

March 27, 2008

United States of America

FairPoint Communications (FRP - US\$ 9.99) 1-Overweight

Company Update

Debt Priced, 3/31 Close on Track

Telecommunications
Telecom Services - Wireline

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Investment Conclusion

□ Last night, FRP announced its \$550M senior notes priced with a coupon of 13 1/8. Although this is roughly 200 bps above FRP's previous estimate, the higher coupon only reduces our '08 FCF estimate by 3%. We view this debt pricing as a positive given that it appears very likely that the transaction will close by the 3/31 target. Despite the drawn-out close (3/31 from 1/31) and reduced dividend (10% from 15%), we continue to believe this transaction is attractive for LT shareholders as it lowers FRP's leverage (to 3.5x from 5.0x), the payout ratio (to 45% from 90%) and increases the stock's liquidity (market cap to \$1B from \$0.4B).

Summary

- Following the 3/31 close, we expect potential FRP selling by VZ holders (60% shareowners) to be orderly for 3 reasons:
 - 1) Many would be FRP investors have been sitting on the sidelines waiting for this overhang to pass.
 - 2) Following its spin from AT, we believe WIN outperformed due to its 8.5% dividend yield. We believe FRP's 10% yield will provide similar support.
 - 3) We expect net index buying of FRP.

Stock Rating

New:	1-Overweight	Target Price	New:	US\$ 22.00
Old:	1-Overweight		Old:	US\$ 22.00

Sector View: 1-Positive

EPS (US\$) (FY Dec)

	2007		2008		2009		% Change		
	Actual	Old	New	St. Est.	Old	New	St. Est.	2008	2009
1Q	0.00A	-0.10E	-0.01E	0.11E	N/A	N/A	0.00E	0%	N/A
2Q	0.88A	0.15E	0.15E	0.10E	N/A	N/A	0.00E	-83%	N/A
3Q	-0.15A	0.16E	0.16E	0.10E	N/A	N/A	0.00E	207%	N/A
4Q	-0.56A	0.14E	0.14E	0.08E	N/A	N/A	0.00E	125%	N/A
Year	0.17A	0.44E	0.44E	0.48E	N/A	0.68E	0.36E	159%	55%
P/E			22.7			14.7			

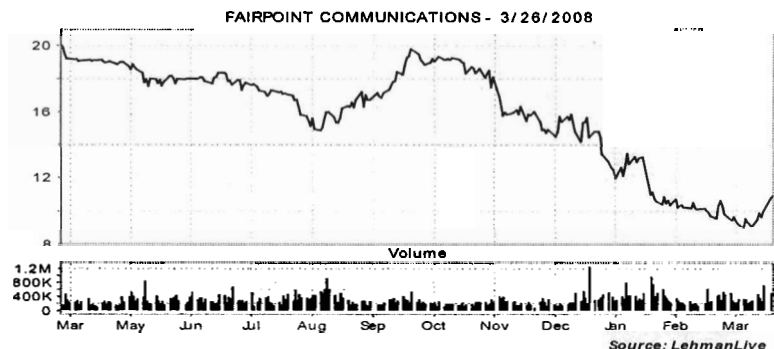
Market Data

Market Cap (Mil.)	350
Shares Outstanding (Mil.)	35.00
Float (%)	95
Dividend Yield	15.00
Convertible	No
52 Week Range	20.32 - 8.55

Financial Summary

Revenue FY08 (Mil.)	274.0
Five-Year EPS CAGR	5.0
Return on Equity	N/A
Current BVPS	N/A
Debt To Capital (%)	50.00

Stock Overview



Last night, FRP announced its \$550M senior notes priced with a coupon of 13 1/8. Although this is roughly 200 bps above the company's previous estimate, the higher coupon only has an annual cash impact of \$7M (just 3% of Leh FCF estimate). Despite the higher rate, we view this debt pricing as a positive given that it appears very likely that the transaction will close by the March 31st target.

Despite the drawn-out close (March 31st from January 31st) and reduced dividend (10% yield from 15%), we continue to believe this transaction is attractive for long-term shareholders as it lowers FRP's leverage (to 3.5x from 5.0x), the payout ratio (to 45% from 90%) and increases the stock's liquidity (market cap to \$1B from \$0.4B). We estimate FRP's post-close EV/EBITDA is roughly 5.0x (vs. IWA 8.3x) and its FCF yield is over 22% (vs. IWA 11%).

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Lehman Brothers is acting as financial advisor to FairPoint Communications, Inc. on a merger with a subsidiary of Verizon Communications Inc., which includes Verizon wireline operations in Maine, New Hampshire, and Vermont.

We Expect Orderly VZ Selling

The transaction is set to close on March 31st. On that day Verizon (VZ) shareholders will receive roughly 1 share of FRP for each 53.22 shares of VZ owned. VZ shareholders will own 60% of FRP. We expect potential VZ selling of FRP to be orderly for three reasons:

- 1) We believe many investors that have become interested in FRP recently have been sitting on the sidelines waiting for this overhang to pass.
- 2) We believe the experience of Windstream (WIN), which was spun-off from Alltel, is more applicable than Embarq (EQ), which was spun-off from Sprint. Following its spin from AT, shares of WIN outperformed vis-à-vis EQ following its spin from S. In our view, WIN's higher dividend yield (8.5% vs. EQ 4.5%) helped support the stock. We believe FRP's attractive 10% dividend yield will also provide similar support.
- 3) We expect net index buying. According to Lehman Index and Portfolio Analyst Gabriela Baez, S&P will add FRP to the S&P 600 and Russell will increase the weight of FRP in the Russell 2000. She estimates there will be a net buy of 9.01M shares of FRP (or 24.3 times the avg. volume). See her 3/26 bullets below.

Index Analysis - Gabriela Baez, CFA - Index & Portfolio Analysis "Verizon Communications (VZ) Spin-off/Merger of Certain Assets with FairPoint Communications (FRP), Effective March 31, 2008" (3/24/08).

Distribution Logistics: VZ will trade with due bills representing the spin-off between the March 7 record date and the March 31 distribution date (i.e., VZ shareholders who sell their shares before the pay date will also sell their right to receive the spin-off). FRP when-issued (FRP-w) and VZ ex-distribution (VZ-w) listed on March 5. Regular-way trading will begin on April 1. 1 VZ = 1 VZ-w + 0.0188 FRP-w (terms approx.)

- **Dividend:** FRP declared a dividend of \$0.39781 per share, payable on April 16 to shareholders of record on March 30. The NYSE has set a tentative ex-dividend date for April 1. VZ shareholders who receive FRP-w shares and purchasers of FRP-w (in the when issued market) will not be entitled to receive this dividend. (1 FRP = 1 FRP-w + \$0.39781).
- **Index Summary:** S&P will add FRP to the S&P 600, Russell will increase the weight of FRP in the Russell 2000 and MSCI will not add FRP-w to the World index. Overall, we estimate there will be a net buy of 9.01 million shares of FRP (or 24.31 times the avg. volume) and a net sell of 7.33 million shares of FRP-w. Note that due to the dividend, FRP and FRP-w are not equal in value.
- **S&P Impact:** S&P will add FRP to the S&P 600 on March 31. We estimate S&P 500 managers will receive 5.58 million shares of FRP-w through their ownership of VZ that they will need to sell and S&P 600 managers will need to buy 5.58 million shares of FRP. Note that S&P will use the regular way price of FRP to add it to the S&P 600, but should use the when issued price (FRP-w) to adjust the price of VZ in the S&P 500.
- **Russell Impact:** Russell will maintain FRP in the Russell 2000 with increased weight. Consequently, we estimate Russell 1000 managers will need to sell all 1.31 million shares of FRP-w received through their ownership of VZ and Russell 2000 managers will need to buy an additional 3.44 million shares of FRP. Russell 3000 managers should receive the necessary shares of FRP through their ownership of VZ. Note that Russell will use the when issued price of FRP-w to adjust the price of VZ in the index.
- **MSCI World Impact:** MSCI will not add FRP-w to the MSCI World index at this time due to low market cap. We estimate index managers will need to sell all 434,500 shares of FRP received through their ownership of VZ. Note that MSCI will apply the change effective at the close on April 1 instead of March 31 like S&P and Russell.

Figure 2: Index Movements

Index	VZ Shares Held	FRP Shares Held	FRP-w Received from Spin	FRP Needed	FRP to Buy *	FRP-w to Sell *	Expected Weight of FRP (bps)	Expected Index Action
SP500	297,143,843	0	5,583,280	0	0	-5,583,280	0.00	FRP-w not added to S&P 500
SP600	0	0	0	5,577,438	5,577,438	0	18.62	FRP added to S&P 600
Russell 1000	69,680,736	0	1,309,289	0	0	-1,309,289	0.00	FRP-w not added to R1000
Russell 2000	0	2,219,742	0	5,656,644	3,436,902	0	8.03	FRP share increase in R2000
MSCI World	23,122,616	0	434,470	0	0	-434,470	0.00	FRP not added to MSCI World **
Net to Buy/Sell					9,014,340	-7,327,039		
Average Volume					370,873	n/a		
Liquidity (Days)					24.31	n/a		

*1 VZ = 1 VZ-w + 0.0188 FRP-w, 1 FRP = 1 FRP-w + \$0.39781

**MSCI will apply the index change effective at the close on April 1

Note: Assumes S&P 500 managers own 10.35%, S&P 600 managers own 6.25%, Russell 1000 managers own 3.5%, Russell 2000 managers own 7.4%, and MSCI managers own 0.8% of the float of every index member.

Source: Lehman Brothers, Standard and Poor's, MSCI, Bloomberg

Lehman Updated Pro-Forma Model

Figure 2: FairPoint Model

26-Mar-08 \$10.52	FRP Stand-Alone			FRP + Spinco Pro-Forma								2010-'15E CAGR
	2006A	2007E	2008E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	
Access Lines	252	238	228	1,494	1,394	1,314	1,262	1,220	1,184	1,153	1,127	-3%
yoy change	-3.4%	-0.6%	-4.4%	-7.5%	-6.7%	-5.7%	-4.0%	-3.3%	-3.0%	-2.6%	-2.2%	
DSL	59	68	74	337	377	406	430	443	454	461	469	3%
penetration	24%	28%	33%	23%	27%	31%	34%	36%	38%	40%	42%	
Revenue	270	283	274	1,427	1,382	1,345	1,314	1,296	1,283	1,273	1,265	-1%
Adj. EBITDA	133	126	127	608	624	628	620	611	603	595	586	-1%
margin	49%	44%	46%	43%	45%	47%	47%	47%	47%	47%	46%	
Operating Income	61	16	66	227	296	331	330	327	325	322	320	-1%
EPS	\$0.89	\$0.17	\$0.44	\$0.23	\$0.73	\$1.01	\$1.07	\$1.15	\$1.27	\$1.42	\$1.61	10%
Adj. EBITDA	133	126	127	608	624	628	620	611	603	595	586	-1%
- Int. Expense	(38)	(39)	(40)	(203)	(199)	(195)	(191)	(187)	(183)	(179)	(175)	
- Cash Taxes	(2)	(2)	(1)	(12)	(40)	(55)	(56)	(56)	(57)	(57)	(58)	
- Capex	(33)	(29)	(28)	(190)	(180)	(171)	(164)	(162)	(160)	(159)	(158)	
CAPD	77	60	56	203	206	207	209	206	203	199	195	-1%
Cumulative CAPD	45	49	50	111	225	340	462	586	713	844	979	
Debt	608	604	649	2,231	2,181	2,131	2,081	2,031	1,981	1,931	1,881	
- Cash	4	3	7	11	0	65	62	61	63	69	79	
= Net Debt	604	601	642	2,220	2,181	2,066	2,019	1,970	1,918	1,862	1,802	-3%
/ EBITDA	4.6x	4.8x	5.1x	3.7x	3.5x	3.3x	3.3x	3.2x	3.2x	3.1x	3.1x	
Shares	35	35	35	89	89	89	85	80	73	66	59	
Ent. Value	970	969	1,008	3,156	3,117	3,002	2,916	2,808	2,686	2,556	2,421	
/ EBITDA	7.3x	7.7x	7.9x	5.2x	5.0x	4.8x	4.7x	4.6x	4.5x	4.3x	4.1x	
Dividend	36	36	36	92	92	92	88	82	75	68	61	
Div / CAPD	46%	60%	63%	45%	45%	44%	42%	40%	37%	34%	31%	

Source: Lehman Brothers Estimates and Company Reports

Analyst Certification:

We, Thomas O. Seitz and Patrick B. Rien, hereby certify (1) that the views expressed in this research Company Note accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Company Note and (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Company Note.

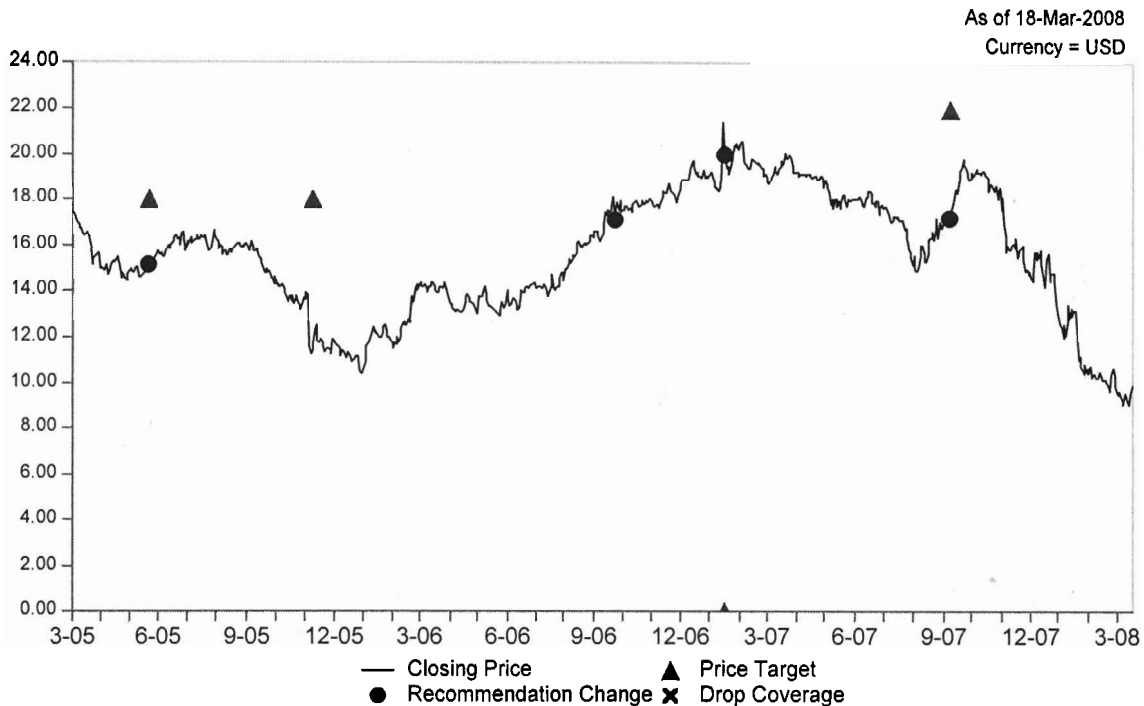
Important Disclosures:

FairPoint Communications (FRP)
Rating and Price Target Chart:

US\$ 9.99 (20-Mar-2008)

1-Overweight / 1-Positive

FAIRPOINT COMMUNICATIONS INC.



Source: FactSet

Currency=US\$

Date	Closing Price	Rating	Price Target
07-Sep-07	17.15		22.00
07-Sep-07	17.15	1 -Overweight	
17-Jan-07	19.94		0.00
17-Jan-07	19.94	RS -Rating Suspended	

Date	Closing Price	Rating	Price Target
22-Sep-06	17.05	2 -Equal weight	
09-Nov-05	11.42		18.00
23-May-05	15.15		18.00
23-May-05	15.15	1 -Overweight	

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Valuation Methodology: Our FRP price target is based on a comparable dividend yield analysis of 7.2%. It is supported by an EV/EBITDA multiple analysis of 9.0x, which is a premium to the comps (8.0x) due to our view that the pending acquisition of Verizon's Northeast businesses will improve the company's operating metrics and financial flexibility. Our PT is also supported by a DCF analysis, which assumes a WACC of 7% and a terminal growth rate of 0.5%.

Risks Which May Impede the Achievement of the Price Target: A sharp rise in interest rates could reduce the attractiveness of FairPoint's dividend stream. FRP could see additional access line losses as a result of competition and increased usage rates. Regulated or legislated changes to the current framework could materially impact revenues and margins, the pending acquisition of Verizon NE businesses could get terminated or not produce the expected results.

Other Material Conflicts: Lehman Brothers is acting as financial advisor to FairPoint Communications, Inc. on a merger with a subsidiary of Verizon Communications Inc., which includes Verizon wireline operations in Maine, New Hampshire, and Vermont.

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Company Name	Ticker	Price (20-Mar-2008)	Stock / Sector Rating
FairPoint Communications	FRP	US\$ 9.99	1-Overweight / 1-Positive

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Cogent Communications Group (CCOI)	Consolidated Communications (CNSL)
Embarq (EQ)	FairPoint Communications (FRP)
Iowa Telecommunications (IWA)	Qwest Commu Int'l (Q)
SAVVIS, Inc. (SVVS)	Telephone & Data Systems (TDS)
Time Warner Telecom (TWTC)	Verizon Communications (VZ)
Windstream Corporation (WIN)	

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