—	(6,678)	(2,339)
Loss on debt extinguishment	—	(62,975)	(29,262)
Other income and (expense), net	(3,376)	(25,116)	(1,898)
Total other income (expense)	(121,416)	(204,069)	(116,631)
Income (loss) from continuing operations before income taxes, minority interest and cumulative effect of change in accounting principle	60,857	(26,948)	50,413
Income tax expense	2,478	665	14,329
Income (loss) from continuing operations before minority interest and cumulative effect of change in accounting principle	58,379	(27,613)	36,084
Minority interest	(254)	(142)	(468)
Income (loss) from continuing operations before cumulative effect of change in accounting principle	58,125	(27,755)	35,616
Discontinued operations	108	—	—
Income (loss) before cumulative effect of change in accounting principle	58,233	(27,755)	35,616
Cumulative effect of change in accounting principle, net of tax of $156	—	—	(269)
Net income (loss)	58,233	(27,755)	35,347
Other comprehensive income (loss)			
Minimum pension liability adjustment, net of tax	(2,813)	(523)	(992)
Interest rate hedging arrangements, net of tax	—	—	1,582
Comprehensive income (loss)	$ 55,420	$ (28,278)	$ 35,937
Earnings (losses) per owners' unit (see Note 13):			
Basic and diluted income (loss) from continuing operations:			
Class A and B common interests	$ 0.73	$ (0.09)	$ 0.09
Class C interests	$ 0.15	$ (0.46)	$ 0.01
Basic and diluted net income (loss):			
Class A and B common interests	$ 0.73	$ (0.09)	$ 0.09
Class C interests	$ 0.15	$ (0.46)	$ 0.01
Earnings per common share — basic (see Note 13):			
Earnings per share from continuing operations	$ —	$ —	$ 0.42
Loss per share from cumulative effect of accounting change	$ —	$ —	$ —
Earnings per share	$ —	$ —	$ 0.42
Earnings per common share — diluted (see Note 13):			
Earnings per share from continuing operations	$ —	$ —	$ 0.42
Loss per share from cumulative effect of accounting change	$ —	$ —	$ (0.01)
Earnings per share	$ —	$ —	$ 0.41
Cash dividends declared per share:	$ —	$ —	$ 1.26

See accompanying notes to consolidated financial statements.

Valor Communications Group, Inc.

Consolidated Statements of Cash Flows

	Year Ended December 31,		
	2003	2004	2005
	(Dollars in thousands)		
Operating activities			
Net income (loss)	$ 58,233	$ (27,755)	$ 35,347
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	81,638	86,451	89,928
Loss on debt extinguishment	—	62,975	29,262
Deferred income taxes	450	203	14,174
Income from discontinued operations	(108)	—	—
Amortization of debt issuance costs	8,105	7,399	3,690
Expense incurred related to cash payment to minority shareholders in connection with reorganization	—	17,988	—
Non-cash interest expense	17,788	—	—
Non-cash unrealized (gain) loss on interest rate hedging arrangements	(8,487)	(8,867)	399
Earnings from unconsolidated cellular partnerships	(3,258)	(1,113)	(421)
Asset impairment	—	—	1,696
Impairment on investment in cellular partnerships	—	6,678	2,339
Provision for doubtful accounts receivable	3,298	4,438	6,073
Non-cash stock compensation	—	1,345	12,699
Redeemable preferred interests of subsidiary	3,314	231	—
Minority interest	254	142	468
Cumulative effect of change in accounting principle, net of tax	—	—	269
Changes in current assets and current liabilities:			
Accounts receivable	3,786	(6,295)	(3,152)
Accounts payable	(6,668)	(8,611)	774
Accrued interest	(401)	2,281	8,234
Other current assets and current liabilities, net	3,316	6,556	(2,937)
Other, net	4,805	(330)	(7,751)
Net cash provided by operating activities from continuing operations	166,065	143,716	191,091
Investing activities			
Acquisition, net of cash acquired	—	(1,500)	—
Additions to property, plant and equipment	(69,850)	(65,525)	(57,385)
Redemption of RTFC capital certificate	—	31,111	24,445
Other, net	3,551	1,056	203
Net cash used in investing activities from continuing operations	(66,299)	(34,858)	(32,737)
Financing activities			
Proceeds from issuance of debt	61,500	1,359,000	400,000
Repayments of long-term debt	(161,549)	(1,223,249)	(820,364)
Notes payable, net	1,742	(8,273)	(1,893)
Proceeds from issuance of common stock, net of offering costs	—	—	411,257
Cash dividends paid	—	—	(62,433)
Prepayment fees paid in connection with the repayment of debt	—	(11,376)	(19,393)
Redemption of redeemable preferred interests	—	(134,102)	—
Redemption of Class C interests	—	(16,458)	—
Cash payment to preferred and common minority shareholders in connection with reorganization	—	(18,646)	—
Redemption of redeemable preferred interests in subsidiary	—	(8,791)	—
Payment of debt issuance costs	(1,158)	(31,330)	(17,530)
Other, net	—	—	(854)
Net cash used in financing activities from continuing operations	(99,465)	(93,225)	(111,210)
Net increase in cash and cash equivalents from continuing operations	301	15,633	47,144
Net operating cash used in discontinued operations	(176)	(13)	—
Net increase in cash and cash equivalents	125	15,620	47,144
Cash and cash equivalents at beginning of period	1,289	1,414	17,034
Cash and cash equivalents at end of period	$ 1,414	$ 17,034	$ 64,178

See accompanying notes to consolidated financial statements.

Valor Communications Group, Inc.

Consolidated Statements of Changes in Stockholders' Equity For the Years Ended December 31, 2003, 2004 and 2005

Owner Units Class A Common	Owner Units Class B Common	Owner Units Class C	Shares Common Stock		Owners' Interests Class A Common	Owners' Interests Class B Common	Owners' Interests Class C	Common Stock	Additional Paid-in Capital	Treasury Stock	Accumulated Other Comprehensive Loss	Deferred Equity Compensation	Accumulated Deficit	Total Stockholders' Equity
(Units and shares in thousands)					(Dollars in thousands)									
65,535	5,057	46,000	—	**Balance, January 1, 2003**	$ 64,633	$ —	$ 46,000	$ —	$ —	$ (34)	$ (4,558)	$ —	$ (111,599)	$ (5,558)
—	—	—	—	Minimum pension liability adjustment, net of tax	—	—	—	—	—	—	(2,813)	—	—	(2,813)
—	—	—	—	Net income	—	—	—	—	—	—	—	—	58,233	58,233
65,535	5,057	46,000	—	**Balance, December 31, 2003**	$ 64,633	$ —	$ 46,000	$ —	$ —	$ (34)	$ (7,371)	$ —	$ (53,366)	$ 49,862
—	—	—	—	Minimum pension liability adjustment, net of tax	—	—	—	—	—	—	(523)	—	—	(523)
—	—	—	—	Redemption of Class C interests	—	—	(16,458)	—	—	—	—	—	—	(16,458)
—	—	—	—	Stock compensation expense	—	—	—	—	—	—	—	—	1,345	1,345
—	—	—	—	Net loss	—	—	—	—	—	—	—	—	(27,755)	(27,755)
65,535	5,057	46,000	—	**Balance, December 31, 2004**	$ 64,633	$ —	$ 29,542	$ —	$ —	$ (34)	$ (7,894)	$ —	$ (79,776)	$ 6,471
(65,535)	(5,057)	(46,000)	39,538	Exchange of owners' interests for common stock related to reorganization	(64,633)	—	(29,542)	4	533,675	34	—	—	(246,563)	192,975
—	—	—	29,375	Issuance of common stock through initial public offering, net of offering costs	—	—	—	3	411,254	—	—	—	—	411,257
—	—	—	—	Dividend on common stock	—	—	—	—	(58,834)	—	—	—	(28,737)	(87,571)
—	—	—	2,218	Issuance of restricted stock, net of forfeitures	—	—	—	—	32,834	(46)	—	(31,201)	(1,587)	—
—	—	—	—	Amortization of deferred equity compensation, restricted stock	—	—	—	—	—	—	—	12,699	—	12,699
—	—	—	—	Minimum pension liability adjustment, net of tax	—	—	—	—	—	—	(992)	—	—	(992)
—	—	—	—	Interest rate swaps, net of tax	—	—	—	—	—	—	1,582	—	—	1,582
—	—	—	—	Net income	—	—	—	—	—	—	—	—	35,347	35,347
—	—	—	71,131	**Balance, December 31, 2005**	$ —	$ —	$ —	$ 7	$ 918,929	$ (46)	$ (7,304)	$ (18,502)	$ (321,316)	$ 571,768

See accompanying notes to consolidated financial statements.

VALOR COMMUNICATIONS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per owner unit and per share amounts)

(1) Background and Basis of Presentation

The consolidated financial statements include the accounts of Valor Communications Group, Inc., ("Valor") and its wholly owned subsidiaries (collectively, the "Company"). All significant intercompany transactions have been eliminated. Valor is a holding company and has no direct operations. Valor was formed for the sole purpose of reorganizing our corporate structure and consummation of our initial public offering. Valor's principle assets are the direct and indirect equity interest of its subsidiaries, Valor Telecommunications, LLC ("VTC"), Valor Telecommunications Southwest, LLC ("VTS") and Valor Telecommunications Southwest II, LLC ("VTS II"). The historical consolidated financial statements prior to the initial public offering represent those of VTC.

The Company was created in 1999 for the purpose of acquiring three groups of rural local telephone exchange properties clustered in New Mexico, Oklahoma, Arkansas and Texas from GTE Southwest Corporation ("GTE"). The Company purchased all of the GTE access lines in Oklahoma and New Mexico, and approximately 15% of GTE's access lines in Texas. A portion of the access lines acquired in Texas is physically located in Texarkana, Arkansas. In addition to local exchange services, the Company also offers long distance and Internet access service through other subsidiaries. On January 31, 2002, the Company acquired Kerrville Communications Corporation, Inc. ("KCC") and has included the operating results of KCC in its consolidated results since the date of acquisition.

As previously announced on December 9, 2005, the board of directors of Valor unanimously approved a strategic merger that will combine Valor and the wireline telecommunications business of Alltel. Pursuant to the Agreement and Plan of Merger Valor entered into on December 8, 2005 with Alltel and Alltel Holding Corp. (which is referred to as "Spinco"), Spinco will merge with and into Valor and Valor will survive as a stand-alone company and will hold and conduct the combined business operations of Valor and Spinco. The merger will take place immediately after Alltel contributes the assets making up its wireline telecommunications business to Spinco and distributes the common stock of Spinco to its stockholders. In the merger, each share of Spinco common stock will be converted into the right to receive approximately 1.04 shares of Valor common stock. Existing shares of Valor common stock will remain outstanding. Following completion of the merger, the separate existence of Spinco will cease. Valor expects to issue approximately 403 million shares of common stock to Alltel stockholders in the merger. However, this amount is subject to change as a result of compensatory equity grants and other issuances of Valor common stock. Valor also expects to assume approximately $4,000,000 in outstanding debt in the merger. Immediately following the merger, Valor expects to change its name and that its common stock will be quoted on the New York Stock Exchange under that new name and with a new ticker symbol, each of which has yet to be determined. When the merger is completed, Alltel stockholders will together own approximately 85%, and Valor's stockholders will own approximately 15%, of the shares of common stock in that entity on a fully diluted basis. The composition of the senior management and board of directors of the combined business will be largely determined by Alltel. While the Company is the legal acquirer and the surviving entity in this transaction, Alltel's wireline business will be deemed to be the accounting acquirer in a transaction treated for accounting purposes as a reverse acquisition. The historical financial statements of Valor Communications Group, Inc. after the close of the merger will be those of Alltel's wireline business. The merger is subject to both regulatory and shareholder approval and is expected to close in mid-2006.

On February 9, 2005, the Company completed its initial public offering ("Offering") through registering 29,375,000 shares of common stock for net proceeds of $411,257. Concurrent with the Offering, the Company issued $400,000 principal amount of $7^3/_4$% senior notes due in 2015 for net proceeds of approximately $389,700. The proceeds from the Offering and the issuance of the senior notes were used to repay the second lien loan, senior subordinated loan, a portion of the existing credit facility and associated fees and expenses.

VALOR COMMUNICATIONS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

In connection with the Offering, certain of the Company's stockholders granted an option to the underwriters to purchase up to 4,406,250 additional shares in the aggregate at the Offering price less the underwriting discount. On March 16, 2005, the underwriters exercised their over-allotment option in full. The Company received no proceeds from the over-allotment exercise.

Immediately prior to and in connection with the Offering, the Company consummated a reorganization pursuant to which the existing equity holders contributed all their equity interests in VTC and VTS to Valor in exchange for 39,537,574 shares of Valor common stock in the aggregate.

(2) Summary of Significant Accounting Policies

Use of Estimates — The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition — Revenue is recognized when evidence of an arrangement 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 ID, 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 recognized as an operating expense over the same period. Costs in excess of revenues are recognized as expense in the period in which activation occurs.

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 the Company's 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 the Company and are calculated by the government agency responsible for administering the support program. Revenues are recognized in the period the service is provided.

Cash and Cash Equivalents — For purposes of reporting cash flows, the Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Cash equivalents are stated at cost, which approximates fair value.

Allowance for doubtful accounts — In evaluating the collectibility of accounts receivable, the Company assesses a number of factors, including a specific customer's or carrier's ability to meet their financial obligations, the length of time the receivable has been past due and historical collection experience. Based on these assessments, the Company recorded both specific and general reserves for uncollectible accounts receivable to the amount the Company ultimately expects to collect from customers and carriers. If circumstances change or economic conditions worsen such that the past collection experience is no longer relevant, the Company's estimate of the recoverability of accounts receivable could be further reduced from the levels reflected in the Company's Consolidated Balance Sheets.

VALOR COMMUNICATIONS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Property, Plant and Equipment — Telephone property, plant and equipment are recorded at original cost of acquisition or construction and related costs, including payroll and other direct and indirect costs related to construction activity. Major replacements and improvements are capitalized. Repairs are charged to operating expense as incurred. Depreciation on telephone plant is based on the estimated remaining lives of the various classes of depreciable property and is calculated using straight-line composite rates. This method provides for the recovery of the remaining net investment in telephone plant, less salvage value, over the remaining asset lives. The composite depreciation rates range from 2.5% to 33.3%. Normal retirements are charged to accumulated depreciation, and any gain or loss on dispositions is amortized over the remaining asset lives of the remaining net investment in telephone plant.

Non-telephone property is depreciated on a straight-line basis. When these assets are retired or otherwise disposed of, the related cost and accumulated depreciation are removed and any gains or losses on disposition are recognized.

Property, plant and equipment, as well as other long-lived assets, are evaluated for impairment in accordance with Statement of Financial Accounting Standards ("SFAS") 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" whenever events or circumstances indicate that the carrying value may not be recoverable.

Self-insurance — The Company is partially self-insured for certain employee health benefits and is self insured for most environmental issues. The Company purchases stop-loss coverage in order to limit its exposure to any significant levels of employee health benefit claims. Self-insured losses are accrued based upon estimates of the aggregate liability for uninsured claims incurred using the Company's own historical claims experience.

Pension and Postretirement Benefit Obligations — The Company maintains defined benefit pension plans covering the majority of its employees, which provide benefit payments to vested participants upon retirement. The Company also provides certain postretirement healthcare and life insurance benefits to eligible employees. These pension and other postretirement benefit plans are accounted for in accordance with SFAS 87, "Employers' Accounting for Pensions" ("SFAS 87") and SFAS 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," ("SFAS 106") which require costs and the related obligations and assets arising from the pension and other postretirement benefit plans to be accounted for based on actuarially determined estimates. The plans use different factors, including age, years of service and eligible compensation, to determine the benefit amount for eligible participants. The Company funds its pension plans in compliance with applicable laws. See Note 9 for further discussion of the Company's pension and postretirement plans.

Income Taxes — As a result of the Company's reorganization that occurred in connection with the Company's Offering in 2005, all of the Company's operations with Valor and VTC became reportable in a consolidated corporate federal income tax return. Accordingly, since the Offering, the financial statement provision for the Company's income taxes includes federal income taxes currently payable and those deferred due to temporary differences between the financial statement and tax bases of assets and liabilities and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. These differences result from the use of different accounting methods for financial and tax reporting purposes principally with respect to depreciable assets, materials and supplies, revenue recognition and pension and postretirement costs. The Company periodically evaluates its deferred tax assets in the various taxing jurisdictions in which it operates and records any related valuation allowance based on the estimate of the amount of such deferred tax assets which the Company believes is more likely than not that such assets will not be realized.

VALOR COMMUNICATIONS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Prior to the reorganization in February 2005, only VTS II had elected to be taxed as a corporation for federal income tax purposes. Each legal operating entity owned directly or indirectly by VTS II is legally formed either as a limited liability company, a limited partnership, or a corporation. However, each of these entities was treated for federal income tax purposes either as a corporation or a disregarded entity (a division of a corporation). Operations for all entities directly or indirectly owned by VTS II were included in a consolidated federal income tax return filed by VTS II. Since VTS II had elected to be treated as a corporation for tax purposes, the income tax expense and the deferred tax assets and liabilities reported in the consolidated results of operations are reported under this entity's name and are computed based upon the consolidated VTS II operations.

Segment Reporting — The Company has two operating segments, rural local exchange carrier ("RLEC") and Other.

As an RLEC, the Company provides regulated telecommunications services to customers in its service areas. These services include local calling services to residential and business customers, as well as providing interexchange carriers ("IXC") with call origination and termination services, on both a flat-rate and usage-sensitive basis, allowing them to complete long distance calls for their customers who reside in the Company's service areas.

In Other, the Company provides unregulated telecommunications services to customers throughout its RLEC service areas. These services include long distance and Internet services. Long distance is provided through resale agreements and national long distance carriers.

The Company has considered the aggregation criteria in SFAS 131, "Disclosures about Segments of an Enterprise and Related Information" and determined that these operating segments are similar in respect to:

- the nature of the services;
- their processes;
- the type or class of customer for these services;
- the methods used to provide these services; and
- the nature of the overall regulatory environment.

In addition to the above criteria, the Company believes the economic characteristics of the two operating segments, as well as their expected future performance, to be similar, and accordingly, has aggregated the two operating segments into a single reportable segment.

Equity Method Investments — Investments in companies in which the Company owns 20 percent to 50 percent of the voting common stock or otherwise exercises significant influence over operating and financial policies of the company are accounted for under the equity method. The Company periodically assesses its investments to determine if an other than a temporary decline in the value of the investment has occurred. If such a decline has occurred and the carrying value is less than the fair value, the Company will recognize a loss on the investment. In the 2004 and 2005, the Company recorded impairment charges of $6,678 and $2,339, respectively, for other than temporary declines in its investments.

Earnings per common share — Subsequent to the Offering, basic earnings per share of common stock are based upon the weighted average number of common shares actually outstanding during each period. Diluted earnings per share include the impact of unvested restricted stock to the extent the unvested restricted stock is dilutive.

Stock Compensation — The Company accounts for its employee stock compensation plans in accordance with Accounting Principles Board ("APB") Opinion 25, "Accounting for Stock Issued to Employees" ("APB 25") as allowed by SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123") As

VALOR COMMUNICATIONS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

permitted by SFAS 123, the Company measures compensation using the intrinsic value based method as prescribed by APB 25, but is required to make proforma disclosures in the footnotes to the financial statements as if the measurement provisions of SFAS 123 and SFAS 148, "Accounting for Stock-Based Compensation-Transition and Disclosure — an Amendment of SFAS 123" had been adopted. Under the intrinsic value method, compensation is measured as the difference between the market value of the stock on the grant date, less the amount required to be paid for the stock. The difference, if any, is charged to expense over the vesting period of the options or the restricted stock. No stock-based employee compensation cost is reflected in net income (loss) for stock options, since options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of grant. The Company recorded $12,699 of non-cash stock compensation expense for the year ended December 31, 2005 related to the difference between the exercise price and the Company's common stock price at the measurement date associated with restricted stock grants. See Note 15 for additional information. If compensation cost had been determined in accordance with SFAS 123, the Company's net income (loss) and per owner unit and common share amounts would have been as follows:

	Year Ended December 31,		
	2003	2004	2005
Net income (loss) as reported	$ 58,233	$ (27,755)	$ 35,347
Deduct: Total stock-based employee compensation expense determined under fair value based method, net of tax	(447)	(377)	(8,031)
Add: Total stock-based employee compensation expense determined under intrinsic value based method, net of tax	—	—	8,031
Pro forma net income (loss)	$ 57,786	$ (28,132)	$ 35,347
Earnings (loss) per owners' unit and common share:			
Basic and diluted net income (loss) as reported:			
Class A and B common interests	$ 0.73	$ (0.09)	$ 0.09
Class C interests	0.15	(0.46)	0.01
Common share — basic	—	—	0.42
Common share — diluted	—	—	0.41
Basic and diluted net income (loss) pro forma:			
Class A and B common interests	$ 0.72	$ (0.10)	$ 0.09
Class C interests	0.15	(0.46)	0.01
Common share — basic	—	—	0.42
Common share — diluted	—	—	0.41

For the year ended December 31, 2003, the following awards were granted under the Southwest Equity Incentive Non-Qualifying Stock Option Plan:

Grants Made During Quarter Ended	Number of Options Granted (000s)	Weighted-Average Exercise Price	Weighted-Average Fair Value per Interest	Weighted-Average Intrinsic Value per Interest
March 31, 2003	455	$ 1	$ 1	$ —
June 30, 2003	5	$ 1	$ 1	$ —
September 30, 2003	—	$ —	$ —	$ —
December 31, 2003	5	$ 1	$ 1	$ —

VALOR COMMUNICATIONS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Concurrent with the Offering, the Company completed a reorganization resulting in the cancellation of equity incentive non-qualifying stock options. There were no option grants made in 2004 or 2005.

Members of the Company's management determined the fair value of the equity instruments issued retrospectively. The Company believes that management possesses the requisite valuation expertise to prepare a reasonable estimate of fair value of the options.

Regulatory Accounting — Certain of the Company's operating subsidiaries, specifically the telephone operations of VTS II, prepare their financial statements in accordance with the provisions of SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation" ("SFAS 71") The provisions of SFAS 71 require, among other things, that regulated enterprises reflect rate actions of regulators in their financial statements, when appropriate. These rate actions can provide reasonable assurance of the existence of an asset, reduce or eliminate the value of an asset, or impose a liability on a regulated enterprise. The Company periodically reviews its position as to the applicability of SFAS 71 based on the current regulatory and competitive environment.

Derivative Financial Instruments — SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended, requires that all derivative instruments, such as interest rate swaps, interest rate caps and interest rate collar agreements, be recognized on the balance sheet at fair value, regardless of the purpose or intent of holding them. In addition, SFAS No. 133 provides that for derivative instruments that qualify for hedge accounting, changes in the fair value will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognized in stockholders' equity as a component of accumulated other comprehensive income (loss) until the hedged item is recognized in earnings, depending on whether the derivative is being used to hedge changes in fair value or cash flows. The ineffective portion of a derivative's change in fair value will be immediately recognized in earnings. Upon termination of an interest rate swap agreement, the cash received or paid that relates to the future value of the swap agreement at the termination date is a deferred gain or loss, which is recognized as a decrease or an increase to interest expense over the remaining life of the original swap agreement.

Goodwill and Intangibles — Goodwill represents the excess of cost over fair value of individual net assets acquired in business combinations accounted for under the purchase method as determined by SFAS No. 141, "Business Combinations." SFAS No. 142, "Goodwill and Other Intangible Assets" requires that goodwill no longer be amortized to earnings, but instead be reviewed for impairment annually. Such an impairment review may result in future periodic write-downs charged to earnings. Goodwill and other intangible assets are stated net of accumulated amortization. See Note 5 for additional information.

Other intangible assets, consisting of the estimated fair value of certain customer lists acquired, are amortized by the straight-line method over the estimated useful life of the customer, which represents three years.

Asset Retirement Obligations — The Company accounts for asset retirement obligations as determined by SFAS No. 143, "Accounting for Asset Retirement Obligations" and Financial Accounting Standards Board Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143" ("FIN 47"). SFAS No. 143 and FIN 47 address financial accounting and reporting for legal obligations associated with the retirement of tangible long-lived assets and the related asset retirement costs. SFAS No. 143 requires that companies recognize the fair value of a liability for an asset retirement obligation ("ARO") in the period in which it is incurred and capitalize the expected retirement costs as part of the book value of the long-lived asset. The Company's ARO, as determined by SFAS No. 143 and FIN 47, primarily relate to chemically treated poles and certain other assets. Historically, the Company generally has had no legal obligation to remove assets and, therefore, has not accrued a liability for anticipated removal costs. Removal costs are expensed as they are incurred. Upon adoption of FIN 47, the Company recorded a liability equal to the fair value of the estimated cost to retire the asset for those items in which there is a

VALOR COMMUNICATIONS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

conditional legal obligation associated with the retirement of tangible long-lived assets. The Company also increased the carrying amount of the related long-lived asset by an amount equal to the liability. The ARO is accreted to its present value and the capitalized costs are depreciated over the useful life of the long-lived asset. Removal costs for other long-lived assets continue to be expensed as incurred. See Note 21 for additional information.

The telephone operations of the Company's subsidiary, VTS II, are subject to SFAS No. 71 and, therefore, have historically included a component for removal costs in excess of the related estimated salvage value even though there is no legal obligation to remove the assets. Notwithstanding SFAS No. 143, SFAS No. 71 requires the Company to continue to reflect this accumulated liability for removal costs in excess of salvage value even though there is no legal obligation to remove the assets.

Other — Advertising costs, expensed as incurred, were $1,587, $1,566 and $1,298 for the years ended December 31, 2003, 2004 and 2005, respectively.

Redeemable Preferred Interests of Subsidiary and Minority Interest — The Company allocated earnings and losses attributable to the redeemable preferred interests of subsidiary and minority interest as determined by the limited liability company agreement. A summary of the allocation terms is as follows:

Earnings

- Earnings are first allocated to redeemable preferred interests to the extent of their 20% accretion and then to common interests. However, if losses had previously been allocated to the respective capital accounts as noted below, the earnings will first be allocated to the redeemable preferred interests to the extent of allocated losses and then to common interests to the extent of their allocated losses.

Losses

- Losses are first allocated to common interests to the extent of capital contributed.
- After losses allocated to the common interests reduce the capital accounts to zero, any additional losses are allocated to the redeemable preferred interests to the extent of their capital contributed.

Before the year ending December 31, 2002, the Company had incurred losses resulting in allocated losses to both common interests and redeemable preferred interests of subsidiary. As of December 31, 2003, all of the redeemable preferred interests of subsidiary's capital account had been restored to their initial capital contribution. For the years ended December 31, 2003 and 2004, the Company allocated the following amounts to the redeemable preferred interests of subsidiary and minority interest:

	Year Ended December 31,		
	2003	2004	2005
Redeemable preferred interests of subsidiary	$(3,314)	$(231)	$ —
Minority interest	(254)	(142)	(468)

In April 2004, the Company repurchased certain interests from a group of individual investors who owned direct equity interest in VTS II (see Note 20). In connection with the Offering, all remaining outstanding preferred interests were exchanged for common stock of Valor.

Recent Accounting Pronouncements — In December 2004, the FASB issued a revision to SFAS 123. This revision will require the Company to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. The cost will be recognized over the period during which an employee is required to provide service in exchange for the award. This revised Statement is effective as of the beginning of the first interim or annual reporting period that begins after December 15, 2005. This revised Statement will apply to all awards granted after the required effective date

and to awards modified, repurchased or canceled after that date. As of the required effective date, the Company will apply this revised Statement using a modified version of prospective application. Under that transition method, compensation cost is recognized on or after the required effective date for the portion of outstanding awards for which the requisite service has not yet been rendered, based on the grant-date fair value of those awards calculated under SFAS 123 for either recognition or pro forma disclosures adjusted for estimated forfeitures. The Company will adopt the provisions of SFAS 123 revision in the first quarter of 2006. The Company does not expect the adoption will have a material impact on our financial position or results of operation.

In January 2004, FASB Staff Position ("FSP") No. 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" ("FSP 106-1") was issued. FSP 106-1 permits the deferral of recognizing the effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") in the accounting for post-retirement health care plan under SFAS 106 and in providing disclosures related to the plan required by SFAS 132 (revised 2003), "Employers' Disclosures about Pensions and Other Postretirement Benefits." In May 2004, FSP 106-2, "Accounting and Disclosure Requirement Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" was issued. FSP 106-2 provides guidance that measures the accumulated post-retirement benefit obligation ("APBO") and net periodic postretirement benefit cost on or after the date of enactment. FSP 106-2 is effective for the first interim or annual period beginning after June 15, 2004. The Act introduces a prescription drug benefit beginning in 2006 under Medicare ("Medicare Part D"), as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. Due to the levels of benefits provided under the Company's health care plans, the Company has concluded that its health care plans are at least "actuarially equivalent" to Medicare Part D. The Company has elected not to apply for the federal subsidy, as the benefit to its results of operations would be minimal.

In June 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections — a replacement of APB Opinion No. 20 and FASB Statement No. 3" ("SFAS 154"). SFAS 154 replaces APB Opinion No. 20, "Accounting Changes" ("APB 20"), and SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements." SFAS 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impracticable to determine either the period-specific effects or the cumulative effects of the change. APB 20 previously required that most voluntary changes in accounting principles be recognized by including in net income in the period of the change the cumulative effect of changing to the new accounting principle. This standard generally will not apply with respect to the adoption of new accounting standards, as new accounting standards usually include specific transition provisions, and will not override transition provisions contained in new or existing accounting literature. SFAS 154 is effective for fiscal years beginning after December 15, 2005, and early adoption is permitted for accounting changes and error corrections made in years beginning after the date that SFAS 154 was issued. The Company does not expect that SFAS 154 will have a significant effect on its financial condition or results of operations upon its adoption.

Reclassification — The Company reclassified certain prior year amounts to conform to current year presentation.

VALOR COMMUNICATIONS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(3) Other Current Assets

Other current assets consist of the following:

	December 31, 2004	December 31, 2005
Deferred service activation costs	$3,982	$ 3,109
Income tax receivable	1,327	1,172
Deferred income taxes	—	3,733
Other	3,512	2,292
Total	$8,821	$ 10,306

(4) Property, Plant and Equipment

Property, plant and equipment consist of the following:

	Weighted Average Life in Years	December 31, 2004	December 31, 2005
Land	—	$ 4,621	$ 4,621
Buildings and leasehold improvements	28	84,304	84,587
Central office equipment	9	329,651	343,648
Outside communications plant	17	571,295	594,973
Furniture, vehicles and other equipment	4	53,387	54,015
Construction in progress	—	5,269	8,093
		1,048,527	1,089,937
Less accumulated depreciation		(298,543)	(372,408)
Property, plant and equipment, net		$ 749,984	$ 717,529

The above table references the weighted average depreciable life of the Company's property, plant and equipment. For the majority of its property, plant and equipment, the Company calculates depreciation expense based on its estimate of the useful life of the assets. Certain of the Company's total property, plant and equipment are accounted for under the requirements of SFAS No. 71. SFAS No. 71 allows the Company to depreciate its assets over useful lives as prescribed by regulatory authorities, which can exceed the estimated useful lives of the assets.

Included in the furniture, vehicles and other equipment amount at December 31, 2004 is $7,793, for vehicles under capital leases. The related accumulated depreciation for these leases is $3,993 at December 31, 2004. In the first quarter of 2005, the Company paid all outstanding capital lease obligations in full.

Depreciation expense was $81,638, $86,295 and $89,673 for the years ended December 31, 2003, 2004 and 2005, respectively, and is included in "Depreciation and amortization" in the Company's Consolidated Statements of Operations. Depreciation expense for 2003 and 2004 includes $1,350 and $1,604 respectively, related to assets acquired under capital lease obligations.

VALOR COMMUNICATIONS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(5) Investments and Other Assets

Investments and other assets consist of the following:

	December 31,	
	2004	2005
Goodwill	$ 1,058,235	$ 1,057,007
RTFC equity certificates	31,718	7,704
Unamortized debt issuance costs	26,696	30,667
Investments in cellular partnerships	10,518	7,402
Other	4,004	6,597
Total	$ 1,131,171	$ 1,109,377

The Company's goodwill primarily represents the excess price paid by the Company over the fair value of the tangible and intangible assets and liabilities of the telephone operating properties purchased in Oklahoma, New Mexico, Arkansas and Texas on the date of acquisition net of accumulated amortization of $74,429. In November 2004, the Company acquired certain high-speed and dial-up Internet assets, along with the related customers and revenues. The purchase price consisted of $1,500 in cash and assumption of $400 of liabilities. The Company performed a preliminary purchase price allocation which resulted in goodwill of $1,228. During 2005, the Company finalized their purchase price allocation resulting in an increase of $146 of tangible assets and a corresponding decrease in goodwill.

The Company evaluates the carrying value of its RLEC reporting unit goodwill as of September 30 of each year and at other times during each year when events or changes in circumstances indicate an impairment may exist. Prior to our November 2004 acquisition, the Company only had goodwill at the RLEC reporting unit. As part of the evaluation, the Company compares the reporting unit's carrying value, including goodwill, with its fair value to determine whether an impairment exists. If the net carrying value, including goodwill, is in excess of the respective fair value, then no impairment is considered to exist. If the fair value of the reporting unit is less then the carrying value, including goodwill, then a goodwill impairment loss would be recognized equal to the excess, if any, of the net carrying value of the reporting unit goodwill over its implied fair value, not to exceed the carrying value of the reporting unit's goodwill. The implied fair value of the reporting unit's goodwill would be the amount equal to the excess of the estimated fair value of the reporting unit over the amount that would be allocated to the tangible and intangible net assets of the reporting unit, including unrecognized intangible assets, as if such reporting unit had been acquired in a purchase business combination accounted for in accordance with GAAP as of the date of the impairment testing.

In determining the estimated fair value for each reporting unit, the Company discounts future cash flow projections to determine if the goodwill can be recovered. Cash flow projections, although subject to a degree of uncertainty, are based on trends of historical performance and management's estimate of future performance, giving consideration to existing and anticipated competitive and economic conditions. Upon completion of its annual assessment for the RLEC reporting unit in the third quarters of 2004 and 2005, the Company determined that no write-down in the carrying value of the goodwill was required. In the fourth quarter of 2005, the Company assessed the recoverability of its goodwill carrying value associated with its Other reporting unit. Based on this analysis, the Company determined the value of the goodwill would not be recoverable and recorded an impairment charge of $1,082.

In accordance with the terms of the Rural Telephone Finance Cooperative ("RTFC") loans, the Company was required to purchase an equity certificate in RTFC equal to approximately 10% of the total amount borrowed from the RTFC. RTFC provided a loan to finance the purchase of the equity certificate. The funds invested in this equity certificate will be refunded to the Company upon repayment of the outstanding loan balance. The RTFC certificate is not marketable and is carried at cost. As a member of RTFC, the Company

VALOR COMMUNICATIONS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

receives non-cash patronage capital certificates based on RTFC earnings. During the years ended December 31, 2004 and 2005, the Company recorded patronage capital certificates with a present value of $404 and $281, respectively. These non-cash patronage capital certificates will accrue interest on a monthly basis and will be redeemed for approximately $1,304 and $731 in the years 2019 and 2020, respectively. In connection with the debt recapitalization in 2004 (see Note 6) and the Offering in 2005, the Company redeemed $31,111 and $24,445, respectively, of RTFC capital certificates.

As a result of amending the terms of its credit facilities in 2003, 2004 and 2005, the Company expensed $555, $44,827 and $9,869 respectively, of its previously deferred debt issuance costs. In addition, in 2004 and 2005 the Company deferred an additional $23,948 and $17,530, respectively, of new debt issuance costs incurred as a result of the debt recapitalization and the credit facility amendment in connection with the Offering, respectively. Debt issuance costs are amortized utilizing the effective interest rate method over the term of the related debt. Amortization expense is expected to be approximately $3,780 in 2006, $4,009 in 2007, $4,255 in 2008, $4,519 in 2009 and $4,686 in 2010.

Investments in cellular partnerships represent the Company's 32% ownership in both CGKC&H and CGKC&H #2. The Company accounts for its investments using the equity method of accounting. Income taxes on the Company's equity in earnings of the partnerships are included in the Company's provision for federal income taxes. In 2004, a wireless competitor began constructing facilities in areas serviced by the Company's unconsolidated cellular partnerships. This has resulted in a significant decrease in roaming revenue further decreasing the Company's earnings from unconsolidated cellular partnerships. In light of the financial results of the cellular partnerships, the Company assessed recoverability of the investments in unconsolidated cellular partnerships, which resulted in an impairment charge of $6,678 in the third quarter of 2004. One of the Company's cellular partnerships continued to experience a significant decline in roaming revenues in 2005. Due to the financial results of this cellular partnership through September 30, 2005, the Company recorded an impairment charge of $2,339 in its Consolidated Statements of Operations.

(6) Long Term Debt

Long-term debt outstanding is as follows:

	December 31,	
	2004	2005
6.0%* Senior Credit Facilities, due 2012	$ 1,197,075	$ 780,555
7.75% Senior Notes, due 2015	—	400,000
10.1% Second Lien, due 2011	265,000	—
12.9% Subordinated Debt, due 2012	135,000	—
5.4% Leases, due in installments through 2009	3,512	—
6.0%* Other debt, due in installments through 2006	391	59
Total long-term debt	1,600,978	1,180,614
Less current maturities	(1,801)	(59)
Long-term debt, excluding current maturities	$ 1,599,177	$ 1,180,555

* weighted average interest rate at December 31, 2005

Debt Recapitalization

On November 10, 2004, the Company completed its debt refinancing and entered into a new $1,300,000 senior credit facility consisting of a $100,000 senior secured revolving facility and a $1,200,000 term loan. The term loan consists of $900,000 of Tranche B, $270,000 of Tranche C and $30,000 of Tranche D.

VALOR COMMUNICATIONS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Concurrently, the Company secured a $265,000 second lien loan and a $135,000 subordinated loan. Proceeds from the credit facility, second lien loan and the subordinated loan were used to (i) repay all amounts owed under the Company's previous senior credit facilities; (ii) redeem $325,500 of 10% senior subordinated notes due 2010 held primarily by our equity sponsors, including accrued interest thereon; (iii) redeem $134,102 of redeemable preferred interests and $16,458 of Class C interests held by the Company's existing equity investors, including our equity sponsors, in VTC; (iv) redeem $8,791 of redeemable preferred minority interests our equity investors held in VTS; and (v) pay $30,719 in associated transaction costs.

As a result of the debt refinancing, the Company accounted for the debt issuance costs associated with the existing and new credit facilities based on Emerging Issue Task Force ("EITF") 96-19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments" and EITF 98-14, "Debtor's Accounting for Changes in Line-of-Credit or Revolving-Debt Arrangements." Based on the terms of the new and old credit facilities and the composition of the respective lending groups, the Company recorded a loss on extinguishment of debt of $62,975 for the year ended December 31, 2004. The loss on extinguishment of debt consisted of prepayment penalty fees of $11,376, write-off of existing deferred financing costs of $44,827 and fees paid to lenders to modify existing credit facilities of $6,772.

Senior Credit Facilities

In connection with the Offering, the Company amended its senior credit facility. The amended senior credit facility resulted in the reduction of the commitment amount of Tranche B Term Loan to $750,000, Tranche C Term Loan to $50,000 and Tranche D Term Loan to $5,556. Under the amended credit facility, the entire principal balances on the Tranches B, C and D are due at maturity, February 2012. Interest on Tranche B bears interest based on LIBOR plus 1.75% and is payable no less frequently than monthly. Interest on the Tranches C and D is fixed at 6.38% through April 2007 and is payable quarterly.

As a result of the repayment of existing indebtedness completed in connection with the Offering, the Company recorded a loss on extinguishment of debt of $29,262 due to prepayment premiums, breakage costs and the write-off of related deferred debt costs.

As a member of RTFC, the Company receives cash distributions based on RTFC earnings. During the year ended December 31, 2003, 2004 and 2005, the Company recorded $3,173, $3,042 and $1,705, respectively, of distributions declared from the RTFC as a reduction of interest expense.

At December 31, 2004 and 2005, the weighted average interest rate of the Senior Credit Facilities was 6.1% and 6.0%, respectively.

The amount of borrowing available to the Company under the Revolving credit facility ("Revolver") is generally based upon achieving certain levels of operating performance. At December 31, 2005, the Company had an aggregate of $99,840 in available borrowings under the Revolver, for which the Company pays a commitment fee of 0.5% based upon certain financial tests. The Revolver matures February 2011.

The Company may borrow funds under the Revolver for short-term requirements for a period not to exceed seven days. Any amounts outstanding under these terms are classified as "Notes Payable" on the Consolidated Balance Sheets. As of December 31, 2004 and 2005, the Company had no balance outstanding.

Borrowings under the Senior Credit Facilities, as amended, are collateralized by virtually all assets of the Company. These agreements limit, among other things, additional borrowings, transactions with affiliates, capital expenditures and the payment of dividends. The agreements also require maintenance of certain financial ratios, including leverage and interest coverage ratios. As of December 31, 2005, the Company is in compliance with all of the covenants included in the credit facility.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Senior Notes

The senior notes were issued in February 2005 in connection with the Offering. In August 2005, the Company completed an exchange of all outstanding 7 3/4% senior notes for substantially identical senior notes that had been registered under the Securities Act of 1933. The senior notes are due 2015. They bear interest at an annual fixed rate of 7 3/4% and pay interest every six months on February 15 and August 15. The senior notes are general unsecured unsubordinated obligations. The senior notes contain covenants similar to those identified in the Senior Credit Facilities. As of December 31, 2005, the Company is in compliance with all of the covenants included in the senior notes.

The senior notes issued are guaranteed jointly and severally by all of Valor's existing subsidiaries (the "Guarantor Subsidiaries") and such guarantees are full and unconditional. Existing subsidiaries include VTC, VTS including its operating entities, and VTS II including its operating entities. Valor has no independent assets or operations. Separate financial information has not been presented for the Guarantor Subsidiaries because the Guarantor Subsidiaries will effectively comprise all of Valor's assets and operations.

Provisions of the senior credit agreement that the Company entered in conjunction with the Offering restrict the ability of all of the Guarantor Subsidiaries to transfer funds to the Company. The senior credit agreement also precludes the guarantor subsidiaries from transferring funds to Valor:

i. to pay dividends on common stock during a dividend suspension period, as defined in the senior credit agreement;

ii. when an event of default has occurred, as defined in the senior credit agreement; or

iii. for the purpose of paying dividends that would exceed available distributable cash, as defined in the senior credit agreement.

Other

The approximate annual debt maturities for the five years subsequent to December 31, 2005 are as follows:

2006	$	59
2007		—
2008		—
2009		—
2010		—
Thereafter		1,180,555

During the years ended December 31, 2003, 2004 and 2005, the Company capitalized $997, $104 and $412, respectively, of interest expense related to construction projects.

Pursuant to the Company's Senior Credit Agreement, the Company is required to enter into swap contracts or other interest rate protection agreements, reasonably satisfactory to the lender, that would be payable in connection with 50 percent of all consolidated funded indebtedness exclusive of any revolving loans. The Company entered into nine agreements, three interest rate caps and six interest rate swaps, with investment grade financial institutions in 2005. In connection with entering the interest rate cap agreements, the Company paid $854.

The interest rate caps are not treated as hedges as prescribed by the accounting literature; therefore, the fair value of the instruments is recorded each reporting period on the Consolidated Balance Sheets, with the change in fair value recorded in the Consolidated Statements of Operations in "Gain (loss) on interest rate hedging arrangements." The interest rate swaps effectively convert our variable rate debt to fixed rate debt.

VALOR COMMUNICATIONS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Since the relevant terms of the interest rate swap agreements match the corresponding terms of long-term debt, there is no hedge ineffectiveness. The Company's interest rate swap agreements qualify for hedge accounting under SFAS No. 133; therefore, they are carried at fair market value and are included on the Consolidated Balance Sheets in "Other assets" or "Deferred credits and other liabilities," with changes in fair value recorded as "Other comprehensive income (loss)" in the accompanying Consolidated Statements of Operations. The Company does not hold or issue derivative financial instruments for trading or speculative purposes. At December 31, 2005, the Company expects to reclassify $627 of net gains on derivative instruments from accumulated other comprehensive income to earnings during the next twelve months due to the payment of variable interest associated with the floating rate debt.

As a further hedge against rising interest rates, the Company selected fixed rate options available under certain of the Senior Credit Facilities. For the year ended December 31, 2005, the Company fixed Tranches C and D debt through April 2007 at the rate of 6.38%.

(7) Deferred Credits and Other Liabilities

Deferred credits and other liabilities were composed of the following:

	December 31,	
	2004	2005
Accrued pension costs (see Note 9)	$ 16,908	$ 9,446
Accrued postretirement medical and life benefit costs (see Note 9)	12,207	13,100
Deferred revenue	2,555	2,166
Deferred income taxes (see Note 8)	6,319	84,056
Other	709	1,431
Total	$ 38,698	$ 110,199

Deferred revenue represents revenues billed to customers for activating services. This revenue is recognized over the average life of the customers along with the costs associated with activating such services (see Note 2).

(8) Income Taxes

In connection with the Offering, the Company completed a reorganization, which resulted in the operations of all entities within Valor and VTC becoming reportable in a consolidated corporate federal tax return. As a result of the reorganization, the Company's previous owners contributed approximately $307,000 of federal net operating losses ("NOLs") that the Company will be able to use, subject to certain limitations, to reduce future taxable income. Furthermore, the Company, as of the Offering date, had cumulative book/tax differences of approximately $499,000 resulting from items such as goodwill amortization and accelerated tax depreciation that the Company has deducted faster for tax purposes under the tax code than for financial reporting purposes. The Company also had other items totaling $818,000, which consist of $725,000 related to unamortized goodwill and $93,000 related to the step-up in tax basis of assets as a result of the reorganization that occurred in connection with the Offering. Unamortized goodwill represents tax deductions through 2015 that will result in a future deferred tax liability for financial reporting purposes due to the book/tax basis difference related to the goodwill. The $93,000 step-up in tax basis of assets, as determined by the applicable tax code, is allocated in part to tangible assets and in part to tax goodwill based upon relative fair market values. The portion allocated to tangible assets will be treated as a temporary difference that will reverse upon the disposition of certain Company assets. The portion attributable to tax goodwill will continue to be treated as a permanent difference in accordance with SFAS No. 109, "Accounting for Income Taxes," since there is no corresponding book goodwill. The Company recorded the tax effect of the items noted above as a net deferred

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

tax liability of approximately $59,000. The net deferred tax liability is an estimate and is subject to change upon finalization of tax valuations, of certain tax calculations and of the partners' tax returns related to the period prior to the Offering. Any changes to this deferred tax liability will be recorded through additional paid-in capital.

The components of the Company's net deferred tax liability consist of the following:

	December 31, 2004	December 31, 2005
Deferred tax assets:		
Reserves and accruals	$ 37	$ 2,518
Net operating losses	—	119,622
Benefit obligations	68	8,244
Other	432	6,156
Deferred tax assets before valuation allowance	537	136,540
Valuation allowance	—	(4,029)
Deferred tax asset after valuation allowance	537	132,511
Deferred tax liabilities:		
Property, plant and equipment	(6,659)	(123,123)
Goodwill and intangible assets	—	(88,232)
Other	(197)	(1,479)
Deferred tax liabilities	(6,856)	(212,834)
Net deferred tax liability	$ (6,319)	$ (80,323)
Current deferred tax asset	$ —	$ 3,733
Non-current deferred tax liability	(6,319)	(84,056)
Net deferred tax liability	$ (6,319)	$ (80,323)

At December 31, 2005, the Company has federal net operating loss ("NOL") carryforwards, which for U.S federal income tax purposes expire in 2020 through 2025, of approximately $320,100. The NOL carryforwards primarily arose from the Company's reorganization that occurred in conjunction with the Offering. The NOLs that were generated prior the Company's reorganization are subject to certain limitations pursuant to Section 382 of the Internal Revenue Code. The Company believes that it is more-likely-than-not that all such NOLs for federal income tax purposes will be utilized to reduce future income tax liabilities. Consequently, no valuation allowance has been recorded to offset the deferred tax asset related to these NOLs. However, certain of the Company's state NOLs have a five-year expiration period beginning in 2005. The Company has considered the likelihood of realizing some portion or all of the deferred tax assets associated with these NOLs and has determined that it is more-likely-than-not that such deferred tax assets will not be realized. Accordingly, the Company has recorded a $4,029 valuation allowance at December 31, 2005.

Income tax expense for the years ended December 31 is as follows:

	Year Ended December 31, 2003	2004	2005
Current expense	$2,028	$462	$ 155
Deferred expense	450	203	14,174
Total income tax expense	$2,478	$665	$ 14,329

VALOR COMMUNICATIONS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

There was no income tax expense associated with the discontinued operations.

The differences between the federal income tax statutory rate and the Company's effective income tax rate is as follows:

	Year Ended December 31,		
	2003	2004	2005
Statutory federal income tax rate	34.0%	(34.0%)	35.0%
Consolidated entities not subject to income taxes	(29.6)	23.9	(4.7)
Permanent differences	—	12.2	—
Other, net	(0.3)	0.4	(1.9)
Effective income tax rate	4.1%	2.5%	28.4%

Permanent differences relate to the Company's purchase of minority interests and the impairment charge on investment in cellular partnerships in 2004. The permanent differences in 2005, which offset each other, relate to the step-up in the Company's tax basis of assets attributable to goodwill that occurred in connection with the Company's reorganization and an impairment charge on the Company's investment in cellular partnership.

(9) Pension and Employee Benefits

The Company sponsors a qualified pension plan and a postretirement benefit plan for the union employees. The pension plan is noncontributory. The Company's postretirement health care plans are generally contributory and include a limit on the Company's share of the cost for recent and future retirees. The Company accrues the costs, as determined by an actuary, of the pension and the postretirement benefits over the period from the date of hire until the date the employee becomes fully eligible for benefits.

VALOR COMMUNICATIONS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following tables provide a reconciliation of the changes in the plans' benefit obligations and fair value of plan assets and a statement of funded status as of December 31:

	Pension Benefits			Postretirement Benefits		
	2003	2004	2005	2003	2004	2005
Change in Benefit Obligation:						
Benefit obligation at January 1	$ 45,168	$ 55,982	$ 60,867	$ 12,751	$ 15,386	$ 15,783
Service cost	3,027	3,517	3,867	394	369	381
Interest cost	2,883	3,458	3,740	882	881	933
Actuarial loss (gain)	8,601	3,048	4,751	1,602	(457)	638
Plan amendments	—	170	—	—	—	—
Benefits paid	(3,697)	(5,308)	(5,633)	(243)	(396)	(588)
Benefit obligation at December 31	$ 55,982	$ 60,867	$ 67,592	$ 15,386	$ 15,783	$ 17,147
Change in Plan Assets:						
Fair value of plan assets at January 1	$ 21,649	$ 24,748	$ 26,494	$ —	$ —	$ —
Actual return on plan assets	4,096	2,360	1,552	—	—	—
Employer contributions	2,700	4,694	15,647	243	396	588
Benefits paid	(3,697)	(5,308)	(5,633)	(243)	(396)	(588)
Fair value of plan assets at December 31	$ 24,748	$ 26,494	$ 38,060	$ —	$ —	$ —
Funded status as of December 31	$(31,234)	$(34,373)	$(29,532)	$(15,386)	$(15,783)	$(17,147)
Unrecognized prior service cost	—	157	133	—	—	—
Unrecognized net actuarial loss	23,864	25,583	29,732	4,181	3,576	4,047
Net amount recognized	$ (7,370)	$ (8,633)	$ 333	$(11,205)	$(12,207)	$(13,100)
Amounts recognized in the consolidated balance sheets consist of:						
Accrued benefit liability	$(15,074)	$(16,908)	$ (9,446)	$(11,205)	$(12,207)	$(13,100)
Intangible asset	—	157	133	—	—	—
Adjustment required to recognize additional minimum liability	7,704	8,118	9,646	—	—	—
Net amount recognized	$ (7,370)	$ (8,633)	$ 333	$(11,205)	$(12,207)	$(13,100)

The accumulated benefit obligation for the pension plan was $39,813, $43,402 and $47,506 as of December 31, 2003, 2004 and 2005, respectively. SFAS 87 requires a company to record a minimum liability that is at least equal to the unfunded accumulated benefit obligation. Changes in the amount of the unfunded accumulated benefit obligation result from factors such as a change in the interest rate used to discount the accumulated benefit obligation to its present settlement amount, contributions to the pension plan and the investment return generated by pension plan assets. As a result, the Company recorded an additional minimum pension liability adjustment of $3,054, $414 and $1,528 in 2003, 2004 and 2005, respectively. The additional minimum pension liability, net of a deferred tax asset, is charged to accumulated other comprehensive loss.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The accrued benefit cost is reflected in "Deferred credits and other liabilities" on the Company's Consolidated Balance Sheets (see Note 7). The Company's 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 following table shows the asset allocations by asset category at December 31:

Asset Category	2004	2005
Broad Market Stock Index Fund	61%	60%
International Stock Index Fund	10%	10%
Bond Index Fund	29%	30%
Total	100%	100%

The following table provides an estimate of the benefit payments expected to be paid during the years ended December 31:

Year	Pension Benefits	Postretirement Benefits
2006	$ 2,628	$ 793
2007	2,967	889
2008	3,545	975
2009	3,650	1,052
2010	4,732	1,154
2011-2015	36,358	6,827

The Company made cash contributions of $15,647 to its defined benefit pension plan in 2005, consisting of: (i) the required 2004 plan year contribution of $6,465, (ii) the required quarterly contributions for the 2005 plan year of $1,616 and $1,566 in April and July, respectively, and (iii) a $6,000 optional cash contribution in September 2005. The optional cash contribution in September 2005 made the Company's plan fully funded on a current liability basis, as determined under ERISA funding law, as of January 1, 2005 for the 2005 plan year. Had the Company not made this optional contribution, the Company would have been required to continue making quarterly contributions in October 2005 and in January 2006. Also, as a result of the Company's optional contribution and the funded status of the plan, the Company does not anticipate that it will be required to make cash contributions in 2006 for the 2005 or 2006 plan years. The Company's earliest required cash contribution will be in 2007. The Company may, however, elect to make optional contributions prior to that date. The Company expects to contribute $793 to its other postretirement benefits plan in 2006.

The following table provides the components of net periodic benefit cost for the years ended December 31:

	Pension Benefits			Postretirement Benefits		
	2003	2004	2005	2003	2004	2005
Service cost	$ 3,027	$ 3,517	$ 3,867	$ 394	$ 369	$ 381
Interest cost	2,883	3,458	3,740	882	881	933
Expected return on plan assets	(2,159)	(2,379)	(2,710)	—	—	—
Amortization of losses	738	1,371	1,776	155	148	166
Early retirement window true-up	—	—	—	(180)	—	—
Net periodic benefit cost	$ 4,489	$ 5,967	$ 6,673	$1,251	$1,398	$1,480

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The weighted-average assumptions used in measuring the Company's benefit obligations as of December 31 are as follows:

	Pension Benefits		Other Postretirement Benefits	
	2004	2005	2004	2005
Discount rate	5.90%	5.70%	5.90%	5.70%
Expected return on plan assets	8.50%	8.50%	—	—
Rate of compensation increase	4.50%	4.50%	—	—

In determining the appropriate discount rate at year-end, the Company considered the current yields on high quality corporate fixed-income investments with maturities and coupon payments corresponding to the expected benefit payments of the plan. As of December 31, 2005, the Company lowered its discount rate 20 basis points to 5.70%.

In 2005, the Company used an expected long-term rate of return of 8.5%. 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. The Company's 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 assumed health care cost trend rate is 9.0% in 2004 and is assumed to decrease gradually to an ultimate rate of 5.0% in the year 2009. In 2005, trend rates are not used since the Company's costs are assumed to have reached the Company's cap on benefits. A one percentage point change in the assumed health care cost trend rate would have no effect on the Company's other postretirement benefits due to the Company's cap on benefit payouts.

The Company also sponsors an employee savings plan under Section 401(k) of the Internal Revenue Code. The plan covers all employees. Under the plan, the Company provides matching contributions based on qualified employee contributions. Matching contributions charged to expense were $1,840, $1,447 and $1,754 during the years ended December 31, 2003, 2004 and 2005, respectively.

(10) Commitments and Contingencies

The Company has operating leases covering primarily buildings and land. Total rental expense was $4,578, $4,723 and $5,320 in 2003, 2004 and 2005, respectively. At December 31, 2005, rental commitments under noncancelable leases with initial or remaining terms in excess of one year are as follows:

Year	Aggregate Amounts
2006	$ 2,336
2007	1,934
2008	1,810
2009	1,784
2010	1,143
Thereafter	228
Total	$ 9,235

The Company has various commitments for capital expenditures of $3,580 at December 31, 2005. Capital expenditures were $69,850, $65,525 and $57,385, for the years ended December 31, 2003, 2004 and 2005,

respectively. Additionally, the Company has unfulfilled contractual commitments for miscellaneous services at December 31, 2005 of $103,967. These commitments primarily relate to administration of our billing and customer care systems provided by Alltel and a long distance resale arrangement with Sprint Nextel Corporation. These commitments extend through 2011.

On July 13, 2005, four former employees served the Company with a Demand for Arbitration, claiming that the Company and its subsidiary, VTS, had breached the terms of the former employees' VTS stock option agreements in its valuation of those options in the reorganization that preceded the Offering. The American Arbitration Association established arbitration to be held in April 2006. The Company believes that it has meritorious defenses and intends to continue to vigorously defend this matter. Even though litigation is inherently uncertain and it is possible that an adverse decision could be rendered, the Company anticipates resolution of this matter will not have a material effect on its consolidated financial statements.

The Company is involved, from time to time, in various other claims, legal actions and regulatory proceedings arising in the ordinary course of its business. Currently no material litigation is pending or, to the knowledge of the Company, threatened that will have a material adverse effect, either individually or in the aggregate, on the Company's consolidated financial condition, results of operations or liquidity.

The Company has collective bargaining agreements with Communications Workers of America ("CWA") and their Local 6171 and Local 7019. One of the Company's contracts with CWA, covering a majority of the represented employees from Local 6171 and all represented employees of Local 7019, expires on February 28, 2008. The second contract, covering employees of Kerrville Telephone Company, a fully owned subsidiary of the Company, was renegotiated in February 2006, when ratified, and will expire March 1, 2008. There is no material impact to our results of operations or liquidity as a result of the new agreement.

(11) Redeemable Preferred Interests

At December 31, 2004, the Company had two classes of Redeemable Preferred Interests: Class A and Class B. The carrying amount of the Redeemable Preferred Interests equals approximately the amount of cash that would be paid under the conditions specified in the Partnership Agreement if settlement of the Redeemable Preferred Interests had occurred at December 31, 2004. The Company was required to make an estimate of the fair value of the Redeemable Preferred Interests in order to determine the carrying value of the liability at December 31, 2004. The Redeemable Preferred Interests were not entitled to dividends and had no voting rights. The Redeemable Preferred Interest did, however, include a provision that entitles the holder to a return equal to the sum of (i) the initial contribution per interest, or $1.00 for Class A Preferred interests and $0.00 for Class B Preferred interests, and (ii) and appreciation amount calculated as interest on $1.00 per interest, at a rate of 20% per year, compounded quarterly upon the occurrence of a liquidation event or redemption. The appreciation amount defined in (ii) above is payable only after all holders of Class A common interests have received a return of their initial $1.00 capital investment. Under this provision, the maximum amount payable to holders of the Redeemable Preferred Interests at December 31, 2004 was $787,668. Since the return to be paid to preferred interest holders upon redemption would vary based upon the total value of the enterprise available to be distributed to holders of the Redeemable Preferred Interests, the fair value of this liability is determined based upon the enterprise value of the Company. As such, the Company did not record accretion on the Redeemable Preferred Interests. The Company has measured this liability at December 31, 2004 as the amount of cash that would be paid if settlement occurred at the reporting date in accordance with paragraph 22 of SFAS 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." Any change in the estimated fair value of Redeemable Preferred Interests in a reporting period would be recorded as interest expense. This requires the Company to make an estimate of its enterprise value at each reporting date to properly measure this liability. The Company concluded that this liability had been fairly stated at an amount equal to the initial contribution of $1.00 per

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

interest for all of the outstanding preferred interests. The Company recognized no changes in the fair value of the liability since inception.

On November 10, 2004, the Company refinanced its existing indebtedness resulting in the repayment of existing indebtedness and return of capital to investors, including $134,102 to holders of Redeemable Preferred Interests (see Note 6). In February 2005, the Company completed its Offering. Concurrent with the Company's Offering, the Company completed a reorganization resulting in the exchange of Redeemable Preferred Interests for common stock in Valor.

Information about the Redeemable Preferred Interests is as follows:

	December 31,	
	2004	2005
Class A: 500,000,000 interests authorized, 370,231,350 interests outstanding	$ 236,129	$ —
Class B: 29,305,106 interests authorized, 28,582,606 interests outstanding	—	—
Total Redeemable Preferred Interests	$ 236,129	$ —

In 1999, VTC authorized the issuance of 353,119,750 Class A Preferred interests and 22,505,106 Class B Preferred interests. On January 1, 2002, the LLC agreement for VTC was amended to reflect total authorized Class A Preferred interests of 500,000,000 and total authorized Class B Preferred interests of 29,305,106.

The Class A and Class B Preferred interests have no stated or par value. 365,733,249 of the Class A Preferred interests were issued for aggregate proceeds of $365,542 or approximately $1 per preferred interest. The balance of 4,498,101 Class A Preferred interests were issued to the founders of the Company in connection with the Company's formation in 1999. Additionally, 22,505,106 Class B Preferred interests were issued to the founders of the Company in connection with the Company's formation in 1999. No cash proceeds were received for the issuance of the founder's interests. No cash proceeds were received by the Company for the issuance of the Class B Preferred interests. 6,077,500 of the Class B interests were issued pursuant to the Valor Telecom Executive Incentive Plan in 2002 (see Note 15).

The number of Class B interests outstanding is as follows:

	December 31,	
	2004	2005
Total Class B preferred interests outstanding	28,582,606	—

(12) Stockholders' Equity

Concurrent with the Company's Offering, the Company completed a reorganization resulting in the exchange of common interests for common stock in Valor. The shares of common stock issued in connection with the Offering have the same voting and dividend rights.

The outstanding Class A common interests, Class B common interests, and Class C interests have no stated or par value. Each of the Class A common interests and Class C interests are entitled to one vote. Dividends may be paid based on certain restrictions related to the preferred interests. Any dividends must be paid in equal amounts on the Class A and Class B common interests out of proceeds associated with operations from sources other than VTS II. Dividends paid on the Class C interests must arise from earnings and profits attributable to the VTS II operations.

In the event of a liquidation of the VTS operations, the holders of the Class A common interests are entitled to $1.00 per interest, (or, if less, the amount of the related capital contribution paid for such interest),

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

after the effects of distributions (other than dividends) and share ratably with the Class B common interest holders in the remaining net assets available for distribution.

In the event of a liquidation of the VTS II operations, the holders of the Class C interests are entitled to $1.00 per interest, (or, if less, the amount of the related capital contribution paid for such interest), after the effects of distributions (other than dividends) and share ratably in the remaining net assets available for distribution.

On November 10, 2004, the Company refinanced its existing indebtedness resulting in $16,458 of redemption of Class C interests (see Note 6).

(13) Earnings Per Share

On February 9, 2005, the Company completed its Offering, registering 29,375,000 shares of common stock. Concurrent with the Offering, the Company issued 41,458,333 shares of common stock in exchange for all outstanding ownership interests in VTC and its subsidiaries outstanding prior to the offering and issuance of shares to management under the Long-Term Incentive Plan. As of December 31, 2005, the Company had 71,134,034 shares of common stock issued and 71,130,634 outstanding (net of treasury shares), including restricted shares issued to management and to the board of directors. The following tables set forth the computation of earnings per share:

	Common Stock 2005
Numerator:	
Net income for the period from February 9 to December 31, 2005	$ 28,796
Denominator:	
Weighted average common shares outstanding for purposes of computing basic EPS	69,368,333
Effect of unvested restricted stock	297,685
Total weighted average shares outstanding for purposes of computing diluted EPS	69,666,018
Basic EPS:	
Net income per common share	$ 0.42
Diluted EPS:	
Net income per common share	$ 0.41

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

	Class A and B Common Interests Year Ended December 31,			Class C Interests Year Ended December 31,		
	2003	2004	2005(1)	2003	2004	2005(1)
Numerator:						
Income (loss) from continuing operations	$ 51,267	$ (6,685)	$ 6,234	$ 6,858	$ (21,070)	$ 317
Net income (loss)	51,375	(6,685)	6,234	6,858	(21,070)	317
Denominator:						
Weighted average common interests outstanding	70,591,699	70,591,699	70,591,699	46,000,000	46,000,000	46,000,000
Basic and Diluted:						
Income (loss) from continuing operations	$ 0.73	$ (0.09)	$ 0.09	$ 0.15	$ (0.46)	$ 0.01
Net income (loss)	0.73	(0.09)	0.09	0.15	(0.46)	0.01

(1) Represents the period prior to the Company's Offering from January 1, 2005 through February 8, 2005.

(14) Supplemental Cash Flow Information

Cash payments for interest were $109,368, $113,536 and $73,997 for the years ended December 31, 2003, 2004 and 2005, respectively.

Cash payments for income taxes were $2,390 and $1,250 for the years ended December 31, 2003 and 2004, respectively. There were no cash payments for income taxes for the year ended December 31, 2005.

A note payable was issued for insurance policies of $3,770 and $3,479 during the years ended December 31, 2003 and 2004, respectively.

The Company entered into long-term capital leases of $1,949 and $863 for the purchase of vehicles for the years ended December 31, 2003 and 2004, respectively.

The Company recognized an intangible pension asset adjustment for $157 and ($24) for the years ended December 31, 2004 and 2005, respectively. The Company also has a minimum pension liability adjustment of $3,054, $414, and $1,528 for the years ended December 31, 2003, 2004 and 2005, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

In connection with the Offering, the Company redeemed all outstanding interests for 39,537,574 shares of Valor common stock and recorded a net deferred tax liability from the existing equity owners of VTC prior to becoming a federal corporate taxpayer as follows:

	DR (CR)
Class A common interests	$ 64,633
Class B common Interests	—
Class C interests	29,542
Redeemable preferred interests	236,129
Redeemable preferred interests in subsidiary	15,776
Deferred tax liability, net	(59,398)
Minority interest	468
Common stock	(4)
Additional paid-in capital	(533,675)
Treasury stock	(34)
Accumulated deficit	246,563

The Company issued 2,352,792 shares of restricted stock in the year ended December 31, 2005. The Company recorded $34,553 to deferred equity compensation with a corresponding offset to either common stock, additional paid-in capital or treasury stock (if issued from treasury stock). The Company recorded $12,699 of non-cash stock based compensation expense related to the issuance of restricted stock to management and the board of directors for the year ended December 31, 2005.

Concurrent with the Offering, the Company exchanged shares of Valor common stock with a value of $1,351 for all outstanding units under the Valor Telecom Executive Incentive Plan.

For the year ended December 31, 2005, certain unvested shares of restricted stock were forfeited. Restricted stock forfeitures of 224,806 shares for $3,372 were recorded as a reduction to deferred equity compensation with a corresponding offset to paid-in capital and treasury stock.

The company wrote off $555, $44,827 and $9,869 of unamortized debt issuance costs in connection with amendments of the credit facility for the year ended December 31, 2003, 2004 and 2005, respectively.

In December 2005, the Company declared a cash dividend of $25,138 that was payable in January 2006.

(15) Equity Based Compensation

Long-term incentive plan — In connection with the Offering in 2005, the Company approved the long-term incentive plan ("LTIP"). The LTIP provides for grants of stock options, restricted stock and performance awards. The Company's directors, officers and other employees and persons who engage in services for the Company are eligible for grants under the plan. The Company authorized 2,500,000 shares of the Company's common stock for issuance under the LTIP. The Company has only granted restricted stock under the LTIP. The following table summarizes information about restricted stock grants:

Restricted Stock	2005
Unvested balance, January 1, 2005	—
Grants	2,352,792
Exchange of outstanding units in Valor Telecom Incentive Plan	90,093
Vested shares	(459,811)
Forfeitures	(224,806)
Unvested balance, December 31, 2005	1,758,268

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The weighted average grant-date fair value of the restricted stock for the year ended December 31, 2005 is $14.69.

Equity Incentive Non-Qualifying Stock Options — In 1999, VTS (a majority-owned subsidiary of the Company) reserved 9,000,000 Class B common interests for issuance to employees of the Company in accordance with the Valor Telecommunications Southwest, LLC 2000 Equity Incentive Non-Qualifying Option Agreement ("the Plan"). The vesting period for these options ranges from immediate to five years and the options expire ten years after the date of grant. The weighted average remaining life of the options outstanding at December 31, 2004 was 5.8 years. The options were granted at the $1.00 stated price of the Class B common interests. The stated price was equivalent to the estimated fair value of the interests.

Stock Options	Number of Options*
Options outstanding, January 1, 2003	4,717
Options granted	465
Forfeited options	(60)
Options outstanding, December 31, 2003	5,122
Options granted	—
Forfeited options	(103)
Options outstanding, December 31, 2004	5,019
Options granted	—
Cancelled options	(5,019)
Options outstanding, December 31, 2005	—
Exercisable options at December 31, 2003	3,383
Exercisable options at December 31, 2004	4,287
Exercisable options at December 31, 2005	—

* number of options expressed in thousands

The fair value for each of the Company's options was estimated at the date of grant using a Black-Scholes option pricing model and the following weighted average assumptions for 2003:

	2003
Dividend yield	0%
Volatility factor	0
Risk-free interest rate	4.05%
Expected life in years	10

There were no option grants in 2004 or 2005.

In 2000, the Company granted an Equity Incentive Non-Qualifying Stock Option to one of its key executives in the amount of 300,000 Class A common interests and 1,700,000 Class A Preferred interests of VTC. The options vested immediately and were granted at a $1.00 stated price. The stated price is equivalent to the estimated fair value of the interests. This option was exercisable at December 31, 2003 and 2004.

Concurrent with the Offering, the Company terminated the Valor Telecom Executive Incentive Plan and cancelled all equity incentive non-qualifying stock options in Class B common interests. The Company

VALOR COMMUNICATIONS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

finalized the 2005 Long-Term Incentive Plan resulting in the issuance of restricted stock. The Company recorded expense as a result of the issuance of the restricted stock.

Phantom Stock Units — The Valor Telecom Executive Incentive Plan was implemented on April 1, 2002 and allowed for awards of up to 1,200,000 Class B common interests and 6,800,000 Class B Preferred interests (collectively, "Phantom Stock Units") to select executive employees of VTC and its subsidiaries. These interests allowed the selected executives to participate in the appreciation on a pro-rata basis with the Class A Preferred interests and Class A common interests held by the Equity Sponsors and Individual Investors. In accordance with FIN 28, "Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans," the amount by which the market value of these Phantom Stock Units exceeds the value specified under the plan is charged to compensation expense over the vesting period. Certain of the awards vested 20% immediately and 20% on January 1 for each of the following four years. The remaining awards vest evenly over five years from the date the award was granted. Unvested units are subject to cancellation upon expiration or termination of employment. Concurrent with the Offering, the Company valued the Phantom Stock Units, which resulted in a compensation charge of $1,345 for the year ended December 31, 2004. VTC issued 1,072,500 Class B Common units and 6,077,500 Class B Preferred units to the Executive Incentive Plan in 2002. These units were granted to Executives as follows:

	Number of Phantom Stock Units*	
	Class B Common	Class B Preferred
Units outstanding, January 1, 2003	1,073	6,078
Units granted	—	—
Forfeited units	—	—
Units outstanding, December 31, 2003	1,073	6,078
Units granted	—	—
Forfeited units	(15)	(85)
Units outstanding, December 31, 2004	1,058	5,993
Units granted	—	—
Exchanged units	(1,058)	(5,993)
Units outstanding, December 31, 2005	—	—
Vested units at December 31, 2003	395	2,236
Vested units at December 31, 2004	609	3,451
Vested units at December 31, 2005	—	—

* number of phantom stock units expressed in thousands

Concurrent with the Offering, the Company terminated the Valor Telecom Executive Incentive Plan and exchanged all Phantom Stock Units for shares of Valor common stock. The Company finalized the 2005 Long-Term Incentive Plan resulting in the issuance of restricted stock. The Company recorded expense as a result of the issuance of the restricted stock.

(16) Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and cash equivalents — The carrying amount approximates fair value because of the short maturity of these instruments.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

RTFC equity certificate — It is not practicable to estimate the fair value of this investment because there is no quoted market price.

Debt — The book value of the long-term debt for 2004 approximates the fair value due to the debt recapitalization in November 2004. The fair value of long-term debt for 2005 was estimated based on the Company's current incremental borrowing rate for debt of the same remaining maturities and quoted market prices.

	December 31, 2004		December 31, 2005	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term debt, including current maturities	$ 1,600,978	$ 1,600,978	$ 1,180,614	$ 1,196,614

Interest Rate Swap and Cap Agreements — The fair value of interest rate swaps is the estimated amount that the respective bank would receive or pay to terminate the swap agreements at the reporting date, taking into account current interest rates and the current credit worthiness of the swap counterparties. The estimated fair value of the Company's interest rate swap and cap agreements is as follows:

Instrument	Effective Date	Maturity Date	Notional Amount	Cap Rate or Pay Rate	December 31, 2005 Fair Value Asset
Interest rate cap	03/31/05	03/31/06	$450,000	5.0%	$ —
	03/31/06	03/30/07	50,000	5.0	53
	03/31/06	03/31/08	100,000	5.0	403
Interest rate swap	03/31/06	03/31/08	75,000	4.5	345
	03/31/06	03/31/08	75,000	4.6	310
	03/31/06	03/31/09	50,000	4.2	844
	03/31/06	03/31/10	100,000	4.7	177
	03/30/07	03/31/08	30,000	4.7	13
	03/31/08	03/31/09	180,000	4.3	816

(17) Risks and Uncertainties

Certain financial instruments potentially subject the Company to concentrations of credit risk. These financial instruments consist primarily of trade receivables and cash and cash equivalents.

The Company places its cash and temporary cash investments with high credit quality financial institutions and limits the amount of credit exposure to any one financial institution. The Company also periodically evaluates the credit worthiness of the institutions with which it invests. The Company does, however, maintain unsecured cash and cash equivalent balances in excess of federally insured limits.

The Company recorded revenue from the Texas Universal Service Fund of 20.7%, 20.1% and 19.8% of total revenue for the years ended December 31, 2003, 2004 and 2005, respectively. The Texas Universal Service Fund is administered by the Texas Public Utility Commission and any legislative change to this program could adversely impact the Company's results of operations and financial condition.

The Company currently outsources much of the billing function to Alltel. Although the Company may be exposed to risk of non-performance of Alltel and transitioning these services to another provider could take a significant period of time and involve substantial costs, the Company considers the risk to be remote. See Note 1 regarding proposed merger with Alltel.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(18) Related Party Transactions

The Company had the following transactions with related parties:

	Year Ended December 31,		
	2003	2004	2005
Issuance of additional note principal in lieu of cash interest payments to the sponsors for Subordinated Debt	$ 17,788	$ —	$ —
Payments to certain Individual Investors for their ownership interests and other expenses (see Note 20)	—	18,646	—
Interest expense to sponsors for Subordinated Debt	15,713	26,974	—
Management fees expensed to sponsors for advisory services	1,000	1,000	—
Various professional fees paid to certain sponsors and individual Investors	228	103	51
Revenue earned from wireless affiliates	489	483	506
Towers and office space lease payments to an employee	—	—	210

The Company had the following balances with related parties:

	December 31,	
	2004	2005
Receivable from wireless affiliates for management services and facility leases	$ 1,096	$ 1,580
Payable to the Sponsors for management fees	500	—

Under the terms of the CGKC&H partnership agreement, the general partners have designated the Company to act as the operating partner of CGKC&H. The agreement provides that the Company is to be reimbursed for all reasonable and necessary expenses incurred on behalf of CGKC&H. During 2003, 2004 and 2005, the Company was reimbursed approximately $958, $1,046 and $1,123, respectively, from CGKC&H for these services.

Effective January 1, 2005, the Company terminated the management agreement, whereby the Company had paid its sponsors management fees for advisory services.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(19) Restructuring Charges

In December 2002, the Company eliminated 81 positions as a result of a restructure in the Company's workforce. Remaining obligations, as a result of this event, comprise the beginning balance in this liability at January 1, 2003. The Company had a subsequent restructuring in December 2003, resulting in the elimination of 15 additional positions. The Company recorded $141 of expense for termination benefits for these 15 employees. In 2004, the Company announced workforce reductions of 99 employees. The Company recorded $625 of expense for termination benefits for these 99 employees. As of December 31, 2005, approximately $5 of the severance obligation remains and the Company expects this amount to be settled in 2006. The following table provides a reconciliation of the changes in the termination benefits obligation for the years ended December 31:

	Total Restructuring
Balance, January 1, 2003	$ 1,471
Termination benefits recorded in 2003	141
Payments in 2003	(1,428)
Balance, December 31, 2003	184
Termination benefits recorded in 2004	625
Termination benefits true-up	(19)
Payments in 2004	(658)
Balance, December 31, 2004	132
Termination benefits true-up	50
Payments in 2005	(177)
Balance, December 31, 2005	$ 5

(20) Significant Events

Agreement with Former Chief Executive Officer — On April 9, 2004, the Company entered into a new employment agreement with its former Chief Executive Officer ("CEO"). The new agreement replaces the existing employment agreement between the Company and the former CEO and is effective through March 31, 2007. Under the new agreement, the former CEO will be employed by the Company on a part-time basis and will serve on its board of directors as Vice-Chairman. In conjunction with the termination of the former CEO's prior employment agreement, the Company paid the former CEO a one-time cash payment of $5,000, which was recorded as expense and is included in "Selling, general and administrative" in the accompanying Consolidated Statements of Operations for the year ended December 31, 2004. As amended, the Company paid the CEO $750 in connection with the debt recapitalization (see Note 6) and agreed to pay an additional $750 on the earlier of either an initial public offering or the termination of his agreement on March 31, 2007. The Company paid the former CEO $750 in connection with the Offering.

Agreement with Individual Investors — On April 20, 2004, the Company entered into an agreement with a group of individual investors who own direct equity interests in the Company's majority-owned subsidiaries VTS, a Delaware limited liability company, and VTS II, a Delaware limited liability company. This agreement provided for the Company to purchase all of the outstanding equity interests of this group of the individual investors for $18,646 in cash. The Company made this cash payment to the group of investors on April 20, 2004. The purchase was accounted for under the guidance provided by SFAS No. 141 and FASB Technical Bulletin, 85-6. Accordingly, approximately $17,988 was allocated to expense and is included in "Other income and (expense), net" in the accompanying Consolidated Statements of Operations for the year ended December 31, 2004.

VALOR COMMUNICATIONS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Offering Costs — In April 2004, the Company filed Form S-1 with the Securities and Exchange Commission ("SEC") for the proposed offering of Income Deposit Securities. In connection with the offering, the Company incurred approximately $6,957 of offering costs. In the third quarter of 2004, the Company decided not to pursue the offering process and instead completed a debt recapitalization of all its existing debt. Upon making this decision, the Company recorded the $6,957 in offering costs as expense, which is included in "Other income and (expense), net" in the accompanying Consolidated Statements of Operations for the year ended December 31, 2004.

Debt Recapitalization — On November 10, 2004, the Company completed its debt refinancing and entered into a new $1,300,000 senior credit facility, consisting of a $100,000 senior secured revolving facility and a $1,200,000 term loan (see Note 6). At the same time, we entered into a $265,000 senior secured second lien and a $135,000 senior subordinated loan. In connection with the debt recapitalization, the Company recorded approximately $5,118 in compensation expense related to bonuses paid to executive management and others as a result of their efforts with the debt recapitalization and past services to the Company.

(21) Cumulative Effect of Change in Accounting Principle

In March 2005, the FASB issued FIN 47, "Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143," which clarifies the term *conditional asset retirement obligation* as used in SFAS 143. The term *conditional asset retirement obligation* refers to an obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. An obligation exists when a law, regulation or contract requires an entity to perform an asset retirement activity. The interpretation requires an entity to recognize a liability — generally upon acquisition, construction or development — for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. In circumstances where sufficient information is not available, the liability should be recognized in the period in which sufficient information becomes available to estimate its fair value. The Company adopted FIN 47 in the fourth quarter of 2005. As a result of the adoption, the Company recorded an asset retirement obligation related to chemically treated poles and certain other assets of $981 and a cumulative effect of accounting change of $269, net of tax of $156. If the provisions of FIN 47 had been followed prior to 2005, the Company's net income (loss) on a pro forma basis would have been as follows:

	Year Ended December 31,		
	2003	2004	2005
Net income (loss) as reported	$58,233	$(27,755)	$35,347
Cumulative effect of change in accounting principle for asset retirement obligations on prior years	(122)	(76)	190
Pro forma net income (loss)	$58,111	$(27,831)	$35,537
Earnings (loss) per owners' unit and common share:			
Basic and diluted net income (loss) as reported:			
Class A and B common interests	$ 0.73	$ (0.09)	$ 0.09
Class C interests	0.15	(0.46)	0.01
Common stock — Basic	—	—	0.42
Common stock — Diluted	—	—	0.41
Basic and diluted net income (loss) pro forma:			
Class A and B common interests	$ 0.73	$ (0.10)	$ 0.09
Class C interests	0.15	(0.46)	0.01
Common stock — Basic	—	—	0.42
Common stock — Diluted	—	—	0.42

VALOR COMMUNICATIONS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The asset retirement obligation on a pro-forma basis would have been as follows:

	December 31,		
	2003	2004	2005
Asset retirement obligation at January 1	$669	$ 825	$914
Liability incurred	127	91	18
Liability settled	(18)	(106)	(11)
Accretion expense	47	104	60
Asset retirement obligation at December 31	$825	$ 914	$981

(22) Quarterly Data (unaudited)

	Quarter Ended			
	March 31	June 30	September 30	December 31
Fiscal Year 2005				
Operating revenues	$ 125,926	$ 126,068	$ 127,960	$ 125,940
Operating income	37,633	44,881	41,330	43,200
Income (loss) from continuing operations before cumulative effect of change in accounting principle	(12,636)	18,242	13,321	16,689
Net income (loss)	(12,636)	18,242	13,321	16,420
Earnings (loss) per common share and owners' unit:				
Basic and diluted income (loss) from continuing operations:				
Class A and B common interests	$ 0.09	$ —	$ —	$ —
Class C interests	0.01	—	—	—
Common stock	(0.28)	0.26	0.19	0.24
Basic and diluted net income (loss):				
Class A and B common interests	$ 0.09	$ —	$ —	$ —
Class C interests	0.01	—	—	—
Common stock	(0.28)	0.26	0.19	0.24

	Quarter Ended			
	March 31	June 30	September 30	December 31
Fiscal Year 2004				
Operating revenues	$ 125,852	$ 126,796	$ 126,631	$ 128,031
Operating income	45,516	44,948	46,020	40,637
Income (loss) from continuing operations	15,614	3,291	6,266	(52,926)
Net income (loss)	15,614	3,291	6,266	(52,926)
Earnings per owners' unit:				
Basic and diluted income (loss) from continuing operations:				
Class A and B common interests	$ 0.20	$ 0.21	$ 0.13	$ (0.64)
Class C interests	0.03	(0.25)	(0.07)	(0.17)
Basic and diluted net income (loss):				
Class A and B common interests	$ 0.20	$ 0.21	$ 0.13	$ (0.64)
Class C interests	0.03	(0.25)	(0.07)	(0.17)

In the first quarter of 2005, the Company completed the Offering and amended its senior credit facility. Expenses related to the Offering that were recorded in the three months ended March 31, 2005 include the following:

- $29,262 in fees and expenses associated with the Company's repayment of existing indebtedness, including write-off of certain deferred debt costs, prepayment premiums and breakage fees;
- $1,693 in compensation expense for the portion of cash transaction bonuses that were paid to members of the Company's management team; and
- $6,387 in compensation expense for restricted shares issued to members of the Company's management team.

In the third quarters of 2005 and 2004, the Company recorded impairment charges of $2,339 and $6,678, respectively, related to its unconsolidated cellular partnerships (see Note 5 for further information).

In the fourth quarter of 2005, the Company incurred $3,306 of costs related to its pending merger with Alltel.

In the second quarter of 2004, the Company made a transition payment of $5,000 to its Chief Executive Officer and expensed $17,988 due to the purchase of substantially all outstanding equity interests from a group of individual investors in connection with its reorganization (see Note 20 for further information).

In the third quarter of 2004, the Company expensed $6,957 of offering costs as a result of our decision to not pursue the previously planned public offering of income deposit securities (see Note 20 for further information).

In the fourth quarter of 2004, the Company recorded a $62,975 loss on extinguishment of debt and recorded approximately $5,118 in compensation expense related to bonuses paid to executive management and others as a result of their efforts to complete the debt recapitalization and their past service to Valor (see Note 20 for further information).

VALOR COMMUNICATIONS GROUP, INC.

SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS

Description	Balance at Beginning of Period	Additions: Charged to Costs and Expenses	Additions: Charged to Other Accounts	Deductions(1)	Balance at End of Period
		(Dollar in thousands)			
Year ended December 2003					
Allowance for doubtful accounts — customers	$ (3,997)	$ (3,160)	$ —	$ 4,485	$ (2,672)
Allowance for doubtful accounts — carriers and other	(793)	(138)	—	279	(652)
Total	$ (4,790)	$ (3,298)	$ —	$ 4,764	$ (3,324)
Year ended December 2004					
Allowance for doubtful accounts — customers	$ (2,672)	$ (4,242)	$ —	$ 5,081	$ (1,833)
Allowance for doubtful accounts — carriers and other	(652)	(196)	—	(33)	(881)
Total	$ (3,324)	$ (4,438)	$ —	$ 5,048	$ (2,714)
Year ended December 2005					
Allowance for doubtful accounts — customers	$ (1,833)	$ (5,609)	$ —	$ 5,380	$ (2,062)
Allowance for doubtful accounts — carriers and other	(881)	(464)	—	391	(954)
Total	$ (2,714)	$ (6,073)	$ —	$ 5,771	$ (3,016)

(1) Deductions represent write-offs net of recoveries.