

STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

DT 07-011

JOINT PETITION BY VERIZON NEW ENGLAND, INC., ET AL.
AND FAIRPOINT COMMUNICATIONS, INC.
TRANSFER OF NEW HAMPSHIRE ASSETS OF
VERIZON NEW ENGLAND, INC. ET AL.

PREFILED REBUTTAL TESTIMONY OF WILLIAM E. KING
ON BEHALF OF
FAIRPOINT COMMUNICATIONS, INC.

SEPTEMBER 10, 2007

Summary: Mr. King's testimony provides an analysis of FairPoint's financial projections prepared in connection with the proposed transaction. Mr. King supports FairPoint's business model, concluding that FairPoint's assumptions and projections are reasonable, and provides a response to critiques of CWA/IBEW witness Randy Barber.

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Mr. King Sponsors the Following Exhibits:

- | | |
|---------------|---|
| Exhibit WEK-1 | Analysis of FairPoint Financial Projections (<i>Highly Confidential</i>) |
| Exhibit WEK-2 | Lehman Brothers, Equity Research Report,
September 7, 2007 (<i>Confidential</i>) |

Introduction

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Q. Please state your name and business address.

A. My name is William E. King. My office is located at 66 Hanover Street, Suite 300,
Manchester, New Hampshire 03106

Q. What is your position and by whom are you employed?

A. I am the president and managing principal of JSI Capital Advisors, LLC and JSI
Transaction Advisors, LLC

Q. Please provide your educational background and professional experience.

A. I received a Bachelor of Arts with a concentration in economics and a Bachelor of
Science in Business Administration with a concentration in accounting from the
University of Maryland in 1981. In 1988, I received a Master of Science in Taxation
from the American University. I am a Certified Public Accountant accredited in business
valuation and hold a Series 24 (general securities principal) and Series 7 (general
securities representative) license with FINRA. I am also a candidate for accreditation as
an Accredited Senior Appraiser with the American Society of Appraisers and a registered
investment advisor licensed in the State of New Hampshire.

I began my career in 1981 as an audit staff accountant in the Washington, DC office of
Price Waterhouse & Co. I worked at Price Waterhouse for nine years eventually leaving
in 1990 as a Tax Senior Manager.

1 In 1990, I was hired as vice president of finance and chief financial officer of Stoner
2 Broadcasting System, Inc., an Annapolis, Maryland-based holding company which at the
3 time held ownership interests in commercial radio broadcast properties throughout the
4 United States and the United Kingdom. In 1994, Stoner Broadcasting System, Inc. was
5 sold to a group that would eventually form American Radio Systems, Inc.

6 During 1994, I provided independent acquisition-related services to entrepreneurial
7 owners of commercial radio properties. During this time, I also provided contract-based
8 consulting services to John Staurulakis, Inc., a Greenbelt, Maryland-based
9 telecommunications consulting firm. In late 1994, I joined John Staurulakis, Inc. as its
10 Director of Financial Services. During the period 1994 through 1998, my responsibilities
11 focused on providing strategic transaction advisory services to clients of John
12 Staurulakis, Inc. This included assisting with the purchase or sale of communications
13 properties including rural local exchange carriers, wireless properties and cable
14 properties.

15 In 1998, I partnered with certain of the principal owners of John Staurulakis, Inc. to form
16 JSI Capital Advisors, LLC. We opened an office in Manchester, New Hampshire in
17 1999. JSI Capital Advisors, LLC provides transaction advisory services to the owners
18 and management of rural and independent communications providers located throughout
19 the country. JSI Capital Advisors, LLC also provides valuation and research services to
20 the communications industry and publishes a series of industry newsletters focused on the
21 rural telephone and wireless industries.

1 I also serve as president of JSI Transaction Advisors, LLC, a wholly-owned subsidiary of
2 JSI Capital Advisors, LLC licensed in various states as a broker/dealer.

3 **Q.** On whose behalf are you testifying?

4 **A.** I am testifying on behalf of FairPoint Communications, Inc. (“FairPoint”).

5 **Purpose of Testimony and Summary of Analysis**

6 **Q.** What is the purpose of your testimony?

7 **A.** FairPoint has asked that I provide testimony regarding the reasonableness of certain
8 financial projections (the “NNE Projections”) prepared in connection with FairPoint’s
9 proposed transaction to merge with Verizon’s Northern New England properties (the
10 “NNE Properties”). The NNE Projections cover the period 2008 through 2015 (the
11 “Projection Period”). I have also been asked to respond to various assertions contained in
12 the direct and super confidential testimonies of Mr. Randy Barber (“Mr. Barber”), which
13 were filed on behalf of the Communications Workers of America and International
14 Brotherhood of Electrical Workers.

15 **Q.** Please summarize the manner in which you performed your analysis.

16 **A.** My analysis entailed performing an analytical review of the NNE Projections. My
17 review included an analysis of historical margin and per unit performance trends
18 demonstrated by Verizon, the NNE Properties, FairPoint and selected “guideline
19 companies.” I then compared observed historical margin and per unit trends to forecasted

1 performance reflected in the NNE Projections in order to gauge the overall
2 reasonableness of the underlying assumptions and resulting conclusions of the NNE
3 Projections. The results of my review are reflected in a series of twenty-four tables to
4 which I refer throughout my testimony. I have attached those tables as Highly
5 Confidential Exhibit WEK-1.

6 **Q.** Please summarize your overall assessment of the NNE Projections?

7 **A.** I believe the NNE Projections are reasonable and support the transaction as proposed.
8 My analysis revealed that the critical assumptions underlying the NNE Projections are
9 supportable and within the range of the observed historical performance of selected
10 guideline companies. In fact, I believe there is a reasonable opportunity for FairPoint to
11 outperform the projections, providing additional “cushion” for the overall plan and
12 serving as the basis for my assertion that the NNE Projections might be conservative.

13 **Guideline Companies**

14 **Q.** You reference certain “guideline companies.” What do you mean by that term?

15 **A.** The term “guideline companies,” also referred to as “comparable companies,” is a term
16 used in the financial and valuation professions to describe companies whose operations
17 and/or operating characteristics (e.g., industry, size, product mix, etc.) are deemed
18 reasonably comparable to those of the subject company. Because of their perceived
19 comparability, they provide observable historical operating metrics which provide a

1 “guideline” for defining, among other factors, reasonable expectations of future
2 performance.

3 **Q.** What “guideline companies” did you select for the purpose of your analysis? What
4 factors were considered in making your selection?

5 **A.** Access to adequate and verifiable financial information is critical, which practically
6 limits the population of potential guideline companies to those that file periodic financial
7 statements with the Securities and Exchange Commission. Table 1.1 lists companies that
8 have significant wireline telephone operations and whose stock is traded on the New
9 York Stock Exchange, American Stock Exchange, NASDAQ or over-the counter. In
10 addition to FairPoint’s existing operations, I selected Iowa Telecom (“IWA”),
11 Consolidated Communications (“CNSL”), Alaska Communications Systems (“ALSK”),
12 Citizens Communications (“CZN”), CenturyTel (“CTL”), Valor Communications
13 (“VCG”) and Windstream Communications (“WIN”) as guideline companies. In order to
14 generate a more comprehensive indication of the range of possible future performance, I
15 selected a cross section of companies whose operations I considered comparable to either
16 FairPoint’s existing operations or the post-acquisition NNE Properties. IWA, CNSL,
17 ALSK and VCG were selected because those companies were of comparable size to
18 FairPoint’s existing operations and shared comparable business and financing models.
19 CZN, CTL and WIN were selected because those companies had size and operational
20 characteristics deemed comparable to the post-acquisition NNE Properties. Other
21 companies listed on Table 1.1 were considered but dismissed due to factors such as the

1 size of their operations, their product mix, or their underlying business and financing
2 model.

3 **Q.** Describe how the observed historical performance of the selected guideline companies
4 was used to assess the reasonableness of the NNE Projections.

5 **A.** I used the observed historical performance of the selected guideline companies to develop
6 a “guideline” for reasonable future performance at the NNE Properties. My analysis
7 included a review of guideline company operating metrics during the period 2004
8 through the first quarter of 2007. Operating metrics assessed included 1) operating cash
9 flow margins, 2) operating income margins, 3) revenue per access line, 4) operating
10 expense per access line, 5) revenue per connection, 6) operating expense per connection,
11 7) capital expenditure (“CAPEX”) margins, 8) CAPEX/depreciation, 9) CAPEX per
12 access line, 10) CAPEX per connection, 11) DSL Penetration and 12) long distance
13 penetration.

14 **Q.** Summarize the results of your guideline company analysis.

15 **A.** Tables 4.1 through 4.4 summarize observed historical operating performance and metrics
16 for the selected guideline companies. Tables 4.7 through Table 4.12 consolidates
17 observed performances by metric and summarizes the range, mean and median of
18 observed metrics. I then compared the range of observed metrics to the range of
19 projected metrics implicit in the NNE Projections. As summarized in Tables 4.5 and 4.6,
20 projected operating metrics implicit in the NNE Projections compare favorably with
21 benchmark metrics observed based on guideline company performance.

1 **Approach to Determining Reasonableness of Projections**

2 **Q.** Mr. Barber characterizes FairPoint’s operating expense projections as “optimistic”¹ and
3 “rosy.”² Based on your guideline company analysis, do you agree?

4 **A.** No. In my assessment operating expense projections reflected in the NNE Projections are
5 reasonable. In fact, I believe there is some opportunity for FairPoint to outperform the
6 operating expense assumptions reflected in the NNE Projections.

7 **Q.** Mr. Barber has called into question the usefulness of the NNE Projections, citing the
8 inability to use the model to perform sensitivity analyses. How do you respond to these
9 assertions and how did your analysis compensate for limitations inherent in the NNE
10 Projections.

11 **A.** My analysis concentrated on assessing the reasonableness of the future operating results
12 implied by the NNE Projections, not the manner in which the projection model was
13 constructed or its resulting functionality. When it comes to building financial models,
14 reasonable people can - and in my experience typically do - disagree on form, function
15 and design preferences. By no means belittling the significance of the tool used to arrive
16 at projected results, the relevance of the exercise is not the journey but, rather, the
17 destination. Like other witnesses, I agree that one could have approached the
18 construction of a base model differently. Having said that, the objective of my analysis

1 See, for example, Direct Testimony of Randy Barber - Confidential, p. 5, ln. 17. and p. 43, ln. 5.
2 Id, p. 5, ln. 18.

1 was not an assessment of the model itself but, rather, a determination of whether the
2 results implied by the NNE Projections were reasonable.

3 My approach entailed comparing projected operating results of the NNE Properties as
4 implied by the NNE Projections to the observed historical operating performance of
5 selected guideline companies. This is a fundamentally different approach than that
6 employed by, for example, Mr. Barber who reviewed increases in historical operating
7 expenses on a total and per unit basis using Verizon's and FairPoint's historical operating
8 results as a base. My approach entailed comparing projected per line cost information
9 reflected in the NNE Projections to similar information generated based on an analysis of
10 the historical performance of selected guideline companies. I preferred this approach
11 because it excludes costs such as, for example, corporate overhead allocations that were
12 implicit in the base numbers and it defined reasonable cost levels based on observed
13 market data rather than by the growth of less relevant historical data.

14 While Mr. Barber has expressed frustration regarding the ability to use the model for the
15 purpose of performing sensitivity analyses, he has nonetheless done precisely that, albeit
16 by developing his own sensitivity analyses. For example, Mr. Barber ran a sensitivity
17 analysis assuming a 2 percent growth in operating expenses, finding that it is "highly
18 likely that FairPoint will not have sufficient cash to meet its capital investment and
19 operational needs, unless it drastically reduces its dividend payments."³ Mr. Barber's
20 conclusion demonstrates one of the principal dangers of spreadsheet-based modeling –
21 the assumption that isolated changes in inputs result in one-dimensional effects rather

1 than a myriad of dynamic consequences. Under most normal circumstances, an
2 unanticipated 2 percent growth in operating expenses over a seven-year period would
3 reasonably elicit corrective measures by management.

4 The manner in which I approached my analysis, by developing ranges of observed
5 historical operating metrics, essentially incorporates a sensitivity analysis based on where
6 metrics reflected in the NNE Projections align within each observed range. The question
7 is, can we consider as reasonable the assumptions implicit in the NNE Projections, which
8 by its result evidences the financial viability of the transaction. As I have already stated,
9 I believe they are.

10 **Q.** What do you mean by “less relevant historical data”?

11 **A.** Going forward, the capital markets will gauge FairPoint’s success in operating the NNE
12 Properties based, in part, on an analysis of FairPoint’s operating metrics, including costs
13 per access line, when compared to the performance of its peers. The market will quickly
14 dismiss as irrelevant the historical per line performance of Verizon. To enhance its
15 access to capital, FairPoint will strive to maintain operating expenses per access line at
16 levels in line with, or better than, its peers. This is good business practice and is
17 consistent with the “guideline company” approach I have taken in my overall analysis.

18 The historical performance of the NNE Properties under Verizon’s ownership is, in my
19 opinion, less relevant than historical guideline company data for two principal reasons.

³ Id., p. 42, ln. 15.

1 First, I do not believe the market will view Verizon as a company whose operations are
2 sufficiently comparable to FairPoint such that a comparison of the two companies'
3 operating metrics would be particularly instructive. Rather, I expect that FairPoint will
4 be evaluated against the performance of certain of the selected guideline companies,
5 particularly Citizens Communications, Windstream and CenturyTel.

6 Second, the presence of significant allocated corporate overhead and other charges
7 impairs the usefulness of Verizon's historical data. I understand that FairPoint will not
8 inherit any of the costs reflected in Verizon's allocated overhead and, instead, will only
9 be responsible for the direct costs of the NNE Properties plus its own new overhead to
10 cover the costs to replace the allocated services previously provided by Verizon. I also
11 understand that the direct costs of the NNE Properties declined at an average annual rate
12 of 1.8 percent during the period 2003 through 2006. In my opinion more relevant and
13 instructive data is provided from an analysis of peer company performance.

14 **Post-Acquisition Cost Savings**

15 **Q.** You have stated that the presence of significant allocated corporate overhead and other
16 charges impairs the usefulness of Verizon's historical data. Hasn't FairPoint identified
17 between \$60 and \$75 million of post-acquisition cost savings that, when removed from
18 historical data, reflects FairPoint's view of necessary cost levels on a going forward
19 basis? What does your analysis say about the reasonableness of FairPoint's assumption
20 regarding post-acquisition cost savings?

1 A. It provides support for the reasonableness of FairPoint's expectations. As reflected in
2 Table 4.5, my analysis indicated that the NNE Projections reflect operating expense per
3 line of *****BEGIN CONFIDENTIAL INFORMATION*****

4 *****END CONFIDENTIAL INFORMATION*****per line in 2015. I have used
5 2009 as the beginning of my analysis because projected 2008 results include transition
6 year costs not reflective of normalized cost levels. In contrast to FairPoint's projected
7 operating expense per average access line of between *****BEGIN CONFIDENTIAL**
8 **INFORMATION***** *****END CONFIDENTIAL INFORMATION*****,

9 the median historical performance demonstrated by the guideline companies ranged from
10 \$350 to \$824 with a mean of \$545 and a median of \$537 per line. However, once the
11 higher-cost guideline companies (FRP, IWA, CNSL, ALSK and VCG) are eliminated,
12 historical operating expense per access line of the remaining guideline companies range
13 from \$413 to \$586, with a mean of \$501 and a median of \$515. Additionally, I would
14 note that of the three guideline companies I consider most comparable to the NNE
15 Properties – CZN, WIN and CTL – CTL's historical operating results and implied
16 operating expense per access line include the expenses associated with CTL's regional
17 fiber transport operations, "LightCore", which were not sufficiently detailed in CTL's
18 financial statements and filings with the Securities and Exchange Commission to allow
19 me to remove those costs from my analysis. Accordingly, it is likely that had I been able
20 to remove LightCore-related expenses from my analysis, CTL's operating expense per
21 access line would have been less than what is reflected in my analysis and closer to the
22 levels observed for CZN and WIN.

Expense Projections

1
2 **Q.** Mr. Barber claims FairPoint's projections are remiss in that they do not adequately reflect
3 expected future inflation. Does your analysis consider the effects of inflation?

4 **A.** My analysis does not directly address the effects of inflation in that I use historical
5 guideline company data to develop a base performance which I then evaluate against
6 performance reflected in the NNE Projections. However, I would note that CZN's
7 operating expense per access line declined from \$477 per line in 2004 to \$447 in 2005 to
8 \$416 in 2006 to \$413 for the first quarter of 2007. Similarly, WIN's operating expense
9 per access line declined from \$550 in 2006 to \$479 in 2007. This same downward trend
10 in operating expense per access line was not observed for CTL; however, I believe this is
11 largely attributable to the impact of costs associated with CTL's fiber transport
12 operations. Accordingly, there is an argument that observed trends for operating expense
13 per line are actually in a period of decline so the need to adjust observed metrics for
14 anticipated inflation is not necessary. Additionally, I believe removing the effect of
15 CTL's fiber transport operations from its observed operating expense per line would have
16 the effect of reducing observed mean and median observations such that projected 2009
17 operating expense per line for the NNE Properties would implicitly incorporate either an
18 inflation adjustment or what might also be considered additional "cushion".

19 My analysis did, however, include a review of "inflation" assumptions implicit in the
20 FairPoint projections and I found them to be reasonable. Table 3.5 details my analysis of
21 increases in cash operating expenses per access line during the Projection Period. For the

1 years 2009 through 2015, FairPoint has projected a compound annual growth rate in cash
2 operating expenses per line of *****BEGIN CONFIDENTIAL INFORMATION*****
3 *****END CONFIDENTIAL INFORMATION*****percent.⁴

4 **Q.** The NNE Projections reflect a *****BEGIN CONFIDENTIAL INFORMATION*****
5 *****END CONFIDENTIAL INFORMATION*****percent compound annual growth in
6 cash operating expenses per access line, which you have assessed as being reasonable.
7 Mr. Barber notes that “both FairPoint and Verizon have experienced significant growth
8 in operating expense per access line, averaging above 6 percent per year over the 2002-
9 2006 period.”⁵ This statement appears to be the principal concern in support of his
10 claim that the NNE Projections are “incredibly optimistic” and “rosy.” How do you
11 respond?

12 **A.** For reasons I have already stated, principally the inclusion of significant allocations of
13 corporate overhead and other charges, I believe Verizon’s historical performance is not
14 relevant. Additionally, the historical operating performance of FairPoint’s existing
15 operations is not relevant because of fundamental differences between the underlying
16 rate-of-return regulatory environment in which those properties operate and the
17 environment to which the NNE Properties will be subject. FairPoint’s existing operations

4 There is not a universally accepted source or method for projecting future inflation rates. Any such source would be subject to significant inaccuracy and estimation. Since 2000, the Federal Open Market Committee of the Federal Reserve (FOMC) has used the “chain-type price index for personal consumption expenditures” as its primary measure of inflation. Some argue that core inflation is an indicator of long-term inflation because it eliminates products that have temporary price shocks such as energy and food products, which can diverge from the overall trend of inflation and give a false measure of inflation. As reflected in the minutes of its June 27-28, 2007 meeting, the FOMC expects inflation, as measured by the core PCE price index, to increase by 2.0 to 2.25 percent in 2007 and 1.75 to 2.0 percent in 2008.

5 Direct Testimony of Randy Barber - Confidential, p. 5, ln. 21.

1 generally provide service in more rural areas than that covered by the NNE Properties
2 and FairPoint's existing operations realize revenues based largely on federal and state
3 regulatory mechanisms that allow the recovery of actual costs of operations, invested
4 capital and approved rates of return. The NNE Properties realize revenues based on
5 "price cap" rules which instead focus on historical rate levels and largely eliminate the
6 reference to actual costs. Accordingly, there are consequential differences between the
7 type of service areas served by FairPoint's existing operations and the NNE Properties
8 and consequential regulatory differences that render a comparison of historical cost
9 patterns of FairPoint's existing properties to projected cost patterns of the NNE
10 Properties irrelevant. Accordingly, I believe Mr. Barber's reference to the historical
11 performance of FairPoint and Verizon during the 2002-2006 period is misplaced.

12 My conclusion that the *****BEGIN CONFIDENTIAL INFORMATION*****
13 *****END CONFIDENTIAL INFORMATION***** percent growth factor is reasonable is
14 made, in part, with reference to projected increases in revenues and operating cash flow.
15 Ignoring what I see as a very real opportunity to outperform the NNE Projections both by
16 increasing revenues as well as further reductions of operating costs, it is only prudent for
17 FairPoint to restrain growth in operating expenses given its expectations regarding
18 revenue growth reflected in the NNE Projections. I note that while operating expenses
19 per access line is expected to grow at a compound annual rate of *****BEGIN**
20 **CONFIDENTIAL INFORMATION*** *****END CONFIDENTIAL**
21 **INFORMATION***** percent over the period 2009 through 2015, revenue per access**

1 line are expected to grow at a mere *****BEGIN CONFIDENTIAL**
2 **INFORMATION***** *****END CONFIDENTIAL INFORMATION***** percent.

3 **Potential to Outperform Projections**

4 **Q.** Explain why you believe FairPoint has a reasonable opportunity to outperform the NNE
5 Projections.

6 **A.** My guideline company analysis indicates two areas where I believe FairPoint could
7 reasonably be expected to outperform assumptions implicit in the NNE Projections –
8 improvement in revenues per average access line or connection and improvements in
9 operating cash flow margins.

10 With respect to improvements in revenue per average access line, the NNE Projections
11 assume average revenue per line of *****BEGIN CONFIDENTIAL**

12 **INFORMATION***** *****END CONFIDENTIAL**

13 **INFORMATION***** in 2013 before tapering off to *****BEGIN CONFIDENTIAL**

14 **INFORMATION***** *****END CONFIDENTIAL INFORMATION***** in 2015.

15 This compares to average revenue per average access line for the guideline companies of
16 \$1,018 and a median revenue per average access line of \$961. Even if I exclude the
17 smaller, high-cost guideline companies – FRP, IWA, CNSL, ALSK and VCG – whose
18 revenues may be more influenced by federal and state high-cost recovery mechanisms,
19 the mean revenue per average access line for the remaining guideline companies was
20 \$1,008 while the median revenue per average access line was \$980.

1 A similar result is arrived at when revenues are analyzed on an average connection basis.

2 The NNE Projections assume average revenue per connection of ***BEGIN

3 CONFIDENTIAL INFORMATION

4 ***END CONFIDENTIAL INFORMATION*** in 2015. This
5 compares to mean revenue per average connection for the guideline companies of \$896
6 and a median revenue per average connection of \$863. Again, if I exclude the smaller,
7 high-cost guideline companies the mean revenue per average connection comes in at
8 \$880 while the median revenue per average connection approximates \$830.

9 All other things being equal, my analysis implies that FairPoint could increase annual
10 revenues by between 10 and 25 percent by performing at the levels consistent with that of
11 the guideline companies.

12 I came to a similar conclusion with respect to my analysis of the cash flow margins
13 implicit in the NNE Projections. The NNE Projections reflect cash flow margins of as
14 high as ***BEGIN CONFIDENTIAL INFORMATION*** ***END

15 CONFIDENTIAL INFORMATION*** percent in 2009 and as low as ***BEGIN

16 CONFIDENTIAL INFORMATION*** ***END CONFIDENTIAL

17 INFORMATION*** percent in 2008. In general, projected cash flow margins hover in
18 the 35+/- percent range. This compares to the guideline companies, which managed to
19 post a 46.2 percent average and 48.9 percent median cash flow margin. Excluding the
20 smaller companies results in an increase to mean and median cash flow margins.

1 All other things being equal, my analysis implies that FairPoint could increase operating
2 cash flow by as much 25 percent or more—through new product offerings and increased
3 penetration of existing offerings, not rate increases—by performing at levels consistent
4 with its peers.

5 **Q.** Are you suggesting that FairPoint could increase revenues by as much as 25 percent
6 above that reflected in the NNE Projections by increasing revenue per average access line
7 or connection and increase operating cash flow by an additional 25 percent?

8 **A.** Based on my review of the historical performance of the guideline companies, that is
9 certainly possible. The ability to realize additional revenues and cash flows would be
10 dependent on factors such as the regulatory environment, the competitive environment,
11 management's ability to execute its plan, and a myriad of other considerations. I believe
12 a majority of any improvement in cash flow margin would likely be realized by virtue of
13 increased revenue per average access line rather than further cost reductions. My
14 analysis indicates a more limited opportunity to improve margins through further cost
15 reductions.

16 **Q.** Why do you think it is more likely that the significant portion of any improved cash flow
17 would be realized as a result of increased revenues rather than decreased costs?

18 **A.** I have already detailed why I believe FairPoint has a reasonable opportunity to
19 outperform the NNE Projections in terms of revenue per average access line or
20 connection. Tables 4.5 and 4.6 detail my analysis of projected operating expense per
21 access line and operating expenses per connection for the NNE Properties and my

1 comparison of those assumptions to the observed historical performances of the guideline
2 companies. I concluded that operating expense per average access line was generally
3 slightly above mean and median observed guideline company metrics and that operating
4 expense per average connection was slightly below average and median guideline
5 company metrics. However, as I have previously indicated, if you eliminate the smaller,
6 high-cost guideline companies, the range of observed operating expense per average
7 access line for the remaining guideline companies ranged from \$413 to \$586 with a mean
8 of \$501 and a median of \$515. Additionally, as I have previously indicated, the observed
9 operating expense per line metrics of CTL include operating expenses associated with
10 CTL's regional fiber transport operations. If it were possible to remove those costs from
11 CTL's operating costs, I believe CTL's operating expense per access line would be closer
12 in line with that observed for CZN (\$413 for the first quarter of 2007) and WIN (\$479 for
13 the first quarter of 2007) resulting in reduced median and mean measures. Accordingly,
14 there would appear to be some opportunity to improve cash flow through further cost
15 reductions by outperforming average observations. Having said that, I believe the "low
16 hanging fruit" available to FairPoint comes more in the form of increased revenue per
17 line than further reductions of costs per line.

18 **Q.** Are you suggesting that in order for FairPoint to outperform the NNE Projections it
19 would have to raise rates charged to its customers?

20 **A.** No. I am suggesting that FairPoint may be able to realize more revenue by selling
21 additional, vertical services to its customers, principally broadband and long distance

1 services. Table 3.2 summarizes the components of projected monthly revenue per access
2 line. The NNE Projections assume that monthly revenues per average access line
3 increase from *****BEGIN CONFIDENTIAL INFORMATION*****
4 *****END CONFIDENTIAL INFORMATION***** per month in 2015.

5 The majority of the projected 8.8 percent increase comes from additional data/Internet
6 revenue generated from each customer, a reflection of FairPoint's underlying assumption
7 that it will increase broadband penetration levels.

8 Revenue Projections

9 **Q.** Do you believe it is reasonable that FairPoint will be able to increase revenue per average
10 access line by 8.8 percent over the Projection Period?

11 **A.** Yes, in fact there are recent examples of companies in like situations improving revenue
12 per access line at an even faster pace. For example, Iowa Telecom, which acquired
13 approximately 280,000 former GTE access lines from Verizon on June 30, 2000,
14 increased its monthly revenue per access line from \$60 in 2001 to \$69 by the third quarter
15 of 2004, a 15 percent increase in just over three years. By the end of 2006, IWA had
16 increased its monthly revenue per average access line to \$76.40, a 27 percent increase in
17 five and one-half years. IWA attributes growth in long distance, broadband and dial-up
18 Internet subscribers for the increase.

19 Valor Telecom acquired approximately 540,000 former GTE lines from Verizon in
20 Oklahoma, Texas and New Mexico in 2000. In 2001 VCG generated monthly revenue of

1 \$64.11 per line. But by the end of the third quarter of 2004 VCG was generating 19
2 percent more, or \$76.11 in monthly revenue per average access line. VCG achieved
3 much of this gain by increasing long distance subscribers from 31,117 in 2001 to 201,287
4 by September 30, 2004.

5 Because Verizon has been providing long distance to customers of the NNE Properties
6 for several years, FairPoint may not have the same opportunity as IWA and VCG to
7 improve monthly revenue per average access line by virtue of increased long distance
8 penetration. However, as indicated in the FCC's January 2007 report entitled "High-
9 Speed Services for Internet Access, June 30, 2006 Update," only 67 percent of Maine
10 residents, 60 percent of Vermont residents and 59 percent of New Hampshire residents
11 had access to xDSL service as of June 30, 2006. Maine ranked 39th, Vermont ranked 44th
12 and New Hampshire ranked 45th out of 45 states or territories for which data was
13 presented. Nationally, 79 percent of all homes had access to xDSL services. In my
14 opinion there is a clear opportunity for FairPoint to measurably improve average revenue
15 per average access line by expanding the availability of DSL services and capturing a
16 reasonable penetration of the increased addressable market.

17 **Q.** In arriving at your conclusion that the NNE Projections are reasonable, you place a
18 significant amount of reliance on FairPoint's ability to drive revenue per average access
19 line at a rate faster than reflected in the projections. Implicit in this assumption is
20 FairPoint's ability to penetrate its existing customer base with vertical services including

1 long distance and broadband services. Do you believe the long distance and DSL
2 penetration rates implicit in the NNE Projections are reasonable?

3 A. Yes. Table 2.3 summarizes historical and projected revenue generating units and
4 penetration assumptions implicit in the NNE Projections. Table 4.12 compares DSL and
5 long distance penetration assumptions over the Projection Period to actual penetration
6 statistics of the guideline companies for 2004 through 2006 and the first quarter of 2007.

7 *****BEGIN CONFIDENTIAL INFORMATION*****

8
9 *****END CONFIDENTIAL**

10 **INFORMATION***** I noted that while the NNE Projections assume a gradual increase
11 in long distance penetration of access lines, the actual number of long distance customers
12 essentially stayed flat throughout the Projection Period. This implies that FairPoint
13 expects increased penetration to be more a function of declining access lines than
14 increasing long distance customers served. This is actually consistent with my position
15 that FairPoint has a reasonable opportunity to outperform revenue per average access line
16 assumptions implicit in the NNE Projections. As competition increases customer churn,
17 an important motivator of customer retention will be the “bundling” of services.

18 I also noted that while FairPoint’s assumption concerning overall long distance
19 penetration at the end of the Projection Period is higher than mean and median
20 penetration demonstrated by the guideline companies, FairPoint’s assumptions are

1 on Table 2.3. The NNE Projections reflect FairPoint's view that the number of access
2 lines will continue to drop, albeit at a declining rate, through-out the Projection Period
3 but that gains in DSL subscribers will essentially offset access line loss resulting in a
4 relatively stable number of total connections. This trend is consistent with telephone
5 company experience over the last several quarters.⁷

6 Over the course of the Projection Period, FairPoint expects the NNE Properties to lose
7 more than 400,000, or 29.3 percent, of its average lines in service. ***BEGIN

8 CONFIDENTIAL INFORMATION***

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10 INFORMATION***

11 Capital Expenditure Projections

12 **Q.** In a sweeping indictment of FairPoint's overall business and financing strategy, Mr.
13 Barber asserts that "FairPoint's approach to business is to invest as little as possible in
14 capital plant and siphon the rest of the cash out of the operating companies to support its
15 extraordinarily high dividend payment."⁸ Please comment on Mr. Barber's assertion
16 regarding FairPoint's capital investment strategy.

17 **A.** To test Mr. Barber's theorem, I evaluated FairPoint's capital expenditure levels from two
18 different perspectives. First, I compared the historical CAPEX margins, CAPEX per

7 Deborah A. Rand, "2006 Access Line Losses Cut Deep: Will Verizon Slow the Bleed?" The ILEC Advisor (April 2007), p. 29.

8 Direct Testimony of Randy Barber - Public, p. 7, ln. 6.

1 access line and CAPEX per connection of FairPoint's existing operations to the observed
2 historical metrics of the guideline companies to assess whether Mr. Barber's statement is
3 supported by FairPoint's past practices. I then compared projections for the same
4 metrics, as reflected in the NNE Projections, to observed historical metrics of the
5 guideline companies to assess whether Mr. Barber's claim could be supported by
6 FairPoint's future plans for the NNE Properties. My analysis was based on a review of
7 three different metrics, 1) CAPEX margin (defined as capital expenditures divided by
8 revenues), 2) CAPEX per access line (defined as capital expenditures divided by the
9 average number of access lines in service, and 3) CAPEX per connection (defined as
10 capital expenditures divided by the average number of connections in service). As
11 detailed below, my analysis indicated that FairPoint has traditionally invested in its plant
12 at a level consistent with the selected guideline companies and that capital expenditure
13 levels reflected in the NNE Projections continue this practice.

14 As detailed in Table 4.10, I compared the historical CAPEX margins of FairPoint's
15 existing operations to the observed CAPEX margins of the selected guideline companies.
16 During the period 2004 through 2006 and for the first three months of 2007, FairPoint
17 invested between 10.7 percent and 14.4 percent of its revenues in capital plant.⁹ This
18 compares to a range of 8.1 percent to 21.7 percent for the selected guideline companies. I
19 noted that the mean CAPEX margin exhibited by the guideline companies—12.4

⁹ I did not consider CAPEX margins reflected for the first quarter of 2007 or the second quarter of 2007. Telecommunications providers typically incur the substantial majority of their capital expenditures through the final three quarters of the year due to weather considerations. Accordingly, first quarter CAPEX margin measures were not considered indicative of full year results.

1 percent—was disproportionately influenced by the observed CAPEX margins of Alaska
2 Communications Systems, the capital expenditure levels of which can be easily attributed
3 to the more rural nature of its service area. If you eliminate ALSK’s results from
4 CAPEX margins calculated in Table 4.10, the adjusted mean CAPEX margin for the
5 guideline companies comes in at 11.9 percent, or slightly below FairPoint’s 12.1 percent
6 average CAPEX margin for the look-back period.

7 In Table 4.11, I also compared the historical CAPEX per access line and CAPEX per
8 connection metrics for FairPoint’s existing operations to the range, mean and median
9 observed for the guideline companies. FairPoint’s historical CAPEX per access line
10 ranged from \$116 per line to \$150 per line, comfortably within the range of observed
11 guideline company metrics. FairPoint’s historical CAPEX per connection ranged from
12 \$100 to \$136 per connection, again comfortably within the range of observed guideline
13 company metrics.

14 My analysis of the historical CAPEX metrics of FairPoint’s existing operations indicate
15 that FairPoint has historically invested in its capital plant at levels consistent with its
16 peers.

17 I then compared the historical capital expenditure trends of the guideline companies to
18 anticipated future capital investment for the NNE Properties as reflected in the NNE
19 Projections using the same three metrics. As detailed in Table 4.6, FairPoint has
20 projected to incur capital expenditures associated with the NNE properties of between

21 *****BEGIN CONFIDENTIAL INFORMATION*****

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1 CONFIDENTIAL INFORMATION*** per average access line, between ***BEGIN

2 CONFIDENTIAL INFORMATION*** ***END CONFIDENTIAL

3 INFORMATION*** per connection, and between ***BEGIN CONFIDENTIAL

4 INFORMATION*** ***END CONFIDENTIAL

5 INFORMATION***percent of revenue during the period 2009 through 2015.¹⁰ Capital
6 expenditures per line and CAPEX margins projected for the NNE properties are in line
7 with observed guideline company capital expenditure trends. Projected capital
8 expenditures per connection are generally lower than observed historical guideline
9 company trends but that difference can be attributed to the effect of projected increased
10 connections.¹¹

11 My analysis of the projected capital expenditures for the NNE Projections imply plans to
12 invest in the NNE Properties at levels consistent with the historical capital investment
13 levels of the guideline companies.

14 **Q.** Mr. Barber apparently believes that the amount of capital investment reflected in the
15 NNE Projections is inadequate, labeling FairPoint’s overall strategy as “high-risk, high
16 dividend/low reinvestment”¹² and asserting FairPoint “is proposing to siphon cash out of
17 Northern New England – cash it collects for depreciation to be reinvested in its

10 I have excluded projected 2008 CAPEX metrics from my analysis. 2008 projected results include expected one-time extraordinary charges associated with the transition of the NNE Properties from Verizon including costs associated with the expansion of network broadband availability.

11 I have defined connections as the aggregate of switched access lines plus UNE-L plus DSL lines. In the absence of significant levels of “naked DSL” subscribers, growth in DSL lines will largely be a reflection of an increase in vertical services sold to individual customers. In other words, while access lines may remain flat or decline, total connections may continue to increase. While capital expenditures on a “per line” basis may increase, capital expenditures “per connection” may decline.

12 Direct Testimony of Randy Barber - Confidential, p. 15, ln. 13.

1 network.”¹³ Do you believe FairPoint should be projecting to invest more capital in the
2 plant of the NNE Properties?

3 A. No. A review of the historical practices of the guideline companies indicates that the
4 NNE Projections include a provision for future capital investment consistent with that
5 made by companies whose operations I deem to be reasonably comparable to the NNE
6 Properties.

7 Mr. Barber seems to reference depreciation as his yardstick for the appropriate level of
8 capital investment and asserts anything less than that constitutes “cannibalization” or the
9 “siphoning” of cash collected “for depreciation to be reinvested in its network.” I would
10 suggest that Mr. Barber’s reference to historical depreciation as a benchmark for future
11 investment is misplaced and ignores very real trends in the telecom sector.

12 Take a very simplistic example. In the early 1990s, I purchased a new, “state-of-the-art”
13 IBM AT personal computer for approximately \$5,000. Mr. Barber’s reinvestment tenet
14 would have had me periodically spend \$5,000 to replace that computer, ignoring the fact
15 that now, some 17 years later, I can purchase a computer with significantly more
16 computing power for less than \$1,000. I acknowledge this to be an extreme example to
17 demonstrate my point and I recognize changes in technology and services may introduce
18 new capital requirements, but this simple example nevertheless illustrates the fallacy of
19 Mr. Barber’s argument. Given the cost trends of many of the components of the telecom
20 network, trends in access line erosion, and the movement towards leveraging the network

13 Id, p. 16, ln. 16.

1 to provide a broader array of services, basing capital investment decisions on what was
2 spent in prior years is nonsensical. Instead, capital expenditure decisions should be based
3 on an informed analysis of the current costs and future benefits of a particular plant
4 investment.

5 Table 4.10 summarizes the ratio of historical capital expenditures to depreciation expense
6 for the selected guideline companies for the period 2004 through the first quarter of 2007.
7 On average, annual capital expenditures for the guideline companies approximated 61.5
8 percent of annual depreciation. In fact, none of the guideline companies incurred capital
9 expenditures in excess of depreciation at any time during the look-back period.

10 Mr. Barber characterizes FairPoint's capital plans for the NNE Properties as "low
11 reinvestment." However, observable market data clearly demonstrates that FairPoint's
12 capital plans are at a level consistent with its peers. I believe observed market data
13 evidence informed management decisions made in light of the competition of dissonant
14 demands on available capital.

15 Reasonableness of Business Model and Financial Plan

16 **Q.** Mr. Barber claims that FairPoint's financial plan has an "extraordinarily small margin of
17 error."¹⁴ Do you concur with Mr. Barber's assessment?

18 **A.** No. My analysis indicated that critical assumptions underlying the NNE Projections are
19 supportable and within the range of the observed historical performance of the selected

14 Id, p. 2, ln. 18.

1 guideline companies. I also believe FairPoint has a reasonable opportunity to outperform
2 the NNE Projections by increasing revenue per line and possible further reductions in
3 costs per line, both of which will increase the “cushion” available to absorb unexpected
4 contingencies.

5 **Q.** On several occasions, Mr. Barber calls into question the sustainability of FairPoint’s
6 business model.¹⁵ Do you believe FairPoint’s business model is sustainable?

7 **A.** Yes, but let me first separate what I consider to be FairPoint’s business model from the
8 manner in which FairPoint finances its business. They are two very different and
9 separate issues and I believe Mr. Barber takes more issue with the manner in which
10 FairPoint finances its business than the manner in which FairPoint conducts its business.

11 FairPoint’s business strategy is concisely articulated in its 10-K filing for the year ended
12 December 31, 2006. The key elements of that strategy include 1) increasing revenue per
13 customer, 2) continuing to enhance operating efficiencies and profitability, 3) enhancing
14 customer loyalty, and 4) growing through selective acquisitions. I am very much of the
15 opinion that any business that successfully executes on the first three of these strategies
16 will remain viable. The fourth strategy, growing through selective acquisitions, is less
17 critical but, if properly executed, can certainly enhance business viability.

18 The question regarding whether the manner in which FairPoint currently finances its
19 business - the use of high-yield dividend stocks or “HYDS” - is an entirely different issue

¹⁵ See, for example, Direct Testimony of Randy Barber – Confidential, p. 15, ln. 10 and p. 43, ln. 16.

1 and less core, in my view, to the long-term viability of FairPoint's business model. As
2 has been the case in the past, I expect the manner in which FairPoint finances its business
3 in the future will be dependent on an assessment of the nature and types of structures and
4 securities available in the capital markets at any given future date. FairPoint's first
5 acquisition occurred on May 6, 1993, more than 14 years ago. During the eleven year
6 period extending from that first acquisition until the initial public offering of FairPoint's
7 common stock on February 3, 2005, a period of time during which it experienced
8 significant growth, FairPoint employed capital from a variety of sources including
9 private equity, traditional bank borrowings and high-yield debt securities.

10 **Q.** Elaborate on why you believe FairPoint's business model is sustainable.

11 **A.** When you get right down to it, FairPoint's four-prong operational strategy is pretty basic:
12 provide quality service and you will endear yourself to your customers who will be more
13 likely to buy more services from you – and while you're doing that, watch your costs. I
14 would be so bold to say that substantially all successful businesses follow that basic tenet
15 whether or not they explicitly recognize it.

16 In the increasingly competitive telecommunications industry, the concept of increasing
17 revenues per customer and enhancing customer loyalty is not only a smart way to run
18 your business but it is also a reaction to regulatory and technological changes that allow
19 telephone companies to provide more services over an established and relatively fixed
20 cost base (e.g., broadband, video, long distance). It is also an effort to make customers
21 more "sticky" so they are less likely to want to switch service providers.

1 The acquisition prong of FairPoint's strategy may be less universal in the business world
2 but it is certainly not unique. In fact, most of the companies I selected as comparable
3 companies for my assessment of FairPoint's financial projections, either in the annual
4 reports, or market actions, clearly view growth through acquisition as one of their core
5 business strategies.

6 Over its 14-year existence FairPoint's acquisition strategy has allowed it to successfully
7 wring inefficiencies out of the cost structure of its acquisitions. For example, based on
8 my analysis of 31 of the company's acquisitions from 1993 through 2006, FairPoint was
9 able to increase the operating cash flow of acquired properties from \$100 million on a
10 trailing basis to \$121 million during the first year subsequent to its acquisition. That's a
11 21 percent increase in "same store" operating cash flow tied to operating efficiencies
12 introduced by FairPoint.

13 It's not a secret that top line growth in the telephone industry is lethargic. The impacts of
14 competition and eroding access lines are largely offsetting gains realized from the
15 provision of new services such as broadband and video, muting overall growth. As
16 reflected on Table 5.1, my analysis of 12 public telephone companies whose operations
17 are principally wireline-related and which reported revenues in each of the past six years
18 revealed that the median five-year compound annual growth rate of reported revenues
19 was 3.1 percent while the median three-year compound annual growth rate was 1.1

1 percent. In comparison, FairPoint grew revenues by 3.2 percent over the five-year period
2 and 5.3 percent over the three-year period.¹⁶

3 With top line growth hard to come by, operators are increasingly looking for
4 opportunities to enhance bottom line growth (in this case, cash flow growth) through
5 acquisitions. The formula for success with this strategy is exactly what FairPoint has
6 accomplished with its previous acquisition of 31 RLECs – buy at market-based multiples
7 and introduce efficiencies to reduce the effective, post-acquisition multiples.

8 **Q.** Mr. Barber notes that “as part of the transaction, Verizon paid FairPoint \$55 million for
9 FairPoint’s interest in a cellular telephone partnership in New York. In addition, Verizon
10 is paying \$40 million of FairPoint’s pre-closing transaction costs.”¹⁷ Because of this he
11 concludes “there are significant risks that FairPoint will not have the ability to
12 successfully undertake a transaction of this magnitude.”¹⁸ Do you agree with Mr.
13 Barber’s assertion that Verizon “needed to provide \$95 million of FairPoint’s projected
14 \$110 million in pre-closing costs”¹⁹?

15 **A.** No. I view the manner in which FairPoint has elected to fund estimated pre-closing costs
16 as a combination of efficient asset utilization and effective contract negotiation. Without
17 commenting on the validity of his argument, I would contend that Mr. Barber’s

16 Admittedly, FairPoint’s revenue growth rate was assisted by acquisitions. However, I did not adjust
observed growth rates for any of the sample companies. For example, Windstream exhibited a five-year
CAGR of 9.1 percent, the highest observed growth rate. CenturyTel exhibited a five-year CAGR of 7.8
percent. Both CenturyTel’s and Windstream’s (formerly ALLTEL) five-year growth rates were largely
fueled by their acquisitions of Verizon lines in Kentucky, Missouri and Alabama back in 2002.

17 Direct Testimony of Randy Barber - Public, p. 8, footnote 4.

18 Id, p. 8, ln 2.

1 suggestion that FairPoint would not have been able to raise sufficient capital to fund the
2 projected \$110 million in pre-closing transaction costs is irrelevant. FairPoint was able to
3 raise the necessary funds by agreeing to sell an otherwise illiquid non-core asset for a
4 reasonable price and by using its negotiating leverage with Verizon and Capgemini to
5 secure favorable contract terms.

6 Mr. Barber somehow interprets FairPoint's ability to creatively finance its expected pre-
7 closing costs so as to minimize its financial pain as an indication of "significant risks that
8 FairPoint will not have the ability to successfully undertake a transaction of this
9 magnitude." I fail to see how having FairPoint pay pre-closing costs out of available cash
10 (or existing or new credit facilities) reduces the risk profile of either the transaction or
11 FairPoint. In fact, I could argue risk is reduced by virtue of the skill demonstrated by
12 FairPoint in negotiating the favorable contract terms and by permitting FairPoint to retain
13 the \$110 million of funds that it would have otherwise needed to produce. Mr. Barber
14 asks "why FairPoint negotiated in such a way as to cover all of its projected pre-closing
15 costs." My answer to that is simply, "because it represented a sound approach to getting
16 the other key parties in the transaction to share the risks prior to receiving the required
17 regulatory approvals."

18 **Q.** Mr. Barber observes that FairPoint's "business model has stalled over the past dozen
19 years"²⁰ and that "for an acquisition-driven company, it hadn't engaged in transactions

19 Id, p. 8, ln. 4.
20 Id, p. 52, ln. 5.

1 that materially increased its size and scope since 2000.”²¹ Mr. Barber goes on to

2 characterize the NNE acquisition as a bit of a “hail Mary.”²² Do you agree?

3 A. No. While I concur with Mr. Barber that the demise of FairPoint’ CLEC initiative
4 probably contributed to a lull in the company’s RLEC acquisition activities, I would note
5 that the RLEC transaction market as a whole slowed during the 2002 through 2004
6 period. In any event, I do not view that as relevant to the validity of FairPoint’s business
7 model nor is it an indication of FairPoint’s inability to identify acquisition opportunities.
8 While the NNE acquisition clearly accelerates FairPoint’s acquisition strategy, under no
9 circumstances would I view it as the desperation last chance lob seemingly implied by
10 Mr. Barber’s “hail Mary” analogy.

11 Transaction activity within the ILEC sector has clearly accelerated over the last several
12 years. Excluding AT&T’s acquisition of BellSouth, I estimate that ILEC deals with an
13 aggregate transaction value of \$9.6 billion closed in 2006, that’s up from an estimated \$2
14 billion in 2005 and \$848 million in 2004.²³ So far in 2007, exclusive of the FairPoint/
15 Verizon transaction, deals valued at an estimated aggregate \$4.1b have either already
16 closed or have been announced. Were it not for the managerial and corporate resources
17 now dedicated to the NNE transaction, FairPoint clearly could have continued to
18 participate in the ILEC deal market, availing itself of considerable opportunity to
19 continue its growth through acquisitions.

21 Id, p. 52, ln. 8.

22 Id, p. 52, ln. 11.

23 William E. King, “*The Deals of 2006*,” The ILEC Advisor (February 2007) p. 2.

1 From my perspective, and I believe from the perspective of many of my peers in the
2 industry, FairPoint has successfully cultivated a reputation as an operationally and
3 financially capable buyer that conducts its business in a manner that is friendly to a
4 target's existing employee base. It is my experience that this perception weighs heavily
5 on decisions made by the owners and management of small telephone properties
6 regarding appropriate potential suitors.

7 So I do not believe the reality of the market supports Mr. Barber's implication that
8 FairPoint had no alternative but to participate in the NNE transaction. I believe FairPoint
9 has the opportunity to grow very nicely by continuing to actively participate in the RLEC
10 deal market. FairPoint has a well-established track record of acquiring and successfully
11 assimilating rural properties into its portfolio. There is clearly an increase in transaction
12 activity in the sector and FairPoint has the benefit of having established a strong
13 reputation as an operationally and financially capable, employee-friendly buyer.
14 FairPoint can continue to participate in this market and, I believe, significantly increase
15 the pace of its growth. The NNE transaction is simply an alternative, and a very unique
16 opportunity for FairPoint to accelerate its acquisition strategy in a region of the country
17 where it makes sense. I do not view the NNE transaction as a desperation move as
18 implied by Mr. Barber's "hail Mary" metaphor.

19 **Q.** Isn't Mr. Barber's "hail Mary" argument supported by analysis prepared by Morgan
20 Stanley as set forth in a certain research report dated June 5, 2007 and entitled "FairPoint

1 Communications, Lowering 2008 Estimates on New Company Forecast". Have you
2 reviewed the Morgan Stanley report and what is your opinion of its conclusion?

3 A. I have reviewed the report and, as with most analyst reports, I believe the Morgan Stanley
4 analyst made some interesting points and observations. However, I believe her
5 conclusions are both irrelevant to this proceeding and both premature and erroneous with
6 respect to her conclusions regarding the future fate of FairPoint and its shares on a stand-
7 alone basis.

8 It is my understanding that the purpose of these proceedings is, in part, to evaluate the
9 financial viability of FairPoint in the event the NNE transaction is consummated.

10 Accordingly, FairPoint's future financial viability in the event the transaction is not
11 approved is not directly a subject of consideration and, therefore, irrelevant.

12 Having said that, I believe the Morgan Stanley report is both premature and erroneous
13 with respect to its conclusion regarding the future fate of both FairPoint and its shares.

14 The analyst bases her conclusion on bifurcated projections of FairPoint's operations,
15 which were included in Securities and Exchange Commission filings made by FairPoint
16 in the context of the NNE transaction. While the projections cited by the analyst do
17 reflect a stand-alone FairPoint's declining ability to continue to pay dividends at current
18 levels, it is unfathomable to me that the analyst did not acknowledge that FairPoint would
19 have ample opportunity to address this issue through operational or strategic adjustments
20 such as alternative acquisitions and adjustments in cost structure. I believe the position
21 advanced by Lehman Brothers in the research report dated September 7, 2007 (attached

1 as Confidential Exhibit WEK-2) is a more realistic view of what would transpire if the
2 NNE transaction is not approved. Lehman Brothers writes: ***BEGIN
3 CONFIDENTIAL INFORMATION***

4
5
6
7
8 ***END CONFIDENTIAL INFORMATION***

9 Lehman Brothers correctly acknowledges a basic fact that seems to have escaped the
10 Morgan Stanley analyst. In the event the NNE transaction is not approved, FairPoint will
11 not adhere to a plan or set of projections that lead it to future financial peril. Instead,
12 FairPoint will pursue a myriad of options to adjust its operations in order to remain viable
13 and profitable and to continue to provide value to its stakeholders.

14 **Q.** Does this conclude your testimony?

15 **A.** Yes it does. Thank you.