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CITIZENS COMMUNICATIONS CO  
Form 10-Q  
August 02, 2007

CITIZENS COMMUNICATIONS COMPANY

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934

For the quarterly period ended June 30, 2007  
-----

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: 001-11001  
-----

CITIZENS COMMUNICATIONS COMPANY

-----  
(Exact name of registrant as specified in its charter)

Delaware

06-0619596

-----  
(State or other jurisdiction of  
incorporation or organization)

-----  
(I.R.S. Employer Identification No.)

3 High Ridge Park  
Stamford, Connecticut

06905

-----  
(Address of principal executive offices)

-----  
(Zip Code)

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(203) 614-5600

-----  
(Registrant's telephone number, including area code)

N/A

-----  
(Former name, former address and former fiscal year,  
if changed since last report)

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 X No  
--- ----

Indicate by check mark whether the registrant is a large accelerated filer, an 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 Exchange Act).

Yes No X  
--- -----

The number of shares outstanding of the registrant's Common Stock as of July 27, 2007 was 338,434,462.

CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

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## PART I. FINANCIAL INFORMATION

### Item 1. Financial Statements

#### CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS (\$ in thousands)

|  | (Unaudited)<br>June 30, 2007 |
|--|------------------------------|
| ASSETS   |                              |
| -----  | -----                        |
| Current assets:  |                              |
| Cash and cash equivalents  | \$ 418,100                   |
| Accounts receivable, less allowances of \$24,195 and \$108,537, respectively | 224,300                      |
| Other current assets   | 53,060                       |
|  | -----                        |
| Total current assets   | 695,460                      |
| Property, plant and equipment, net   | 3,300,540                    |
| Goodwill, net  | 2,486,640                    |
| Other intangibles, net   | 849,640                      |
| Investments  | 21,200                       |
| Other assets   | 174,230                      |

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|  |             |
|--|-------------|
| Total assets   | \$ 7,527,74 |
| -----  |             |
| LIABILITIES AND SHAREHOLDERS' EQUITY   |             |
| -----  |             |
| Current liabilities:   |             |
| Long-term debt due within one year   | \$ 32,77    |
| Accounts payable and other current liabilities   | 404,59      |
|  | -----       |
| Total current liabilities  | 437,37      |
| Deferred income taxes  | 759,53      |
| Other liabilities  | 402,48      |
| Long-term debt   | 4,698,58    |
| Shareholders' equity:  |             |
| Common stock, \$0.25 par value (600,000,000 authorized shares; 340,250,000 and 322,265,000 outstanding, respectively, 349,456,000 issued at June 30, 2007 and 343,956,000 issued at December 31, 2006) | 87,36       |
| Additional paid-in capital   | 1,287,31    |
| Retained earnings  | 72,09       |
| Accumulated other comprehensive loss, net of tax   | (78,75)     |
| Treasury stock   | (138,24)    |
|  | -----       |
| Total shareholders' equity   | 1,229,76    |
|  | -----       |
| Total liabilities and shareholders' equity   | \$ 7,527,74 |
|  | =====       |

The accompanying Notes are an integral part of these Consolidated Financial Statements.

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PART I. FINANCIAL INFORMATION (Continued)

CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
FOR THE THREE MONTHS ENDED JUNE 30, 2007 AND 2006  
(\$ in thousands, except for per-share amounts)  
(Unaudited)

|                               |            |
|-------------------------------|------------|
|                               | 2007       |
|                               | -----      |
| Revenue                       | \$ 578,826 |
| Operating expenses:           |            |
| Network access expenses       | 51,878     |
| Other operating expenses      | 215,188    |
| Depreciation and amortization | 140,462    |
|                               | -----      |
| Total operating expenses      | 407,528    |
|                               | -----      |
| Operating income              | 171,298    |

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|   |           |
|---|-----------|
| Investment and other income (loss), net               | (6,517)   |
| Interest expense                                      | 98,649    |
|   | -----     |
| Income from continuing operations before income taxes | 66,132    |
| Income tax expense                                    | 25,573    |
|   | -----     |
| Income from continuing operations                     | 40,559    |
| Discontinued operations (see Note 6):                 |           |
| Income from discontinued operations                   | -         |
| Income tax expense                                    | -         |
|   | -----     |
| Income from discontinued operations                   | -         |
|   | -----     |
| Net income available for common shareholders          | \$ 40,559 |
|   | =====     |
| Basic income per common share:                        |           |
| Income from continuing operations                     | \$ 0.12   |
| Income from discontinued operations                   | -         |
|   | -----     |
| Net income per common share                           | \$ 0.12   |
|   | =====     |
| Diluted income per common share:                      |           |
| Income from continuing operations                     | \$ 0.12   |
| Income from discontinued operations                   | -         |
|   | -----     |
| Net income per common share                           | \$ 0.12   |
|   | =====     |

The accompanying Notes are an integral part of these Consolidated Financial Statements.

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PART I. FINANCIAL INFORMATION (Continued)

CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
FOR THE SIX MONTHS ENDED JUNE 30, 2007 AND 2006  
(\$ in thousands, except for per-share amounts)  
(Unaudited)

|                               |              |
|-------------------------------|--------------|
|                               | 2007         |
|                               | -----        |
| Revenue                       | \$ 1,134,973 |
| Operating expenses:           |              |
| Network access expenses       | 102,671      |
| Other operating expenses      | 405,059      |
| Depreciation and amortization | 262,643      |
|                               | -----        |
| Total operating expenses      | 770,373      |
|                               | -----        |
| Operating income              | 364,600      |

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|   |            |
|---|------------|
| Investment and other income (loss), net               | 3,500      |
| Interest expense                                      | 192,613    |
|   | -----      |
| Income from continuing operations before income taxes | 175,487    |
| Income tax expense                                    | 67,261     |
|   | -----      |
| Income from continuing operations                     | 108,226    |
| Discontinued operations (see Note 6):                 |            |
| Income from discontinued operations                   | -          |
| Income tax expense                                    | -          |
|   | -----      |
| Income from discontinued operations                   | -          |
|   | -----      |
| Net income available for common shareholders          | \$ 108,226 |
|   | =====      |
| Basic income per common share:                        |            |
| Income from continuing operations                     | \$ 0.33    |
| Income from discontinued operations                   | -          |
|   | -----      |
| Net income per common share                           | \$ 0.33    |
|   | =====      |
| Diluted income per common share:                      |            |
| Income from continuing operations                     | \$ 0.32    |
| Income from discontinued operations                   | -          |
|   | -----      |
| Net income per common share                           | \$ 0.32    |
|   | =====      |

The accompanying Notes are an integral part of these Consolidated Financial Statements.

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PART I. FINANCIAL INFORMATION (Continued)

CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
FOR THE YEAR ENDED DECEMBER 31, 2006 AND THE SIX MONTHS ENDED JUNE 30, 2007  
(\$ in thousands)  
(Unaudited)

| Common Stock |        | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss |
|--------------|--------|----------------------------------|----------------------|---|
| Shares       | Amount |                                  |                      |   |
| -----        | -----  | -----                            | -----                | -----   |

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|  |         |          |              |             |              |
|--|---------|----------|--------------|-------------|--------------|
| Balance January 1, 2006  | 343,956 | \$85,989 | \$ 1,374,610 | \$ (85,344) | \$ (123,242) |
| Cumulative effect adjustment   | -       | -        | -            | 36,392      | -            |
| Stock plans  | -       | -        | (1,875)      | -           | -            |
| Conversion of EPPICS   | -       | -        | (2,563)      | -           | -            |
| Dividends on common stock of<br>\$1.00 per share                                 | -       | -        | (162,773)    | (160,898)   | -            |
| Shares repurchased   | -       | -        | -            | -           | -            |
| Net income   | -       | -        | -            | 344,555     | -            |
| Pension liability adjustment, after<br>adoption of SFAS No. 158, net of<br>taxes | -       | -        | -            | -           | (83,634)     |
| Other comprehensive income, net of<br>tax and reclassifications<br>adjustments   | -       | -        | -            | -           | 124,977      |
| Balance December 31, 2006  | 343,956 | 85,989   | 1,207,399    | 134,705     | (81,899)     |
| Stock plans  | -       | -        | 546          | -           | -            |
| Acquisition of Commonwealth  | 5,500   | 1,375    | 77,945       | -           | -            |
| Conversion of EPPICS   | -       | -        | (535)        | -           | -            |
| Conversion of Commonwealth Notes   | -       | -        | 1,957        | -           | -            |
| Dividends on common stock of<br>\$0.50 per share                                 | -       | -        | -            | (170,841)   | -            |
| Shares repurchased   | -       | -        | -            | -           | -            |
| Net income   | -       | -        | -            | 108,226     | -            |
| Other comprehensive income, net of<br>tax and reclassifications<br>adjustments   | -       | -        | -            | -           | 3,144        |
| Balance June 30, 2007  | 349,456 | \$87,364 | \$ 1,287,312 | \$ 72,090   | \$ (78,755)  |

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2007 AND 2006  
(\$ in thousands)  
(Unaudited)

|   | For the three months ended June 30, |            | For |
|---|-------------------------------------|------------|-----|
|   | 2007                                | 2006       |     |
| Net income  | \$ 40,559                           | \$ 101,702 |     |
| Other comprehensive income(loss), net<br>of tax and reclassifications adjustments | 3,164                               | 2          |     |
| Total comprehensive income  | \$ 43,723                           | \$ 101,704 |     |

The accompanying Notes are an integral part of these Consolidated  
Financial Statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS  
 FOR THE SIX MONTHS ENDED JUNE 30, 2007 AND 2006  
 (\$ in thousands)  
 (Unaudited)

|   | 2007   |
|---|--------|
| Cash flows provided by (used in) operating activities:  |        |
| Net income  | \$ 108 |
| Deduct: Income from discontinued operations, net of tax   |        |
| Adjustments to reconcile income to net cash provided by operating activities:                         |        |
| Depreciation and amortization expense   | 262    |
| Stock based compensation expense  | 5      |
| Investment gain   |        |
| Other non-cash adjustments  | 4      |
| Deferred income taxes   | 28     |
| Change in accounts receivable   | 4      |
| Change in accounts payable and other liabilities  | (71)   |
| Change in other current assets  | 6      |
|   | 349    |
| Net cash provided by continuing operating activities  | 349    |
| Cash flows from investing activities:   |        |
| Capital expenditures  | (111)  |
| Cash paid for Commonwealth (net of cash acquired)   | (657)  |
| Other assets (purchased) distributions received, net  | 3      |
|   | (765)  |
| Net cash used by investing activities   | (765)  |
| Cash flows from financing activities:   |        |
| Receipt (payment) of customer advances for construction and contributions in aid of construction, net |        |
| Long-term debt borrowings   | 950    |
| Long-term debt payments   | (914)  |
| Financing costs paid  | (11)   |
| Issuance of common stock  | 11     |
| Common stock repurchased  | (70)   |
| Dividends paid  | (170)  |
|   | (206)  |
| Net cash used by financing activities   | (206)  |
| Cash flows of discontinued operations:  |        |
| Operating cash flows  |        |
| Investing cash flows  |        |
| Financing cash flows  |        |
|   | (623)  |
| Decrease in cash and cash equivalents   | (623)  |
| Cash and cash equivalents at January 1,   | 1,041  |
|   | 418    |
| Cash and cash equivalents at June 30,   | \$ 418 |
|   | 418    |
| Cash paid during the period for:  |        |
| Interest  | \$ 17  |
| Income taxes  | \$ 4   |
| Non-cash investing and financing activities:  |        |



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|   |    |    |
|---|----|----|
| Change in fair value of interest rate swaps | \$ | (  |
| Conversion of EPPICS                        | \$ |    |
| Conversion of Commonwealth Notes            | \$ | 3  |
| Debt-for-debt exchange, net                 | \$ |    |
| Shares issued for Commonwealth acquisition  | \$ | 24 |

The accompanying Notes are an integral part of these Consolidated Financial Statements.

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### PART I. FINANCIAL INFORMATION (Continued) CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### (1) Summary of Significant Accounting Policies:

##### (a) Basis of Presentation and Use of Estimates:

Citizens Communications Company and its subsidiaries are referred to as "we," "us," "our," or the "Company" in this report. Our unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and should be read in conjunction with the consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2006. Certain reclassifications of balances previously reported have been made to conform to the current presentation. All significant intercompany balances and transactions have been eliminated in consolidation. These unaudited consolidated financial statements include all adjustments (consisting of normal recurring accruals) considered necessary to present fairly the results for the interim periods shown.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions which 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 revenue and expenses during the reporting period. Actual results may differ from those estimates. Estimates and judgments are used when accounting for allowance for doubtful accounts, impairment of long-lived assets, intangible assets, depreciation and amortization, employee benefit plans, income taxes, contingencies and pension and postretirement benefits expenses among others. Certain information and footnote disclosures have been excluded and/or condensed pursuant to Securities and Exchange Commission rules and regulations. The results of the interim periods are not necessarily indicative of the results for the full year.

##### (b) Cash Equivalents:

We consider all highly liquid investments with an original maturity of three months or less to be cash equivalents.

##### (c) Revenue Recognition:

Revenue is recognized when services are provided or when products are delivered to customers. Revenue that is billed in advance includes: monthly recurring network access services, special access services and monthly recurring local line charges. The unearned portion of this

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revenue is initially deferred as a component of other liabilities on our consolidated balance sheet and recognized in revenue over the period that the services are provided. Revenue that is billed in arrears includes: non-recurring network access services, switched access services, non-recurring local services and long-distance services. The earned but unbilled portion of this revenue is recognized in revenue in our statement of operations and accrued in accounts receivable in the period that the services are provided. Excise taxes are recognized as a liability when billed. Installation fees and their related direct and incremental costs are initially deferred and recognized as revenue and expense over the average term of a customer relationship. We recognize as current period expense the portion of installation costs that exceeds installation fee revenue.

The Company collects various taxes from its customers and subsequently remits such funds to governmental authorities. Substantially all of these taxes are recorded through the consolidated balance sheet and presented on a net basis in our consolidated statements of operations. We also collect Universal Service Fund ("USF") surcharges from customers (primarily federal USF) which have been recorded on a gross basis in our consolidated statements of operations and have been included in revenues and other operating expenses at \$9.9 million and \$11.1 million for the three months ended June 30, 2007 and 2006, respectively, and at \$17.2 million and \$21.3 million for the six months ended June 30, 2007 and 2006, respectively.

(d) Property, Plant and Equipment:

-----  
Property, plant and equipment are stated at original cost or fair market value for our acquired properties, including capitalized interest. Maintenance and repairs are charged to operating expenses as incurred. The gross book value of routine property, plant and equipment retired is charged against accumulated depreciation.

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PART I. FINANCIAL INFORMATION (Continued)  
CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

(e) Goodwill and Other Intangibles:

-----  
Intangibles represent the excess of purchase price over the fair value of identifiable tangible assets acquired. We undertake studies to determine the fair values of assets and liabilities acquired and allocate purchase prices to assets and liabilities, including property, plant and equipment, goodwill and other identifiable intangibles. We annually (during the fourth quarter) examine the carrying value of our goodwill and trade name to determine whether there are any impairment losses.

Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets," requires that intangible assets with estimated useful lives be amortized over those lives and be reviewed for impairment in accordance with SFAS No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets," to determine whether any changes to these lives are required. We periodically reassess the useful life of our intangible assets to determine whether any changes to those lives are required.

(f) Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed

-----  
of:  
---

We review long-lived assets to be held and used and long-lived assets to be disposed of, including intangible assets with estimated useful lives, for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Recoverability of assets to be held and used is measured by comparing the carrying amount of the asset to the future undiscounted net cash flows expected to be generated by the asset. Recoverability of assets held for sale is measured by comparing the carrying amount of the assets to their estimated fair market value. If any assets are considered to be impaired, the impairment is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value.

(g) Derivative Instruments and Hedging Activities:  
-----

We account for derivative instruments and hedging activities in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended. SFAS No. 133, as amended, requires that all derivative instruments, such as interest rate swaps, be recognized in the financial statements and measured at fair value regardless of the purpose or intent of holding them.

We have interest rate swap arrangements related to a portion of our fixed rate debt. These hedge strategies satisfy the fair value hedging requirements of SFAS No. 133, as amended. As a result, the fair value of the swaps is carried on the consolidated balance sheets in other liabilities and the related hedged liabilities are also adjusted to fair value by the same amount.

(h) Stock Plans:  
-----

We have various employee stock-based compensation plans. Awards under these plans are granted to eligible officers, management employees, non-management employees and non-employee directors. Awards may be made in the form of incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock or other stock-based awards. We have no awards with market or performance conditions. Our general policy is to issue shares upon the grant of restricted shares and exercise of options from treasury.

On January 1, 2006, we adopted the provisions of SFAS No. 123 (revised 2004), "Share-Based Payment" (SFAS No. 123R) and elected to use the modified prospective transition method. The modified prospective transition method requires that compensation cost be recognized in the financial statements for all awards granted after the date of adoption as well as for existing awards for which the requisite service had not been rendered as of the date of adoption. Estimated compensation cost for awards that are outstanding at the effective date will be recognized over the remaining service period using the compensation cost calculated for pro forma disclosure purposes. Prior periods have not been restated.

On November 10, 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position SFAS No. 123R-3, "Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards." We elected to adopt the alternative transition method provided for calculating the tax effects of share-based compensation pursuant to

SFAS No. 123R. The alternative transition method includes a simplified method to establish the beginning balance of the additional paid-in capital pool (APIC pool) related to the tax effects of employee share-based compensation, which is available to absorb tax deficiencies recognized subsequent to the adoption of SFAS No. 123R.

In accordance with the adoption of SFAS No. 123R, we recorded stock-based compensation expense for the cost of stock options, restricted shares and stock units issued under our stock plans (together, Stock-Based Awards). Stock-based compensation expense was \$2.0 million and \$2.7 million for the three months ended June 30, 2007 and 2006, respectively, and \$5.4 million and \$5.3 million for the six months ended June 30, 2007 and 2006, respectively.

The compensation cost recognized is based on awards ultimately expected to vest. SFAS No. 123R requires forfeitures to be estimated and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Prior to the adoption of SFAS No. 123R, we applied Accounting Principles Board Opinion (APB) No. 25 and related interpretations to account for our stock plans resulting in the use of the intrinsic-value based method to value the stock. Under APB No. 25, we were not required to recognize compensation expense for the cost of stock options issued under our stock plans.

(i) Net Income Per Common Share Available for Common Shareholders:

-----  
 Basic net income per common share is computed using the weighted average number of common shares outstanding during the period being reported on. Except when the effect would be antidilutive, diluted net income per common share reflects the dilutive effect of the assumed exercise of stock options using the treasury stock method at the beginning of the period being reported on as well as common shares that would result from the conversion of convertible preferred stock (EPPICS) and convertible notes. In addition, the related interest on debt (net of tax) is added back to income since it would not be paid if the debt was converted to common stock.

(2) Recent Accounting Literature and Changes in Accounting Principles:

-----  
 Accounting for Uncertainty in Income Taxes

-----  
 In July 2006, the FASB issued FASB Interpretation No. (FIN) 48, "Accounting for Uncertainty in Income Taxes." Among other things, FIN No. 48 requires applying a "more likely than not" threshold to the recognition and derecognition of uncertain tax positions either taken or expected to be taken in the Company's income tax returns. We adopted the provisions of FIN No. 48 in the first quarter of 2007. The total amount of our FIN No. 48 tax liability for tax positions that may not be sustained under a "more likely than not" threshold is reflected on the Company's balance sheet as of the date of adoption at \$44.7 million and amounts to \$47.5 million as of June 30, 2007. This amount includes an accrual for interest in the amount of \$5.2 million as of June 30, 2007. These balances include amounts of \$9.0 million and \$1.4 million for total FIN No. 48 tax liabilities and accrued interest, respectively, pursuant to the Company's acquisition of Commonwealth Telephone Enterprises, Inc., completed in March 2007. The amount of our total FIN No. 48 tax liabilities reflected above that would positively impact the calculation of our effective income tax rate, if our

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tax positions are sustained, is \$23.7 million as of June 30, 2007.

The Company's policy regarding the classification of interest and penalties is to include these amounts as a component of income tax expense. This treatment of interest and penalties is consistent with prior periods. We have recognized in our year to date statement of operations additional interest in the amount of \$0.5 million. We do not expect that our balances with respect to our uncertain tax positions will significantly increase or decrease within the next 12 months. We are subject to income tax examinations generally for the years 2003 forward for both our federal and state filing jurisdictions.

### How Taxes Collected from Customers and Remitted to Governmental Authorities ----- Should be Presented in the Income Statement -----

In June 2006, the FASB issued EITF Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should be Presented in the Income Statement," which requires disclosure of the accounting policy for any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction, that is Gross versus Net presentation. EITF No. 06-3 is effective for periods beginning after December 15, 2006. We adopted the disclosure requirements of EITF No. 06-3 commencing January 1, 2007.

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### Accounting for Purchases of Life Insurance -----

In September 2006, the FASB reached consensus on the guidance provided by EITF No. 06-5, "Accounting for Purchases of Life Insurance-Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance." EITF No. 06-5 states that a policyholder should consider any additional amounts included in the contractual terms of the insurance policy other than the cash surrender value in determining the amount that could be realized under the insurance contract. EITF No. 06-5 also states that a policyholder should determine the amount that could be realized under the life insurance contract assuming the surrender of an individual-life by individual-life policy (or certificate by certificate in a group policy). EITF No. 06-5 is effective for fiscal years beginning after December 15, 2006. The adoption of the accounting requirements of EITF No. 06-5 in the first quarter of 2007 had no impact on our financial position, results of operation or cash flows.

### Accounting for Endorsement Split-Dollar Life Insurance Arrangements -----

In September 2006, the FASB reached consensus on the guidance provided by EITF No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements." The guidance is applicable to endorsement split-dollar life insurance arrangements, whereby the employer owns and controls the insurance policy, that are associated with a postretirement benefit. EITF No. 06-4 requires that for a split-dollar life insurance arrangement within the scope of the issue, an employer should recognize a liability for future benefits in accordance with SFAS No. 106 (if, in substance, a postretirement benefit plan exists) or Accounting Principles Board Opinion No. 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee. EITF No. 06-4 is effective for fiscal years beginning after December 15, 2007. The Company is currently evaluating the impact the adoption of the standard will have on the Company's results of operations or financial condition.

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### Fair Value Measurements

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In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The provisions of SFAS No. 157 are effective as of the beginning of our 2008 fiscal year. The Company is currently evaluating the impact that the adoption of the standard will have on the Company's results of operations or financial condition.

### Fair Value Option for Financial Assets and Financial Liabilities

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In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115," which permits entities to choose to measure many financial instruments and certain other items at fair value. The provisions of SFAS No. 159 are effective as of the beginning of our 2008 fiscal year. The Company is currently evaluating the impact that the adoption of the standard will have on the Company's results of operations or financial condition.

### Accounting for Collateral Assignment Split-Dollar Life Insurance

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#### Arrangements

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In March 2007, the FASB ratified the consensus reached by the EITF on Issue No. 06-10, "Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements." EITF No. 06-10 provides guidance on an employers' recognition of a liability and related compensation costs for collateral assignment split-dollar life insurance arrangements that provide a benefit to an employee that extends into postretirement periods and the asset in collateral assignment split-dollar life insurance arrangements. The effective date of EITF No. 06-10 is for fiscal years beginning after December 15, 2007. The Company is currently evaluating the impact that the adoption of the standard will have on the Company's results of operations or financial condition.

### (3) Acquisition of Commonwealth Telephone:

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On March 8, 2007, we acquired Commonwealth Telephone Enterprises, Inc. ("Commonwealth" or "CTE") in a cash-and-stock taxable transaction, for a total consideration of approximately \$1.1 billion. We paid \$798.0 million in cash (\$657.6 million net, after cash acquired), issued common stock with a value of \$247.3 million and had \$10.5 million of accrued closing costs at June 30, 2007.

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In connection with the acquisition of Commonwealth, we assumed \$35.0 million of debt under a revolving credit facility and \$191.8 million face amount of Commonwealth convertible notes (fair value of \$209.6 million). During March 2007, we paid down the \$35.0 million credit facility. We have retired all but \$8.5 million of the \$191.8 million face amount of Commonwealth convertible notes as of June 30, 2007. The notes were retired by the payment of \$165.4 million in cash and the issuance of our common stock valued at \$36.7 million. The premium paid of \$18.9 million was recorded as \$17.8 million to goodwill and \$1.1 million to expense.

We have accounted for the acquisition of Commonwealth as a purchase under U.S. generally accepted accounting principles. Under the purchase method of accounting, the assets and liabilities of Commonwealth are recorded as of

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the acquisition date, at their respective fair values, and consolidated with those of Citizens. The reported consolidated financial condition of Citizens as of June 30, 2007 reflects a preliminary estimated allocation of these fair values.

The following schedule provides a summary of the purchase price paid by Citizens in the acquisition of Commonwealth as of June 30, 2007 (\$ in thousands):

|                                       |    |           |
|---------------------------------------|----|-----------|
| Cash paid                             | \$ | 798,015   |
| Value of Citizens common stock issued |    | 247,315   |
| Accrued closing costs                 |    | 10,540    |
|                                       |    | -----     |
| Total Purchase Price                  | \$ | 1,055,870 |
|                                       |    | =====     |

The allocation of the purchase price to assets and liabilities is preliminary. The estimated purchase price has been allocated to the net tangible and intangible assets and liabilities acquired as follows (\$ in thousands):

|  |    |           |
|--|----|-----------|
| Allocation of estimated purchase price:        |    |           |
| Current assets (1)                             | \$ | 190,361   |
| Property, plant and equipment                  |    | 387,720   |
| Goodwill                                       |    | 568,891   |
| Other intangibles - customer list              |    | 500,000   |
| Other assets                                   |    | 11,234    |
| Current portion of debt                        |    | (35,000)  |
| Accounts payable and other current liabilities |    | (77,224)  |
| Deferred income taxes                          |    | (247,208) |
| Convertible Notes                              |    | (209,553) |
| Other liabilities                              |    | (33,351)  |
|  |    | -----     |
| Total Purchase Price                           | \$ | 1,055,870 |
|  |    | =====     |

(1) Includes \$140.5 million of acquired cash.

The final allocation of the purchase price will be based on the fair values of the assets acquired and liabilities assumed as determined by third-party valuation. The actual allocation may differ significantly from the preliminary allocation.

The following unaudited pro forma financial information presents the combined results of operations of Citizens and Commonwealth as if the acquisition had occurred at the beginning of each period presented. The historical results of the Company include the results of Commonwealth from the date of acquisition on March 8, 2007. The pro forma information is not necessarily indicative of what the financial position or results of operations actually would have been had the acquisition been completed at the date indicated. In addition, the unaudited pro forma financial information does not purport to project the future financial position or operating results of Citizens after completion of the acquisition.

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|  | 2007         | 2006         |
|--|--------------|--------------|
| (\$ in thousands, except per share amounts)  |              |              |
| Revenue                                      | \$ 1,197,237 | \$ 1,177,430 |
| Operating income                             | \$ 376,130   | \$ 357,481   |
| Income from continuing operations            | \$ 116,223   | \$ 157,337   |
| Income from discontinued operations          | \$ -         | \$ 13,452    |
| Net income available for common shareholders | \$ 116,223   | \$ 170,789   |
| Basic income per common share:               |              |              |
| Income from continuing operations            | \$ 0.35      | \$ 0.46      |
| Income from discontinued operations          | -            | 0.04         |
| Net income per common share                  | \$ 0.35      | \$ 0.50      |
| Diluted income per common share:             |              |              |
| Income from continuing operations            | \$ 0.35      | \$ 0.45      |
| Income from discontinued operations          | -            | 0.04         |
| Net income per common share                  | \$ 0.35      | \$ 0.49      |

(4) Accounts Receivable:

The components of accounts receivable, net at June 30, 2007 and December 31, 2006 are as follows:

|                                       | June 30, 2007 | December 31, |
|---------------------------------------|---------------|--------------|
| (\$ in thousands)                     |               |              |
| End user                              | \$ 223,953    |              |
| Other                                 | 24,550        |              |
| Less: Allowance for doubtful accounts | (24,195)      |              |
| Accounts receivable, net              | \$ 224,308    |              |

The Company maintains an allowance for estimated bad debts based on its estimate of collectibility of its accounts receivable. Bad debt expense, which is recorded as a reduction of revenue, was \$6.7 million and \$2.8 million for the three months ended June 30, 2007 and 2006, respectively, and \$11.6 million and \$7.2 million for the six months ended June 30, 2007 and 2006, respectively.

Our allowance for doubtful accounts (and "end user" receivables) declined from December 31, 2006, primarily as a result of the resolution of a carrier dispute. On March 12, 2007, we entered into a settlement agreement with a carrier pursuant to which we were paid \$37.5 million, resulting in a favorable impact on our revenue in the first quarter of 2007 and for the six months ended June 30, 2007 of \$38.7 million.

(5) Property, Plant and Equipment, Net:

Property, plant and equipment at June 30, 2007 and December 31, 2006 are as follows:



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| (\$ in thousands)<br>-----         | June 30, 2007<br>----- | December 31,<br>----- |
|------------------------------------|------------------------|-----------------------|
| Property, plant and equipment      | \$ 7,153,975           | \$ 6                  |
| Less: accumulated depreciation     | (3,853,426)            | (3                    |
| Property, plant and equipment, net | <u>\$ 3,300,549</u>    | <u>\$ 2</u>           |

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Depreciation expense is principally based on the composite group method. Depreciation expense was \$93.4 million and \$88.0 million for the three months ended June 30, 2007 and 2006, respectively, and \$180.0 million and \$178.4 million for the six months ended June 30, 2007 and 2006, respectively.

(6) Discontinued Operations:  
-----

On July 31, 2006, we sold our CLEC business, Electric Lightwave, LLC (ELI), for \$255.3 million in cash plus the assumption of approximately \$4.0 million in capital lease obligations. We recognized a pre-tax gain on the sale of ELI of approximately \$116.7 million. Our after-tax gain on the sale was \$71.6 million. Our cash liability for taxes as a result of the sale is expected to be approximately \$5.0 million due to the utilization of existing tax net operating losses on both the federal and state level.

In accordance with SFAS No. 144, any component of our business that we dispose of, or classify as held for sale, that has operations and cash flows clearly distinguishable from continuing operations for financial reporting purposes, and that will be eliminated from the ongoing operations, should be classified as discontinued operations. Accordingly, we have classified the results of operations of ELI as discontinued operations in our consolidated statement of operations.

Summarized financial information for ELI is set forth below:

| (\$ in thousands)<br>----- | For the three months<br>ended June 30, 2006<br>----- | For the six months<br>ended June 30, 2006<br>----- |
|----------------------------|--|--|
| Revenue                    | \$ 43,584  | \$ 86,078  |
| Operating income           | \$ 11,482  | \$ 21,940  |
| Income taxes               | \$ 4,526   | \$ 8,488   |
| Net income                 | \$ 6,956   | \$ 13,452  |

(7) Other Intangibles:  
-----

Other intangibles at June 30, 2007 and December 31, 2006 are as follows:

| (\$ in thousands)<br>-----                 | June 30, 2007<br>----- | December 31, 2006<br>----- |
|--|------------------------|----------------------------|
| Customer base - amortizable over 96 months | \$ 1,494,605           | \$ 994,605                 |
| Trade name - non-amortizable               | 122,058                | 122,058                    |

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|                                |            |            |
|--------------------------------|------------|------------|
| Other intangibles              | 1,616,663  | 1,116,663  |
| Less: Accumulated amortization | (767,018)  | (684,310)  |
|                                | -----      | -----      |
| Total other intangibles, net   | \$ 849,645 | \$ 432,353 |
|                                | =====      | =====      |

Amortization expense was \$47.2 million and \$31.6 million for the three months ended June 30, 2007 and 2006, respectively, and \$82.7 million and \$63.2 million for the six months ended June 30, 2007 and 2006, respectively. Amortization expense for the three and six months ended June 30, 2007 is comprised of \$31.6 million and \$63.2 million, respectively, for our "base Citizens business" and \$15.6 million and \$19.5 million, respectively, for the customer base acquired in the Commonwealth acquisition. On a preliminary basis, \$500.0 million has been allocated to the customer base acquired in the Commonwealth acquisition, with amortization to be based on an eight-year life (\$62.5 million annually).

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(8) Long-Term Debt:

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The activity in our long-term debt from December 31, 2006 to June 30, 2007 is as follows:

| (\$ in thousands)                       | Six months ended June 30, 2007 |              |                   |  |                       |               |
|---|--------------------------------|--------------|-------------------|--|-----------------------|---------------|
|   | December 31,<br>2006           | Payments     | New<br>Borrowings | Assumed<br>From<br>Commonwealth<br>Acquisition | Interest<br>Rate Swap | Reclass<br>Ot |
| -----                                   | -----                          | -----        | -----             | -----  | -----                 | -----         |
| FIXED RATE                              |                                |              |                   |  |                       |               |
| Rural Utilities Service                 |                                |              |                   |  |                       |               |
| Loan Contracts                          | \$ 21,886                      | \$ (3,877)   | \$ -              | \$ -   | \$ -                  | \$ -          |
| Senior Unsecured Debt                   | 4,435,018                      | (896,399)    | 950,000           | 226,779  | (3,628)               | (17,000)      |
| EPPICS                                  | 17,860                         | -            | -                 | -  | -                     | (3,000)       |
| Industrial Development<br>Revenue Bonds | 58,140                         | (14,240)     | -                 | -  | -                     | -             |
| TOTAL LONG-TERM DEBT                    | \$ 4,532,904                   | \$ (914,516) | \$ 950,000        | \$ 226,779                                     | \$ (3,628)            | \$ (21,000)   |
|   | -----                          | =====        | =====             | =====  | =====                 | =====         |
| Less: Debt Discount                     | (32,878)                       |              |                   |  |                       |               |
| Less: Current Portion                   | (39,271)                       |              |                   |  |                       |               |
|   | -----                          |              |                   |  |                       |               |
|   | \$ 4,460,755                   |              |                   |  |                       |               |
|   | =====                          |              |                   |  |                       |               |

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\* Interest rate includes amortization of debt issuance costs, debt premiums or discounts. The interest rates for Rural Utilities Service Loan Contracts, Senior Unsecured Debt, and Industrial Development Revenue Bonds represent a weighted average of multiple issuances.

For the six months ended June 30, 2007, we retired an aggregate principal amount of \$935.6 million of debt, including \$3.3 million of 5% Company Obligated Mandatorily Redeemable Convertible Preferred Securities due 2036 (EPPICS) and \$17.8 million of 3.25% Commonwealth convertible notes that were converted into our common stock. As further described below, we temporarily borrowed and repaid \$200.0 million during the month of March 2007, utilized to temporarily fund our acquisition of Commonwealth. Although this borrowing does not appear in our December 31, 2006 or June 30, 2007 balance sheet, the borrowing and repayment are shown gross in the above table.

During the first quarter of 2006, we entered into two debt-for-debt exchanges of our debt securities. As a result, \$47.5 million of our 7.625% notes due 2008 were exchanged for approximately \$47.4 million of our 9.00% notes due 2031. The 9.00% notes are callable on the same general terms and conditions as the 7.625% notes that were exchanged. No cash was exchanged in these transactions. However, a non-cash pre-tax loss of approximately \$2.4 million was recognized in accordance with EITF No. 96-19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments," which is included in investment and other income (loss), net for the six months ended June 30, 2006.

In connection with the acquisition of Commonwealth, we assumed \$35.0 million of debt under a revolving credit facility and approximately \$191.8 million face amount of Commonwealth convertible notes (fair value of approximately \$209.6 million). During March 2007 we paid down the \$35.0 million credit facility, and through June 30, 2007 we have retired approximately \$183.3 million face amount (for which we paid \$165.4 million in cash and \$36.7 million in common stock) of the convertible notes (premium paid of \$18.9 million was recorded as \$17.8 million to goodwill and \$1.1 million to expense), resulting in a remaining outstanding balance of \$8.5 million as of June 30, 2007.

On March 23, 2007, we issued in a private placement an aggregate \$300.0 million principal amount of 6.625% Senior Notes due 2015 and \$450.0 million principal amount of 7.125% Senior Notes due 2019. Proceeds from the sale were used to pay down \$200.0 million principal amount of indebtedness borrowed on March 8, 2007 under a bridge loan facility. The bridge loan was established to help fund our acquisition of Commonwealth, and with the pay down the facility was terminated.

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During the first quarter of 2007, we incurred and expensed approximately \$4.0 million of fees associated with the bridge loan facility. We also filed with the SEC a registration statement for an exchange offer on the \$750.0 million in total of private placement notes described above, in addition to the \$400.0 million principal amount of 7.875% Senior Notes issued in a private placement on December 22, 2006, for registered notes. The exchange offer was completed in the second quarter of 2007. On April 26, 2007, we redeemed \$495.2 million principal amount of our 7.625% Senior Notes due 2008 at a price of 103.041% plus accrued and unpaid interest. The debt retirement generated a pre-tax loss on the early extinguishment of debt at a premium of approximately \$16.3 million in the second quarter of 2007 and is included in investment and other income (loss), net. As a result of this debt redemption, we also terminated three interest rate swap

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agreements hedging an aggregate \$150.0 million of indebtedness. Payments on the swap terminations of approximately \$1.0 million were made in the second quarter of 2007.

As of June 30, 2007, EPPICS representing a total principal amount of \$197.2 million have been converted into 15,912,949 shares of our common stock. Approximately \$4.1 million of EPPICS, which are convertible into 355,493 shares of our common stock, were outstanding at June 30, 2007. Our long-term debt footnote indicates \$14.6 million of EPPICS outstanding at June 30, 2007, of which \$10.5 million is debt of related parties for which the company has an offsetting receivable.

A summary of the activity for our industrial development revenue bonds is as follows (\$ in millions):

|  |         |
|--|---------|
| Principal amount outstanding at December 31, 2006  | \$ 58.1 |
| Retirements during the first six months of 2007    | (14.2)  |
|  | -----   |
| Principal amount outstanding at June 30, 2007      | 43.9    |
| Expected retirements on August 1, 2007             | (30.4)  |
|  | -----   |
| Remaining principal with a maturity at May 1, 2030 | \$ 13.5 |
|  | =====   |

As of June 30, 2007, we had available lines of credit with financial institutions in the aggregate amount of \$250.0 million and there were no outstanding standby letters of credit issued under the facility. Associated facility fees vary, depending on our debt leverage ratio, and were 0.20% per annum as of June 30, 2007. The expiration date for this new \$250.0 million five year revolving credit agreement is May 18, 2012. During the term of the credit facility we may borrow, repay and reborrow funds. The credit facility is available for general corporate purposes but may not be used to fund dividend payments.

We are in compliance with all of our debt and credit facility covenants.

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(9) Net Income Per Common Share:

The reconciliation of the net income per common share calculation for the three and six months ended June 30, 2007 and 2006, respectively, is as follows:

| (\$ in thousands, except per-share amounts)    | For the three months ended June 30, |           | For th |
|--|-------------------------------------|-----------|--------|
|  | 2007                                | 2006      |        |
| Net income used for basic and diluted earnings |                                     |           |        |
| per common share:                              |                                     |           |        |
| Income from continuing operations              | \$ 40,559                           | \$ 94,746 |        |
| Income from discontinued operations            | -                                   | 6,956     |        |
| Total basic net income available for common    |                                     |           |        |

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|   |           |            |
|---|-----------|------------|
| shareholders  | \$ 40,559 | \$ 101,702 |
|   | =====     | =====      |
| Effect of conversion of preferred securities -<br>EPPICS      | 32        | 79         |
|   | -----     | -----      |
| Total diluted net income available for common<br>shareholders | \$ 40,591 | \$ 101,781 |
|   | =====     | =====      |
| Basic earnings per common share:<br>-----                     |           |            |
| Weighted-average shares outstanding - basic                   | 340,469   | 322,337    |
|   | -----     | -----      |
| Income from continuing operations                             | \$ 0.12   | \$ 0.30    |
| Income from discontinued operations                           | -         | 0.02       |
|   | -----     | -----      |
| Net income per share available for common<br>shareholders     | \$ 0.12   | \$ 0.32    |
|   | =====     | =====      |
| Diluted earnings per common share:<br>-----                   |           |            |
| Weighted-average shares outstanding                           | 340,469   | 322,337    |
| Effect of dilutive shares                                     | 760       | 698        |
| Effect of conversion of preferred securities -<br>EPPICS      | 359       | 847        |
|   | -----     | -----      |
| Weighted-average shares outstanding - diluted                 | 341,588   | 323,882    |
|   | =====     | =====      |
| Income from continuing operations                             | \$ 0.12   | \$ 0.29    |
| Income from discontinued operations                           | -         | 0.02       |
|   | -----     | -----      |
| Net income per share available for common<br>shareholders     | \$ 0.12   | \$ 0.31    |
|   | =====     | =====      |

Stock Options

-----  
For the three and six months ended June 30, 2007, options to purchase 1,221,150 shares (at exercise prices ranging from \$15.94 to \$18.46) issuable under employee compensation plans were excluded from the computation of diluted EPS for those periods because the exercise prices were greater than the average market price of common shares and, therefore, the effect would be antidilutive. In calculating diluted EPS we apply the treasury stock method and include future unearned compensation as part of the assumed proceeds.

For the three and six months ended June 30, 2006, options to purchase 1,960,000 shares at exercise prices ranging from \$13.03 and \$18.46 issuable under employee compensation plans were excluded from the computation of diluted EPS for those periods because the exercise prices were greater than the average market price of our common stock and, therefore, the effect would be antidilutive.

In addition, for the three and six months ended June 30, 2007 and 2006, restricted stock awards of 1,389,000 and 1,212,000 shares, respectively, are excluded from our basic weighted average shares outstanding and included in our dilutive shares until the shares are no longer contingent upon the satisfaction of all specified conditions.

EPPICS

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As a result of our July 2004 dividend announcement with respect to our common stock, our EPPICS began to convert into shares of our common stock.

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As of June 30, 2007, approximately 98% of the EPPICS outstanding, or about \$197.2 million aggregate principal amount of EPPICS, have converted into 15,912,949 shares of our common stock, including shares issued from treasury.

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At June 30, 2007, we had 81,507 shares of potentially dilutive EPPICS, which were convertible into our common stock at a 4.3615 to 1 ratio at an exercise price of \$11.46 per share. If all remaining EPPICS are converted, we would issue approximately 355,493 shares of our common stock. These securities have been included in the diluted income per common share calculation for the period ended June 30, 2007.

At June 30, 2006, we had 180,594 shares of potentially dilutive EPPICS, which were convertible into our common stock at a 4.3615 to 1 ratio at an exercise price of \$11.46 per share. If all remaining EPPICS had been converted we would have issued approximately 787,661 shares of our common stock. These securities have been included in the diluted income per common share calculation for the period ended June 30, 2006.

### Stock Units

At June 30, 2007 and 2006, we had 191,450 and 282,000 stock units, respectively, issued under our Non-Employee Directors' Deferred Fee Equity Plan (Deferred Fee Plan), Non-Employee Directors' Equity Incentive Plan (Directors' Equity Plan) and Non-Employee Directors' Retirement Plan. These securities have not been included in the diluted income per share of common stock calculation because their inclusion would have had an antidilutive effect.

### Share Repurchase Programs

In February 2007, our Board of Directors authorized us to repurchase up to \$250.0 million of our common stock in public or private transactions over the following twelve-month period. This share repurchase program commenced on March 19, 2007. As of June 30, 2007, we had repurchased approximately 4,633,000 shares of our common stock at an aggregate cost of approximately \$70.7 million.

### (10) Stock Plans:

At June 30, 2007, we had five stock-based compensation plans pursuant to which grants are outstanding, which are described below. Prior to the adoption of SFAS No. 123R, we applied APB No. 25 and related interpretations to account for our stock plans resulting in the use of the intrinsic value to value the stock and determine compensation expense. Under APB No. 25, we were not required to recognize compensation expense for the cost of stock options. In accordance with the adoption of SFAS No. 123R, we recorded stock-based compensation expense for the cost of stock options, restricted shares and stock units issued pursuant to the Management Equity Incentive Plan (MEIP), the 1996 Equity Incentive Plan (1996 EIP), the Amended and Restated 2000 Equity Incentive Plan (2000 EIP), the Deferred Fee Plan and the Directors' Equity Plan. Our general policy is to issue shares upon the grant of restricted shares and exercise of options from treasury. At June 30, 2007, there were 16,058,182 shares authorized for grant under these plans and 5,225,199 shares available for grant. No further awards may be granted under the MEIP, the 1996 EIP or the Deferred Fee Plan.

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## Management Equity Incentive Plan

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Prior to its expiration on June 21, 2000, awards of our common stock could have been granted under the MEIP to eligible officers, management employees and non-management employees in the form of incentive stock options, non-qualified stock options, stock appreciation rights (SARs), restricted stock or other stock-based awards.

Since the expiration of the MEIP, no awards have been or may be granted under the MEIP. The exercise price of stock options issued was equal to or greater than the fair market value of the underlying common stock on the date of grant. Stock options were not ordinarily exercisable on the date of grant but vest over a period of time (generally 4 years). Under the terms of the MEIP, subsequent stock dividends and stock splits have the effect of increasing the option shares outstanding, which correspondingly decreases the average exercise price of outstanding options.

## 1996 and 2000 Equity Incentive Plans

-----

Since the expiration date of the 1996 EIP on May 22, 2006, no awards have been or may be granted under the 1996 EIP. Under the 2000 EIP, awards of our common stock may be granted to eligible officers, management employees and non-management employees in the form of incentive stock options, non-qualified stock options, SARs, restricted stock or other stock-based awards. As discussed under the Non-Employee Directors' Compensation Plans below, prior to May 25, 2006 non-employee directors received an award of stock options under the 2000 EIP upon commencement of service.

At June 30, 2007, there were 13,517,421 shares authorized for grant under the 2000 EIP and 2,820,503 shares available for grant, as adjusted to reflect stock dividends. No awards will be granted more than 10 years after the effective date (May 18, 2000) of the 2000 EIP.

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The exercise price of stock options and SARs under the 2000 and 1996 EIP generally shall be equal to or greater than the fair market value of the underlying common stock on the date of grant. Stock options are not ordinarily exercisable on the date of grant but vest over a period of time (generally 4 years). Under the terms of the EIPs, subsequent stock dividends and stock splits have the effect of increasing the option shares outstanding, which correspondingly decrease the average exercise price of outstanding options.

The following summary presents information regarding outstanding stock options as of June 30, 2007 and changes during the six months then ended with regard to options under the MEIP and the EIPs:

|                            | Shares<br>Subject to<br>Option | Weighted<br>Average<br>Option Price<br>Per Share |
|----------------------------|--------------------------------|--|
| Balance at January 1, 2007 | 5,242,000                      | \$12.41  |
| Options granted            | -                              | -  |

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|                                       |             |         |
|---------------------------------------|-------------|---------|
| Options exercised                     | (1,018,000) | \$10.32 |
| Options canceled, forfeited or lapsed | (17,000)    | \$11.53 |
| -----                                 |             |         |
| Balance at June 30, 2007              | 4,207,000   | \$12.92 |
| =====                                 |             |         |
| Exercisable at June 30, 2007          | 4,184,000   | \$12.92 |
| =====                                 |             |         |

There were no options granted during the first six months of 2007. Cash received upon the exercise of options during the first six months of 2007 totaled \$11.5 million. Total remaining unrecognized compensation cost associated with unvested stock options at June 30, 2007 was \$0.1 million and the weighted average period over which this cost is expected to be recognized is approximately one year.

The total intrinsic value of stock options exercised during the first six months of 2006 was \$4.3 million. The total intrinsic value of stock options outstanding and exercisable at June 30, 2006 was \$14.3 million and \$13.2 million, respectively. Options granted during the first six months of 2006 totaled 13,000. The weighted average grant-date fair value of options granted during the six months ended June 30, 2006 was \$3.08. Cash received upon the exercise of options during the first six months of 2006 totaled \$12.8 million.

For purposes of determining compensation expense, the fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model which requires the use of various assumptions including expected life of the option, expected dividend rate, expected volatility, and risk-free interest rate. The expected life (estimated period of time outstanding) of stock options granted was estimated using the historical exercise behavior of employees. The risk free interest rate is based on the U.S. Treasury yield curve in effect at the time of the grant. Expected volatility is based on historical volatility for a period equal to the stock option's expected life, calculated on a monthly basis.

The following table presents the weighted average assumptions used for grants in fiscal 2006:

|                         |         |
|-------------------------|---------|
| 2006                    |         |
| -----                   | -----   |
| Dividend yield          | 7.55%   |
| Expected volatility     | 44%     |
| Risk-free interest rate | 4.89%   |
| Expected life           | 5 years |
| -----                   | -----   |

The following summary presents information regarding unvested restricted stock as of June 30, 2007 and changes during the six months then ended with regard to restricted stock under the MEIP and the EIPs:

| Number of<br>Shares | Weighted<br>Average<br>Grant Date<br>Fair Value | Aggrega<br>Fair Valu<br>June 3<br>2007 |
|---------------------|---|--|
| -----               |   |  |



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|                            |           |         |          |
|----------------------------|-----------|---------|----------|
| Balance at January 1, 2007 | 1,174,000 | \$12.89 |          |
| Restricted stock granted   | 696,000   | \$15.08 | \$10,638 |
| Restricted stock vested    | (468,000) | \$12.76 | \$ 7,151 |
| Restricted stock forfeited | (13,000)  | \$14.23 | \$ 197   |
|                            |           |         |          |
| Balance at June 30, 2007   | 1,389,000 | \$14.02 | \$21,211 |
|                            |           |         |          |

For purposes of determining compensation expense, the fair value of each restricted stock grant is estimated based on the average of the high and low market price of a share of our common stock on the date of grant. Total remaining unrecognized compensation cost associated with unvested restricted stock awards at June 30, 2007 was \$17.5 million and the weighted average period over which this cost is expected to be recognized is approximately three years.

The total fair value of shares granted and vested during the six months ended June 30, 2006 was approximately \$9.5 million and \$7.6 million, respectively. The total fair value of unvested restricted stock at June 30, 2006 was \$15.8 million. The weighted average grant-date fair value of restricted shares granted during the six months ended June 30, 2006 was \$12.86. Shares granted during the first six months of 2006 totaled 730,000.

### Non-Employee Directors' Compensation Plans

Upon commencement of his or her service on the Board of Directors, each non-employee director receives a grant of 10,000 stock options. These options are currently awarded under the Directors' Equity Plan. Prior to effectiveness of the Directors' Equity Plan on May 25, 2006, these options were awarded under the 2000 EIP. The exercise price of these options, which become exercisable six months after the grant date, is the fair market value (as defined in the relevant plan) of our common stock on the date of grant. Options granted under the Directors' Equity Plan expire on the earlier of the tenth anniversary of the grant date or the first anniversary of termination of service as a director. Options granted under the 2000 EIP expire on the tenth anniversary of the grant date.

Each non-employee director also receives an annual grant of 3,500 stock units. These units are currently awarded under the Directors' Equity Plan and prior to effectiveness of that plan, were awarded under the Deferred Fee Plan. Since the effectiveness of the Directors' Equity Plan, no further grants have been made under the Deferred Fee Plan. Prior to April 20, 2004, each non-employee director received an award of 5,000 stock options. The exercise price of such options was set at 100% of the fair market value on the date the options were granted. The options are exercisable six months after the grant date and remain exercisable for ten years after the grant date.

In addition, each year, each non-employee director is also entitled to receive a retainer, meeting fees, and, when applicable, fees for serving as a committee chair or as Lead Director, which are awarded under the Directors' Equity Plan. For 2007, each non-employee director had to elect, by December 31 of the preceding year, to receive \$40,000 cash or 5,760 stock units as an annual retainer and to receive meeting fees and Lead Director and committee chair stipends in the form of cash or stock units. Directors making a stock unit election must also elect to convert the units to either common stock (convertible on a one-to-one basis) or cash upon retirement or death. Prior to June 30, 2003, a director could elect to receive 20,000 stock options as an annual retainer in lieu of cash or stock units. The exercise price of the stock options was set at the average of the high and low market prices of our common stock on the date of grant. The options were exercisable six months after the date of grant and had a

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10-year term.

The number of shares of common stock authorized for issuance under the Directors' Equity Plan is 2,540,761, which includes 540,761 shares that were available for grant under the Deferred Fee Plan on the effective date of the Directors' Equity Plan. In addition, if and to the extent that any "plan units" outstanding on May 25, 2006 under the Deferred Fee Plan are forfeited, or if any option granted under the Deferred Fee Plan terminates, expires, or is cancelled or forfeited, without having been fully exercised, shares of common stock subject to such "plan units" or options cancelled shall become available under the Directors' Equity Plan. At June 30, 2007, there were 2,404,696 shares available for grant. There were 13 directors participating in the directors' plans during the second quarter of 2007. In the first six months of 2007, total plan units earned were 81,249. At June 30, 2007, 177,951 options were exercisable at a weighted average exercise price of \$12.61.

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We account for the Deferred Fee Plan and the Directors' Equity Plan in accordance with SFAS No. 123R. To the extent directors elect to receive the distribution of their stock unit accounts in cash, they are considered liability-based awards. To the extent directors elect to receive the distribution of their stock unit accounts in common stock, they are considered equity-based awards. Compensation expense for stock units that are considered equity-based awards is based on the market value of our common stock at the date of grant. Compensation expense for stock units that are considered liability-based awards is based on the market value of our common stock at the end of each period. For awards granted prior to 1999, a director could elect to be paid in stock options. Generally, compensation cost was not recorded because the options were granted at the fair market value of our common stock on the grant date under APB No. 25 and related interpretations.

We had also maintained a Non-Employee Directors' Retirement Plan providing for the payment of specified sums annually to our non-employee directors, or their designated beneficiaries, starting at the director's retirement, death or termination of directorship. In 1999, we terminated this Plan. As of June 30, 2007, the liability for such payments was reduced to \$0, as the obligation was fully settled during the second quarter of 2007.

### (11) Segment Information:

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As of January 1, 2007, we operate in one reportable segment, Frontier. Frontier provides both regulated and unregulated communications services to residential, business and wholesale customers and is typically the incumbent provider in its service areas.

As permitted by SFAS No. 131, we have utilized the aggregation criteria in combining our markets because all of our Frontier properties share similar economic characteristics, in that they provide the same products and services to similar customers using comparable technologies in all of the states in which we operate. The regulatory structure is generally similar. Differences in the regulatory regime of a particular state do not materially impact the economic characteristics or operating results of a particular property.

### (12) Derivative Instruments and Hedging Activities:

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Interest rate swap agreements are used to hedge a portion of our debt that is subject to fixed interest rates. Under our interest rate swap agreements, we agree to pay an amount equal to a specified variable rate of

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interest times a notional principal amount, and to receive in return an amount equal to a specified fixed rate of interest times the same notional principal amount. The notional amounts of the contracts are not exchanged. No other cash payments are made unless the agreement is terminated prior to maturity, in which case the amount paid or received in settlement is established by agreement at the time of termination and represents the market value, at the then current rate of interest, of the remaining obligations to exchange payments under the terms of the contracts.

The interest rate swap contracts are reflected at fair value in our consolidated balance sheets and the related portion of fixed-rate debt being hedged is reflected at an amount equal to the sum of its book value and an amount representing the change in fair value of the debt obligations attributable to the interest rate risk being hedged. Changes in the fair value of interest rate swap contracts, and the offsetting changes in the adjusted carrying value of the related portion of the fixed rate debt being hedged, are recognized in the consolidated statements of operations in interest expense. The notional amounts of interest rate swap contracts hedging fixed-rate indebtedness as of June 30, 2007 and December 31, 2006 were \$400.0 million and \$550.0 million, respectively. Such contracts require us to pay variable rates of interest (average pay rates of approximately 9.22% as of June 30, 2007 and approximately 9.02% as of December 31, 2006) and receive fixed rates of interest (average receive rates of 8.50% as of June 30, 2007 and 8.26% as of December 31, 2006). The fair value of these derivatives is reflected in other liabilities as of June 30, 2007 and December 31, 2006, in the amount of (\$13.9 million) and (\$10.3 million), respectively. The related underlying debt has been decreased by a like amount. For the three and six months ended June 30, 2007, the interest expense resulting from these interest rate swaps totaled approximately \$0.8 million and \$2.0 million, respectively.

We do not anticipate any non-performance by counter-parties to our derivative contracts as all counter-parties have investment grade credit ratings.

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(13) Investment and Other Income (Loss), Net:

The components of investment and other income (loss), net are as follows:

| (\$ in thousands)   | For the three months ended June 30, |          | For the s |
|---|-------------------------------------|----------|-----------|
|   | 2007                                | 2006     | 2007      |
| Interest and dividend income                                | \$ 8,444                            | \$ 4,213 | \$        |
| Bridge loan fee   | -                                   | -        |           |
| Gain from Rural Telephone Bank<br>Dissolution               | -                                   | 61,428   |           |
| Loss on exchange of debt                                    | -                                   | (41)     |           |
| Premium on Debt Repurchases                                 | (17,092)                            | -        | (         |
| Equity earnings/minority interest<br>in joint ventures, net | 1,575                               | (794)    |           |
| Other, net  | 556                                 | 557      |           |
| <b>Total investment and other</b>                           |                                     |          |           |

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|                    |            |           |       |
|--------------------|------------|-----------|-------|
| income (loss), net | \$ (6,517) | \$ 65,363 | \$    |
|                    | =====      | =====     | ===== |

The gain of \$61.4 million resulted from the dissolution and liquidation of the Rural Telephone Bank in April 2006.

(14) Company Obligated Mandatorily Redeemable Convertible Preferred Securities:

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In 1996, our consolidated wholly owned subsidiary, Citizens Utilities Trust (the Trust), issued, in an underwritten public offering, 4,025,000 shares of EPPICS, representing preferred undivided interests in the assets of the Trust, with a liquidation preference of \$50 per security (for a total liquidation amount of \$201.3 million). These securities convert into our common stock at an adjusted conversion price of \$11.46 per share of our common stock. The conversion price was reduced from \$13.30 to \$11.46 during the third quarter of 2004 as a result of the \$2.00 per share of common stock special, non-recurring dividend. The proceeds from the issuance of the Trust Convertible Preferred Securities and a Company capital contribution were used to purchase \$207.5 million aggregate liquidation amount of 5% Partnership Convertible Preferred Securities due 2036 from another wholly owned subsidiary, Citizens Utilities Capital L.P. (the Partnership). The proceeds from the issuance of the Partnership Convertible Preferred Securities and a Company capital contribution were used to purchase from us \$211.8 million aggregate principal amount of 5% Convertible Subordinated Debentures due 2036. The sole assets of the Trust are the Partnership Convertible Preferred Securities, and our Convertible Subordinated Debentures are substantially all the assets of the Partnership. Our obligations under the agreements related to the issuances of such securities, taken together, constitute a full and unconditional guarantee by us of the Trust's obligations relating to the Trust Convertible Preferred Securities and the Partnership's obligations relating to the Partnership Convertible Preferred Securities.

In accordance with the terms of the issuances, we paid the annual 5% interest in quarterly installments on the Convertible Subordinated Debentures in the first and second quarters of 2007 and the four quarters of 2006. Cash was paid (net of investment returns) to the Partnership in payment of the interest on the Convertible Subordinated Debentures. The cash was then distributed by the Partnership to the Trust and then by the Trust to the holders of the EPPICS.

As of June 30, 2007, EPPICS representing a total principal amount of \$197.2 million have been converted into 15,912,949 shares of our common stock. A total of approximately \$4.1 million of EPPICS is outstanding as of June 30, 2007 and if all outstanding EPPICS were converted, 355,493 shares of our common stock would be issued upon such conversion. Our long-term debt footnote indicates \$14.6 million of EPPICS outstanding at June 30, 2007, of which \$10.5 million is debt of related parties for which the company has an offsetting receivable.

(15) Retirement Plans:

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The following tables provide the components of net periodic benefit cost:

Pension Benefit

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For the three months ended

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|  | June 30, |          |
|--|----------|----------|
|  | 2007     | 2006     |
| -----  |          |          |
| (\$ in thousands)  |          |          |
| -----  |          |          |
| Components of net periodic benefit cost                            |          |          |
| -----  |          |          |
| Service cost   | \$ 2,754 | \$ 1,759 |
| Interest cost on projected benefit obligation                      | 13,115   | 11,504   |
| Expected return on plan assets                                     | (17,106) | (15,126) |
| Amortization of prior service cost and unrecognized net obligation | 81       | (61)     |
| Amortization of unrecognized loss                                  | 2,906    | 3,085    |
|  | -----    | -----    |
| Net periodic benefit cost  | \$ 1,750 | \$ 1,161 |
|  | =====    | =====    |

|  | Other Postretirement       |          |
|--|----------------------------|----------|
|  | For the three months ended |          |
|  | June 30,                   |          |
|  | 2007                       | 2006     |
| -----  |                            |          |
| (\$ in thousands)  |                            |          |
| -----  |                            |          |
| Components of net periodic benefit cost                            |                            |          |
| -----  |                            |          |
| Service cost   | \$ 175                     | \$ 174   |
| Interest cost on projected benefit obligation                      | 2,218                      | 2,211    |
| Expected return on plan assets                                     | (254)                      | (245)    |
| Amortization of prior service cost and unrecognized net obligation | (1,447)                    | (1,026)  |
| Amortization of unrecognized loss                                  | 1,171                      | 1,513    |
|  | -----                      | -----    |
| Net periodic benefit cost  | \$ 1,863                   | \$ 2,627 |
|  | =====                      | =====    |

We expect that our 2007 pension and other postretirement benefit expenses, including the costs associated with our recently acquired Commonwealth plans, will be between \$13.0 million and \$15.0 million, and that no contribution will be required to be made by us to the pension plans in 2007.

(16) Commitments and Contingencies:

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We anticipate capital expenditures of approximately \$315.0 million - \$325.0 million for 2007. Although we from time to time make short-term purchasing commitments to vendors with respect to these expenditures, we generally do not enter into firm, written contracts for such activities.

The City of Bangor, Maine, filed suit against us on November 22, 2002, in the U.S. District Court for the District of Maine (City of Bangor v. Citizens Communications Company, Civ. Action No. 02-183-B-S). The City alleged, among other things, that we are responsible for the costs of cleaning up environmental contamination alleged to have resulted from the operation of a manufactured gas plant owned by Bangor Gas Company from 1852-1948 and by us from 1948-1963. In acquiring the operation in 1948, we acquired the stock of Bangor Gas Company and merged it into us. The City

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alleged the existence of extensive contamination of the Penobscot River and initially asserted that money damages and other relief at issue in the lawsuit could exceed \$50.0 million. The City also requested that punitive damages be assessed against us. We filed an answer denying liability to the City, and asserted a number of counterclaims against the City. In addition, we identified a number of other potentially responsible parties that may be liable for the damages alleged by the City and joined them as parties to the lawsuit. These additional parties include UGI Utilities, Inc. and Centerpoint Energy Resources Corporation. The Court dismissed all but two of the City's claims, including its claims for joint and several liability under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) and the claim against us for punitive damages.

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On June 27, 2006, the court issued Findings of Fact and Conclusions of Law in the first phase of the case. The court found contamination in only a small section of the River and determined that Citizens and the City should share cleanup costs.

Subsequent to the June 27, 2006 findings, we began settlement discussions with the City, with participation from the State of Maine. In February 2007, we reached an agreement to settle the matter for a payment by us of \$7.6 million. The payment was made on July 31, 2007 and the settlement is now final. Under the settlement agreement, we and the City will share in any recoveries from the various third party defendants. We also executed a Consent Decree with the City and the State that subsequently was approved and entered by the Court. On July 31, certain of the third party defendants filed a notice of appeal concerning entry of the Consent Decree. Even if such appeal (which we intend to vigorously contest) were successful, it would not affect the finality of our settlement with the City.

In addition, we have demanded that various of our insurance carriers defend and indemnify us with respect to the City's lawsuit, and on December 26, 2002, we filed a declaratory judgment action against those insurance carriers in the Superior Court of Penobscot County, Maine, for the purpose of establishing their obligations to us with respect to the City's lawsuit. We intend to vigorously pursue this lawsuit and to obtain from our insurance carriers indemnification for any amounts paid by us in settlement of the City's lawsuit as well as to recover the costs of our defense of that lawsuit. We cannot at this time determine what amount we may recover from third parties or insurance carriers.

Ronald A. Katz Technology Licensing, LP, filed suit against us for patent infringement on June 8, 2007 in the U.S. District Court for the District of Delaware. Katz Technology alleges that by operating automated telephone systems, including customer service systems, that allow our customers to utilize telephone calling cards, order internet, DSL, and dial-up services, and perform a variety of account related tasks such as billing and payments, we have infringed thirteen of Katz Technology's patents and continue to infringe three of Katz Technology's patents. Katz Technology seeks unspecified damages resulting from our alleged infringement, as well as a permanent injunction enjoining us from continuing the alleged infringement. Katz Technology subsequently filed a tag-along notice with the Judicial Panel on Multi-District Litigation, notifying them of this action and its relatedness to In re Katz Interactive Dial Processing Patent Litigation (MDL No. 1816), pending in the Central District of California before Judge R. Gary Klausner. The Judicial Panel on Multi-District Litigation has transferred the case to the Central District of California. We intend to vigorously defend against this lawsuit.

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On June 24, 2004, one of our subsidiaries, Frontier Subsidiary Telco, Inc., received a "Notice of Indemnity Claim" from Citibank, N.A., that is related to a complaint pending against Citibank and others in the U.S. Bankruptcy Court for the Southern District of New York as part of the Global Crossing bankruptcy proceeding. Citibank bases its claim for indemnity on the provisions of a credit agreement that was entered into in October 2000 between Citibank and our subsidiary. We purchased Frontier Subsidiary Telco, Inc., in June 2001 as part of our acquisition of the Frontier telephone companies. The complaint against Citibank, for which it seeks indemnification, alleges that the seller improperly used a portion of the proceeds from the Frontier transaction to pay off the Citibank credit agreement, thereby defrauding certain debt holders of Global Crossing North America Inc. Although the credit agreement was paid off at the closing of the Frontier transaction, Citibank claims the indemnification obligation survives. Damages sought against Citibank and its co-defendants could exceed \$1.0 billion. In August 2004, we notified Citibank by letter that we believe its claims for indemnification are invalid and are not supported by applicable law. In 2005, Citibank moved to dismiss the underlying complaint against it. That motion is currently pending. We have received no further communications from Citibank since our August 2004 letter.

We are party to other legal proceedings arising in the normal course of our business. The outcome of individual matters is not predictable. However, we believe that the ultimate resolution of all such matters, after considering insurance coverage, will not have a material adverse effect on our financial position, results of operations, or our cash flows.

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We sold all of our utility businesses as of April 1, 2004. However, we have retained a potential payment obligation associated with our previous electric utility activities in the state of Vermont. The Vermont Joint Owners (VJO), a consortium of 14 Vermont utilities, including us, entered into a purchase power agreement with Hydro-Quebec in 1987. The agreement contains "step-up" provisions that state that if any VJO member defaults on its purchase obligation under the contract to purchase power from Hydro-Quebec the other VJO participants will assume responsibility for the defaulting party's share on a pro-rata basis. Our pro-rata share of the purchase power obligation is 10%. If any member of the VJO defaults on its obligations under the Hydro-Quebec agreement, then the remaining members of the VJO, including us, may be required to pay for a substantially larger share of the VJO's total power purchase obligation for the remainder of the agreement (which runs through 2015). Paragraph 13 of FIN No. 45 requires that we disclose "the maximum potential amount of future payments (undiscounted) the guarantor could be required to make under the guarantee." Paragraph 13 also states that we must make such disclosure "... even if the likelihood of the guarantor's having to make any payments under the guarantee is remote..." As noted above, our obligation only arises as a result of default by another VJO member, such as upon bankruptcy. Therefore, to satisfy the "maximum potential amount" disclosure requirement we must assume that all members of the VJO simultaneously default, a highly unlikely scenario given that the two members of the VJO that have the largest potential payment obligations are publicly traded with credit ratings equal to or superior to ours, and that all VJO members are regulated utility providers with regulated cost recovery. Regardless, despite the remote chance that such an event could occur, or that the State of Vermont could or would allow such an event, assuming that all the members of the VJO defaulted on January 1, 2008 and remained in default for the duration of the contract (another 8 years), we estimate that our undiscounted purchase obligation for 2008 through 2015 would be

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approximately \$1.1 billion. In such a scenario the Company would then own the power and could seek to recover its costs. We would do this by seeking to recover our costs from the defaulting members and/or reselling the power to other utility providers or the northeast power grid. There is an active market for the sale of power. We could potentially lose money if we were unable to sell the power at cost. We caution that we cannot predict with any degree of certainty any potential outcome.

### (17) Subsequent Events:

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We have entered into an agreement with Country Road Communications LLC ("Country Road") to acquire Global Valley Networks Inc. ("GVN") and GVN Services ("GVS") through the purchase from Country Road of 100% of the outstanding common stock of Evans Telephone Holdings, Inc., the parent company of GVN and GVS. The purchase price is \$62.0 million in cash, subject to adjustment. We intend to finance the acquisition with cash on hand. The closing is subject to satisfaction of certain usual and customary conditions, including Hart-Scott-Rodino antitrust clearance and necessary approvals from the Federal Communications Commission and the California Public Utilities Commission. The transaction is expected to close within six to nine months.

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### Item 2. Management's Discussion and Analysis of Financial Condition and Results ----- of Operations -----

#### Forward-Looking Statements -----

This quarterly report on Form 10-Q contains forward-looking statements that are subject to risks and uncertainties that could cause actual results to differ materially from those expressed or implied in the statements. Statements that are not historical facts are forward-looking statements made pursuant to the "Safe Harbor" provisions of the Private Securities Litigation Reform Act of 1995. Words such as "believes," "anticipates," "expects" and similar expressions are intended to identify forward-looking statements. Forward-looking statements (including oral representations) are only predictions or statements of current plans, which we review continuously. Forward-looking statements may differ from actual future results due to, but not limited to, and our future results may be materially affected by, any of the following possibilities:

- \* Our ability to successfully integrate Commonwealth's operations and to realize the synergies from the acquisition;
- \* Changes in the number of our revenue generating units, which consist of access lines plus high-speed internet subscribers;
- \* The effects of competition from wireless, other wireline carriers (through voice over internet protocol (VOIP) or otherwise), high-speed cable modems and cable telephony;
- \* The effects of greater than anticipated competition requiring new pricing, marketing strategies or new product offerings and the risk that we will not respond on a timely or profitable basis;
- \* The effects of general and local economic and employment conditions on our revenues;



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- \* Our ability to effectively manage service quality;
- \* Our ability to successfully introduce new product offerings, including our ability to offer bundled service packages on terms that are both profitable to us and attractive to our customers;
- \* Our ability to sell enhanced and data services in order to offset ongoing declines in revenue from local services, switched access services and subsidies;
- \* Changes in accounting policies or practices adopted voluntarily or as required by generally accepted accounting principles or regulators;
- \* The effects of ongoing changes in the regulation of the communications industry as a result of federal and state legislation and regulation, including potential changes in access charges and subsidy payments, and regulatory network upgrade and reliability requirements;
- \* Our ability to comply with federal and state regulation (including state rate of return limitations on our earnings) and our ability to successfully renegotiate state regulatory plans as they expire or come up for renewal from time to time;
- \* Our ability to effectively manage our operations, operating expenses and capital expenditures, to pay dividends and to reduce or refinance our debt;
- \* Adverse changes in the ratings given to our debt securities by nationally accredited ratings organizations, which could limit or restrict the availability and/or increase the cost of financing;
- \* The effects of bankruptcies in the telecommunications industry, which could result in potential bad debts;

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- \* The effects of technological changes and competition on our capital expenditures and product and service offerings, including the lack of assurance that our ongoing network improvements will be sufficient to meet or exceed the capabilities and quality of competing networks;
- \* The effects of increased medical, retiree and pension expenses and related funding requirements;
- \* Changes in income tax rates, tax laws, regulations or rulings, and/or federal or state tax assessments;
- \* The effects of state regulatory cash management policies on our ability to transfer cash among our subsidiaries and to the parent company;
- \* Our ability to successfully renegotiate expiring union contracts;
- \* Our ability to pay a \$1.00 per common share dividend annually may be affected by our cash flow from operations, amount of capital expenditures, debt service requirements, cash paid for income taxes (which will increase in the future) and our liquidity;
- \* The effects of utilizing our Federal and state net operating loss carry forwards and AMT tax credit carry forwards which will significantly increase our cash taxes in 2007 and beyond;

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- \* The effects of any future liabilities or compliance costs in connection with worker health and safety matters;
- \* The effects of any unfavorable outcome with respect to any of our current or future legal, governmental, or regulatory proceedings, audits or disputes; and
- \* The effects of more general factors, including changes in economic, business and industry conditions.

Any of the foregoing events, or other events, could cause financial information to vary from management's forward-looking statements included in this report. You should consider these important factors, as well as the risks set forth under Item 1A. "Risk Factors," in our Annual Report on Form 10-K for the year ended December 31, 2006, in evaluating any statement in this report on Form 10-Q or otherwise made by us or on our behalf. The following information is unaudited and should be read in conjunction with the consolidated financial statements and related notes included in this report. We have no obligation to update or revise these forward-looking statements.

### Overview

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We are a full-service communications provider and one of the largest exchange telephone carriers in the country. We offer our incumbent local exchange carrier (ILEC) services under the "Frontier" name. On July 31, 2006, we sold our competitive local exchange carrier (CLEC), Electric Lightwave, LLC (ELI). We accounted for ELI as a discontinued operation in our consolidated statements of operations. On March 8, 2007, we completed the acquisition of Commonwealth Telephone Enterprises, Inc., which includes a small CLEC component. This acquisition expands our presence in Pennsylvania and strengthens our position as a market-leading full-service communications provider to rural markets.

Competition in the telecommunications industry is intense and increasing. We experience competition from many telecommunications service providers, including cable operators, wireless carriers, voice over internet protocol (VOIP) providers, long distance providers, competitive local exchange carriers, internet providers and other wireline carriers. We believe that competition will continue to intensify in 2007 across all of our products and in all of our markets. Our Frontier business experienced erosion in access lines and switched access minutes in 2006 and the first half of 2007 as a result of competition. Competition in our markets may result in reduced revenues in 2007.

The communications industry is undergoing significant changes. The market is extremely competitive, resulting in lower prices. These trends are likely to continue and result in a challenging revenue environment. These factors could also result in more bankruptcies in the sector and, therefore, affect our ability to collect money owed to us by carriers.

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Revenues from data and internet services such as high-speed internet continue to increase as a percentage of our total revenues and revenues from services such as local line and access charges (including federal and state subsidies) are decreasing as a percentage of our revenues. These factors, along with the potential for increasing operating costs, could cause our profitability and our cash generated by operations to decrease.

### a) Liquidity and Capital Resources

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### Cash Flow from Operating Activities

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As of June 30, 2007, we had cash and cash equivalents aggregating \$418.1 million. Our primary source of funds continues to be cash generated from operations. For the six months ended June 30, 2007, we used cash flow from continuing operations and cash and cash equivalents to fund a significant portion of the acquisition of Commonwealth, capital expenditures, dividends, interest payments, debt repayments and stock repurchases.

We believe our operating cash flows, existing cash balances, and credit facility will be adequate to finance our working capital requirements, fund capital expenditures, make required debt payments through 2008, pay taxes, pay dividends to our stockholders in accordance with our dividend policy and support our short-term and long-term operating strategies. We have approximately \$31.6 million of debt maturing during the last six months of 2007 and \$2.4 million and \$2.5 million of debt maturing in 2008 and 2009, respectively.

A number of factors, including but not limited to, losses of access lines, increases in competition and lower subsidy and access revenues are expected to reduce our cash generated by operations and may require us to increase capital expenditures. Our below investment grade credit ratings may make it more difficult and expensive to refinance our maturing debt. We have in recent years paid relatively low amounts of cash taxes. We expect that in 2007 and beyond our cash taxes will increase substantially as our Federal and state net operating loss carry forwards and AMT tax credit carry forwards are estimated to be fully utilized during 2007 and 2008. We paid \$47.4 million in cash taxes during the first six months of 2007 and expect to pay approximately \$30.0 million to \$35.0 million in the second half of 2007.

### Cash Flow from Investing Activities

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#### Acquisition

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On March 8, 2007, we acquired Commonwealth in a cash-and-stock taxable transaction, for a total consideration of approximately \$1.1 billion. We paid \$798.0 million in cash (\$657.6 million net, after cash acquired), issued common stock with a value of \$247.3 million and had \$10.5 million of accrued closing costs at June 30, 2007.

In connection with the acquisition of Commonwealth, we assumed \$35.0 million of debt under a revolving credit facility and \$191.8 million face amount of Commonwealth convertible notes (fair value of \$209.6 million). During March 2007, we paid down the \$35.0 million credit facility. We have retired all but \$8.5 million of the \$191.8 million face amount of Commonwealth notes as of June 30, 2007. The notes were retired by the payment of \$165.4 million in cash and the issuance of our common stock valued at \$36.7 million. The premium paid of \$18.9 million was recorded as \$17.8 million to goodwill and \$1.1 million to expense.

#### Capital Expenditures

-----

For the six months ended June 30, 2007, our capital expenditures were \$111.8 million. We continue to closely scrutinize all of our capital projects, emphasize return on investment and focus our capital expenditures on areas and services that have the greatest opportunities with respect to revenue growth and cost reduction. We anticipate capital expenditures of approximately \$315.0 million - \$325.0 million for 2007.

Increasing competition and improving the capabilities or reducing the maintenance costs of our plant may cause our capital expenditures to increase in

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the future. Our capital expenditures planned for new services such as wireless and VOIP in 2007 are not material. However, based on the success of our planned roll-out of these products that began in late 2006, our capital expenditures for these products may increase in the future.

### Rural Telephone Bank

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In August 2005, the Board of Directors of the Rural Telephone Bank (RTB) voted to dissolve the bank. In November 2005, the liquidation and dissolution of the RTB was initiated with the signing of the 2006 Agricultural Appropriation bill by President Bush. We received approximately \$64.6 million in cash from the dissolution of the RTB in April 2006, which resulted in the recognition of a pre-tax gain of approximately \$61.4 million during the second quarter of 2006 as reflected in investment and other income (loss), net in the consolidated statements of operations. Our tax net operating losses were used to absorb the cash liability for taxes.

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### Cash Flow from Financing Activities

#### Debt Reduction and Debt Exchanges

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For the six months ended June 30, 2007, we retired an aggregate principal amount of \$935.6 million of debt, including \$3.3 million of 5% Company Obligated Mandatorily Redeemable Convertible Preferred Securities (EPPICS) and \$17.8 million of 3.25% Commonwealth convertible notes that were converted into our common stock. On April 26, 2007, we redeemed \$495.2 million principal amount of our 7.625% Senior Notes due 2008 at a price of 103.041% plus accrued and unpaid interest. During the first quarter of 2007, we temporarily borrowed and repaid \$200.0 million utilized to temporarily fund the acquisition, and we paid down the \$35.0 million Commonwealth credit facility. Through June 30, 2007 we have retired \$183.3 million face amount of Commonwealth convertible notes for which we paid \$165.4 million in cash and \$36.7 million in common stock (premium paid of \$18.9 million was recorded as \$17.8 million to goodwill and \$1.1 million to expense), resulting in a remaining outstanding balance of \$8.5 million as of June 30, 2007. We also paid down \$14.2 million of industrial development revenue bonds and \$3.9 million of rural utilities service loan contracts.

We may from time to time repurchase our debt in the open market, through tender offers, exchanges of debt securities, by exercising rights to call or in privately negotiated transactions. We may also exchange existing debt for newly issued debt obligations.

#### Issuance of Debt Securities

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On March 23, 2007, we issued in a private placement an aggregate \$300.0 million principal amount of 6.625% Senior Notes due 2015 and \$450.0 million principal amount of 7.125% Senior Notes due 2019. Proceeds from the sale were used to refinance \$200.0 million principal amount of indebtedness incurred on March 8, 2007 under a bridge loan facility in connection with the acquisition of Commonwealth. We also filed with the SEC a registration statement for an exchange offer on the \$750.0 million in total of private placement notes described above, in addition to the \$400.0 million principal amount of 7.875% Senior Notes issued in a private placement on December 22, 2006, for registered notes. The exchange offer was completed in the second quarter of 2007.

#### EPPICS

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In 1996, our consolidated wholly owned subsidiary, Citizens Utilities Trust (the Trust), issued, in an underwritten public offering, 4,025,000 shares of 5%

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Company Obligated Mandatorily Redeemable Convertible Preferred Securities due 2036 (Trust Convertible Preferred Securities or EPPICS), representing preferred undivided interests in the assets of the Trust, with a liquidation preference of \$50 per security (for a total liquidation amount of \$201.3 million). These securities have an adjusted conversion price of \$11.46 per share of our common stock. The conversion price was reduced from \$13.30 to \$11.46 during the third quarter of 2004 as a result of the \$2.00 per share of common stock special, non-recurring dividend. The proceeds from the issuance of the Trust Convertible Preferred Securities and a Company capital contribution were used to purchase \$207.5 million aggregate liquidation amount of 5% Partnership Convertible Preferred Securities due 2036 from another wholly owned consolidated subsidiary, Citizens Utilities Capital L.P. (the Partnership). The proceeds from the issuance of the Partnership Convertible Preferred Securities and a Company capital contribution were used to purchase from us \$211.8 million aggregate principal amount of 5% Convertible Subordinated Debentures due 2036. The sole assets of the Trust are the Partnership Convertible Preferred Securities, and our Convertible Subordinated Debentures are substantially all the assets of the Partnership. Our obligations under the agreements related to the issuances of such securities, taken together, constitute a full and unconditional guarantee by us of the Trust's obligations relating to the Trust Convertible Preferred Securities and the Partnership's obligations relating to the Partnership Convertible Preferred Securities.

In accordance with the terms of the issuances, we paid the annual 5% interest in quarterly installments on the Convertible Subordinated Debentures in the first and second quarters of 2007 and the four quarters of 2006. Cash was paid (net of investment returns) to the Partnership in payment of the interest on the Convertible Subordinated Debentures. The cash was then distributed by the Partnership to the Trust and then by the Trust to the holders of the EPPICS.

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As of June 30, 2007, EPPICS representing a total principal amount of \$197.2 million have been converted into 15,912,949 shares of our common stock, and a total of \$4.1 million remains outstanding to third parties. Our long-term debt footnote indicates \$14.6 million of EPPICS outstanding at June 30, 2007, of which \$10.5 million is debt of related parties for which we have an offsetting receivable.

### Interest Rate Management

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In order to manage our interest expense, we have entered into interest swap agreements. Under the terms of these agreements, we make semi-annual, floating rate interest payments based on six month LIBOR and receive a fixed rate on the notional amount. The underlying variable rate on these swaps is set either in advance or in arrears.

The notional amounts of fixed-rate indebtedness hedged as of June 30, 2007 and December 31, 2006 were \$400.0 million and \$550.0 million, respectively. Such contracts require us to pay variable rates of interest (estimated average pay rates of approximately 9.22% as of June 30, 2007 and approximately 9.02% as of December 31, 2006) and receive fixed rates of interest (average receive rate of 8.50% as of June 30, 2007 and 8.26% as of December 31, 2006). All swaps are accounted for under SFAS No. 133 (as amended) as fair value hedges. For the three and six months ended June 30, 2007, the interest expense resulting from these interest rate swaps totaled approximately \$0.8 million and \$2.0 million, respectively.

### Credit Facilities

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As of June 30, 2007, we had available lines of credit with financial institutions in the aggregate amount of \$250.0 million and there were no outstanding standby letters of credit issued under the facility. Associated facility fees vary, depending on our debt leverage ratio, and were 0.20% per annum as of June 30, 2007. The expiration date for this \$250.0 million five year revolving credit agreement is May 18, 2012. During the term of the credit facility we may borrow, repay and reborrow funds. The credit facility is available for general corporate purposes but may not be used to fund dividend payments.

### Covenants

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The terms and conditions contained in our indentures and credit facilities agreements include the timely payment of principal and interest when due, the maintenance of our corporate existence, keeping proper books and records in accordance with GAAP, restrictions on the allowance of liens on our assets, and restrictions on asset sales and transfers, mergers and other changes in corporate control. We currently have no restrictions on the payment of dividends either by contract, rule or regulation.

Our \$200.0 million term loan facility with the Rural Telephone Finance Cooperative (RTFC) contains a maximum leverage ratio covenant. Under the leverage ratio covenant, we are required to maintain a ratio of (i) total indebtedness minus cash and cash equivalents in excess of \$50.0 million to (ii) consolidated adjusted EBITDA (as defined in the agreement) over the last four quarters no greater than 4.00 to 1.

Our \$250.0 million credit facility and our \$150.0 million senior unsecured term loan contain a maximum leverage ratio covenant. Under the leverage ratio covenant, we are required to maintain a ratio of (i) total indebtedness minus cash and cash equivalents in excess of \$50.0 million to (ii) consolidated adjusted EBITDA (as defined in the agreements) over the last four quarters no greater than 4.50 to 1. Although both facilities are unsecured, they will be equally and ratably secured by certain liens and equally and ratably guaranteed by certain of our subsidiaries if we issue debt that is secured or guaranteed.

Certain indentures for our senior unsecured debt obligations limit our ability to create liens or merge or consolidate with other companies and our subsidiaries' ability to borrow funds, subject to important exceptions and qualifications.

We are in compliance with all of our debt and credit facility covenants.

### Proceeds from the Sale of Equity Securities

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We receive proceeds from the issuance of our common stock pursuant to our stock-based compensation plans. For the six months ended June 30, 2007 and 2006, we received approximately \$11.5 million and \$12.8 million, respectively, upon the exercise of outstanding stock options.

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### Share Repurchase Programs

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In February 2007, our Board of Directors authorized us to repurchase up to \$250.0 million of our common stock in public or private transactions over the following twelve month period. This share repurchase program commenced on March 19, 2007. As of June 30, 2007, we had repurchased approximately 4,633,000 shares of our common stock at an aggregate cost of approximately \$70.7 million.

In February 2006, our Board of Directors authorized us to repurchase up to

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\$300.0 million of our common stock in public or private transactions over the following twelve-month period. This share repurchase program commenced on March 6, 2006. As of December 31, 2006, we had repurchased 10,199,900 shares of our common stock at an aggregate cost of approximately \$135.2 million. No more shares can be repurchased under this authorization.

### Dividends

Our ongoing annual dividends of \$1.00 per share of common stock under our current policy utilize a significant portion of our cash generated by operations and therefore could limit our operating and financial flexibility. While we believe that the amount of our dividends will allow for adequate amounts of cash flow for other purposes, any reduction in cash generated by operations and any increases in capital expenditures, interest expense or cash taxes would reduce the amount of cash available in excess of dividends.

### Off-Balance Sheet Arrangements

We do not maintain any off-balance sheet arrangements, transactions, obligations or other relationships with unconsolidated entities that would be expected to have a material current or future effect upon our financial statements.

### Critical Accounting Policies and Estimates

We review all significant estimates affecting our consolidated financial statements on a recurring basis and record the effect of any necessary adjustment prior to their publication. Uncertainties with respect to such estimates and assumptions are inherent in the preparation of financial statements; accordingly, it is possible that actual results could differ from those estimates and changes to estimates could occur in the near term. The preparation of our financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of the contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Estimates and judgments are used when accounting for allowance for doubtful accounts, impairment of long-lived assets, intangible assets, depreciation and amortization, employee benefit plans, income taxes, contingencies, and pension and postretirement benefits expenses among others.

Management has discussed the development and selection of these critical accounting estimates with the Audit Committee of our Board of Directors and our Audit Committee has reviewed our disclosures relating to them.

There have been no material changes to our critical accounting policies and estimates from the information provided in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" included in our Annual Report on Form 10-K for the year ended December 31, 2006.

### New Accounting Pronouncements

#### Accounting for Uncertainty in Income Taxes

In July 2006, the FASB issued FASB Interpretation No. (FIN) 48, "Accounting for Uncertainty in Income Taxes." Among other things, FIN No. 48 requires applying a "more likely than not" threshold to the recognition and derecognition of uncertain tax positions either taken or expected to be taken in the Company's income tax returns. We adopted the provisions of FIN No. 48 in the first quarter of 2007. The total amount of our FIN No. 48 tax liability for tax positions that may not be sustained under a "more likely than not" threshold is reflected on the Company's balance sheet as of the date of adoption at \$44.7 million and amounts to \$47.5 million as of June

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30, 2007. This amount includes an accrual for interest in the amount of \$5.2 million as of June 30, 2007. These balances include amounts of \$9.0 million and \$1.4 million for total FIN No. 48 tax liabilities and accrued interest, respectively, pursuant to the Company's acquisition of Commonwealth Telephone Enterprises, Inc., completed in March 2007. The amount of our total FIN No. 48 tax liabilities reflected above that would positively impact the calculation of our effective income tax rate, if our tax positions are sustained, is \$23.7 million as of June 30, 2007.

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The Company's policy regarding the classification of interest and penalties is to include these amounts as a component of income tax expense. This treatment of interest and penalties is consistent with prior periods. We have recognized in our year to date statement of operations additional interest in the amount of \$0.5 million. We do not expect that our balances with respect to our uncertain tax positions will significantly increase or decrease within the next 12 months. We are subject to income tax examinations generally for the years 2003 forward for both our federal and state filing jurisdictions.

### How Taxes Collected from Customers and Remitted to Governmental Authorities

#### ----- Should be Presented in the Income Statement -----

In June 2006, the FASB issued EITF Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should be Presented in the Income Statement," which requires disclosure of the accounting policy for any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction, that is Gross versus Net presentation. EITF No. 06-3 is effective for periods beginning after December 15, 2006. We adopted the disclosure requirements of EITF No. 06-3 commencing January 1, 2007.

### Accounting for Purchases of Life Insurance

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In September 2006, the FASB reached consensus on the guidance provided by EITF No. 06-5, "Accounting for Purchases of Life Insurance-Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance." EITF No. 06-5 states that a policyholder should consider any additional amounts included in the contractual terms of the insurance policy other than the cash surrender value in determining the amount that could be realized under the insurance contract. EITF No. 06-5 also states that a policyholder should determine the amount that could be realized under the life insurance contract assuming the surrender of an individual-life by individual-life policy (or certificate by certificate in a group policy). EITF No. 06-5 is effective for fiscal years beginning after December 15, 2006. The adoption of the accounting requirements of EITF No. 06-5 in the first quarter of 2007 had no material impact on our financial position, results of operation or cash flows.

### Accounting for Endorsement Split-Dollar Life Insurance Arrangements

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In September 2006, the FASB reached consensus on the guidance provided by EITF No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements." The guidance is applicable to endorsement split-dollar life insurance arrangements, whereby the employer owns and controls the insurance policy, that are associated with a postretirement benefit. EITF No. 06-4 requires



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that for a split-dollar life insurance arrangement within the scope of the issue, an employer should recognize a liability for future benefits in accordance with SFAS No. 106 (if, in substance, a postretirement benefit plan exists) or Accounting Principles Board Opinion No. 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee. EITF No. 06-4 is effective for fiscal years beginning after December 15, 2007. The Company is currently evaluating the impact the adoption of the standard will have on the Company's results of operations or financial condition.

### Fair Value Measurements

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In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The provisions of SFAS No. 157 are effective as of the beginning of our 2008 fiscal year. The Company is currently evaluating the impact that the adoption of the standard will have on the Company's results of operations or financial condition.

### Fair Value Option for Financial Assets and Financial Liabilities

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In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115," which permits entities to choose to measure many financial instruments and certain other items at fair value. The provisions of SFAS No. 159 are effective as of the beginning of our 2008 fiscal year. The Company is currently evaluating the impact that the adoption of the standard will have on the Company's results of operations or financial condition.

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### Accounting for Collateral Assignment Split-Dollar Life Insurance

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#### Arrangements

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In March 2007, the FASB ratified the consensus reached by the EITF on Issue No. 06-10, "Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements." EITF No. 06-10 provides guidance on an employers' recognition of a liability and related compensation costs for collateral assignment split-dollar life insurance arrangements that provide a benefit to an employee that extends into postretirement periods and the asset in collateral assignment split-dollar life insurance arrangements. The effective date of EITF No. 06-10 is for fiscal years beginning after December 15, 2007. The Company is currently evaluating the impact that the adoption of the standard will have on the Company's results of operations or financial condition.

#### (b) Results of Operations

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##### REVENUE

Revenue is generated primarily through the provision of local, network access, long distance, and data and internet services. Such services are provided under either a monthly recurring fee or based on usage at a tariffed rate and revenue recognition is not dependent upon significant judgments by management, with the exception of a determination of a provision for uncollectible amounts.

Consolidated revenue for the three months ended June 30, 2007 increased \$71.9 million, or 14%, as compared with the prior year period. Consolidated revenue

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for the six months ended June 30, 2007 increased \$121.2 million, or 12%, as compared with the prior year period. Excluding the additional revenue due to the CTE acquisition, revenue increased \$17.6 million during the first half of 2007, or 2%, as compared with the prior year period. During the first quarter of 2007, we had a significant favorable settlement of a dispute with a carrier that resulted in a favorable one-time impact to our revenues of \$38.7 million. Excluding the impact of the CTE acquisition and the one-time favorable settlement, our revenues for the six months ended June 30, 2007 would have been \$992.6 million, a decrease of \$21.1 million, or 2%, as compared to the prior year period.

Change in the number of our access lines is important to our revenue and profitability. We have lost access lines primarily because of competition, changing consumer behavior, economic conditions, changing technology and by some customers disconnecting second lines when they add high-speed internet or cable modem service. Excluding the impact of the CTE acquisition, we lost approximately 54,300 access lines during the six months ended June 30, 2007, but added approximately 32,500 high-speed internet subscribers during this same period. For the three months ended June 30, 2007, CTE lost approximately 3,100 access lines. The loss of lines during the first six months of 2007 was primarily among residential customers. The non-residential line losses were principally in our central region and Rochester, New York, while the residential losses were throughout our markets. We expect to continue to lose access lines but to increase high-speed internet subscribers during 2007. A continued loss of access lines, combined with increased competition and the other factors discussed herein may cause our revenues, profitability and cash flows to decrease in the second half of 2007.

Our historical results include the results of operations of Commonwealth from the date of its acquisition on March 8, 2007. The financial tables below include a comparative analysis of our results of operations on a historical basis for the three and six months ended June 30, 2007 and 2006. We have also presented an analysis of each category for the three and six months ended June 30, 2007 for the results of Citizens (excluding CTE) and the results of CTE for the last 23 days of March and the three months ended June 30, 2007, as included in the consolidated results of operations. All variance explanations in the succeeding paragraphs are based on analysis of the three and six months ended June 30, 2007 financial data for Citizens (excluding CTE) in comparison to the three and six months ended June 30, 2006, as presented below.

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### TELECOMMUNICATIONS REVENUE

| (\$ in thousands)          | For the three months ended June 30, 2007 |           |                          | For the three months ended June 30, 2006 |
|----------------------------|--|-----------|--------------------------|--|
|                            | As Reported                              | CTE       | Citizens (excluding CTE) |  |
| Local services             | \$ 232,622                               | \$ 36,391 | \$ 196,231               | \$ 203,622                               |
| Data and internet services | 131,984                                  | 10,623    | 121,361                  | 103,623                                  |
| Access services            | 113,429                                  | 22,673    | 90,756                   | 104,673                                  |
| Long distance services     | 47,053                                   | 8,031     | 39,022                   | 38,031                                   |
| Directory services         | 28,664                                   | 275       | 28,389                   | 28,664                                   |
| Other                      | 25,074                                   | 4,984     | 20,090                   | 28,664                                   |
|                            | \$ 578,826                               | \$ 82,977 | \$ 495,849               | \$ 506,826                               |

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For the six months ended June 30, 2007

| (\$ in thousands)          | -----          |                       |                             | For the si               |
|----------------------------|----------------|-----------------------|-----------------------------|--------------------------|
| -----                      | As<br>Reported | CTE<br>(for 114 days) | Citizens<br>(excluding CTE) | months end<br>June 30, 2 |
| -----                      | -----          |                       |                             | -----                    |
| Local services             | \$ 438,664     | \$ 45,065             | \$ 393,599                  | \$ 406,                  |
| Data and internet services | 248,410        | 13,179                | 235,231                     | 203,                     |
| Access services            | 252,454        | 28,368                | 224,086                     | 215,                     |
| Long distance services     | 87,481         | 10,078                | 77,403                      | 77,                      |
| Directory services         | 57,334         | 343                   | 56,991                      | 57,                      |
| Other                      | 50,630         | 6,610                 | 44,020                      | 52,                      |
|                            |                |                       |                             |                          |
|                            | \$ 1,134,973   | \$ 103,643            | \$ 1,031,330                | \$ 1,013,                |
|                            | =====          | =====                 | =====                       | =====                    |

### Local Services

Local services revenue for the three months ended June 30, 2007 decreased \$7.0 million, or 3%, as compared with the prior year period. The loss of access lines accounted for \$6.5 million of the decline in local revenue.

Local services revenue for the six months ended June 30, 2007 decreased \$13.2 million, or 3%, as compared with the prior year period. The loss of access lines accounted for \$12.4 million of the decline in local revenue. Enhanced services revenue increased \$1.3 million, as compared with the prior year period, primarily due to sale of additional feature packages.

Economic conditions or increasing competition could make it more difficult to sell our packages and bundles and cause us to lower our prices for those products and services, which would adversely affect our revenues, profitability and cash flow.

### Data and Internet Services

Data and internet services revenue for the three months ended June 30, 2007 increased \$17.9 million, or 17%, as compared with the prior year period primarily due to growth in data and high-speed internet services. The number of the Company's high-speed internet subscribers has increased by more than 66,800, or 19%, since June 30, 2006. Data and Internet services also includes revenue from data transmission services to other carriers and high-volume commercial customers with dedicated high-capacity circuits like DS-1's and DS-3's. Revenue from these dedicated high-capacity circuits increased \$6.1 million, or 12%, as compared with the prior year period, primarily due to growth in those circuits.

Data and internet services revenue for the six months ended June 30, 2007 increased \$31.7 million, or 16%, as compared with the prior year period, primarily due to growth in data and high-speed internet services. Revenue from the dedicated high-capacity circuits increased \$8.2 million, or 8%, as compared with the prior year period, primarily due to growth in those circuits.

### Access Services

Access services revenue for the three months ended June 30, 2007 decreased \$13.9 million, or 13%, as compared with the prior year period. Switched access revenue of \$61.8 million decreased \$1.0 million, as compared with the prior year period, primarily due to the impact of a decline in minutes of use related to access line losses. Access service revenue includes subsidy payments we receive from federal and state agencies. Subsidy revenue of \$29.0 million decreased \$12.9 million, primarily due to lower receipts under the Federal High Cost Fund program resulting from our lower cost structure and an increase in the program's national average cost per local loop (NACPL), along with reductions in USF surcharges due to the elimination of high-speed internet units from the USF calculation. Second quarter 2007 subsidy revenue was negatively impacted by a \$3.3 million local switching support true-up relating to 2005.

Access services revenue for the six months ended June 30, 2007 increased \$8.2 million, or 4%, as compared with the prior year period. Switched access revenue of \$162.3 million increased \$31.6 million, or 24%, as compared with the prior year period, primarily due to the settlement in the first quarter of a dispute with a carrier resulting in a favorable impact on our revenue of \$38.7 million (a one-time event), partially offset by the impact of a decline in minutes of use related to access line losses. Subsidy revenue of \$61.8 million decreased \$23.4 million, primarily due to lower receipts under the Federal High Cost Fund program resulting from our lower cost structure and an increase in the program's NACPL, along with reductions in USF surcharges due to the elimination of high-speed internet units from the USF calculation.

Increases in the number of Competitive Eligible Telecommunications Companies (including wireless companies) receiving federal subsidies, among other factors, may lead to further increases in the NACPL, thereby resulting in decreases in our federal subsidy revenue in the future. The FCC and state regulators are currently considering a number of proposals for changing the manner in which eligibility for federal subsidies is determined as well as the amounts of such subsidies. The FCC is also reviewing the mechanism by which subsidies are funded. Additionally, the FCC has an open proceeding to address reform to access charges and other intercarrier compensation. We cannot predict when or how these matters will be decided nor the effect on our subsidy or access revenues. Future reductions in our subsidy and access revenues are not expected to be accompanied by proportional decreases in our costs, so any further reductions in those revenues will directly affect our profitability and cash flows.

#### Long Distance Services

Long distance services revenue for the three months ended June 30, 2007 increased \$0.3 million, or 1%, as compared with the prior year period. Long distance services revenue for the six months ended June 30, 2007 decreased \$0.4 million, or 1%, as compared with the prior year period. We have actively marketed a package of unlimited long distance minutes with our digital phone bundled service offerings. The sale of our digital phone product and its associated unlimited minutes has resulted in an increase in minutes used by our long distance customers and has had the effect of lowering our overall average rate per minute billed. Our long distance minutes of use increased by 9% during the six months ended June 30, 2007 compared to the first half of 2006 and, as noted below, has increased our cost of services provided. Our long distance revenues have remained relatively steady, but may decrease in the future due to lower rates and/or minutes of use. Competing services such as wireless, VOIP, and cable telephony are resulting in a loss of customers, minutes of use and further declines in the rates we charge our customers. We expect these factors to affect our long distance revenues during the remainder of 2007.

#### Directory Services

Directory services revenue for the three and six months ended June 30, 2007 was relatively unchanged as compared with the prior year periods with slightly lower yellow pages advertising, mainly in Rochester, New York.

#### Other

Other revenue for the three months ended June 30, 2007 decreased \$8.3 million, or 29%, as compared with the prior year period, primarily due to higher bad debt expenses and the impact of our free video promotions in some of our markets.

Other revenue for the six months ended June 30, 2007 decreased \$8.3 million, or 16%, as compared with the prior year period, primarily due to higher bad debt expenses and the impact of our free video promotions in some of our markets.

## NETWORK ACCESS EXPENSES

| (\$ in thousands)<br>----- | For the three months ended June 30, 2007 |          |                             | For the three<br>months ended<br>June 30, 2006 |
|----------------------------|--|----------|-----------------------------|--|
|                            | As<br>Reported                           | CTE      | Citizens<br>(excluding CTE) |  |
| Network access             | \$ 51,878                                | \$ 6,837 | \$ 45,041                   | \$ 38,402                                      |

  

| (\$ in thousands)<br>----- | For the six months ended June 30, 2007 |                       |                             | For the six<br>months ended<br>June 30, 2006 |
|----------------------------|--|-----------------------|-----------------------------|--|
|                            | As<br>Reported                         | CTE<br>(for 114 days) | Citizens<br>(excluding CTE) |  |
| Network access             | \$ 102,671                             | \$ 10,686             | \$ 91,985                   | \$ 78,620                                    |

Network access expenses for the three months ended June 30, 2007 increased \$6.6 million, or 17%, as compared with the prior year period, primarily due to increasing rates and usage related to our long distance product and our data backbone. Network access expenses for the six months ended June 30, 2007 increased \$13.4 million, or 17%, as compared with the prior year period, primarily due to increasing rates and usage related to our long distance product and our data backbone. As we continue to increase our sales of data products such as high-speed internet and expand the availability of our unlimited long distance calling plans, our network access expense is likely to continue to increase. Expenses associated with access lines lost have offset some of the increase.

## OTHER OPERATING EXPENSES

| (\$ in thousands)<br>-----    | For the three months ended June 30, 2007 |           |                             | For the<br>months e<br>June 30, |
|-------------------------------|--|-----------|-----------------------------|---------------------------------|
|                               | As<br>Reported                           | CTE       | Citizens<br>(excluding CTE) |                                 |
| Operating expenses            | \$ 162,246                               | \$ 37,266 | \$ 124,980                  | \$ 13                           |
| Taxes other than income taxes | 22,754                                   | 971       | 21,783                      | 2                               |
| Sales and marketing           | 30,188                                   | 2,797     | 27,391                      | 2                               |
|                               | \$ 215,188                               | \$ 41,034 | \$ 174,154                  | \$ 17                           |

  

| (\$ in thousands)<br>-----    | For the six months ended June 30, 2007 |                       |                             | For the<br>months e<br>June 30, |
|-------------------------------|--|-----------------------|-----------------------------|---------------------------------|
|                               | As<br>Reported                         | CTE<br>(for 114 days) | Citizens<br>(excluding CTE) |                                 |
| Operating expenses            | \$ 301,971                             | \$ 44,192             | \$ 257,779                  | \$ 27                           |
| Taxes other than income taxes | 48,954                                 | 2,260                 | 46,694                      | 4                               |
| Sales and marketing           | 54,134                                 | 4,586                 | 49,548                      | 4                               |
|                               | \$ 405,059                             | \$ 51,038             | \$ 354,021                  | \$ 36                           |

Operating expenses for the three months ended June 30, 2007 decreased \$10.8 million, or 8%, as compared with the prior year period, primarily due to a reduction in employees, improved expense control in benefit costs and the allocation of common corporate costs over a larger base of operations. Operating expenses in the second quarter of 2007 included approximately \$3.0 million of incremental expenses related to the CTE integration and severance costs in other areas of the business. Operating expenses for the six months ended June 30, 2007 decreased \$16.3 million, or 6%, as compared with the prior year period, primarily due to headcount reductions and associated decreases in salaries and benefits and the allocation of common corporate costs over a larger base of operations. The USF contribution rate and PUC fees decreased from the prior year period, resulting in a reduction in costs of \$5.7 million.

We routinely review our operations, personnel and facilities to achieve greater efficiencies. We are in the process of consolidating our call center operations and pursuing workforce efficiencies in other areas. As we work through the consolidation, including the opening of a new call center in Deland, FL in August 2006, and the closing of call centers in 2007, we expect that our operating expenses will temporarily increase. During the third quarter of 2007, we expect that over 100 employees will have accepted early retirement incentives or had their positions eliminated. Some of these positions will be replaced in other locations. Accordingly, a charge for the severance or early retirement costs will be recorded in the third quarter of 2007, and such charge may be in the range of \$5.0 million to \$10.0 million, based on the acceptances of early retirement and other employment considerations. As noted elsewhere, the introduction of new service offerings may also negatively impact our cost structure.

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Included in operating expenses is stock compensation expense. Stock compensation expense was \$2.0 million and \$2.7 million for the three months ended June 30, 2007 and 2006, respectively, and \$5.4 million and \$5.3 million for the six months ended June 30, 2007 and 2006, respectively. In 2006, we began expensing the cost of the unvested portion of outstanding stock options pursuant to SFAS No. 123R.

Included in operating expenses is pension and other postretirement benefit expenses. Based on current assumptions and plan asset values, we estimate that our 2007 pension and other postretirement benefit expenses, including the costs associated with our recently acquired Commonwealth plans, will be approximately \$13.0 million to \$15.0 million and that no contribution will be required to be made by us to the pension plans in 2007. In future periods, if the value of our pension assets decline and/or projected pension and/or postretirement benefit costs increase, we may have increased pension and/or postretirement expenses.

Taxes other than income taxes for the three and six months ended June 30, 2007 were relatively unchanged as compared with the prior year periods.

Sales and marketing expenses for the three months ended June 30, 2007 increased \$4.7 million, or 20%, as compared with the prior year period. Sales and marketing expenses for the six months ended June 30, 2007 increased \$3.6 million, or 8%, as compared with the prior year period. Sales and marketing expenses may increase due to higher advertising and marketing in a competitive environment and the launch of new products.

DEPRECIATION AND AMORTIZATION EXPENSE

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| (\$ in thousands)<br>----- | For the three months ended June 30, 2007 |           |                          | For the three months ended June 30, 2006 |
|----------------------------|--|-----------|--------------------------|--|
|                            | As Reported                              | CTE       | Citizens (excluding CTE) |  |
| Depreciation expense       | \$ 93,286                                | \$ 11,488 | \$ 81,798                | \$ 87,900                                |
| Amortization expense       | 47,176                                   | 15,582 *  | 31,594                   | 31,500                                   |
|                            | \$ 140,462                               | \$ 27,070 | \$ 113,392               | \$ 119,400                               |

| (\$ in thousands)<br>----- | For the six months ended June 30, 2007 |                    |                          | For the six months ended June 30, 2006 |
|----------------------------|--|--------------------|--------------------------|--|
|                            | As Reported                            | CTE (for 114 days) | Citizens (excluding CTE) |  |
| Depreciation expense       | \$ 179,933                             | \$ 14,448          | \$ 165,485               | \$ 178,300                             |
| Amortization expense       | 82,710                                 | 19,520 *           | 63,190                   | 63,100                                 |
|                            | \$ 262,643                             | \$ 33,968          | \$ 228,675               | \$ 241,400                             |

\*Represents amortization expense related to the customer base acquired in the Commonwealth acquisition.

Depreciation expense for the three months ended June 30, 2007 decreased \$6.2 million, or 7%, as compared with the prior year period due to a declining net asset base partially offset by changes in the remaining useful lives of certain assets.

Depreciation expense for the six months ended June 30, 2007 decreased \$12.9 million, or 7%, as compared with the prior year period due to a declining net asset base partially offset by changes in the remaining useful lives of certain assets.

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INVESTMENT AND OTHER INCOME (LOSS), NET / INTEREST EXPENSE / INCOME TAX EXPENSE

| (\$ in thousands)<br>-----              | For the three months ended June 30, 2007 |           |                          | For the three months ended June 30, 2006 |
|---|--|-----------|--------------------------|--|
|   | As Reported                              | CTE       | Citizens (excluding CTE) |  |
| Investment and other income (loss), net | \$ (6,517)                               | \$ 3,381  | \$ (9,898)               | \$ (6,517)                               |
| Interest expense                        | \$ 98,649                                | \$ (394)  | \$ 99,043                | \$ 98,649                                |
| Income tax expense                      | \$ 25,573                                | \$ 14,136 | \$ 11,437                | \$ 25,573                                |

| (\$ in thousands) | For the six months ended June 30, 2007 |     |          | For the six months ended June 30, 2006 |
|-------------------|--|-----|----------|--|
|                   | As                                     | CTE | Citizens |  |

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|   | Reported  | (for 114 days) | (excluding CTE) | June 30 |
|---|-----------|----------------|-----------------|---------|
| Investment and other income (loss), net | \$ 3,500  | \$ 4,165       | \$ (665)        | \$      |
| Interest expense                        | \$192,613 | \$ (169)       | \$192,782       | \$1     |
| Income tax expense                      | \$ 67,261 | \$ 16,417      | \$ 50,844       | \$      |

Investment and other income (loss), net for the three months ended June 30, 2007 decreased \$75.3 million, or 115%, as compared with the prior year period, primarily due to the \$64.6 million in proceeds received in April 2006 as a result of the liquidation and dissolution of the RTB, the loss on retirement of debt in the second quarter of 2007 for \$17.1 million, partially offset by an increase of \$4.2 million in income from short-term investments of cash. Investment and other income (loss), net for the six months ended June 30, 2007 decreased \$64.7 million, or 101%, as compared with the prior year period, primarily due to the \$64.6 million in proceeds received in April 2006 as a result of the liquidation and dissolution of the RTB, the loss on retirement of debt during the first six months of 2007 for \$18.2 million, partially offset by an increase of \$15.0 million in income from short-term investments of cash.

In August 2005, the Board of Directors of the Rural Telephone Bank (RTB) voted to dissolve the bank. In November 2005, the liquidation and dissolution of the RTB was initiated with the signing of the 2006 Agricultural Appropriation bill by President Bush. We received approximately \$64.6 million in cash from the dissolution of the RTB in April 2006, which resulted in the recognition of a pre-tax gain of approximately \$61.4 million during the second quarter of 2006. Our tax net operating losses were used to absorb the cash liability for taxes.

We borrowed \$550.0 million in December 2006 in anticipation of the Commonwealth acquisition in 2007. Our average cash balance was \$729.6 million and \$205.1 million for the six months ended June 30, 2007 and 2006, respectively.

Interest expense for the three months ended June 30, 2007 increased \$13.7 million, or 16%, as compared with the prior year period, primarily due to a higher average debt balance resulting from financing the Commonwealth acquisition. Our average debt outstanding was \$5,064.5 million and \$4,110.6 million for the three months ended June 30, 2007 and 2006, respectively. Our composite average borrowing rate (including the effect of our swap agreements) for the three months ended June 30, 2007 as compared with the prior year period was 17 basis points lower, decreasing from 8.16% to 7.99%.

Interest expense for the six months ended June 30, 2007 increased \$22.0 million, or 13%, as compared with the prior year period, primarily due to a higher average debt balance resulting from financing the Commonwealth acquisition. Our average debt outstanding was \$4,887.3 million and \$4,152.3 million for the six months ended June 30, 2007 and 2006, respectively.

Income taxes for the three and six months ended June 30, 2007 decreased \$43.3 million, or 79% and \$30.5 million, or 37%, respectively, as compared with the prior year periods, primarily due to changes in taxable income. The effective tax rate on a fully consolidated basis for the first six months of 2007 was 38.3% as compared with 37.0% for the first six months of 2006. Our cash taxes paid for the six months ended June 30, 2007 were \$47.4 million, an increase of \$44.6 million over the first six months of 2006, as our tax loss carryforwards become utilized. We expect to pay approximately \$30.0 million to \$35.0 million in the second half of 2007.



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DISCONTINUED OPERATIONS

| (\$ in thousands)<br>----- | For the three months ended June 30, |           |             |
|----------------------------|-------------------------------------|-----------|-------------|
|                            | 2007                                | 2006      | \$ Change   |
| Revenue                    | \$ -                                | \$ 43,584 | \$ (43,584) |
| Operating income           | \$ -                                | \$ 11,482 | \$ (11,482) |
| Income taxes               | \$ -                                | \$ 4,526  | \$ (4,526)  |
| Net income                 | \$ -                                | \$ 6,956  | \$ (6,956)  |

| (\$ in thousands)<br>----- | For the six months ended June 30, |           |             |
|----------------------------|-----------------------------------|-----------|-------------|
|                            | 2007                              | 2006      | \$ Change   |
| Revenue                    | \$ -                              | \$ 86,078 | \$ (86,078) |
| Operating income           | \$ -                              | \$ 21,940 | \$ (21,940) |
| Income taxes               | \$ -                              | \$ 8,488  | \$ (8,488)  |
| Net income                 | \$ -                              | \$ 13,452 | \$ (13,452) |

On July 31, 2006, we sold our CLEC business, Electric Lightwave, LLC (ELI), for \$255.3 million in cash plus the assumption of approximately \$4.0 million in capital lease obligations. We recognized a pre-tax gain on the sale of ELI of approximately \$116.7 million. Our after-tax gain on the sale was \$71.6 million. Our cash liability for taxes as a result of the sale is expected to be approximately \$5.0 million due to the utilization of existing tax net operating losses on both the federal and state level.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to market risk in the normal course of our business operations due to ongoing investing and funding activities. Market risk refers to the potential change in fair value of a financial instrument as a result of fluctuations in interest rates and equity prices. We do not hold or issue derivative instruments, derivative commodity instruments or other financial instruments for trading purposes. As a result, we do not undertake any specific actions to cover our exposure to market risks, and we are not party to any market risk management agreements other than in the normal course of business or to hedge long-term interest rate risk. Our primary market risk exposures are interest rate risk and equity price risk as follows:

Interest Rate Exposure

Our exposure to market risk for changes in interest rates relates primarily to the interest-bearing portion of our investment portfolio and interest on our long-term debt. The long-term debt include various instruments with various maturities and weighted average interest rates.

Our objectives in managing our interest rate risk are to limit the impact of interest rate changes on earnings and cash flows and to lower our overall borrowing costs. To achieve these objectives, a majority of our borrowings have fixed interest rates. Consequently, we have limited material future earnings or

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cash flow exposures from changes in interest rates on our long-term debt. An adverse change in interest rates would increase the amount that we pay on our variable obligations and could result in fluctuations in the fair value of our fixed rate obligations. Based upon our overall interest rate exposure at June 30, 2007, a near-term change in interest rates would not materially affect our consolidated financial position, results of operations or cash flows.

In order to manage our interest rate risk exposure, we have entered into interest rate swap agreements. Under the terms of the agreements, we make semi-annual, floating interest rate interest payments based on six month LIBOR and receive a fixed rate on the notional amount.

### Sensitivity analysis of interest rate exposure

At June 30, 2007, the fair value of our long-term debt was estimated to be approximately \$4.7 billion, based on our overall weighted average interest rate of 8.02% and our overall weighted average maturity of approximately 13 years. There has been no material change in the weighted average maturity applicable to our obligations since December 31, 2006.

The overall weighted average interest rate decreased approximately 7 basis points during the second quarter of 2007. A hypothetical increase of 80 basis points (10% of our overall weighted average borrowing rate) would result in an approximate \$264.4 million decrease in the fair value of our fixed rate obligations.

### Equity Price Exposure

Our exposure to market risks for changes in equity prices as of June 30, 2007 is limited to our pension assets. We have no other equity investments of any material amount.

## Item 4. Controls and Procedures

-----

### (a) Evaluation of disclosure controls and procedures

We carried out an evaluation, under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, regarding the effectiveness of the design and operation of our disclosure controls and procedures. Based upon this evaluation, our principal executive officer and principal financial officer concluded, as of the end of the period covered by this report, June 30, 2007, that our disclosure controls and procedures are effective.

### (b) Changes in internal control over financial reporting

As a result of our Commonwealth acquisition we have begun to integrate certain business processes and systems of the acquired entity. Accordingly, certain changes have been made and will continue to be made to our internal controls over financial reporting until such time as this integration is complete. There have been no other changes in our internal control over financial reporting identified in an evaluation thereof that occurred during the second fiscal quarter of 2007 that materially affected or is reasonably likely to materially affect our internal control over financial reporting.

## PART II. OTHER INFORMATION CITIZENS COMMUNICATIONS COMPANY AND SUBSIDIARIES

## Item 1. Legal Proceedings

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There have been no material changes to our legal proceedings from the information provided in Item 3. Legal Proceedings included in our Annual Report on Form 10-K for the year ended December 31, 2006, except as set forth below:

As reported in our Annual Report on Form 10-K for the year ended December 31, 2006, the City of Bangor, Maine, filed suit against us on November 22, 2002, in the U.S. District Court for the District of Maine (City of Bangor v. Citizens Communications Company, Civ. Action No. 02-183-B-S). The City alleged, among other things, that we are responsible for the costs of cleaning up environmental contamination alleged to have resulted from the operation of a manufactured gas plant owned by Bangor Gas Company from 1852-1948 and by us from 1948-1963. In acquiring the operation in 1948, we acquired the stock of Bangor Gas Company and merged it into us. The City alleged the existence of extensive contamination of the Penobscot River and initially asserted that money damages and other relief at issue in the lawsuit could exceed \$50.0 million. The City also requested that punitive damages be assessed against us. We filed an answer denying liability to the City, and asserted a number of counterclaims against the City. In addition, we identified a number of other potentially responsible parties that may be liable for the damages alleged by the City and joined them as parties to the lawsuit. These additional parties include UGI Utilities, Inc. and Centerpoint Energy Resources Corporation. The Court dismissed all but two of the City's claims, including its claims for joint and several liability under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) and the claim against us for punitive damages.

On June 27, 2006, the court issued Findings of Fact and Conclusions of Law in the first phase of the case. The court found contamination in only a small section of the River and determined that Citizens and the City should share cleanup costs.

Subsequent to the June 27, 2006 findings, we began settlement discussions with the City, with participation from the State of Maine. In February 2007, we reached an agreement to settle the matter for a payment by us of \$7.6 million. The payment was made on July 31, 2007 and the settlement is now final. Under the settlement agreement, we and the City will share in any recoveries from the various third party defendants. We also executed a Consent Decree with the City and the State that subsequently was approved and entered by the Court. On July 31, certain of the third party defendants filed a notice of appeal concerning entry of the Consent Decree. Even if such appeal (which we intend to vigorously contest) were successful, it would not affect the finality of our settlement with the City.

In addition, we have demanded that various of our insurance carriers defend and indemnify us with respect to the City's lawsuit, and on December 26, 2002, we filed a declaratory judgment action against those insurance carriers in the Superior Court of Penobscot County, Maine, for the purpose of establishing their obligations to us with respect to the City's lawsuit. We intend to vigorously pursue this lawsuit and to obtain from our insurance carriers indemnification for any amounts paid by us in settlement of the City's lawsuit as well as to recover the costs of our defense of that lawsuit. We cannot at this time determine what amount we may recover from third parties or insurance carriers.

Ronald A. Katz Technology Licensing LP, filed suit against us for patent infringement on June 8, 2007 in the U.S. District Court for the District of Delaware. Katz Technology alleges that, by operating automated telephone systems, including customer service systems, that allow our customers to utilize telephone calling cards, order internet, DSL, and dial-up services, and perform a variety of account related tasks such as billing and payments, we have infringed thirteen of Katz Technology's patents and continue to infringe three of Katz Technology's patents. Katz Technology seeks unspecified damages resulting from our alleged infringement, as well as a permanent injunction enjoining us from continuing the alleged infringement. Katz Technology

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subsequently filed a tag-along notice with the Judicial Panel on Multi-District Litigation, notifying them of this action and its relatedness to In re Katz Interactive Dial Processing Patent Litigation (MDL No. 1816), pending in the Central District of California before Judge R. Gary Klausner. The Judicial Panel on Multi-District Litigation has transferred the case to the Central District of California. We intend to vigorously defend against this lawsuit.

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On June 24, 2004, one of our subsidiaries, Frontier Subsidiary Telco, Inc., received a "Notice of Indemnity Claim" from Citibank, N.A., that is related to a complaint pending against Citibank and others in the U.S. Bankruptcy Court for the Southern District of New York as part of the Global Crossing bankruptcy proceeding. Citibank bases its claim for indemnity on the provisions of a credit agreement that was entered into in October 2000 between Citibank and our subsidiary. We purchased Frontier Subsidiary Telco, Inc., in June 2001 as part of our acquisition of the Frontier telephone companies. The complaint against Citibank, for which it seeks indemnification, alleges that the seller improperly used a portion of the proceeds from the Frontier transaction to pay off the Citibank credit agreement, thereby defrauding certain debt holders of Global Crossing North America Inc. Although the credit agreement was paid off at the closing of the Frontier transaction, Citibank claims the indemnification obligation survives. Damages sought against Citibank and its co-defendants could exceed \$1.0 billion. In August 2004, we notified Citibank by letter that we believe its claims for indemnification are invalid and are not supported by applicable law. In 2005, Citibank moved to dismiss the underlying complaint against it. That motion is currently pending. We have received no further communications from Citibank since our August 2004 letter.

Item 1A. Risk Factors  
-----

There have been no material changes to our risk factors from the information provided in Item 1A. "Risk Factors" included in our Annual Report on Form 10-K for the year ended December 31, 2006.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds  
-----

There were no unregistered sales of equity securities during the quarter ended June 30, 2007.

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| Period | (a) Total<br>Number of<br>Shares<br>Purchased | (b) Average<br>Price Paid<br>per Share | (c) Total<br>Shares P<br>Part o<br>Announc<br>Pr |
|--------|---|--|--|
|--------|---|--|--|

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April 1, 2007 to April 30, 2007

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|                                       |           |         |     |
|---------------------------------------|-----------|---------|-----|
| Share Repurchase Program (1)          | 1,155,400 | \$15.28 | 1,9 |
| Employee Transactions (2)             | 4,225     | \$15.46 |     |
|                                       |           |         |     |
| May 1, 2007 to May 31, 2007           |           |         |     |
| Share Repurchase Program (1)          | 1,100,000 | \$15.65 | 3,0 |
| Employee Transactions (2)             | 273       | \$15.67 |     |
|                                       |           |         |     |
| June 1, 2007 to June 30, 2007         |           |         |     |
| Share Repurchase Program (1)          | 1,554,400 | \$15.34 | 4,6 |
| Employee Transactions (2)             | -         | \$ -    |     |
|                                       |           |         |     |
| Totals April 1, 2007 to June 30, 2007 |           |         |     |
| Share Repurchase Program (1)          | 3,809,800 | \$15.41 | 4,6 |
| Employee Transactions (2)             | 4,498     | \$15.47 |     |

- (1) In February 2007, our Board of Directors authorized us to repurchase up to \$250.0 million of our common stock, in public or private transactions over the following twelve-month period. This share repurchase program commenced on March 19, 2007.
- (2) Includes restricted shares withheld (under the terms of grants under employee stock compensation plans) to offset minimum tax withholding obligations that occur upon the vesting of restricted shares. The Company's stock compensation plans provide that the value of shares withheld shall be the average of the high and low price of the Company's common stock on the date the relevant transaction occurs.

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

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- (a) The registrant held its 2007 Annual Meeting of the Stockholders on May 18, 2007 (the "Meeting").
- (b) Election of directors. At the Meeting, all nominees were elected pursuant to the following votes:

| DIRECTOR<br>-----      | Number of Votes |                   |
|------------------------|-----------------|-------------------|
|                        | FOR<br>---      | WITHHELD<br>----- |
| Kathleen Q. Abernathy  | 292,095,408     | 14,555,073        |
| Leroy T. Barnes, Jr.   | 289,333,550     | 17,316,931        |
| Michael T. Dugan       | 292,230,330     | 14,420,151        |
| Jeri B. Finard         | 290,019,145     | 16,631,335        |
| Lawton W. Fitt         | 289,884,698     | 16,765,783        |
| William M. Kraus       | 283,385,838     | 23,264,643        |
| Howard L. Schrott      | 284,997,277     | 21,653,204        |
| Larraine D. Segil      | 284,781,732     | 21,868,748        |
| Bradley E. Singer      | 290,654,624     | 15,995,857        |
| David H. Ward          | 289,049,068     | 17,601,413        |
| Myron A. Wick, III     | 290,183,581     | 16,466,900        |
| Mary Agnes Wilderotter | 289,284,504     | 17,365,977        |

- (c) Other matters submitted to stockholders at the Meeting:

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- (1) Adoption of the 2008 Citizens Incentive Plan. The matter passed with the following vote:

|                            |             |
|----------------------------|-------------|
| Number of votes FOR        | 284,889,080 |
| Number of votes AGAINST    | 16,337,549  |
| Number of votes ABSTAINING | 5,423,849   |

- (2) Adoption of the amendment to the Amended and Restated 2000 Equity Incentive Plan. The matter passed with the following vote:

|                            |             |
|----------------------------|-------------|
| Number of votes FOR        | 280,306,779 |
| Number of votes AGAINST    | 20,063,425  |
| Number of votes ABSTAINING | 6,280,276   |

- (3) Ratification of appointment of KPMG LLP as the Company's independent registered public accounting firm for 2007. The matter passed with the following vote:

|                            |             |
|----------------------------|-------------|
| Number of votes FOR        | 296,763,309 |
| Number of votes AGAINST    | 7,003,372   |
| Number of votes ABSTAINING | 2,883,797   |

### Item 5. Other Information

-----

As disclosed in our Proxy Statement for the 2007 Annual Meeting, proposals that stockholders wish to include in our Proxy Statement and form of proxy for our 2008 annual Stockholders meeting must be received by the Secretary of the Company no later than December 22, 2007. For a stockholder proposal that is not intended to be included in our Proxy Statement for our 2008 Annual Meeting, the proposal must be received by the Secretary of the Company not earlier than January 18, 2008 nor later than February 19, 2008 in order to be properly presented at the 2008 annual meeting. Furthermore, in accordance with the proxy rules and regulations of the Securities and Exchange Commission, if a stockholder does not notify us of a proposal by February 19, 2008, then our proxies would be able to use their discretionary voting authority if a stockholder's proposal is raised at the meeting.

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### Item 6. Exhibits

-----

a) Exhibits:

31.1 Certification of Principal Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.

31.2 Certification of Principal Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.

32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURE

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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.

CITIZENS COMMUNICATIONS COMPANY

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(Registrant)

By: /s/ Robert J. Larson

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Robert J. Larson  
Senior Vice President and  
Chief Accounting Officer

Date: August 2, 2007