VALOR COMMUNICATIONS GROUP INC
Form S-1/A
June 14, 2004

Table of Contents

As filed with the Securities and Exchange Commission on May 28, 2004

Registration No. 333-114298

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Amendment No. 1
to

Form S-1

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

Valor Communications Group, Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware	**4813**	**20-0792300**
(State or other jurisdiction of incorporation or organization)	*(Primary Standard Industrial Classification Code Number)*	*(I.R.S. Employer Identification Number)*

201 E. John Carpenter Freeway, Suite 200

Irving, Texas 75062
(972) 373-1000
(Address, including zip code, and telephone number, including area code, of Registrant s principal executive offices)

WILLIAM M. OJILE, JR., ESQ.

Senior Vice President,
Chief Legal Officer & Secretary
Valor Communications Group, Inc.
201 E. John Carpenter Freeway, Suite 200
Irving, Texas 75062
(972) 373-1000
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

Joshua N. Korff, Esq.	**David J. Goldschmidt, Esq.**
Kirkland & Ellis LLP	**Richard L. Muglia, Esq.**
Citigroup Center	**Skadden, Arps, Slate, Meagher & Flom LLP**
153 East 53rd Street	**Four Times Square**
New York, New York 10022	**New York, New York 10036**
(212) 446-4800	**(212) 735-3000**

Approximate date of commencement of proposed sale to the public: As soon as practicable after the effective date of this Registration Statement.

(continued on next page)

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Proposed Maximum Aggregate Offering Price(1)	Amount of Registration Fee(1)
Income Deposit Securities (IDSs)(2)		
Class A Common Stock, par value $0.01 per share(3)		
% Senior Subordinated Notes due 2019(4)		
Subsidiary Guarantees of % Senior Subordinated Notes due 2019(5)		
Total	$875,000,000	$110,863(6)

(1) Estimated solely for the purpose of computing the amount of the registration fee pursuant to Rule 457(o) promulgated under the Securities Act of 1933, as amended.

(2) The IDSs represent underlying shares of the Class A common stock and $ aggregate principal amount of underlying % senior subordinated notes of Valor Communications Group, Inc. (Valor). Includes IDSs subject to the underwriters over-allotment option and an indeterminate number of IDSs of the same series which may be received by holders of IDSs in the future on one or more occasions in replacement of the IDSs being offered hereby in the event of a subsequent issuance of IDSs, upon an automatic exchange of portions of the senior subordinated notes for identical portions of such additional notes as discussed in note (4) below.

(3) Represents shares of Valor s Class A common stock included in the IDSs described above.

(4) Includes $ million aggregate principal amount of Valor s % senior subordinated notes included in the IDSs described above and $ million principal amount of senior subordinated notes of the same series that will be issued separately (not in the form of IDSs). Also includes an indeterminate principal amount of notes of the same series as the senior subordinated notes, which will be received by holders of senior subordinated notes in the future on one or more occasions in the event of a subsequent issuance of IDSs, upon an automatic exchange of portions of the senior subordinated notes for identical portions of such additional notes.

(5) Each of the subsidiary guarantors listed in the Table of Additional Registrants on the next page will guarantee the senior subordinated notes represented by the IDSs and the senior subordinated notes of the same series that will be issued separately from the IDSs. Pursuant to Rule 457(n) under the Securities Act of 1933, no separate fee for the guarantees is payable.

(6) Previously paid.

The Registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission, acting pursuant to such Section 8(a), may determine.

Table of Contents

(continued from previous page)

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. o

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act of 1933, please check the following box and list the Securities Act of 1933 registration statement number of the earlier effective registration statement for the same offering. o

If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act of 1933, check the following box and list the Securities Act of 1933 registration statement number of the earlier effective registration statement for the same offering. o

If this form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act of 1933, check the following box and list the Securities Act of 1933 registration statement number of the earlier effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. o

Table of Contents

Table of Additional Registrant Guarantors

Exact Name of Registrant Guarantor as Specified in its Charter	State or Other Jurisdiction of Incorporation or Organization	I.R.S. Employer Identification Number	Address Including Zip Code, Telephone Number Including Area Code of Registrant Guarantor s Principal Executive Offices
Valor Telecommunications, LLC	Delaware	52-2171586	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Valor Telecommunications of Texas, LP	Texas	52-2194219	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Valor Telecommunications Equipment, LP	Texas	75-2884400	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Valor Telecommunications Services, LP	Texas	75-2884846	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Valor Telecommunications Investments, LLC	Delaware	47-0902124	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Valor Telecommunications Enterprises, LLC	Delaware	75-2884398	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Valor Telecommunications LD, LP	Delaware	75-2884847	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Southwest Enhanced Network Services, LP	Delaware	75-2885419	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Western Access Services, LLC	Delaware	20-0081823	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Western Access Services of Arizona, LLC	Delaware	20-0081863	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Western Access Services of Arkansas, LLC	Delaware	20-0081902	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000

Table of Contents

Exact Name of Registrant Guarantor as Specified in its Charter	State or Other Jurisdiction of Incorporation or Organization	I.R.S. Employer Identification Number	Address Including Zip Code, Telephone Number Including Area Code of Registrant Guarantor s Principal Executive Offices
Western Access Services of Colorado, LLC	Delaware	20-0081934	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Western Access Services of Oklahoma, LLC	Delaware	20-0081944	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Western Access Services of New Mexico, LLC	Delaware	20-0081922	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Western Access Services of Texas, LP	Delaware	20-0081952	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Valor Telecommunications Corporate Group, LP	Texas	75-2895493	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Valor Telecommunications Southwest, LLC	Delaware	52-2194218	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Valor Telecommunications Southwest II, LLC	Delaware	75-2950066	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Valor Telecommunications Enterprises II, LLC	Delaware	75-2950064	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Kerrville Communications Corporation	Texas	74-2197091	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Kerrville Communications Management, LLC	Delaware	30-0135974	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Kerrville Communications Enterprises, LLC	Delaware	32-0047694	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Advanced Tel-Com Systems, LP	Texas	74-2228603	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000

Table of Contents

Exact Name of Registrant Guarantor as Specified in its Charter	State or Other Jurisdiction of Incorporation or Organization	I.R.S. Employer Identification Number	Address Including Zip Code, Telephone Number Including Area Code of Registrant Guarantor s Principal Executive Offices
Kerrville Telephone, LP	Texas	74-0724580	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Kerrville Cellular, LP	Texas	74-2513782	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
KCC TelCom, LP	Texas	74-2955898	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Kerrville Cellular Management, LLC	Delaware	51-0411886	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Kerrville Cellular Holdings, LLC	Delaware	51-0411889	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Kerrville Mobile Holdings, Inc.	Texas	74-3008924	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000
Kerrville Wireless Holdings, LP	Texas	74-3012850	201 E. John Carpenter Freeway, Suite 200 Irving, TX 75062 (972) 373-1000

Subject to Completion, Dated May 28, 2004

Income Deposit Securities (IDSs)

representing
Shares of Class A Common Stock and
$ million % Senior Subordinated Notes due 2019 and

$ million % Senior Subordinated Notes due 2019

We are selling IDSs in the United States and Canada representing shares of our Class A common stock and $ million aggregate principal amount of our % senior subordinated notes due 2019. Each IDS initially represents:

- one share of our Class A common stock; and
- a % senior subordinated note with a $ million principal amount.

We are also selling $ million aggregate principal amount of our % senior subordinated notes separately (not in the form of IDSs). The completion of the offering of separate senior subordinated notes is a condition to our sale of IDSs. In addition, as part of our reorganization described elsewhere in this prospectus, we are issuing IDSs representing shares of our Class A common stock and $ million aggregate principal amount of our % senior subordinated notes to our existing equity holders, including management, in exchange for the interests they hold in our subsidiaries, see Detailed Transaction Steps on page 94.

This is the initial public offering of our IDSs and senior subordinated notes. We anticipate that the public offering price of the IDSs will be between $ and $ per IDS and the public offering price of the senior subordinated notes will be % of their stated principal amount.

Holders of IDSs may separate the IDSs into the shares of our Class A common stock and senior subordinated notes represented thereby at any time after the earlier of 45 days from the closing of this offering or the occurrence of a change of control. Similarly, any holder of shares of our Class A common stock and senior subordinated notes may, at any time, unless the IDSs have automatically separated, combine the applicable number of shares of Class A common stock and principal amount of senior subordinated notes to form IDSs.

Upon a subsequent issuance by us of IDSs or senior subordinated notes of the same series (not in the form of IDSs), a portion of your senior subordinated notes may be automatically exchanged for an identical principal amount of the senior subordinated notes issued in such subsequent issuance, and in that event your IDSs will be replaced with new IDSs. For more information regarding these automatic exchanges and the effect they may have on your investment, see Description of IDSs Procedures Relating to Subsequent Issuance on page 99 and Material United States Federal Income Tax Consequences United States Holders Senior Subordinated Notes Additional Issuances on page 150.

We have applied to list the IDSs on the New York Stock Exchange under the trading symbol VCG. In addition, we intend to list the IDSs on the Toronto Stock Exchange under the trading symbol VLR.un and our shares of Class A common stock under the symbol VLR.

Investing in our IDSs and our senior subordinated notes involves risks. See Risk Factors beginning on page 20.

	Per IDS	Total	Per Note	Total
Public offering price(1)	$	$	%	$
Underwriting discount	$	$	%	$
Proceeds to Valor Communications Group, Inc. (before expenses)(2)	$	$	%	$

(1) The offering price in Canada is payable in Canadian dollars and is the approximate equivalent of the U.S. dollar offering price based on the noon buying rate on the date of this prospectus as quoted by the Federal Reserve Bank of New York.

(2) Approximately $ million of these proceeds will be paid to our existing equity holders. The table above does not reflect IDSs being issued to our existing equity holders in exchange for their interests in our subsidiaries.

Certain holders of IDSs have granted the underwriters an option to purchase up to additional IDSs to cover over-allotments.

The underwriters expect to deliver the IDSs and the senior subordinated notes on or about , 2004.

Joint Book-Running Lead Managers

CIBC World Markets **Merrill Lynch & Co.** **Lehman Brothers**

Banc of America Securities LLC **JPMorgan**

, 2004

Table of Contents

Table of Contents

Summary

The following is a summary of the principal features of this offering of IDSs and senior subordinated notes and should be read together with the more detailed information and financial data and statements contained elsewhere in this prospectus.

Our Company

Overview

We are one of the largest providers of telecommunications services in rural communities in the southwestern United States and, based on the number of telephone lines we have in service, the seventh largest independent local telephone company in the country. We operate approximately 550,000 telephone access lines in primarily rural areas of Texas, Oklahoma, New Mexico and Arkansas. We believe that in many of our markets we are the only service provider that offers customers an integrated package of local and long distance voice, high-speed data and Internet access, and enhanced services such as voicemail and caller identification. For the year ended December 31, 2003, we generated revenues of $497.3 million.

We formed our company in 2000 in connection with the acquisition of select telephone assets from GTE Southwest Corporation, which is now part of Verizon, and have since acquired the local telephone company serving Kerrville, Texas. The rural telephone businesses that we own have been operating in the markets we serve for over 75 years. Since our inception, we have invested substantial resources to improve and expand our network infrastructure to provide high quality telecommunications services and superior customer care. This capital investment, in combination with a focused selling effort, has contributed to an increase in our revenue of $72.4 million, or 17.0%, from 2001 to 2003. We believe that we are well positioned for future revenue and cash flow growth through both expanded service offerings and acquisitions.

We operate our business through telephone company subsidiaries that qualify as rural local exchange carriers under the Telecommunications Act of 1996. Like many rural telephone companies, our business is characterized by stable operating results, revenue and cash flow and a relatively favorable regulatory environment, which includes support payments from the state and federal Universal Service Fund. In 2003, 24.1% of our revenues were attributable to such support payments. We have historically experienced less competition than regional Bell operating companies because of the low customer density and high residential component of our customer base. Since our customer base is located in areas that are generally less densely populated than areas served by other rural telephone companies, we believe that we are more insulated from competitive pressures than many other local telecommunications providers.

Our Strengths

Ability to Generate Consistent Cash Flows. We have increased our operating cash flow in each year since our inception by growing revenues, reducing expenses and optimizing our capital expenditures. In addition, a steady demand for telecommunications services and public policies that support universal, affordable local telephone service have generally enabled rural telephone companies to attain predictable and stable cash flow from operations.

Leading Market Position. We maintain our position as the leading provider of telecommunications in the markets we serve by providing reliable customer service, offering a full range of voice and data services and maintaining a strong local presence in the communities we serve. In addition, we generally face less competition than other industry participants because competitive entry into our markets is less attractive due to the low population density and primarily residential customer base.

Table of Contents

Scalable, State-of-the-Art Network Infrastructure. Our investment of more than $300 million since our inception in 2000 to improve and expand our network infrastructure has enabled us to provide additional services to our customers, improve the overall quality of our network and position our company for future cash flow growth.

Wide Array of Integrated Services. We believe that we are the only telecommunications service provider in many of the markets we serve that can provide an integrated package of local, long distance, high-speed data and Internet access as well as a variety of enhanced services such as voicemail and caller identification.

Experienced and Proven Management Team. Our highly experienced senior management team has an average of over 20 years of experience in the local telecommunications industry, including managing the expansion of public telecommunications companies through both internal growth and integration of acquisitions.

Business Strategy

Increase Penetration of Higher Margin Services. We intend to capitalize on our ability to cross-sell higher margin enhanced voice and data services as a bundled package which we believe represents a significant opportunity for us to continue to increase our revenue per customer.

Provide Superior Service and Customer Care. We seek to build long-term customer relationships by providing personalized customer care through three call centers, while also automating many of our customer service functions to enable our customers to interact with our company 24 hours a day, 365 days a year.

Improve Operating Efficiency and Profitability. We strive for greater efficiencies and improved profit margins by consolidating corporate functions, negotiating favorable terms with our suppliers and contractors and focusing capital expenditures on projects that exceed our internal rate of return thresholds.

Pursue Selective Strategic Acquisitions. We believe that there are numerous opportunities to acquire telecommunications assets that are accretive and that we possess the management team, network infrastructure and labor force that can identify, acquire, integrate and successfully support significant growth through acquisitions.

New Credit Facility

Concurrently with the closing of this offering, we will enter into a $ million new senior secured credit facility with a syndicate of financial institutions, including Banc of America Securities LLC and CIBC World Markets Corp., as joint lead arrangers and joint book-managers. CIBC is also acting as a joint book-running lead manager of this offering. Throughout this prospectus, we refer to this credit facility as the new credit facility. We expect that the new credit facility will be comprised of a senior secured revolving credit facility in a total principal amount of up to $ million, which we refer to as the new revolver, and a senior secured term loan facility in an aggregate principal amount of $ million, which we refer to as the new term loan. We expect that the new revolving credit facility and the new term loan will each have an approximately five-year maturity with no amortization of principal prior to maturity. The senior subordinated notes will rank junior to the new credit facility and will be guaranteed by all of Valor s subsidiaries. The closing of this offering is conditioned upon the closing of the new credit facility. See Description of Certain Indebtedness New Credit Facility. As a result of the borrowings we expect to make initially under the new credit facility and the issuance of senior subordinated notes in this offering, we anticipate that upon the consummation of the offering we will have approximately $ of total debt outstanding.

Table of Contents

Our Reorganization

All the equity interests in Valor Telecommunications, LLC, or VTC, Valor Telecommunications Southwest, LLC, or VTS, and Valor Telecommunications Southwest II, LLC, or VTS II, are currently held by affiliates of Welsh, Carson Anderson & Stowe, affiliates of Vestar Capital Partners, and affiliates of Citicorp Venture Capital, to whom we refer to collectively as our equity sponsors, our management and employees, and a group of individuals. We refer to these persons and entities collectively throughout this prospectus as our existing equity holders.

As discussed in Detailed Transactions Steps on page 94 immediately prior to and in connection with this offering we will consummate a reorganization pursuant to which our existing equity holders will contribute all their equity interests in VTC, VTS and VTS II to Valor Communications Group, Inc., or Valor, in exchange for IDSs, shares of Class B common stock and $ million in cash in the aggregate. Following our reorganization, Valor will exist as a holding company with no direct operations and each of VTC, VTS and VTS II will be either a direct or an indirect wholly-owned subsidiary of Valor. Valor s principal assets are the direct and indirect equity interests of its subsidiaries, all of which will be pledged to the creditors under the new credit facility as described above.

Following our reorganization our management will collectively hold an aggregate of IDSs and will be eligible to receive over time under an incentive compensation plan that shall be designed to align the interests of management with those of the IDS holders. In addition, affiliates of Welsh, Carson, Anderson & Stowe, affiliates of Vestar Capital Partners and affiliates of Citicorp Venture Capital, or CVC, will beneficially own %, % and %, respectively of our common stock. Therefore, Welsh Carson, Vestar and CVC together will be able to exert substantial influence over our company.

Table of Contents

Our Corporate Structure After This Offering

The following chart reflects our capital structure immediately after the offering:

(1) Certain Valor Operating Entities and Kerville Operating Entities will also be borrowers under our new credit facility. We, Valor Telecommunications, LLC and certain of our operating subsidiaries will guarantee the obligations of these borrowers under the new credit facility.

We incorporated in Delaware in March 2004. Our principal executive offices are located at 201 E. John Carpenter Freeway, Suite 200, Irving, Texas 75062 and our telephone number is (972) 373-1000. Our website address is www.valortelecom.com. Information included or referred to on our website is not a part of this prospectus.

Table of Contents

General Information About This Prospectus

Throughout this prospectus, unless otherwise noted, we have assumed that our reorganization will be consummated and that the underwriters over-allotment exercise will not be exercised.

Unless the context otherwise requires, references in this prospectus to the offering refer collectively to the offering of:

- an aggregate of IDSs to the public;
- an aggregate of IDSs to our existing equity holders; and
- $ million aggregate principal amount of our % senior subordinated notes to the public separately (not in the form of IDSs).

Furthermore, unless the context otherwise requires, references in this prospectus to senior subordinated notes refer to both senior subordinated notes underlying IDSs as well as senior subordinated notes issued separately (not in the form of IDSs).

Risk Factors

You should carefully consider the information under the heading Risk Factors and all other information in this prospectus before investing in the IDSs (including the shares of our Class A common stock and senior subordinated notes represented by the IDSs) or in our senior subordinated notes.

The Offering

Summary of the IDSs and the Senior Subordinated Notes

We are offering IDSs at an assumed initial public offering price of $ per IDS (comprised of $ allocated to each subordinated note and $ allocated to each share of Class A common stock), which represents the midpoint of the range set forth on the cover page of this prospectus. We are also offering $ million aggregate principal amount of our % senior subordinated notes separately (not in the form of IDSs) at an initial public offering price of % of the stated principal amount for each note. As described below, assuming we make our scheduled interest payments and pay dividends in the amount contemplated by our initial dividend policy, holders of IDSs will receive in the aggregate approximately $ per year in dividends and interest on the Class A common stock and notes represented by each IDS, and holders of our notes will receive $ per year in interest per note. Dividend payments, however, are not mandatory or guaranteed, and our board of directors may, in its discretion, amend or repeal or deviate from our initial dividend policy or otherwise decide not to declare one or more dividends or to declare dividends in different amounts. In addition, our ability to pay dividends will be restricted if we do not meet certain financial tests as set forth in the new credit facilities and the indenture governing the notes. See Risk Factors We are subject to restrictive debt covenants that impose operating and financial restrictions on our operations and could limit our ability to grow our business. Further, our ability to pay dividends is restricted by Delaware law. See Initial Dividend Policy and Restrictions. Holders of our common stock do not have any legal right to receive or require the payment of dividends.

Our sale of IDSs will be conditioned upon the consummation of our separate offering of senior subordinated notes. In addition, no purchaser, including our existing equity investors, or any affiliate of such purchaser, is entitled to purchase both IDSs and senior subordinated notes in the offering. Furthermore, as part of our reorganization described elsewhere in this prospectus, we are issuing IDSs to our existing equity holders, including management, in exchange for the interests they hold in our subsidiaries, see Detailed Transaction Steps on page 94.

What are IDSs?

IDSs are securities comprised of Class A common stock and senior subordinated notes.

Each IDS initially represents:

- one share of our Class A common stock; and
- a % senior subordinated note with a $ principal amount.

The ratio of Class A common stock to principal amount of senior subordinated notes represented by an IDS is subject to change in the event of a stock split, recombination or reclassification of our Class A common stock. For example, if we effect a two-for-one stock split, from and after the effective date of the stock split, each IDS will represent two shares of Class A common stock and the same principal amount of senior subordinated notes as it previously represented. Likewise, if we effect a recombination or reclassification of our Class A common stock, each IDS will thereafter represent the appropriate number of shares of Class A common stock on a recombined or reclassified basis, as applicable, and the same principal amount of senior subordinated notes as it previously represented.

To our knowledge, no statutory, judicial or administrative authority, including the Internal Revenue Service, has directly addressed the tax consequences of the IDS structure or the subsequent issuance of senior subordinated notes.

Table of Contents

What payments can I expect to receive as a holder of IDSs?

Assuming we make our scheduled interest payments on the senior subordinated notes and pay dividends in the amount contemplated by our anticipated dividend policy, you will receive in the aggregate approximately $ per year in interest on the senior subordinated notes and dividends on the Class A common stock represented by each IDS. We expect to make interest and dividend payments on the fifteenth day of March, June, September and December of each year to holders of record on the fifth day of each such month or the immediately preceding business day.

Subject to certain restrictions, we may choose to defer interest payments on our senior subordinated notes. In addition, our Board of Directors, in its sole discretion, decides whether or not we will pay dividends and determines the amount of any such dividend payment on the shares of our common stock.

You will be entitled to receive quarterly interest payments at an annual rate of % of the aggregate principal amount of senior subordinated notes represented by your IDSs or approximately $ per IDS per year, subject to our right, if we are not otherwise in default under the indenture, for an aggregate period not to exceed eight quarters prior to 2009, and up to four occasions after , 2009 for a period of up to two quarters per occasion, to defer interest payments on our senior subordinated notes. For a detailed description of these circumstances, see Description of Senior Subordinated Notes Interest Deferral.

You will also receive quarterly dividends on the shares of our Class A common stock represented by your IDSs, if and to the extent dividends are declared by our board of directors and permitted by applicable law and the terms of the new credit facility, the indenture governing our senior subordinated notes and any of our other then outstanding indebtedness. Specifically, the indenture governing our senior subordinated notes restricts our ability to declare and pay dividends on our common stock as described under Dividend Policy. In addition, the new credit facility restricts our ability to declare and pay dividends on our common stock as described under Dividend Policy and Description of Certain Indebtedness New Credit Facility. Upon the closing of this offering, our board of directors is expected to adopt a dividend policy which contemplates that, subject to applicable law and the terms of our then existing indebtedness, annual dividends will be approximately $ per share of our Class A common stock for the first year following the consummation of this offering. However, our board of directors may, in its discretion, modify or repeal this dividend policy. We cannot assure you that we will pay dividends at this level in the future or at all.

Will my rights as a holder of IDSs be any different than the rights of a beneficial owner of separately held Class A common stock and senior subordinated notes?

No. As a holder of IDSs you are the beneficial owner of the Class A common stock and senior subordinated notes represented by your IDSs. As such, through your broker or other financial institution and The Depository Trust Company, or DTC, you will have exactly the same rights, privileges and preferences, including voting rights, rights to receive distributions, rights and preferences in the event of a default under the indenture governing our senior subordinated notes, ranking upon bankruptcy and rights to receive communications and notices as a beneficial owner of separately held Class A common stock and senior subordinated notes, as applicable, would have through its broker or other financial institution and DTC.

Will the terms of the notes represented by IDSs be the same as the notes sold separately (not in the form of IDSs)?

Yes. The terms of the notes sold separately (not in the form of IDSs) will be identical in all respects to the notes represented by IDSs and will be part of the same series of notes issued under the same indenture. Accordingly, holders of notes sold separately and holders of notes represented by IDSs will vote together as a single class, in proportion to the aggregate principal amount of notes they hold, on all matters on which they were eligible to vote under the indenture.

May purchasers of the senior subordinated notes being offered separately (and not in the form of IDSs) also purchase IDSs in this offering?
No. Prior to the closing of this offering, each person purchasing separate notes in this offering will be required to represent to us in writing that:

- Neither such purchaser nor any entity, investment fund or account over which such purchaser exercises investment control is purchasing IDSs in this offering or owns or has the contractual right to acquire our equity securities; and
- there is no plan or pre-arrangement by which,
  - such purchaser will acquire any IDSs or our company equity, or
  - separate notes being acquired by such purchaser will be transferred to any holder of the IDSs or company equity.

Will the shares of our Class A common stock and senior subordinated notes represented by the IDSs be separately listed on an exchange?
We will apply to list the shares of our Class A common stock on the Toronto Stock Exchange under the trading symbol VLR. We cannot assure you that our Class A common stock will trade on the Toronto Stock Exchange or any other exchange or that our senior subordinated notes will trade separately from the IDSs on any exchange. We currently do not expect an active trading market for our Class A common stock or senior subordinated notes to develop. However, we will use reasonable efforts to list our Class A common stock for separate trading on the New York Stock Exchange if a sufficient number of shares of our Class A common stock are held separately to meet the minimum requirements for separate trading on the New York Stock Exchange for at least 30 consecutive trading days. The shares of Class A common stock and senior subordinated notes offered hereby will be freely tradable without restriction or further registration under the Securities Act of 1933, unless they are held by affiliates as that term is defined in Rule 144 under the Securities Act.

In what form will IDSs and the shares of our Class A common stock and senior subordinated notes represented by the IDSs be issued?
The IDSs and the shares of our Class A common stock and senior subordinated notes represented by the IDSs will be issued in book-entry form only. This means that you will not be a registered holder of IDSs or the securities represented by the IDSs and you will not receive a certificate for your IDSs or the securities represented by your IDSs. You must rely on your broker or other financial institution that will maintain your book-entry position to receive the benefits and exercise the rights of a holder of IDSs.

Can I separate my IDSs into shares of Class A common stock and senior subordinated notes or recombine shares of Class A common stock and senior subordinated notes to form IDSs?
Yes. Holders of IDSs, whether purchased in this offering or in a subsequent offering of IDSs of the same series, may, at any time after the earlier of 45 days from the date of the closing of this offering or the occurrence of a change of control, through their broker or other financial institution, separate the IDSs into the shares of our Class A common stock and senior subordinated notes represented thereby. Any holder of shares of our Class A common stock and senior subordinated notes, whether represented by IDSs purchased in this offering or a subsequent offering and separated, or purchased separately in the secondary market, may, at any time, through his or her broker or other financial institution, combine the applicable number of shares of Class A common stock and senior subordinated notes to form IDSs unless the IDSs have previously been automatically separated. Separation and recombination of IDSs will occur

Table of Contents

promptly in accordance with The Depository Trust Company s procedures and upon receipt of instructions from your broker and may involve transaction fees charged by your broker and/or other financial intermediaries. Trading in the IDSs will not be suspended as a result of any such separation or recombination of IDSs. See Description of IDSs Book-Entry Settlement and Clearance Separation and Combination.

Will my IDSs automatically separate into shares of Class A common stock and senior subordinated notes upon the occurrence of certain events?

Yes. Separation of all of the IDSs will occur automatically 90 days following the acceleration of the maturity of the senior subordinated notes for any reason, upon the continuance of a payment default on the senior subordinated notes for 90 days, upon the occurrence of any redemption, whether in whole or in part, of the senior subordinated notes or upon the maturity of the senior subordinated notes. Following any such automatic separation, shares of Class A common stock and senior subordinated notes may be no longer be combined to form IDSs.

What will happen if we issue additional IDSs or senior subordinated notes of the same series in the future?

Subsequently issued IDSs or senior subordinated notes will have terms that are identical to those of the IDSs and senior subordinated notes, respectively, sold in this offering, except that:

- if additional IDSs are issued 45 days or more from the closing of this offering, they will be immediately separable; and

- if additional IDSs are issued less than 45 days from the closing of this offering, they will be separable on and after the same date the IDSs issued in this offering may separate.

If we issue senior subordinated notes (whether or not in the form of IDSs) in the future and these senior subordinated notes are sold with original issue discount, or OID, for U.S. federal income tax purposes, holders of our senior subordinated notes outstanding prior to such issuance and purchasers of the newly issued notes will automatically exchange among themselves a portion of the senior subordinated notes they hold so that immediately following such automatic exchange, each holder will own a *pro rata* portion of the new notes and the old notes. The aggregate amount of new notes and old notes held by any holder prior to the exchange will be the same as such holder holds subsequent to the exchange. This exchange will be effected automatically, without any action by the holders, through the facilities of DTC. DTC has advised us that the implementation of this automatic exchange may cause a delay in the settlement of trades of up to 24 hours. See Description of IDSs Procedures Relating to Subsequent Issuances.

Other than potential tax and bankruptcy implications and subject to market perception, we do not believe that the automatic exchange will affect the economic attributes of your investment in our IDSs or senior subordinated notes. The tax and bankruptcy implications of an automatic exchange are summarized below and described in more detail in Risk Factors Risks Relating to the IDSs, the Shares of Class A Common Stock, and Senior Subordinated Notes Represented by the IDSs, the Senior Subordinated Notes Offered Separately (not in the form of IDSs), and our New Credit Facility and Material United States Federal Income Tax Consequences United States Holders Senior Subordinated Notes Additional Issuances.

This automatic exchange should not impair the rights any holder might otherwise have to assert a claim under applicable securities laws, against us or the underwriters, with respect to the full amount of senior subordinated notes purchased by such holder.

Table of Contents

What will be the United States federal income tax consequences of an investment in the IDSs?

The United States federal income tax consequences of the purchase, ownership and disposition of IDSs or senior subordinated notes in this offering are not entirely clear.

Treatment of Purchase of IDSs. Our counsel, Kirkland & Ellis LLP, is of the opinion that the purchase of IDSs in this offering should be treated for United States federal tax purposes as the purchase of shares of our Class A common stock and senior subordinated notes, rather than as the purchase of a single integrated security, and, by purchasing IDSs, you will agree to such treatment. We have not received an opinion of counsel as to the tax consequence of an additional issuance of IDSs of the same series in the future. You must allocate the purchase price of the IDSs between those shares of Class A common stock and senior subordinated notes in proportion to their respective initial fair market values, which will establish your initial tax basis in each component of the IDSs. The value attributed to the shares of Class A common stock and senior subordinated notes represented by the IDSs have been established based on the fair market value of such shares of Class A common stock and senior subordinated notes. We will report the initial fair market value of each share of Class A common stock as $ and the initial fair market value of each $ principal amount of senior subordinated notes as $, and by purchasing IDSs, you will agree to such allocation.

Treatment of Senior Subordinated Notes. Our counsel is of the opinion that the senior subordinated notes should be treated as debt for United States federal income tax purposes. If the senior subordinated notes were treated as equity rather than as debt for United States federal income tax purposes, then the stated interest on the senior subordinated notes could be treated as a dividend, and interest on the senior subordinated notes would not be deductible by us for United States federal income tax purposes, which could significantly reduce our future cash flow. In addition, payments on the senior subordinated notes to foreign holders would be subject to United States federal withholding tax at rates up to 30%. Payments to foreign holders would not be grossed-up on account of any such taxes.

For a more complete discussion of the material United States federal income tax considerations in connection with an investment in IDSs or senior subordinated notes, see Material U.S. Federal Income Tax Consequences.

What will be the United States federal income tax consequences of a subsequent issuance of senior subordinated notes?

The United States federal income tax consequences to you of the subsequent issuance of senior subordinated notes with OID (or any issuance of senior subordinated notes thereafter), are not entirely clear.

Exchange of Senior Subordinated Notes. The indenture governing the senior subordinated notes and the agreements with DTC will provide that, in the event that there is a subsequent issuance of senior subordinated notes with OID, and in connection with each issuance of senior subordinated notes thereafter, including an issuance of senior subordinated notes upon an exchange of shares of Class B common stock, each holder of IDSs or separately held senior subordinated notes, as the case may be, agrees that a portion of such holder s senior subordinated notes will be exchanged for a portion of the senior subordinated notes acquired by the holders of such subsequently issued senior subordinated notes, as described above. As a result of these exchanges, the OID associated with the issuance of the new senior subordinated notes effectively will be spread among all holders of senior subordinated notes on a *pro rata* basis, which may adversely affect your tax treatment, as described below. OID is generally the excess, if any, of the stated redemption price at maturity of a note over its issue price. If the difference is de minimus as defined in the Code and the Treasury regulations relating to OID, then there is no OID.

Due to the lack of applicable authority, it is unclear whether the exchange of senior subordinated notes for subsequently issued senior subordinated notes will result in a taxable exchange for United States federal income tax purposes, and it is possible that the Internal Revenue Service, or IRS, might successfully assert that such an exchange should be treated as a taxable exchange. In such case, a holder would recognize any gain realized on such exchange, but a loss realized might be disallowed. If the exchange of senior subordinated notes is treated as a taxable exchange, then your initial tax basis in the senior subordinated notes deemed to have been received in the exchange would be the fair market value of such senior subordinated notes on the date of the deemed exchange (adjusted to reflect any disallowed loss), and your holding period for such senior subordinated notes would begin on the day after the deemed exchange.

Reporting of OID. Regardless of whether the exchange of senior subordinated notes is treated as a taxable event, such exchange could result in holders having to include OID in taxable income prior to the receipt of cash. Following any subsequent issuance of senior subordinated notes with OID (or any issuance of senior subordinated notes thereafter) and resulting exchange, we (and our agents) will report any OID on the subsequently issued senior subordinated notes ratably among all holders of IDSs and separately held senior subordinated notes, and each holder of IDSs and separately held senior subordinated notes will, by purchasing IDSs or senior subordinated notes, agree to report OID in a manner consistent with this approach. However, we cannot assure you that the IRS will not assert that any OID should be reported only by the persons that initially acquired such subsequently issued senior subordinated notes (and their transferees) and they may challenge a holder s reporting of OID on its tax returns.

We will immediately file a Current Report on Form 8-K (or any other applicable form) to announce and quantify any changes in the ratio of IDS components or changes in original issue discount attributed to the senior subordinated notes.

Because a subsequent issuance will affect the senior subordinated notes in the same manner, regardless of whether the senior subordinated notes are held as part of IDSs or separately, the combination of senior subordinated notes and shares of Class A common stock to form IDSs, or the separation of IDSs into their component parts, should not affect your tax treatment.

Because there is no statutory, judicial or administrative authority directly addressing the tax treatment of the IDSs or instruments similar to the IDSs, we urge you to consult your own tax advisor concerning the tax consequences of an investment in the IDSs or senior subordinated notes. For additional information, see Material United States Federal Income Tax Consequences.

What is the initial and prospective accounting treatment of the IDSs?

There is no explicit guidance under generally accepted accounting principles regarding the accounting and reporting for unit securities comprised of common stock and notes like the IDSs. Any accounting followed by us for the IDSs may be subject to future scrutiny and challenge. Authoritative accounting bodies such as the FASB, EITF or SEC may issue future guidance, rules or interpretations which may require us to adjust our accounting for our IDSs. For our interpretation of the accounting treatment based on existing guidance available, see Management s Discussion and Analysis Critical Accounting Policies (Income Taxes and IDSs, Class B common stock and preferred stock).

Table of Contents

Summary of the Capital Stock

Issuer	Valor Communications Group, Inc.
Common stock	We have shares of authorized Class A common stock, par value $0.01 per share, shares of authorized Class B common stock, par value $0.01 per share, and shares of authorized Class C common stock, par value $0.01 per share. Class A common stock, Class B common stock and Class C common stock are identical in all respects, except that only Class A common stock is eligible to be included in IDSs and each class carries different dividend rights, as more fully described in Dividend Policy and Description of Capital Stock Common Stock Dividends. In addition, we have entered into an agreement with our equity sponsors that provides that following the second anniversary of the consummation of this offering, at the option of our equity sponsors, upon any subsequent sale of any shares of Class B common stock, we will exchange with the purchasers of such shares, one IDS for each share of Class B common stock, subject to compliance with law and applicable agreements more fully described in Related Party Transactions Equity Sponsors Investor Rights Agreement. Furthermore, our bylaws provide that we may only issue additional shares of Class A common stock and IDSs pursuant to a registration statement that has been declared effective by the Securities and Exchange Commission. Unless the context otherwise requires, references to our common stock throughout this prospectus refer to our Class A common stock, Class B common stock and Class C common stock.
Shares of Class A common stock represented by IDSs being offered to the public:	
by Valor	shares.
by our existing equity holders	shares if the underwriters over-allotment option is exercised in full (which shares shall be offered from the shares of Class A common stock represented by IDSs that we are issuing to our existing equity holders in this offering).
Shares of Class A common stock represented by IDSs being issued to our existing equity holders	shares.
Shares of common stock to be outstanding following the offering	shares of Class A common stock and shares of Class B common stock. No shares of Class C common stock will be outstanding following the consummation of this offering.
Voting rights	Each outstanding share of our common stock will carry one vote per share and all classes of common stock will vote as a single class on all matters presented to the stockholders for a vote. Our existing equity investors, through their ownership of shares of Class A common stock and Class B common stock, will own % of the voting power of our common stock outstanding immediately following the offering.
Dividends	You will receive dividends on the shares of our common stock if and to the extent dividends are declared by our board of directors and permitted by applicable law and the terms of our then outstanding

	indebtedness. Specifically, the senior subordinated notes indenture and the new credit facility both restrict our ability to declare and pay dividends on our common stock, as described in detail under Dividend Policy. Upon the closing of this offering, our board of directors is expected to adopt a dividend policy which contemplates that, subject to applicable law and the terms of our then existing indebtedness, annual dividends will be approximately $ per share of our Class A common stock for the first year following the consummation of this offering. Our amended and restated certificate of incorporation contains dividend provisions with respect to our Class B common stock that are intended to replicate the yield on our IDS units. Any time a dividend is paid to holders of Class A common stock, holders of Class B common stock will be paid a dividend equal to the amount per share paid to holders of Class A common stock. In addition to any such dividend, shares of our Class B common stock accrue dividends at a rate of % per annum on a deemed issuance price of $ per share, as more fully described in Description of Capital Stock Common Stock Dividends. Following the consummation of this offering, no shares of Class C common stock will be outstanding and therefore we have not established a dividend policy with respect to shares of Class C common stock. Our board of directors may, in its discretion, modify or repeal this dividend policy. We cannot assure that we will pay dividends at this level or at all in the future.
Dividend payment dates	If declared, dividends on our Class A common stock and Class B common stock will be paid quarterly on the fifteenth day of each March, June, September and December of each year to holders of record on the fifth day of such month or the immediately preceding business day. To the extent not previously paid, the % dividend that accrues on shares of Class B common stock will be paid at such time when such shares of Class B Common stock are exchanged for IDSs.
Listing	We have applied to list the IDSs on the New York Stock Exchange under the trading symbol VCG. In addition, we intend to apply to list the IDSs on the Toronto Exchange under the trading symbol VLR.un and our shares of Class A common stock under the symbol VLR. We cannot assure you that our Class A common stock will trade separately from the IDSs on the Toronto Stock Exchange or any other exchange and we currently do not expect an active trading market for our Class A common stock to develop. However, we will use reasonable efforts to list our Class A common stock for separate trading on the New York Stock Exchange if a sufficient number of shares of our Class A common stock are held separately to meet the minimum requirements for separate trading on the New York Stock Exchange for at least 30 consecutive trading days. Our Class A common stock will be freely tradable without restriction or further registration under the Securities Act, unless held by affiliates as that term is defined in Rule 144 under the Securities Act.

Table of Contents

Summary of the Senior Subordinated Notes

Issuer	Valor Communications Group, Inc.
Senior subordinated notes represented by IDSs being offered to the public:	
by Valor	$ million aggregate principal amount of % senior subordinated notes.
by our existing equity holders	$ million aggregate principal amount of % senior subordinated notes if the underwriters over-allotment option to purchase IDSs is exercised in full (which notes shall be offered from the notes represented by IDSs that we are issuing to our existing equity holders in this offering).
Senior subordinated notes represented by IDSs being issued to our existing equity holders	$ million aggregate principal amount of % senior subordinated notes.
Senior subordinated notes being offered to the public separately (and not in the form of IDSs)	$ million aggregate principal amount of % senior subordinated notes.
Senior subordinated notes to be outstanding following the offering	$ million aggregate principal amount of % senior subordinated notes.
Interest rate	% per year.
Interest payment dates	Interest will be paid quarterly in arrears on the fifteenth day of March, June, September and December of each year, commencing , 2004, to holders of record on the fifth day of each such month or the immediately preceding business day.
Interest deferral	Prior to , 2009, we may, subject to certain restrictions, defer interest payments on our senior subordinated notes on one or more occasions for up to an aggregate period of eight quarters. In addition, after , 2009 we may, subject to certain restrictions, defer interest payments on our senior subordinated notes on up to four occasions for no more than two quarters on each occasion; provided that at the end of any interest deferral period following , 2009, we may not defer interest unless and until all deferred interest and accrued interest thereon is paid in full. During any interest deferral period and so long as any deferred interest or interest on deferred interest remains outstanding, we will not be permitted to declare or pay dividends on the common stock. For a detailed description of the interest deferral provisions of the indenture, see Description of Senior Subordinated Notes Interest Deferral. In the event that interest payments on the senior subordinated notes are deferred, you would be required to continue to include the yield on the senior subordinated notes in your income for United States federal

	income tax purposes as it accrues, even if you do not receive any cash interest payments.
Maturity date	The senior subordinated notes will mature on , 2019.
Optional redemption	We may not redeem the senior subordinated notes prior , 2011. On and after , 2011 and prior to , 2016, we may redeem for cash all or part of the senior subordinated notes upon not less than 30 or more than 60 days notice by mail to the owners of senior subordinated notes, at the redemption prices set forth under Description of Notes Optional Redemption. After , 2016, we may redeem all or any part of the senior subordinated notes upon not less than 30 or more than 60 days notice by mail to the holders of senior subordinated notes at a redemption price of 100% of the principal amount to be redeemed. In addition, if at any time we receive an opinion of a nationally recognized tax counsel that all or a substantial portion of the interest on the senior subordinated notes will not be deductible by us for United States federal income tax purposes, we may redeem the senior subordinated notes, in whole but not in part, at a redemption price of 100% of the principal amount to be redeemed. If we redeem the senior subordinated notes in whole or in part, the senior subordinated notes and Class A common stock represented by each IDS will be automatically separated and cannot thereafter be recombined.
Change of control	Upon the occurrence of a change of control, as defined under Description of Senior Subordinated Notes Change of Control, each holder of senior subordinated notes will have the right to require us to repurchase that holder s senior subordinated notes at a price equal to 101% of the principal amount of the senior subordinated notes being repurchased, plus any accrued but unpaid interest to but not including the repurchase date. If senior subordinated notes are held in the form of IDSs, in order to exercise that right, a holder of IDSs must separate its IDSs into the shares of Class A common stock and senior subordinated notes represented thereby and hold the senior subordinated notes separately.
Guarantees of senior subordinated notes	The senior subordinated notes will be fully and unconditionally guaranteed, on an unsecured senior subordinated basis, jointly and severally, by each of our direct and indirect wholly-owned domestic subsidiaries existing on the closing of this offering and each of our future wholly-owned domestic restricted subsidiaries that has total assets of more than $500,000. The guarantees will be subordinated to the guarantees issued by the subsidiary guarantors under the new credit facility.
Ranking of senior subordinated notes and guarantees	Valor is a holding company and derives all of its operating income and cash flow from its subsidiaries. The senior subordinated notes will be our and any guarantor s unsecured senior subordinated indebtedness, will be subordinated in right of payment to all our and any guarantor s existing and future senior indebtedness, including our borrowings and all guarantees of the subsidiary guarantors under the new credit facility. The senior subordinated notes and guarantees will rank *pari passu* in right of payment with all of our and any guarantor s existing

Table of Contents

	and future senior subordinated indebtedness and trade payables, except for such indebtedness and trade payables that are statutorily or contractually subordinated. The senior subordinated notes will also be effectively subordinated to any of our and any guarantor s secured indebtedness to the extent of the value of the assets securing the indebtedness. The indenture governing the senior subordinated notes will permit Valor and the subsidiary guarantors to incur additional indebtedness, including senior indebtedness, subject to specified limitations. On a pro forma basis as of March 31, 2004: Valor would have had no senior or *pari passu* indebtedness outstanding except for its guarantee under the new credit facility, as described below; and VTC would have had $ million aggregate principal amount of senior secured indebtedness outstanding under the new credit facility plus approximately $ million of letters of credit, which would have been guaranteed on a senior secured basis by the subsidiary guarantors, and approximately $ million of capital leases.
Restrictive covenants	The indenture governing the senior subordinated notes will contain covenants with respect to us and our restricted subsidiaries that will restrict: the incurrence of additional indebtedness and the issuance of preferred stock and certain redeemable capital stock; the payment of dividends on, and redemption of, capital stock; a number of other restricted payments, including investments; specified sales of assets; specified transactions with affiliates; the creation of a number of liens; and consolidations, mergers and transfers of all or substantially all of our assets. The limitations and prohibitions described above are subject to a number of other important qualifications and exceptions described under Description of Senior Subordinated Notes Certain Covenants.
Listing	We do not anticipate that our senior subordinated notes will be listed separately on any exchange.
Representation Letter	None of the senior subordinated notes sold separately (not in the form of IDSs) in this offering, which we refer to as the separate notes may be purchased, directly or indirectly, by persons who are also (1) purchasing IDSs in this offering or (2) holders of Class B common stock following our recapitalization. Furthermore, prior to the closing of this offering, each person purchasing separate senior subordinated notes in this offering will be asked to make certain representations to us in connection with these restrictions. See Underwriting.

Table of Contents

Summary Consolidated Financial Information

Valor is a holding company and has no direct operations. Valor was formed for the sole purpose of reorganizing our corporate structure and consummating this offering. Valor s principle assets are the direct and indirect equity interests of its subsidiaries. As a result, we have not provided separate historical financial results for Valor and present only the historical consolidated financial results of Valor Telecommunications, LLC. The following table sets forth our summary consolidated financial information derived from our audited consolidated financial statements for each of the years ended December 31, 2001 through December 31, 2003, and our unaudited consolidated financial information for the three months ended March 31, 2003 and 2004.

The information in the table below is only a summary and should be read together with our audited consolidated financial statements for the years ended December 31, 2001, 2002 and 2003 and the related notes, our unaudited consolidated financial statements as of March 31, 2004 and for the three months ended March 31, 2003 and 2004 and Management s Discussion and Analysis of Financial Condition and Results of Operations, all as included elsewhere in this prospectus.

	Year Ended December 31,			Three Months Ended March 31,	
	2001	2002(1)	2003	2003	2004
	(Dollars in thousands)				
Statement of operations data:					
Operating revenues	$ 424,916	$ 479,883	$497,334	$122,119	$125,852
Operating income	103,298	159,251	182,273	46,019	45,516
Net (loss) income(2)	(53,355)	16,302	58,233	12,159	15,614
Cash flow data from continuing operations:					
Net cash provided by operating activities	$ 100,301	$ 150,383	$166,065	$ 41,485	$ 50,109
Net cash used in investing activities	(106,614)	(216,773)	(66,299)	(14,178)	(16,723)
Net cash provided by (used in) financing activities	8,117	71,015	(99,465)	(26,484)	(31,041)
Other data:					
Capital expenditures	$ 107,869	$ 89,527	$ 69,850	$ 14,486	$ 16,654
Acquisition of Kerrville Communications Corporation(3)	$	$ 128,135	$	$	$
Depreciation and amortization(4)	$ 110,843	$ 73,273	$ 81,638	$ 19,950	$ 20,827
Adjusted EBITDA(5)	$ 215,141	$ 240,595	$262,707	$ 64,609	$ 66,872
Ratio of earnings to fixed charges(6)		1.2x	1.5x	1.4x	1.6x
Deficiency in the coverage of earnings to fixed charges(6)	$ 47,024				
Total access lines(7)	551,599	571,308	556,745	568,933	557,278

	March 31, 2004		
	Actual	Adjustments	Pro Forma As Adjusted(8)
	(Dollars in thousands)		
Balance sheet data:			
Cash and cash equivalents	$ 3,750	$	$
Net property, plant and equipment	$ 765,430	$	$
Total assets	$2,026,191	$	$
Long-term debt (including current maturities)	$1,430,196	$	$
Redeemable preferred interests	$ 370,231	$	$
Total common owners equity	$ 65,476	$	$

(1) We acquired all the outstanding common stock, preferred stock and common stock equivalents of Kerrville Communications Corporation (KCC) on January 31, 2002 and have included the assets, liabilities and results of operations of KCC from that date.

(2) Net (loss) income reported on the table above is after the effect of minority interest of $(3,595), $615 and $3,568 in 2001, 2002 and 2003, respectively, relating to individual investors interests in our subsidiaries.
(3) Reflects the purchase price for our acquisition of KCC, net of cash acquired.
(4) In accordance with Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets , effective January 1, 2002, we discontinued the amortization of goodwill. Amortization expense associated with goodwill was $53,900 for the year ended December 31, 2001.
(5) Adjusted EBITDA, as defined in the indenture governing our senior subordinated notes, is calculated as net (loss) income, as adjusted for the following items:

Income tax expense;
Interest expense;
Depreciation and amortization;
Minority interest;
Loss on interest rate hedging arrangements;
Earnings from unconsolidated cellular partnerships;
Other income and expense, net;
Loss on discontinued operations;
Cumulative effect of change in accounting principle;
Management fees paid to equity sponsors; and
Other non-recurring items, as defined in the indenture.

We consider Adjusted EBITDA an important indicator to investors in IDSs because it provides information related to our ability to provide cash flows to service debt, pay dividends and fund capital expenditures. We present this discussion of Adjusted EBITDA because covenants in the indenture governing our senior subordinated notes contain ratios based on this measure. As such, the summary historical financial information presented above includes our historical Adjusted EBITDA. For example, our ability to incur additional debt and make restricted payments requires a ratio of total leverage to Adjusted EBITDA of 5.75 to 1.00, except that we may incur certain debt and make certain restricted payments without regard to the ratio. Adjusted EBITDA is not a measure in accordance with GAAP, and should not be considered a substitute for, operating income (loss), net income (loss), and other measures of financial performance reported in accordance with GAAP. In addition, Adjusted EBITDA should not be used as a substitute for the Company s various cash flow measures (e.g., operating, investing and financing cash flows), which are discussed in Management s Discussion and Analysis of Financial Condition and Results of Operations.

	Year Ended December 31,			Three Months Ended March 31,	
	2001	2002	2003	2003	2004
	(Dollars in thousands)				
Calculation of Adjusted EBITDA:					
Net (loss) income	$ (53,355)	$ 16,302	$ 58,233	$12,159	$15,614
Adjustments:					
Income tax expense(a)		1,649	2,478	758	567
Interest expense	133,156	127,365	119,185	31,926	27,730
Depreciation and amortization	110,843	73,273	81,638	19,950	20,827
Minority interest	(3,595)	615	3,568	770	1,518
Loss on interest rate hedging arrangements	14,292	12,348	2,113	1,229	342
Earnings from unconsolidated cellular partnerships		(2,757)	(3,258)	(783)	(325)
Other income and expense, net	(358)	268	62	(40)	70
Loss (income) on discontinued operations	8,443	3,461	(108)		
Cumulative effect of change in accounting principle	4,715				
Management fees paid to equity sponsors	1,000	1,000	1,000	250	250
Total adjustments	268,496	217,222	206,678	54,060	50,979
Other non-recurring items, as defined in the indenture:					
		1,768			279

Termination benefits associated with workforce reduction					
MCI bankruptcy		4,998	(3,386)	(1,610)	
Transaction fees for acquisitions not consummated		305	1,182		
Total other non-recurring items, as defined in the indenture		7,071	(2,204)	(1,610)	279
Adjusted EBITDA	$215,141	$240,595	$262,707	$64,609	$66,872

(a) Relates to the federal income tax expense of Valor Telecommunications Southwest II, LLC, the holding company of the operating entities relating to our KCC business, which has elected to be taxed as a corporation.

Table of Contents

	Year Ended December 31,			Three Months Ended March 31	
	2001	2002(1)	2003	2003	2004
	(Dollars in thousands)				
Reconciliation of Net Cash Provided by Operating Activities to Adjusted EBITDA:					
Net cash provided by operating activities	$100,301	$150,383	$166,065	$41,485	$50,109
Adjustments:					
Interest expense	133,156	127,365	119,185	31,926	27,730
Amortization of debt issuance costs	(5,735)	(6,801)	(8,105)	(1,803)	(2,019)
Non-cash interest expense	(29,025)	(32,612)	(17,788)	(8,894)	
Provision for doubtful accounts receivable	(11,378)	(11,393)	(3,298)	(209)	(1,769)
Changes in working capital	29,923	(3,291)	(33)	1,530	(8,507)
Other, net	(2,743)	7,049	5,795	1,233	285
Income tax expense		1,649	2,478	758	567
Deferred income taxes		(93)	(450)	(17)	(123)
Other income and expense, net	(358)	268	62	(40)	70
Management fees paid to equity sponsors	1,000	1,000	1,000	250	250
Other non-recurring items, as defined in the indenture:					
Termination benefits associated with workforce reduction		1,768			279
MCI bankruptcy		4,998	(3,386)	(1,610)	
Transaction fees for acquisitions not consummated		305	1,182		
Adjusted EBITDA	$215,141	$240,595	$262,707	$64,609	$66,872

(6) For purposes of determining the ratio of earnings to fixed charges, earnings are defined as pretax income from continuing operations before adjustment for minority interest, less earnings from unconsolidated cellular partnerships and interest capitalized plus fixed charges, amortization of capitalized interest and distributed income from unconsolidated cellular partnerships. Fixed charges include interest costs, both expensed and capitalized, on all indebtedness, amortization of deferred financing costs and one-third of the rental expense on operating leases, representing the portion of rental expense we consider to be attributable to interest. Where earnings are inadequate to cover fixed charges, the deficiency is reported in the table above.

(7) We calculate our access lines in service by counting the number of working communication facilities that provide local service that terminate in a central office or to a customers premise. Non-revenue producing lines provisioned for company official use and for test purposes are included in our total access line counts. There were 11,305, 11,258 and 11,703 non-revenue producing lines included in our total access line count at December 31, 2001, 2002 and 2003 which represented 2.1%, 2.0% and 2.0% of our total access line counts, respectively, and 10,943 and 11,668 non-revenue producing lines included in our total access line count at March 31, 2003 and 2004 which represented 1.9% and 2.1% of our total access line count, respectively.

(8) The pro forma as adjusted balance sheet data have been prepared assuming the closing of this offering, the repurchase of 100% of our senior subordinated notes and completion of the bank refinancing, including payment of related fees and expenses. The pro forma as adjusted balance sheet data give effect to those transactions as if they had occurred on March 31, 2004. As described in Risk Factors and further described in Material United States Federal Income Tax Consequences, we plan to account for the issuance of the IDSs as representing shares of common stock and senior subordinated notes. We will deduct the interest expense on the senior subordinated notes from taxable income for income tax purposes and report the full benefit of the income tax deduction in our consolidated financial statements. We cannot assure you that the Internal Revenue Service will not seek to challenge the treatment of these senior subordinated notes as debt and the amount of interest expense deducted. If the Internal Revenue Service were to challenge this treatment successfully, we would have to provide an additional liability for the previously recorded benefit for the interest deductions.

Table of Contents

Risk Factors

Before you invest in the IDSs (including the shares of our Class A common stock and our senior subordinated notes represented by the IDSs) or the senior subordinated notes, you should carefully consider the various risks of the investment, including those described below, together with all of the other information included in this prospectus. If any of these risks actually occur, our business, financial condition or operating results could be adversely affected.

Risks Relating to the IDSs, the Shares of Class A Common Stock and Senior Subordinated Notes Represented by the IDSs, the Senior Subordinated Notes Offered Separately (not in the Form of IDSs), and our New Credit Facility

Our substantial indebtedness could restrict our ability to pay interest and principal on the senior subordinated notes and to pay dividends with respect to shares of our Class A common stock represented by the IDSs and impact our financing options and liquidity position.

Upon the consummation of this offering, we will have approximately $ million of total debt outstanding, $ million of which will rank senior to the senior subordinated notes. The degree to which we are leveraged on a consolidated basis could have important consequences to the holders of the IDSs and of separate senior subordinated notes, including:

- it may be more difficult to satisfy our obligations under the senior subordinated notes and to pay dividends on our Class A common stock;
- our ability to obtain additional financing in the future for working capital, capital expenditures or acquisitions may be limited;
- we may be unable to refinance our indebtedness on terms acceptable to us or at all;
- a significant portion of our cash flow from operations is likely to be dedicated to the payment of the principal of and interest on our indebtedness, thereby reducing funds available for other corporate purposes; and
- our substantial indebtedness may make us more vulnerable to economic downturns and limit our ability to withstand competitive pressures.

We may be able to incur substantially more debt, which could exacerbate the risks associated with our substantial indebtedness described above.

While our new credit facility will contain total leverage, senior leverage and interest coverage covenants and the indenture governing the senior subordinated notes will contain incurrence covenants that will restrict our ability to incur debt as described under Description of Certain Indebtedness New Credit Facility, and Description of Senior Subordinated Notes Additional Notes, as long as we meet these financial covenants we will be allowed to incur additional indebtedness, including senior subordinated notes with terms identical to the senior subordinated notes offered hereby.

The terms of our new credit facility restrict our ability to pay interest on our senior subordinated notes and dividends on shares of our common stock and we may amend these terms or enter into new agreements that are more restrictive.

Our new credit facility contains significant restrictions on our ability to pay interest on the senior subordinated notes and dividends on shares of common stock based on meeting our interest coverage ratio and senior leverage ratio and compliance with other conditions. As a result of general economic conditions, conditions in the lending markets, the results of our business or for any other reason, we may elect or be required to amend or refinance our new credit facility, at or prior to maturity, or enter into additional agreements for senior indebtedness. Regardless of any protection you have in the indenture governing the senior subordinated notes, any such amendment, refinancing or additional indebtedness may contain covenants that could limit in a significant manner our ability to make interest payments and pay dividends to you.

Table of Contents

We are subject to restrictive debt covenants that impose operating and financial restrictions on our operations and could limit our ability to grow our business.

The agreements governing our indebtedness impose significant operating and financial restrictions on us. These restrictions prohibit or limit, among other things:

- the incurrence of additional indebtedness and the issuance of preferred stock and certain redeemable capital stock;
- a number of other restricted payments, including investments and acquisitions;
- specified sales of assets;
- specified transactions with affiliates;
- the creation of a number of liens;
- consolidations, mergers and transfers of all or substantially all of our assets; and
- our ability to change the nature of our business.

These restrictions could limit our ability to obtain future financing, make acquisitions, withstand downturns in our business or take advantage of business opportunities.

If we fail to comply with the restrictive debt covenants in the agreements governing our indebtedness, our senior lenders may accelerate the payment of indebtedness outstanding under our new credit facility which is senior to the senior subordinated notes.

The terms of the new credit facility include several restrictive covenants that prohibit us from prepaying our other indebtedness, including the senior subordinated notes, while indebtedness under the new credit facility is outstanding. The new credit facility also requires us to maintain specified financial ratios and satisfy financial condition tests. Our ability to comply with the ratios or tests may be affected by events beyond our control, including prevailing economic, financial and industry conditions. See the information under Description of Certain Indebtedness for a fuller description of these restrictions and covenants.

A breach of any of these covenants, ratios or tests could result in a default under the new credit facility and/or the indenture. Events of default under the new credit facility would prohibit us from making payments on the senior subordinated notes in cash, including payment of interest when due. In addition, upon the occurrence of an event of default under the new credit facility, the lenders could elect to declare all amounts outstanding under the new credit facility, together with accrued interest, to be immediately due and payable. If we were unable to repay those amounts, the lenders could proceed against the security granted to them to secure that indebtedness. If the lenders accelerate the payment of the indebtedness, our assets may not be sufficient to repay in full this indebtedness and our other indebtedness, including the senior subordinated notes.

We are a holding company with no operations, and unless we receive dividends and other payments, advances and transfers of funds from our subsidiaries, we will be unable to meet our debt service and other obligations.

We are a holding company and conduct all of our operations through our subsidiaries. We currently have no significant assets other than equity interests in our subsidiaries. As a result, we will rely on dividends and other payments or distributions from our subsidiaries to meet our debt service obligations and enable us to pay dividends. The ability of our subsidiaries to pay dividends or make other payments or distributions to us will depend on their respective operating results and may be restricted by, among other things, the laws of their jurisdiction of organization (which may limit the amount of funds available for the payment of dividends), agreements of those subsidiaries, the terms of the new credit facility (under which the equity interests of our subsidiaries will be pledged), and the covenants of any future outstanding indebtedness we or our subsidiaries incur.

Table of Contents

You may not receive interest payments on your senior subordinated notes on the regularly scheduled payment dates as we may defer the payment of interest to you for a significant period of time, subject to restrictions set forth in the indenture.

Prior to , 2009, we may, subject to restrictions set forth in the indenture, defer interest payments on our senior subordinated notes on one or more occasions for up to an aggregate period of eight quarters. In addition, after , 2009, we may, subject to certain restrictions, defer interest payments on our senior subordinated notes on up to four occasions for up to an aggregate period of two consecutive quarters on each occasion. For any interest deferred during the first five years, we are not obligated to pay any deferred interest until , 2009, so you may be owed a substantial amount of deferred interest that will not be due and payable until such time. For any interest deferred after , 2009, however, we are obligated to pay all of the interest deferred on any prior occasion, together with any accrued interest thereon, before we may again defer interest payments.

You may not receive the level of dividends provided for in the dividend policy that our board of directors is expected to adopt upon the closing of this offering or any dividends at all.

Our board of directors may, in its discretion, amend or repeal the dividend policy it is expected to adopt upon the closing of this offering. Our board of directors may decrease the level of dividends provided for in this dividend policy or entirely discontinue the payment of dividends. The amount of future dividends with respect to shares of our capital stock, if any, will depend on, among other things, our results of operations, cash requirements, financial condition, contractual restrictions, business opportunities, provisions of applicable law and other factors that our board of directors may deem relevant. In addition, the indenture governing our senior subordinated notes and the new credit facility each contain significant restrictions which could affect your receipt of dividends, because among other things, if we defer interest on the senior subordinated notes, we may not pay dividends until we have paid all deferred interest and accrued interest thereon.

Furthermore, if the senior subordinated notes were treated as equity rather than as debt for United States federal income tax purposes, then the stated interest on the senior subordinated notes could be treated as a dividend and would not be deductible by us for United States federal income tax purposes. Our inability to deduct interest on the senior subordinated notes could materially increase our taxable income and, thus, our United States federal and applicable state income tax liability. If this were to occur, our after-tax cash flow available for dividend and interest payments would be reduced.

You will be immediately diluted by $ per share of Class A common stock if you purchase IDSs in this offering.

If you purchase IDSs in this offering, based on the book value of the assets and liabilities reflected on our balance sheet, you will experience an immediate dilution of $ per share of Class A common stock represented by the IDSs which exceeds the entire price allocated to each share of Class A common stock represented by the IDSs in this offering because there will be a net tangible book deficit for each share of Class A common stock outstanding immediately after this offering. Our net tangible book value as of March 31, 2004, after giving effect to this offering, was approximately $ million, or $ per share of Class A common stock.

Our interest expense may increase significantly and could cause our net income and distributable cash to decline significantly.

The new credit facility will be subject to periodic renewal or must otherwise be refinanced. We may not be able to renew or refinance the new credit facility, or if renewed or refinanced, the renewal or refinancing may occur on less favorable terms, including higher interest rates. Borrowings under the revolving facility will be made at a floating rate of interest. In the event of an increase in the base reference interest rates, our interest expense will increase and could have a material adverse effect on our ability to make cash dividend payments to our shareholders. Our ability to continue to expand our business will, to a large extent, be dependent upon our ability to borrow funds under our new credit facility and to obtain other third party financing, including through the sale of IDSs or other securities. We cannot assure you that such financing will be available to us on favorable terms or at all.

If we are unable to generate sufficient funds from operations we will be unable to pay our indebtedness at maturity or upon the exercise by holders of their rights upon a change of control.

Because a significant portion of our cash flow from operations will be dedicated to servicing our debt requirements and making capital expenditures to maintain the quality of our physical plant, we may not have sufficient funds from operations to repay the principal amount of our indebtedness at maturity or in case you exercise your right to require us to purchase your notes upon a change of control. In addition, we currently expect to distribute a significant portion of any remaining cash earnings to our stockholders in the form of quarterly dividends. Moreover, prior to the maturity of our senior subordinated notes, we will not be required to make any payments of principal on our senior subordinated notes. We may, therefore, need to refinance our debt or raise additional capital to meet our obligations. These alternatives may not be available to us when needed or on satisfactory terms due to prevailing market conditions, a decline in our business or restrictions contained in our senior debt obligations.

We may pay a significant portion of our free cash flow to stockholders in the form of dividends thereby reducing the amounts available to us to satisfy our obligations on the senior subordinated notes.

Our new credit facility and the indenture governing our senior subordinated notes permit us to pay a significant portion of our free cash flow to stockholders in the form of dividends, subject to certain limitations. Following completion of this offering, we intend to pay quarterly dividends. Any amounts paid by us in the form of dividends will not be available in the future to satisfy our obligations under the senior subordinated notes. The limitations on our ability to pay dividends are more fully described in Description of Senior Subordinated Notes Certain Covenants and Description of Certain Indebtedness New Credit Facility.

If the realizable value of our assets is insufficient to satisfy claims, you could lose all or part of your investment upon a liquidation of our company.

At March 31, 2004, our assets included goodwill of $1,057 million and deferred financing costs of $52 million. Combined, these items represent approximately 54.8% of our total consolidated assets. The value of these assets will continue to depend significantly upon the success of our business as a going concern and the growth in cash flows. As a result, in the event of a default under our new credit facility or on our senior subordinated notes or any bankruptcy or dissolution of our company, the realizable value of these assets may be substantially lower and may be insufficient to satisfy the claims of our creditors.

Deferral of interest payments would have adverse tax consequences for you.

If we defer interest payments on the senior subordinated notes, you will be required to recognize interest income for United States federal income tax purposes in respect of the senior subordinated notes before you receive any cash payment of this interest. In addition, we will not pay you this cash if you sell the IDSs or the senior subordinated notes, as the case may be, before the end of any deferral period or before the record date relating to interest payments that are to be paid.

Deferral of interest payments may also adversely affect the trading price of the senior subordinated notes.

The IDSs or the senior subordinated notes may trade at a price that does not fully reflect the value of accrued but unpaid interest on the senior subordinated notes if we defer interest payments. In addition, the requirement that we defer payments of interest on the senior subordinated notes under certain circumstances may mean that the market price for the IDSs or the senior subordinated notes may be more volatile than other securities that do not have this requirement.

Because of the subordinated nature of the notes, holders of our senior subordinated notes may not be entitled to be paid in full, if at all, in a bankruptcy, liquidation or reorganization or similar proceeding.

As a result of the subordinated nature of our notes and related guarantees, upon any distribution to our creditors or the creditors of the subsidiary guarantors in bankruptcy, liquidation or reorganization or similar

Table of Contents

proceeding relating to us or the subsidiary guarantors or our or their property, the holders of our senior indebtedness and senior indebtedness of the subsidiary guarantors will be entitled to be paid in full in cash before any payment may be made with respect to our senior subordinated notes or the subsidiary guarantees. Holders of our senior subordinated notes would participate with all other holders of unsecured indebtedness of ours or the subsidiary guarantors that are similarly subordinated in the assets remaining after we and the subsidiary guarantors have paid all senior indebtedness. However, because of the existence of the subordination provisions, including the requirement that holders of the senior subordinated notes pay over distributions to holders of senior indebtedness, holders of the senior subordinated notes may receive less, ratably, than our other unsecured creditors, including trade creditors. In any of these cases, we and the subsidiary guarantors may not have sufficient funds to pay all of our creditors. Holders of our senior subordinated notes may, therefore, receive less, ratably, than the holders of our senior indebtedness.

On a pro forma basis as of March 31, 2004, our senior subordinated notes and the associated subsidiary guarantees would have ranked junior, on a consolidated basis, to $ million of outstanding senior secured indebtedness plus approximately $100,000 of letters of credit and the subsidiary guarantees would have ranked junior to no senior unsecured debt and *pari passu* with approximately $ million of outstanding indebtedness of ours and the subsidiary guarantors. In addition, as of March 31, 2004, on a pro forma basis, we would have had the ability to borrow up to an additional amount of $ million under the new credit facility (less amounts reserved for letters of credit), which would have ranked senior in right of payment to our senior subordinated notes.

Holders of our senior subordinated notes will be structurally subordinated to the debt of our non-guarantor subsidiaries. Our partially owned domestic subsidiaries will not be guarantors of our senior subordinated notes. As a result, no payments are required to be made to us from the assets of these subsidiaries.

In the event of a bankruptcy, liquidation or reorganization or similar proceeding of any of the non-guarantor subsidiaries, holders of their indebtedness, including their trade creditors, would generally be entitled to payment of their claims from the assets of those subsidiaries before any assets are made available for distribution to us for payment to you.

In the event of bankruptcy or insolvency, the senior subordinated notes and guarantees could be adversely affected by principles of equitable subordination or recharacterization.

In the event of bankruptcy or insolvency, a party in interest may seek to subordinate the senior subordinated notes or the guarantees under the principles of equitable subordination or to recharacterize the senior subordinated notes as equity. There can be no assurance as to the outcome of such proceedings. In the event a court subordinates the senior subordinated notes or guarantees or recharacterizes the senior subordinated notes as equity, we cannot assure you that you would recover any amounts owed on the senior subordinated notes or the guarantees and you may be required to return any payments made to you within six years before the bankruptcy on account of the senior subordinated notes. In addition, should the court equitably subordinate the senior subordinated notes or the guarantees or recharacterize the senior subordinated notes as equity, you may not be able to enforce the guarantees.

If the guarantees of the senior subordinated notes by our subsidiaries were determined to be unenforceable, holders of the senior subordinated notes may be unable to recover their investment in the event of a bankruptcy or liquidation proceeding.

Under federal bankruptcy law and comparable provisions of state fraudulent transfer laws, a guarantee or any payment by a guarantor could be voided, or claims in respect of a guarantee could be subordinated to all other debt of the guarantor, if, among other things, the guarantor, at the time that it assumed the guarantee received less than reasonably equivalent value or fair consideration for issuing the guarantee and was insolvent or rendered insolvent by reason of issuing the guarantee and the application of the proceeds of the guarantee.

Generally, a person would be considered insolvent if, at the time it incurred the debt:

- the sum of its debts, including contingent liabilities, was greater than the fair saleable value of its assets;

- the present fair saleable value of its assets was less than the amount that would be required to pay its probable liability on its existing debts, including contingent liabilities, as they become absolute and mature; or

- it could not pay its debts as they become due.

The proceeds of the offering will be used to purchase a portion of the equity interests of our subsidiaries from their existing equity holders and to redeem notes issued by our subsidiaries, which may subject the senior subordinated note holders to the claim that we did not receive fair consideration for the senior subordinated notes. In the event that we meet any of the financial condition fraudulent transfer tests described above at the time of or as a result of this offering, a court could view the issuance of our senior subordinated notes with the distribution to our subsidiaries shareholders and the payment of our subsidiaries notes as a single integrated offering, and therefore conclude that we did not receive fair value for the offering. In such a case, a court could conclude that the obligations represented by the senior subordinated notes are void, unenforceable or subordinate to the claims of other creditors.

In addition, the guarantee of our senior subordinated notes by any subsidiary guarantor could be subject to the claim that since the guarantee was incurred for the benefit of Valor and only indirectly for the benefit of the subsidiary guarantor, the obligations of the subsidiary guarantor were incurred for less than fair consideration. If such a claim were successful and it was proven that the subsidiary guarantor was insolvent at the time the guarantee was issued, a court could void the obligations of the subsidiary guarantor under the guarantee or subordinate these obligations to the subsidiary guarantor s other debt or take action detrimental to holders of the senior subordinated notes. If the guarantee of any subsidiary guarantor were voided, our senior subordinated notes would be effectively subordinated to the indebtedness and other credit obligations of that subsidiary guarantor.

The United States federal income tax consequences of the purchase, ownership and disposition of IDSs and senior subordinated notes are unclear.

No statutory, judicial or administrative authority has directly addressed the treatment of the IDSs or the senior subordinated notes, or instruments similar to the IDSs or the senior subordinated notes, for United States federal income tax purposes. As a result, the United States federal income tax consequences of the purchase, ownership and disposition of IDSs and senior subordinated notes are unclear. We will receive an opinion from our counsel, Kirkland & Ellis, LLP, to the effect that an IDS should be treated as a unit representing a share of common stock and senior subordinated notes, and that the senior subordinated notes should be classified as debt for United States federal income tax purposes. However, the IRS or the courts may take the position that the IDSs are a single security classified as equity, or that the senior subordinated notes are properly classified as equity for United States federal income tax purposes, which could adversely affect the amount, timing and character of income, gain or loss in respect of your investment in IDSs or senior subordinated notes, and materially increase our taxable income and, thus, our United States federal and applicable state income tax liability. This would reduce our after-tax cash flow and materially and adversely impact our ability to make interest and dividend payments on the senior subordinated notes and the common stock. Foreign holders could be subject to withholding or estate taxes with regard to the senior subordinated notes in the same manner as they will be with regard to the common stock. Payments to foreign holders would not be grossed-up for any such taxes. Further, we have not received any opinion of counsel as to the treatment of senior subordinated notes that we may issue in any subsequent issuance, including in connection with an exchange of Class B common stock for IDSs and any subsequently issued senior subordinated notes may be treated as equity for United States federal income tax purposes. Apart from the exchanges of Class B common stock for IDSs, subsequent issuances of senior subordinated notes underlying IDSs will be made at the determination of our board of directors. For discussion of these tax-related risks, see Material United States Federal Income Tax Consequences.

Table of Contents

The allocation of the purchase price of the IDSs may not be respected, which may lead to you having to include original issue discount in your income even if you have not received the cash attributable to that income.

The purchase price of each IDS must be allocated for tax purposes between the share of common stock and senior subordinated notes comprising the IDS in proportion to their respective fair market values at the time of purchase. It is possible that the IRS will successfully challenge our allocation. If the allocation of the purchase price to the senior subordinated notes were determined to be too high, then it is possible that the senior subordinated notes would be treated as having been issued with OID, and you generally would be required to include the OID in income in advance of the receipt of cash attributable to that income. If, on the other hand, the allocation of purchase price to the senior subordinated notes were determined to be too low, then it is possible that the senior subordinated notes would be treated as having been issued with amortizable bond premium, and you would generally be able to elect to amortize such bond premium over the term of the senior subordinated notes.

Because of the deferral of interest provisions, the senior subordinated notes may be treated as issued with OID.

Under applicable Treasury regulations, a remote contingency that stated interest will not be timely paid is disregarded in determining whether a debt instrument is issued with OID. Although there is no authority directly on point, based on our financial forecasts, we believe that the likelihood of deferral of interest payments on the senior subordinated notes is remote within the meaning of the Treasury regulations. Based on the foregoing, although the matter is not free from doubt because of the lack of direct authority, the senior subordinated notes should not be considered to be issued with OID at the time of their original issuance. If deferral of any payment of interest were determined not to be remote, then the senior subordinated notes would be treated as issued with OID at the time of issuance. In such case, all stated interest on the senior subordinated notes would be treated as OID, with the consequence that all holders would be required to include the yield on the senior subordinated notes in income as it accrued on a constant yield basis, possibly in advance of their receipt of the associated cash and regardless of their method of tax accounting.

Subsequent issuances of senior subordinated notes may cause you to recognize taxable gain and/or original issue discount.

The United States federal income tax consequences to you of the subsequent issuance of senior subordinated notes with OID (or any issuance of senior subordinated notes thereafter) are unclear. In the future, we may issue senior subordinated notes underlying IDSs in exchange for shares of our Class B common stock. The indenture governing the senior subordinated notes and the agreements with DTC will provide that, in the event that there is a subsequent issuance of senior subordinated notes with OID, and in connection with each issuance of senior subordinated notes thereafter and any other issuance of senior subordinated notes that require a new CUSIP number, each holder of senior subordinated notes or IDSs, as the case may be, agrees that a portion of such holder s senior subordinated notes will be automatically exchanged for a portion of the senior subordinated notes acquired by the holders of such subsequently issued senior subordinated notes. The aggregate stated principal amount of senior subordinated notes owned by you and each other holder will not change as a result of such subsequent issuance and exchange. Due to the lack of applicable authority, it is unclear whether an exchange of senior subordinated notes for subsequently issued senior subordinated notes will result in a taxable exchange for United States federal income tax purposes, and it is possible that the IRS might successfully assert that such an exchange should be treated as a taxable exchange. In such case, you would recognize any gain realized on the exchange, but a loss realized might be disallowed. For a more complete description of the tax consequences of a subsequent issuance, see Material United States Federal Income Tax Consequences Senior Subordinated Notes Additional Issuances.

Regardless of whether the exchange is treated as a taxable event, such exchange may result in an increase in the amount of OID, if any, that you are required to accrue with respect to senior subordinated notes. Following any subsequent issuance of senior subordinated notes with OID or any issuance of senior subordinated notes thereafter and resulting exchange, we and our agents will report any OID on any subsequently issued senior subordinated notes ratably among all holders of senior subordinated notes and IDSs, and each holder of senior subordinated notes and IDSs will, by purchasing senior subordinated notes or IDSs, as the case may be, agree to report OID in a manner consistent with this approach. Consequently, you may be required to report OID as a result of a subsequent issuance, even though you purchased senior subordinated notes having no OID. This will generally result in you reporting more interest income over the term of the senior subordinated notes than you would have reported had no such subsequent issuance and exchange occurred. However, the IRS may assert that any OID should be reported only to the persons that initially acquired such subsequently issued senior subordinated notes and their transferees. In such case, the IRS might further assert that, unless a holder can establish that it is not such a person or a transferee thereof, all of the senior subordinated notes held by such holder will have OID. Any of these assertions by the IRS could create significant uncertainties in the pricing of IDSs and senior subordinated notes and could adversely affect the market for IDSs and senior subordinated notes.

If we subsequently issue senior subordinated notes with significant OID, then we may be unable to deduct all the interest on the senior subordinated notes.

It is possible that the senior subordinated notes that we issue in a subsequent issuance will be issued at a discount to their face value and, accordingly, may have significant OID and thus be classified as applicable high yield discount obligations. If any such senior subordinated notes were so treated, then a portion of the OID on such notes could be nondeductible by us and the remainder would be deductible only when paid. This treatment would have the effect of increasing our taxable income and may adversely affect our cash flow available for interest payments and distributions to our shareholders.

A subsequent issuance of senior subordinated notes or an allocation of IDS purchase price that results in OID may reduce the amount you can recover upon an acceleration of the payment of principal due on the senior subordinated notes or in the event of our bankruptcy.

Under New York and federal bankruptcy law, holders of subsequently issued senior subordinated notes having original issue discount may not be able to collect the portion of the principal face amount of such senior subordinated notes that represents unamortized original issue discount as of the acceleration or filing date, as the case may be, in the event of an acceleration of the senior subordinated notes or in the event of our bankruptcy prior to the maturity date of the senior subordinated notes. As a result, a treatment of the senior subordinated notes as having been issued with OID or an automatic exchange that results in a holder receiving a senior subordinated note with original issue discount could have the effect of ultimately reducing the amount such holder can recover from us in the event of an acceleration or bankruptcy.

Before this offering, there has not been a public market for our IDSs, shares of our Class A common stock or senior subordinated notes. The price of the IDSs, shares of our Class A common stock or senior subordinated notes may fluctuate substantially, which could negatively affect the value of your investment.

None of the IDSs, the shares of our Class A common stock or the senior subordinated notes has a public market history. In addition, there has not been an established market in the United States or in Canada for securities similar to the IDSs. We cannot assure you that an active trading market for the IDSs will develop in the future, and we currently do not expect that an active trading market for the shares of our Class A common stock will develop until the senior subordinated notes are redeemed or mature. If the senior subordinated notes represented by your IDSs are redeemed or mature, the IDSs will automatically separate and you will then hold the shares of our Class A common stock. We will not apply to list our shares of Class A common stock for separate trading on the New York Stock Exchange or any other exchange other than the Toronto Stock Exchange until the number of shares held separately and not represented by IDSs is sufficient to satisfy applicable requirements for separate trading on such exchange. The Class A common stock may not be approved for listing at such time. We do not intend to list our senior subordinated notes on any securities exchange.

The initial public offering price of the IDSs has been determined by negotiations among us, the existing equity holders and the representatives of the underwriters and may not be indicative of the market price of the IDSs after the offering. Factors such as quarterly variations in our financial results, announcements by us or others, developments affecting us, our clients and our suppliers, general interest rate levels and general market volatility could cause the market price of the IDSs to fluctuate significantly.

The limited liquidity of the trading market for the senior subordinated notes sold separately (not represented by IDSs) may adversely affect the trading price of the separate senior subordinated notes.

We are separately selling (not represented by IDSs) $ million aggregate principal amount of senior subordinated notes, representing approximately 10% of the total outstanding senior subordinated notes. While the senior subordinated notes sold separately (not represented by IDSs) are part of the same series of notes as, and are identical to, the senior subordinated notes represented by IDSs at the time of the issuance of the separate senior subordinated notes, the senior subordinated notes represented by the IDSs will not be separable for at least 45 days and will not be separately tradeable until separated. As a result, the initial trading market for the senior subordinated notes sold separately (not represented by IDSs) will be very limited. Even after holders of the IDSs are permitted to separate their IDSs, a sufficient number of holders of IDSs may not separate their IDSs into shares of our Class A common stock and senior subordinated notes to create a sizable and more liquid trading market for the senior subordinated notes not represented by IDSs. Therefore, a liquid market for the senior subordinated notes may not develop, which may adversely affect the ability of the holders of the separate senior subordinated notes to sell any of their separate senior subordinated notes and the price at which these holders would be able to sell any of the senior subordinated notes sold separately.

Future sales or the possibility of future sales of a substantial amount of IDSs, shares of our common stock or our senior subordinated notes may depress the price of the IDSs and the shares of our common stock and our senior subordinated notes.

Future sales or the availability for sale of substantial amounts of IDSs or shares of our common stock or a significant principal amount of our senior subordinated notes in the public market could adversely affect the prevailing market price of the IDSs and the shares of our common stock and senior subordinated notes and could impair our ability to raise capital through future sales of our securities.

We may issue shares of our Class A common stock and senior subordinated notes, which may be in the form of IDSs, or other securities from time to time as consideration for future acquisitions and investments. In the event any such acquisition or investment is significant, the number of shares of our Class A common stock and the aggregate principal amount of senior subordinated notes, which may be in the form of IDSs, or the number or aggregate principal amount, as the case may be, of other securities that we may issue may in turn be significant. In addition, we may also grant registration rights covering those IDSs, shares of our common stock, senior subordinated notes or other securities in connection with any such acquisitions and investments. Any or all of these occurrences could depress the trading prices of our securities.

Regulatory Risks

We received 24.1% of our 2003 revenues from the Texas and federal Universal Service Funds and any adverse regulatory developments with respect to these funds could curtail our profitability.

We receive Texas and federal Universal Service Fund, or USF, revenues to support the high cost of providing affordable telecommunications services in rural markets. Such support payments constituted 24.1% of our revenues for the year ended December 31, 2003 and 23.9% of our revenues for the three months ended March 31, 2004. Of these support payments, in the year ended December 31, 2003, $103.1 million, or 20.7% of our revenues, and in the three months ended March 31, 2004, $25.5 million, or 20.2% of our revenues, were received from the Texas USF. In addition, we are required to make contributions to the Texas USF and federal USF each year. Current state and federal regulations allow us to recover these costs by including a surcharge on our customers bills. Furthermore, we incur no incremental costs associated with the support payments we receive or the contributions we are required to make. Thus, if Texas and/or federal regulations changed and we were unable to receive support, such support was reduced, or we are unable to recover the amounts we contribute to the Texas USF and federal

Table of Contents

USF from our customers, our earnings would be directly and adversely affected. For a more detailed discussion of the regulations affecting our company, see Regulation.

The rules governing USF could be altered or amended as a result of regulatory, legislative or judicial action and impact the amount of USF support that we receive and our ability to recover our USF contributions by assessing surcharges on our customers bills. For example, the enabling statute for the Texas USF will become subject to review and renewal in late 2005 and may be modified. It is not possible to predict at this time whether state or federal regulators, Congress or state legislatures will order modification to those rules or statutes, or the ultimate impact any such modification might have on us.

In addition, the Texas USF rules provide that the Texas Public Utility Commission must open an investigation within 90 days after any changes are made to the federal USF. Therefore, changes to the federal USF may prompt similar or conforming changes to the Texas USF. The outcome of any of these legislative or regulatory changes could affect the amount of Texas USF support that we receive, and could have an adverse effect on our business, revenue or profitability.

Reductions in the amount of network access revenue that we receive could negatively impact our results of operations.

In the year ended December 31, 2003, we derived $132.0 million, or 26.6% of our revenues, and in the three months ended March 31, 2004, we derived $33.0 million, or 26.3% of our revenues, from network access charges. Our network access revenue consists of (1) usage sensitive fees we charge to long distance companies for access to our network in connection with the completion of interstate and intrastate long distance calls, (2) fees charged for use of dedicated circuits and (3) end user fees, which are monthly flat-rate charges assessed on access lines. Federal and state regulatory commissions set these access charges, and they could change the amount of the charges or the manner in which they are charged at any time. The FCC is currently examining proposals to revise interstate access charges and other intercarrier compensation. Also, as people in our markets decide to use Internet, wireless or cable television providers for their local or long distance calling needs, rather than using our wireline network, the reduction in the number of access lines or minutes of use over our network could reduce the amount of access revenue we collect. As penetration rates for these technologies increase in rural markets, our revenues could decline. In addition, if our customers take advantage of favorable calling plans offered by wireless carriers for their long distance calling needs, it could reduce the number of long distance calls made over our network, thereby decreasing our access revenue. Furthermore, disputes are pending as to whether providers of Voice over Internet Protocol, or VoIP technology, which allow customers to make voice calls over the Internet or using Internet Protocol, are subject to FCC or state regulations that would require them to pay network charges. With the emergence of VoIP technology, the FCC and state commissions are considering the status of VoIP and other Internet services and there can be no assurance that the FCC and state regulators will require such providers to pay access charges. Any or all of these developments could reduce the amount of access revenue that we receive which could negatively impact our revenues and profitability.

The introduction of new competitors or the better positioning of existing competitors due to regulatory changes could cause us to lose customers and impede our ability to attract new customers.

Changes in regulations that open our markets to more competitors offering substitute services could impact our profitability because of increases in the costs of attracting and retaining customers and decreases in revenues due to lost customers and the need to offer competitive prices. We face competition from current and potential market entrants, including:

- domestic and international long distance providers seeking to enter, reenter or expand entry into the local telecommunications marketplace;

- other domestic and international competitive telecommunications providers, wireless carriers, resellers, cable television companies and electric utilities; and

- providers of broadband and Internet services.

Regulatory requirements designed to facilitate the introduction of competition, the applicability of different regulatory requirements between our competitors and us, or decisions by legislators or regulators to exempt certain providers or technologies from the same level of regulation that we face, could adversely impact our market position and our ability to offer competitive alternatives.

In November 2003, the FCC ordered us and other local exchange carries to allow to adopt wireline-to-wireless local number portability. This may help wireless carriers compete against us because if customers switch from traditional local telephone service to wireless service, they can now transfer their local telephone number to their wireless provider. In addition, federal and state regulators and courts are addressing many aspects of our obligations to provide unbundled network elements and discounted wholesale rates to competitors.

New regulations and changes in existing regulations may force us to incur significant expenses.

Our business may also be impacted by legislation and regulation that impose new or greater obligations related to assisting law enforcement, bolstering homeland security, minimizing environmental impacts or addressing other issues that impact our business. For example, existing provisions of the Communications Assistance for Law Enforcement Act, or CALEA, and FCC regulations implementing CALEA require telecommunications carriers to ensure that their equipment, facilities, and services are able to facilitate authorized electronic surveillance. We cannot predict whether and when the FCC might modify its CALEA rules or any other rules or what compliance with new rules might cost. Similarly, we cannot predict whether or when federal or state legislators or regulators might impose new security, environmental or other obligations on our business.

For a more thorough discussion of the regulation of our company and how that regulation may affect our business, see Regulation.

Certain transactions related to the enforceability of the guarantees of the senior subordinated notes by certain of our subsidiaries may require FCC or state regulatory commission approval, which may not be granted or which may be subject to delays or conditions that could affect your ability to enforce the guarantees.

In the event that it becomes necessary to enforce the guarantees of the senior subordinated notes, approvals may be required for certain of our subsidiaries that are subject to federal or state regulatory authority, including approval for the transfer of control of various radio licenses held by our operating subsidiaries or the transfer of control over or sale of the assets of our operating subsidiaries. Such approvals may not be obtained, in which case such guarantees would be unenforceable, or may be subject to delays or conditions that could affect your ability to enforce the guarantees.

Risks Relating to Our Business

We provide services to our customers over access lines and if we continue to lose access lines our revenues and earnings may decrease.

Our business generates revenue by delivering voice and data services over access lines. We have experienced net access line loss over the past few years, and during the year ended December 31, 2003, the number of access lines we serve declined by 2.6% due to challenging economic conditions and increased competition. We may continue to experience net access line loss in our markets for an unforeseen period of time. Our inability to retain access lines could adversely affect our revenue and earnings.

Rapid and significant changes in technology in the telecommunications industry could adversely affect our ability to compete effectively in the markets in which we operate.

The rapid introduction and development of enhanced or alternative services that are more cost effective, more efficient or more technologically advanced than the services we offer is a significant source of potential competition in the telecommunications industry. Technological developments may reduce the competitiveness of our networks, make our service offerings less attractive or require expensive and time-consuming capital improvements. If we fail to adapt successfully to technological changes or fail to obtain timely access to important new technologies, we could lose customers and have difficulty attracting new customers or selling new services to our existing customers.

We cannot predict the impact of technological changes on our competitive position, profitability or industry. Wireless and cable technologies that have emerged in recent years provide certain advantages over traditional wireline voice and data services. The mobility afforded by wireless voice services and its competitive pricing appeal to many customers. The ability of cable television providers to offer voice, video and data services as an integrated package provides an attractive alternative to traditional voice services from local exchange carriers. In addition, as the emerging VoIP services develop, some customers may be able to bypass network access charges. Increased penetration rates for these technologies in our markets could cause our revenues to decline.

The competitive nature of the telecommunications industry could adversely affect our revenues, results of operations and profitability.

The telecommunications industry is very competitive. Increased competition could lead to price reductions, declining sales volumes, loss of market share, higher marketing costs and reduced operating margins. Significant and potentially larger competitors could enter our markets at any time, including local service providers, cable television companies and wireless telecommunications providers.

For a more thorough discussion of the competition that may affect our business, see Business Competition.

Weak economic conditions may decrease demand for our services.

We are sensitive to economic conditions and downturns in the economy. Downturns in the economies in the markets we serve could cause our existing customers to reduce their purchases of our basic and enhanced services and make it difficult for us to obtain new customers.

We depend on a few key vendors and suppliers to conduct our business and any disruption in our relationship with any one or more of them could adversely affect our results of operations.

We rely on vendors and suppliers to support many of our administrative functions and to enable us to provide long distance services. For example, we currently outsource much of our operational support services to ALLTEL, including our billing and customer care services. Transitioning these support services to another provider could take a significant period of time and involve substantial costs. In addition, we have resale agreements with MCI and Sprint to provide our long distance transmission services. Replacing these resale agreements could be difficult as there are a limited number of national long distance providers. Any disruptions in our relationship with these third party providers could have an adverse effect on our business and operations.

Recent difficulties in the telecommunications industry could negatively impact our revenues and results of operations.

We originate and terminate long distance phone calls on our networks for other interexchange carriers, some of which are our largest customers in terms of revenues. In the year ended December 31, 2003 and the three months ended March 31, 2004, we generated 17.5% and 17.2%, respectively, of our total revenues from originating and terminating phone calls for interexchange carriers. Several of these interexchange carriers have declared bankruptcy during the past two years or are experiencing substantial financial difficulties. MCI WorldCom (now MCI), which declared bankruptcy in 2002, is one of the major interexchange carriers with which we conduct business. We recorded a net $1.6 million charge due to MCI s failure to pay amounts owed to us. Further bankruptcies or disruptions in the businesses of these interexchange carriers could have an adverse effect on our financial results and cash flows.

Following the consummation of this offering, our equity sponsors will collectively be able to exercise substantial influence over matters requiring stockholder approval and their interests may diverge from the interests of the holders of the IDSs.

Following the consummation of this offering, affiliates of Welsh, Carson, Anderson & Stowe, or WCAS, affiliates of Vestar Capital Partners, or Vestar, and affiliates of Citicorp Venture Capital, or CVC, will beneficially own %, % and %, respectively, of our outstanding shares of Class A common stock

Table of Contents

as part of the IDSs, and %, % and %, respectively, of our outstanding shares of Class B common stock. As a result, WCAS, Vestar and CVC collectively exercise substantial influence over matters requiring stockholder approval, including decisions about our capital structure. In addition, WCAS has two designees and Vestar has one designee serving on our board of directors. The interests of our equity sponsors may conflict with your interests as a holder of the IDSs.

Our amended and restated certificate of incorporation and by-laws and several other factors could limit another party s ability to acquire us and deprive our investors of the opportunity to obtain a takeover premium for their securities.

A number of provisions in our amended and restated certificate of incorporation and by-laws will make it difficult for another company to acquire us and for you to receive any related takeover premium on our securities. For example, our amended and restated certificate of incorporation provides that stockholders may not act by written consent and that only our board of directors may call a special meeting. In addition, stockholders are required to provide us with advance notice if they wish to nominate any persons for election to our board of directors or if they intend to propose any matters for consideration at an annual stockholders meeting. Our amended and restated certificate of incorporation authorizes the issuance of preferred stock without stockholder approval and upon such terms as the board of directors may determine. The rights of the holders of shares of our common stock will be subject to, and may be adversely affected by, the rights of holders of any class or series of preferred stock that may be issued in the future.

Table of Contents

Cautionary Statement Regarding Forward-Looking Statements

Some of the statements under Summary, Risk Factors, Management s Discussion and Analysis of Financial Condition and Results of Operations, Business, Regulation and elsewhere in this prospectus may include forward-looking statements which reflect our current views with respect to future events and financial performance. Statements which include the words may, will, should, could, would, predicts, potential, co future, estimates, expect, intend, plan, believe, project, anticipate and similar statements of a future or forward-looking nature ident forward-looking statements for purposes of the federal securities laws or otherwise.

All forward-looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause actual results to differ materially from those indicated in these statements. We believe that these factors include the following:

- our high degree of leverage and significant debt service obligations;
- our ability to amend our new credit facility in ways that restrict our right to pay dividends on our common stock and interest on our senior subordinated notes;
- any adverse changes in government regulation;
- the risk that the senior subordinated notes represented by IDSs will not be treated as debt for United States federal income tax purposes;
- the risk that we may not be able to retain existing customers or obtain new customers;
- the risk of technological innovations outpacing our ability to adapt or replace our equipment to offer comparable services;
- the risk of increased competition in the markets we serve; and
- the risk of weaker economic conditions within the United States.

We undertake no obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise.

Table of Contents

Use of Proceeds

We estimate that we will receive net proceeds from this offering of approximately $ million after deducting underwriting discounts and commissions and other estimated offering expenses payable by us. We will use these net proceeds, together with $ million of borrowings under our new credit facility as follows:

- $ million to repay all outstanding amounts owed under our existing senior credit facilities; and

- $ million to repurchase all our outstanding 10% senior subordinated notes due 2010 held primarily by our equity sponsors.

All remaining proceeds will be paid to the existing equity holders as part of the consideration for their contribution to us of their equity interests in our subsidiaries.

Of the IDSs offered by this prospectus, IDSs in the aggregate, having an aggregate implied value of $ million based on an assumed initial public offering price of $, will be issued to our existing equity holders as part of the consideration for their contribution to us of their equity interests in our subsidiaries. This amount is not included in our net proceeds from this offering described above.

If the underwriters exercise their over-allotment option in full, the underwriters will purchase an aggregate of IDSs from our existing equity holders for resale to the public. We will not receive any of the proceeds from the sale of IDSs by our existing equity holders.

We have set forth our estimate of the sources and uses of funds required to effect the transactions contemplated hereby in the table below. See Detailed Transaction Steps for more information. The estimated sources and uses are based on an assumed initial public offering price of $ per IDS and % of the stated principal amount of the senior subordinated notes being sold separately (not in the form of IDSs). Actual amounts will vary from the amounts shown below.

Sources		Uses	
New credit facility(1)	$	Repayment of existing indebtedness	$
IDSs sold hereby		Fees and expenses(2)	
Senior subordinated notes sold separately hereby, net of discount		Proceeds to existing equity holders(3)	
Total sources of funds	$	Total uses of funds	$

(1) Represents a $ term loan. No amounts will be drawn on the new revolver in connection with the contemplated transactions.
(2) Includes an estimated $ million payable to the underwriters of our IDS offering, approximately $ million payable to the lenders under our new credit facility, approximately $ million in the aggregate payable to affiliates of Welsh, Carson, Anderson & Stowe and affiliates of Vestar Capital Partners in professional fees and expenses associated with our redemption of existing indebtedness.
(3) The proceeds to our equity holders shown on the table above does not include IDSs that we are issuing to them in this offering in connection with our reorganization.

The existing senior credit facilities that will be repaid consist of both the revolving facility and term loan facility under our existing senior credit facility for Valor Telecommunications Southwest, LLC and our existing senior credit facility for Valor Telecommunications Southwest II, LLC. The term loans under both the Valor Telecommunications Southwest, LLC and Valor Telecommunications Southwest II, LLC senior credit facilities are comprised of tranches that have maturity dates ranging from June 30, 2007 through October 31, 2013. Amounts outstanding under the revolvers under the Valor Telecommunications Southwest, LLC and the Valor Telecommunications Southwest II, LLC senior credit facilities will mature on June 30, 2007 and July 31, 2010, respectively. As of March 31, 2004, amounts outstanding under the revolver and the term loan bore interest at a weighted average annual rate of 6.2%.

Initial Dividend Policy and Restrictions

Upon the closing of this offering, our board of directors is expected to adopt a dividend policy with respect to our shares of Class A common stock pursuant to which, in the event and to the extent we have any cash that is available for distribution to the holders of shares of our Class A common stock as of the fifth day or the immediately preceding business day, of each March, June, September and December of each year and subject to applicable law, as described below, and the terms of the new credit facility, the indenture governing our senior subordinated notes and any other then outstanding indebtedness of ours, our board of directors will declare cash dividends on our Class A common stock. The initial annual dividend level is expected to be $ per share of Class A common stock for the first year. We will pay those dividends on or about the fifteenth day of each March, June, September and December of each year.

Our amended and restated certificate of incorporation contains dividend provisions with respect to our shares of Class B common stock which are intended to replicate the initial yield on our IDS units. Any time a dividend is paid to holders of Class A common stock, holders of Class B common stock will be paid a dividend equal to the amount per share paid to holders of Class A common stock. In addition to any such dividend, shares of our Class B common stock will accrue dividends at a level of % per annum on the deemed issuance price of $ per share for the first year; provided that during the continuation of any event of default under the indenture governing the senior subordinated notes, dividends will accrue at a rate of % per annum. Such dividends will accrue, and to the extent not paid, accumulate, whether or not declared and whether or not we have funds legally available for the payment of dividends. Such dividends will be paid, if declared by the board, on the fifteenth day of each March, June, September and December of each year, or, to the extent not previously paid, at such time as such shares of Class B common stock are exchanged for IDSs; provided, that such dividends may only be paid to the extent allowable under applicable law, the terms of our new credit facility, any other then existing indebtedness and the indenture governing our senior subordinated notes.

Upon the closing of the offering no shares of our Class C common stock will be outstanding and we do not anticipate that we will issue shares of Class C common stock or declare dividends thereon in the near future.

If we have any remaining cash after the payment of dividends as contemplated above, our board of directors will, in its sole discretion, decide to use that cash to fund capital expenditures or acquisitions, repay indebtedness, pay additional dividends in equal amounts per share to holders of the shares of Class A and Class B common stock or for general corporate purposes.

If we do not have enough available cash in any quarter to pay the amount of dividends to the holders of the shares of Class A and Class B common stock as contemplated above, we will first pay any unpaid dividends that have been accruing on the shares of Class B common stock and then pay any additional amounts in equal amounts per share to holders of the shares of Class A and Class B common stock.

The indenture governing our senior subordinated notes restricts our ability to declare and pay dividends on our common stock as follows:

we may not pay dividends if such payment together with all other restricted payments we made since the date of this offering will exceed 100% of our excess cash (as defined below) for the period beginning on the first day of the first fiscal quarter following this offering and ending on the last day of our then most recently ended fiscal quarter for which internal financial statements are available as the time such dividend is declared and paid. Excess cash shall mean with respect to any period, Adjusted EBITDA, as defined in the indenture, minus the sum of (i) cash interest expense (ii) deferred interest, if any, (iii) cash income tax expense, (iv) capital expenditures, (v) any non-recurring fees, expenses or charges deducted in such period in computing Consolidated Net Income, as defined in the indenture, that represent cash payments and (vi) any mandatory prepayment that results in a permanent reduction of the principal amount of senior indebtedness prior to its scheduled maturity, in each case, for such period;

Table of Contents

- we may not pay any dividends if not permitted under any of our senior indebtedness;

- we may not pay any dividends while interest on the senior subordinated notes is being deferred or, after the end of any interest deferral, so long as any deferred interest has not been paid in full; and

- we may not pay any dividends if a default or event of default under the indenture has occurred and is continuing.

See Description of Notes Certain Covenants Limitation on Restricted Payments for a complete description of these restrictions.

The new credit facility restricts our ability to declare and pay dividends on our common stock if and for so long as we do not meet the interest coverage ratio and senior leverage ratio tests specified in the new credit facility. If we fail to achieve any of these ratios for any quarter but resume compliance in a subsequent quarter and satisfy the other conditions specified in the new credit facility (including timely delivery of applicable financial statements), we may resume the payment of dividends. The new credit facility permits us to use up to 100% of the distributable cash, as defined in the new credit facility to fund dividends on our shares of common stock.

Our board of directors may, in its discretion, amend or repeal this dividend policy. Our board of directors may decrease the level of dividends provided for in this dividend policy or discontinue entirely the payment of dividends. We have not paid dividends in the past.

Future dividends with respect to shares of our capital stock, if any, will depend on, among other things, our results of operations, cash requirements, financial condition, contractual restrictions, provisions of applicable law and other factors that our board of directors may deem relevant. Under Delaware law, our board of directors may declare dividends only to the extent of our surplus (which is defined as total assets at fair market value minus total liabilities, minus statutory capital), or if there is no surplus, out of our net profits for the then current and/or immediately preceding fiscal years.

Table of Contents

Capitalization

The following table sets forth our cash and cash equivalents and capitalization as of March 31, 2004:

on an actual basis; and

on a pro forma as adjusted basis as if this offering, including the use of proceeds from this offering, the repayment of all outstanding borrowings under our existing credit facilities and our reorganization had occurred on that date and that we had entered into the new credit facility on that date.

	As of March 31, 2004		
	Actual	Adjustments	Pro Forma as Adjusted
		(In thousands)	
Cash and cash equivalents	$ 3,750		
Long-term debt, including current portion			
Current maturities of long-term debt(1)	39,705		
Existing credit facilities (long-term portion)(1)	1,073,876		
Existing senior subordinated notes	314,257		
Capital leases	2,358		
New credit facility			
% senior subordinated notes			
Total long-term debt	1,390,491		
Redeemable preferred interests(2)	370,231		
Class B common stock, $0.01 par value per share(3)			
Stockholders equity			
Class A common interests, no par or stated value	64,633		
Class B common interests, no par or stated value			
Class C interests, no par or stated value	46,000		
Class A common stock, $0.01 par value per share			
Class B common stock, $0.01 par value per share			
Class C common stock, $0.01 par value per share			
Additional paid-in capital			
Accumulated deficit(4)	(37,752)		
Accumulated other comprehensive loss	(7,371)		
Treasury stock	(34)		
Total common owners equity	65,476		
Total capitalization	$ 1,869,653		

(1) In connection with the repayment of existing indebtedness, we will be required to write-off approximately $ in deferred financing costs.

(2) As a result of our existing equity holders contribution of their redeemable preferred interests in VTC, VTS and VTS II to Valor, we will record an expense of approximately $ resulting from the excess of the fair value of the IDSs, Class B common stock and cash received over the carrying amount of the redeemable preferred interests.

(3) Following the second anniversary of the consummation of this offering, at the option of the holders of Class B common stock, upon any subsequent sale of any shares of Class B common stock, we will exchange with the purchasers of such shares, one IDS for each share of Class B common stock, subject to compliance with law and applicable agreements more fully described in Related Party Transactions Equity Sponsors Investor Rights Agreement. Accordingly, the portion of the Class B common stock convertible into senior subordinated debt has been classified as mezzanine equity.

(4) In connection with the reorganization, management will receive in exchange for their outstanding equity interests resulting in compensation expense to us of approximately $.

Table of Contents

Dilution

Dilution is the amount by which the portion of the offering price paid by the purchasers of the IDSs to be sold in the offering that is allocated to our shares of Class A common stock represented by the IDSs exceeds the net tangible book value or deficiency per share of our Class A common stock after the offering. Net tangible book value or deficiency per share of our Class A common stock is determined at any date by subtracting our total liabilities from our total assets less our intangible assets and dividing the difference by the number of shares of Class A common stock deemed to be outstanding at that date.

Our net tangible book value as of March 31, 2004 was approximately $ million, or $ per share of Class A common stock. After giving effect to our receipt and intended use of approximately $ million of estimated net proceeds (after deducting estimated underwriting discounts and commissions and offering expenses) from our sale of IDSs and separate senior subordinated notes in this offering based on an assumed initial public offering price of $ per IDS (the midpoint of the range set forth on the cover page of this prospectus) and % of the stated principal amount of the senior subordinated notes being sold separately, and assuming all of our outstanding shares of Class B common stock are exchanged for IDSs, our pro forma as adjusted net tangible book value as of March 31, 2004 would have been approximately $ million, or $ per share of Class A common stock. This represents an immediate increase in net tangible book value of $ per share of our Class A common stock to existing stockholders and an immediate dilution of $ per share of our Class A common stock to new investors purchasing IDSs in this offering.

The following table illustrates this substantial and immediate dilution to new investors:

	Per Share of Common Stock
Portion of the assumed initial public price of $ per IDS allocated to one share of Class A common stock	$
Net tangible book value per share as of March 31, 2004	
Increase per share attributable to cash payments made by investors in this offering	
Pro forma as adjusted net tangible book value after this offering	$
Dilution in net tangible book value per share to new investors	$

The following table sets forth on a pro forma basis as of March 31, 2004, assuming no exercise of the over-allotment option:

- the total number of shares of our Class A common stock and Class B common stock to be owned by the existing equity holders and the total number of shares of our Class A common stock to be owned by the new investors, as represented by the IDSs to be sold in this offering;
- the total consideration to be paid by the existing equity holders and to be paid by the new investors purchasing IDSs in this offering; and
- the average price per share of existing Class A common stock and Class B common stock to be paid by existing equity holders (cash and stock) and the average price per share of Class A common stock to be paid by new investors purchasing IDSs in this offering:

	Shares of Class A[(1)] Common Stock Purchased		Total Consideration		Average Price Per Share of Class A Common Stock
	Number	Percent	Amount	Percent	
Existing equity holders		%	$	%	$
New investors		%		%	

Total		100.0%	$	100.0%

(1) Assumes exchange of all shares of outstanding Class B common stock held existing equity investors for IDS.

Table of Contents

Selected Historical Financial Information

Valor is a holding company and has no direct operations. Valor was formed for the sole purpose of reorganizing our corporate structure and consummating this offering. Valor s principle assets are the direct and indirect equity interests of its subsidiaries. As a result, we have not provided separate historical financial results for Valor and present only the historical consolidated financial results of Valor Telecommunications, LLC. The selected historical consolidated financial information set forth below as of and for the period ended December 31, 2000, as well as the selected historical consolidated financial information as of and for the year ended December 31, 2001, 2002 and 2003, have been derived from our audited consolidated financial statements. The selected historical consolidated financial information as of and for the three months ended March 31, 2003 and 2004 is unaudited, has been prepared on the same basis as the audited statements, and in the opinion of management, contains all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of our operating results for such period and our financial condition at such date. The financial information for the three months ended March 31, 2003 and 2004 is not necessarily indicative of the results to be expected for any other interim period or any future fiscal year. In addition, as described in more detail in Business, we acquired, at the time of our formation, select telephone assets from GTE Southwest Corporation. We refer to these properties as the Acquired Businesses and we believe the Acquired Businesses to be the predecessor of our company, prior to formation in 2000. This is because the Acquired Businesses, with the exception of our Kerrville business that was acquired by us in 2002, effectively include nearly all the businesses currently operated by us, and do not include any businesses that have been discontinued or sold. Accordingly, the selected historical financial information below includes the combined accounts of the Acquired Businesses as of and for the year ended December 31, 1999, as well as the combined accounts as of and for the period ended August 31, 2000. The combined accounts do not include any purchase accounting adjustments that occurred as a result of our acquisition of the Acquired Businesses in 2000.

The information in the following table should be read together with our audited consolidated financial statements for the years ended December 31, 2001, 2002 and 2003 and the related notes, our unaudited consolidated financial statements for the three months ended March 31, 2003 and 2004 and Management s Discussion and Analysis of Financial Condition and Results of Operations, all as included elsewhere in this prospectus.

Table of Contents

	Predecessor Company(1)							
	Year Ended December 31, 1999	Period Ended August 31, 2000	Period Ended December 31, 2000(2)	Year Ended December 31, 2001	2002(3)	2003	Three Months Ended March 31, 2003	2004
	(Dollars in thousands, except per owner unit data)		(Dollars in thousands, except per owner unit data)					
Statement of Operations Data:								
Operating revenues	$367,724	$260,933	$ 148,784	$ 424,916	$ 479,883	$497,334	$122,119	$125,852
Operating expenses	282,719	178,948	164,172	321,618	320,632	315,061	76,100	80,336
Operating income (loss)	85,005	81,985	(15,388)	103,298	159,251	182,273	46,019	45,516
Net income (loss) from continuing operations	57,434	50,678	(71,909)	(44,912)	19,763	58,125	12,159	15,614
Earnings per owners unit:								
Basic and diluted (loss) income from continuing operations:(4)								
Class A and B common interests	n/a	n/a	$ (1.05)	$ (0.58)	$ 0.22	$ 0.73	$ 0.15	$ 0.20
Class C interests	n/a	n/a	$	$	$ 0.09	$ 0.15	$ 0.04	$ 0.03
Basic and diluted net (loss) income:								
Class A and B common interests	n/a	n/a	$ (1.05)	$ (0.77)	$ 0.17	$ 0.73	$ 0.15	$ 0.20
Class C interests	n/a	n/a	$	$	$ 0.09	$ 0.15	$ 0.04	$ 0.03
Cash Flow Data:								
Net cash provided by operating activities	$154,279	$119,557	$ 16,197	$ 100,301	$ 150,383	$166,065	$ 41,485	$ 50,109
Net cash used in investing activities	$ (85,109)	$ (56,018)	$(1,821,699)	$(106,614)	$(216,773)	$ (66,299)	$ (14,178)	$ (16,723)
Net cash provided by (used in) financing activities	$ (69,170)	$ (63,539)	$ 1,811,613	$ 8,117	$ 71,015	$ (99,465)	$ (26,484)	$ (31,041)

	Predecessor Company(1)							
	Year Ended December 31, 1999	Period Ended August 31, 2000	Period Ended December 31, 2000(2)	Year Ended December 31, 2001	2002(3)	2003	Three Months Ended March 31, 2003	2004
	(Dollars in thousands)				(Dollars in thousands)			
Other Data:								
Capital expenditures	$85,109	$56,018	$36,918	$107,869	$ 89,527	$69,850	$14,486	$16,654
Acquisition of Kerrville Communications Corporation(5)					$128,135			
Depreciation and amortization(6)	$97,111	$64,103	$40,327	$110,843	$ 73,273	$81,638	$19,950	$20,827
Ratio of earnings to fixed charges(7)	n/a	n/a			1.2x	1.5x	1.4x	1.6x
Deficiency in the coverage of earnings to fixed charges(7)	n/a	n/a	$71,909	$ 47,024				

Table of Contents

	Predecessor Company(1)						
	As of December 31, 1999	As of August 31, 2000	As of December 31, 2000(2)	As of December 31, 2001	2002	2003	As March 31, 2004
	(Dollars in thousands)		(Dollars in thousands)				
Balance Sheet Data:							
Total assets	$573,681	$567,073	$1,935,695	$1,913,057	$2,062,404	$2,039,043	$2,026,191
Long-term debt (including current maturities)			$1,440,643	$1,469,420	$1,544,285	$1,463,973	$1,430,196
Redeemable preferred interests			$ 370,231	$ 370,231	$ 370,231	$ 370,231	$ 370,231

(1) The selected historical financial information presented for the Predecessor Company above was derived from unaudited financial statements prepared on a carve-out basis by GTE Southwest Corporation (the Carve-Out Financial Statements). This information reflects the results of operations and financial position of the Acquired Businesses for the year ended December 31, 1999 and for the period beginning January 1, 2000 through our acquisition date of these businesses. We acquired GTE s business in Oklahoma on July 1, 2000 and GTE s businesses in Texas, New Mexico and Arkansas on September 1, 2000.

(2) Our consolidated financial statements for the period ended December 31, 2000 include the results of operations for the businesses we acquired from GTE in Texas, Oklahoma, New Mexico and Arkansas beginning on the date of acquisition, as well as certain start-up costs that we incurred prior to commencing operations.

(3) We acquired all the outstanding common stock, preferred stock and common stock equivalents of Kerrville Communications Corporation (KCC) on January 31, 2002 and have included the assets, liabilities and results of operations of KCC from that date.

(4) Per unit data is not applicable with respect to periods covered by our Predecessor s Carve-Out Financial Statements.

(5) Reflects the purchase price for our acquisition of KCC, net of cash acquired. Excludes $1,724,119 we paid to purchase predecessor businesses in 2000.

(6) In accordance with Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets, effective January 1, 2002, we discontinued the amortization of goodwill. Amortization expense associated with goodwill was $20,529 for the period ended December 31, 2000 and $53,900 for the year ended December 31, 2001.

(7) Ratio of earnings to fixed charges is not applicable with respect to periods covered by our Predecessor s Carve-Out Financial Statements. For purposes of determining the ratio of earnings to fixed charges, earnings are defined as pretax income from continuing operations before adjustment for minority interest, less earnings from unconsolidated cellular partnerships and interest capitalized plus fixed charges, amortization of capitalized interest and distributed income from unconsolidated cellular partnerships. Fixed charges include interest costs, both expensed and capitalized, on all indebtedness, amortization of deferred financing costs and one-third of the rental expense on operating leases, representing the portion of rental expense we consider to be attributable to interest. Where earnings are inadequate to cover fixed charges, the deficiency is reported in the table above.

Table of Contents

Management s Discussion and Analysis of Financial Condition

and Results of Operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and accompanying notes which appear elsewhere in this prospectus. It contains forward-looking statements that involve risks and uncertainties. Please see Cautionary Statement Regarding Forward-Looking Statements for more information. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those discussed below and elsewhere in this prospectus, particularly under the headings Risk Factors and Cautionary Statement Regarding Forward-Looking Statements.

Overview

We are one of the largest providers of telecommunications services in rural communities in the southwestern United States and the seventh largest independent telephone company in the country. We operate approximately 550,000 telephone access lines in primarily rural areas of Texas, Oklahoma, New Mexico and Arkansas. We believe that in many of our markets we are the only service provider that offers customers an integrated package of local and long distance voice, high-speed data and Internet access as well as a variety of enhanced services such as voicemail and caller identification. We generated revenues of $497.3 million in the year ended December 31, 2003 and $125.9 million in the three months ended March 31, 2004.

We formed our company in connection with the acquisition in 2000 of select telephone assets from GTE Southwest Corporation, which is now part of Verizon. Our formation was orchestrated by our equity sponsors Welsh, Carson, Anderson & Stowe, or WCAS, Vestar Capital Partners and Citicorp Venture Capital, Anne K. Bingaman and our management. Ms. Bingaman, along with Bob Mathew and Michael Page, formed a predecessor to our company and later joined with our equity sponsors, led by WCAS, to negotiate and finance the acquisition of the telephone assets from GTE. Ms. Bingaman, Mr. Mathew, Mr. Page and WCAS were assisted in these efforts by twelve prominent business persons from the Southwestern United States who have local, statewide and national public service experience and decades of successful private business experience. They are Toney Anaya, Ernesto M. Chavarria, John C. Corella, William E. Garcia, Edward J. Lujan, Manuel Lujan, Jr., Ronald E. Montoya, M. Ann Padilla, Andrew Ramirez, Henry M. Rivera, Edward L. Romero and J. Ben Trujillo. Ms. Bingaman served as our Chairman since 1999 and was our first Chief Executive Officer. Once the negotiation of the terms of the acquisition from GTE was completed, Ms. Bingaman and WCAS recruited our management team, including Kenneth R. Cole, our first chief operating officer. Together, these groups and individuals were instrumental in helping us complete the transactions with GTE and successfully launch our initial operations.

The rural telephone businesses that we own have been operating in the markets we serve for over 75 years. Since our inception, we have acquired the local telephone company serving Kerrville, Texas and we have invested substantial resources to improve and expand our network infrastructure to provide high quality telecommunications services and superior customer care. We believe that we are well positioned for future revenue and cash flow growth through both expanded service offerings and acquisitions.

Access lines are an important element of our business. Historically, rural telephone companies have experienced consistent growth in access lines because of positive demographic trends, insulated rural local economies and little competition. Recently, however, many rural telephone companies have experienced a loss of access lines due to challenging economic conditions, increased competition from wireless providers, competitive local exchange carriers and in some cases, cable television operators. We have not been immune to these conditions. We have experienced modest net losses in access lines due primarily to poor economic conditions and increased competition. Access line losses may also increase if cable television operators begin to offer telephony service in our markets.

Despite our net losses of access lines, we have generated growth in our revenues each year since our inception in 2000. We have accomplished this by providing our customers with services not previously available in most of our markets such as enhanced voice services and data services, including digital

Table of Contents

subscriber lines, or DSL, and through acquisitions. We are continuing to add access lines through plant improvements, bundling services, win-back programs, increased community involvement and a variety of other programs.

We are subject to regulation primarily by federal and state government agencies. At the federal level, the Federal Communications Commission, or FCC, has jurisdiction over interstate and international telecommunications services. State telecommunications regulators exercise jurisdiction over intrastate telecommunications services. We operate under price cap regulation at the federal level and at the state level in Texas and New Mexico. We are regulated as a rural telephone company in Oklahoma. We are regulated on a rate of return basis in Arkansas. For a more extensive discussion of regulatory matters, see Risk Factors Regulatory Matters and Regulation.

Reorganization

Immediately prior to and in connection with the consummation of this offering, we will reorganize our corporate structure. Our existing equity holders currently own equity interests in Valor Telecommunications, LLC, or VTC, Valor Telecommunications Southwest, LLC, or VTS, and Valor Telecommunications Southwest II, LLC, or VTS II. As part of this reorganization, our existing equity holders will contribute their equity interests in VTC, VTS and VTS II to us in exchange for IDSs, shares of Class B common stock and $ in cash from the proceeds of this offering. As a result of this reorganization, each of VTC, VTS and VTS II will be either a direct or indirect wholly-owned subsidiary of Valor Communications Group, Inc. See Detailed Transaction Steps on page 94.

Impact of Our Reorganization and this Offering on Our Results of Operations and Liquidity

Results of Operations. As a result of the significant amount of debt that we will have outstanding through both new credit facility, the senior subordinated note portion of the outstanding IDSs and the senior subordinated notes sold separately (not in the form of IDS), our interest expense will likely increase. Any such increase would be permanent throughout the term of the senior subordinated notes as it is anticipated that our new credit facility will provide that we only pay interest, and no principal, throughout the term of the agreement. We will be required to refinance the new credit facility upon its maturity and if interest rates are higher at the time we are required to refinance the new credit facility, it will likely cause interest expense to increase further.

Additionally, we will be required to record a substantial number of one-time expenses related to this reorganization and offering including the following:

- $ in compensation expense associated with management s exchange of all of their equity interests in Valor Telecommunications, LLC for an aggregate of ;
- $ in interest expense from the write-off of deferred financing costs associated with our existing indebtedness;
- $ in expenses associated with our reorganization, redemption of existing indebtedness and other professional fees;
- $5.0 million in compensation expense associated with the payment made to our former CEO upon the termination of his previous employment agreement;
- $ in compensation expense for cash transaction bonuses paid to members of our senior management team upon the consummation of this offering; and
- $ in expenses associated with our agreement to repurchase minority interests in our wholly-owned subsidiaries Valor Telecommunications Southwest, LLC, a Delaware limited liability company, and Valor Telecommunications Southwest II, LLC, a Delaware limited liability company from a group of the individual investors.

Table of Contents

We will incur higher expenses as a public company after the consummation of this offering. These expenses will include additional accounting and finance expenses, audit fees, legal fees and increased premiums for director and officer liability insurance coverage. We estimate that these additional expenses will be approximately $2.5 million annually.

We will likely implement an additional incentive plan for management that will be designed to align the interests of management with those of the IDS holders. The provisions of this plan will likely require us to record additional compensation expense.

Liquidity. We expect that upon the closing of this offering our Board of Directors will adopt a dividend policy which contemplates that, subject to applicable law and terms of our then existing indebtedness, initial annual dividends will be approximately $ per share of our Class A common stock and $ per share of our Class B common stock. We expect the aggregate annual impact of this dividend policy to be $. The cash requirements of the expected dividend policy are in addition to the increase in our indebtedness and related debt service requirements discussed above in Results of Operations. We expect that the cash requirements discussed here and above in Results of Operations will be funded through cash flow generated from the operations of our business. We will also have access to a Revolving Credit Facility of $100 million to supplement our liquidity position as needed.

Although we believe that the senior subordinated notes should be treated as debt for United States federal income tax purposes in accordance with the opinion of our tax counsel, this conclusion cannot be assured. If all or a portion of the senior subordinated notes were treated as equity rather than debt for United States federal income tax purposes, then a corresponding portion of the interest on the senior subordinated notes would not be deductible by us for United States federal income tax purposes. In addition we would be subject to liability for United States withholding taxes on interest payments to non-United States holders if such payments were determined to be dividends. Our inability to deduct interest on the senior subordinated notes could materially increase our taxable income and, thus, our United States federal and applicable state income tax liability. Our liability for income taxes (and withholding taxes) if the senior subordinated notes were determined to be equity for income tax purposes would materially reduce our after-tax cash flow and would materially and adversely impact our ability to make dividend and/or interest payments.

Regulatory Matters

We operate in a regulated industry, and the majority of our revenues comes from the provision of regulated telecommunications services, including state and federal support for the provision of telephone services in high-cost rural areas. To further the public policy of providing universal and comparable telecommunications services throughout the United States, state and federal regulatory bodies have historically given support to rural telephone companies to offset the high costs of providing telecommunications services in rural areas. Operating in this regulated industry means that we are also generally subject to certification, service quality, rate regulation, tariff filing and other ongoing regulatory requirements by state and federal regulators.

State Regulation. We operate in Texas, Oklahoma, New Mexico and Arkansas and each state has its own regulatory framework for intrastate services.

In Texas, most of our operations are subject to price caps on our basic telecommunications services, while we maintain pricing flexibility on some non-basic services. While the Texas regulatory structure under which we operate will become subject to review and renewal in late 2005, we do not expect a material change in the benefits we have under current regulation. In addition, we currently have a petition pending in Texas that requests the implementation of a surcharge for expanded local calling that would compensate us for our costs and lost revenues associated with replacing long distance routes between selected towns with flat rated local service. If granted, the petition would generate additional revenues and increased earnings.

Table of Contents

In New Mexico, we operate under an Alternative Form of Regulation Plan that is specific to our company. The Plan was adopted in 2000 and will expire on March 31, 2006. During its term, the Plan provides for a freeze on the prices of our intrastate telecommunications services, requires us to invest $83 million in capital in New Mexico, provides for a streamlined tariff approval process and prescribes quality of service standards, including penalties for failure to meet certain service levels. Under the Plan, we will be able to increase our prices for optional services by 10% if we meet the quality service standards in 2005.

Recently enacted legislation mandates that the New Mexico Public Regulation Commission adopt rules tailored to the size and market demographics of local exchange carriers like our company that have between 50,000 and 375,000 access lines and flexible rules that allow pricing freedoms on retail services. It also mandates the streamlining of rules governing the introduction and withdrawal of tariffs and the packaging and bundling of services. Therefore, we will not have to renegotiate and renew our current Plan.

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

We also operate under rate of return regulation in the provision of intrastate telecommunications services in Arkansas. We operate approximately 17,000 access lines in Texarkana, Arkansas, which is our only market in Arkansas. Pursuant to an agreement with the Arkansas Public Service Commission, our Arkansas tariffs mirror the prices charged for retail services in our Texas tariffs.

Federal Regulation. Most of our interstate access revenues are regulated pursuant to the FCC s price cap rules. Generally, these rules establish an upper limit for access prices, but allow annual formula-based adjustments and limited pricing flexibility. In 2000, the FCC adopted the Coalition for Affordable Local and Long Distance Service, or CALLS plan, an integrated interstate access reform and universal service framework for price cap local exchange carriers. The CALLS plan allowed subscriber line charges billed to end users to rise, but forced substantial decreases in access charges billed to long distance carriers. The CALLS plan will expire in mid-2005, unless extended by the FCC. The FCC is currently considering whether to make substantial changes in the manner in which local exchange carriers can charge for access to their networks. It has proposed that current intercarrier compensation for all types of telecommunications traffic be collected only from the end user customers of the carriers. We do not know whether the FCC will adopt this proposal or what impact its adoption would have on our business.

Universal Service Fund

In furtherance of public policy, we receive Universal Service Fund, or USF, revenues from the State of Texas and the federal government to support the high cost of providing telecommunications services in rural markets.

Texas Universal Service Fund. The Texas Universal Service Fund, or the Texas USF, supports eligible telecommunications providers that serve high cost markets. We received $103.1 million from the Texas USF in 2003, representing 20.7% of total revenues for that year and we received $25.5 million from the Texas USF during the three months ended March 31, 2004, representing 20.3% of total revenues for that period. Texas USF is promulgated under a statute that will become subject to review and renewal in late 2005. We expect that the Texas Legislature will renew the statute or replace it with a similar regulation that will not materially change the benefits we receive under the current regulatory structure.

Federal Universal Service Fund. The federal USF revenue we receive helps to offset interstate access charges, defrays the high fixed switching costs in areas with fewer than 50,000 access lines and provides support where our average cost per line exceeds 115% of the national average cost per line. In 2003, we received $16.7 million, or 3.4% of our total revenues, in federal USF support and in the three months ended March 31, 2004, we received $4.6 million, or 3.7% of our total revenues, in federal USF support. Currently, significant policy debate is occurring at the FCC and in Congress over whether universal service support should be available as a means to foster competitive entry in rural telecommunications markets, rather than its historic purpose to offset the high cost to serve the country s rural areas. Several parties have raised objections to the size of the universal service fund and the types of services eligible for support and the sources of contribution to the USF. The outcome of any of these proceedings or other legislative or regulatory changes could affect the amount of federal universal service support that we receive, and could have an adverse effect on our business, revenue or profitability.

Critical Accounting Policies and Use of Estimates

Our financial statements are prepared in accordance with accounting principles that are generally accepted in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Management continually evaluates its estimates and judgments including those related to revenue recognition, allowance for doubtful accounts, pension and postretirement benefits, accounting for goodwill and intangible assets, and estimated useful lives of property, plant and equipment. Actual results may differ from these estimates. We believe that of our significant accounting policies, the following may involve a higher degree of judgment and complexity (See Note 2 to the consolidated financial statements for a complete discussion of our significant accounting policies.):

Revenue Recognition. Revenue is recognized when evidence of an arrangement between our customer and us exists, the earnings process is complete and collectibility is reasonably assured. The prices for most services are filed in tariffs with the appropriate regulatory bodies that exercise jurisdiction over the various services.

Basic local services, enhanced calling features such as caller identification, special access circuits, long distance flat rate calling plans, and most data services are billed one month in advance. Revenue for these services is recognized in the month services are rendered. The portion of advance-billed revenue associated with services that will be delivered in a subsequent period is deferred and recorded as a current liability under Advance billings and customer deposits in the Consolidated Balance Sheets.

Amounts billed to customers for activating service are deferred and recognized over the average life of the customer. The costs associated with activating such services are deferred and are recognized as an operating expense over the same period. Costs in excess of revenues are recognized as an operating expense in the period of activation.

Revenues for providing usage based services, such as per-minute long distance service and access charges billed to long distance companies for originating and terminating long distance calls on our network, are billed in arrears. Revenues for these services are recognized in the month services are rendered.

Universal Service revenues are government-sponsored support received in association with providing service in mostly rural, high-cost areas. These revenues are typically based on information provided by us and are calculated by the government agency responsible for administering the support program and are recognized in the month the service is performed.

Allowance for doubtful accounts. In evaluating the collectibility of accounts receivable, we assess a number of factors, including a specific customer s or carrier s ability to meet its financial obligations, the length of time the receivable has been past due and historical collection experience. Based on these assessments, we record both specific and general reserves for uncollectible accounts receivable to the amount we ultimately expect to collect from customers and carriers. If circumstances change or economic conditions worsen such that our past collection experience is no longer relevant, our estimate of the recoverability of accounts receivable could be further reduced from the levels reflected in the accompanying consolidated balance sheet.

Pension and postretirement benefits. The amounts recognized in the financial statements related to pension and postretirement benefits are determined on an actuarial basis utilizing several critical assumptions.

Table of Contents

A significant assumption used in determining our pension and postretirement benefit expense is the expected long-term rate of return on plan assets. In 2003, we used an expected long-term rate of return of 8.5%. We continue to believe that 8.5% is an appropriate rate of return for our plan assets given our investment strategy and will continue to use this assumption for 2004. The projected portfolio mix of the plan assets is developed in consideration of the expected duration of related plan obligations and as such is more heavily weighted toward equity investments, including public and private equity positions. Our investment policy is to invest 55-75% of the pension assets in equity funds with the remainder being invested in fixed income funds and cash equivalents. The expected return on plan assets is determined by applying the expected long-term rate of return to the market-related value of plan assets. The actual return on our equity portfolio has been significantly below expected return levels due to overall equity market conditions in 2001 and 2002.

Another significant estimate is the discount rate used in the annual actuarial valuation of pension and postretirement benefit plan obligations. In determining the appropriate discount rate at year-end, we considered the current yields on high quality corporate fixed-income investments with maturities corresponding to the expected duration of the benefit obligations. As of December 31, 2003, we reduced the discount rate by 45 basis points to 6.05%.

We expect to contribute $4.7 million to our pension plan and $0.6 million to our other postretirement benefits plan in 2004.

Goodwill and Intangible Assets. During 2001, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, or SFAS 142, which requires that effective January 1, 2002, goodwill recorded in business combinations cease amortizing. SFAS 142 requires that goodwill be reviewed for impairment using fair value measurement techniques. Specifically, goodwill impairment is determined using a two-step process. The first step of the goodwill impairment test is used to identify potential impairment by comparing the fair value of the reporting unit to its carrying value, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired and the second step of the impairment test is unnecessary. If the fair value of the reporting unit is less than the carrying value, the second step of the goodwill impairment test calculation is performed to measure the amount of the impairment charge. The second step of the goodwill impairment test compares the implied fair value of the reporting unit s goodwill with its carrying value. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. That is, the fair value of the reporting unit is allocated to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit. If the implied fair value of goodwill is less than its carrying value, goodwill must be written down to its implied fair value.

Determining the fair value of a reporting unit under the first step of the goodwill impairment test and determining the fair value of individual assets and liabilities of a reporting unit (including unrecognized intangible assets) under the second step of the goodwill impairment test is judgmental in nature and often involves the use of significant estimates and assumptions. These estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and also the magnitude of any such charge. We perform internal valuation analyses and consider other market information that is publicly available. Estimates of fair value are primarily determined using discounted cash flows. This approach uses significant estimates and assumptions including projected future cash flows (including timing) and the selection of a discount rate that reflects the risk inherent in future cash flows.

Upon completion of our initial assessment in May 2002, and our annual assessments in the third quarters of 2002 and 2003, we determined that no write-down in the carrying value of goodwill was required.

Useful Life of Property, Plant and Equipment. We estimate the useful lives of property, plant and equipment in order to determine the amount of depreciation expense to be recorded during any reporting period. The majority of our telecommunications plant, property and equipment is depreciated using the group method, which develops a depreciation rate based on the average useful life of a specific group of assets, rather than the individual asset as would be utilized under the unit method. The estimated life of the group is based on historical experience with similar assets as well as taking into account anticipated technological or other changes. If technological changes were to occur more rapidly than anticipated or in a different form than anticipated, the useful lives assigned to these assets may need to be shortened, resulting in the recognition of increased depreciation expense in future periods. Likewise, if the anticipated technological or other changes occur more slowly than anticipated, the life of the group could be extended based on the life assigned to new assets added to the group. This could result in a reduction of depreciation expense in future periods. We review these types of assets for impairment when events or circumstances indicate that the carrying amount may not be recoverable over the remaining lives of the assets. In assessing impairment, we follow the provisions of Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, or SFAS 144, utilizing cash flows which take into account management s estimates of future operations.

Redeemable Preferred Interests and Phantom Stock Units. We are required to make an estimate of the fair value of our Redeemable Preferred Interests in order to determine the carrying value of the liability at the balance sheet date. In addition, we are required to make an estimate of the fair value of our Phantom Stock Units in order to determine the appropriate related compensation expense. We estimate the fair value of these items by initially determining an overall enterprise value and allocating the enterprise value to the various preferred and common equity components that impact the determination of the fair value of the Redeemable Preferred Interests and the Phantom Stock Units. The enterprise value is estimated through a combination of a discounted cash flow analysis and an enterprise comparability analysis to publicly traded companies in the same industry classification. We expect that after the reorganization of our corporate structure, we will not be required to make an estimate of fair value of these items because both the Redeemable Preferred Interests and the Phantom Stock Units will be exchanged for IDSs and Class B common stock.

Income Taxes. We intend to treat our issuance of the IDSs in this offering as an issuance of separate securities shares of class A common stock and senior subordinated notes and to allocate the proceeds received for each IDS unit between the Class A common stock and senior subordinated notes in proportion to their respective fair market values at the time of issuance. As discussed below, based on the opinion of our tax counsel, we are of the view that the senior subordinated notes should be treated as debt for United States federal income tax purposes and we intend to claim a deduction for interest expense of approximately $ in respect of the senior subordinated notes each year against our taxable income for United States federal income tax purposes. There can be no assurance that our classification of the senior subordinated notes as debt (or the amount of interest expense deducted) will not be challenged by the IRS or will be sustained if challenged, although to date we have neither been informed by the IRS that it believes that the senior subordinated notes should be treated as equity rather than debt for United States federal income tax purposes, nor have we sought a ruling from the IRS that the senior subordinated notes should be treated as debt. If our treatment of the senior subordinated notes as debt is put at risk in the future as a result of a future ruling by the IRS, including by an adverse ruling with respect to IDSs issued by another company or by an adverse ruling with respect to our own IDSs requiring the senior subordinated notes to be treated as equity for income tax purposes, we may need to consider the effect of such developments on the determination of our future tax provisions and obligations. In the event that the senior subordinated notes are required to be treated as equity for income tax purpose, then the cumulative interest expense associated with the senior subordinated notes would not be deductible from taxable income and we would be required to recognize additional tax expense and establish a related income tax liability. The additional tax due to the federal and state authorities would be based on our taxable income or loss for each of the years that we claim the interest expense deduction, would adversely affect our financial position, cash flow, and liquidity and could affect our ability to make interest or dividend payments on the senior subordinated notes and the shares of common stock represented by the IDSs, and our ability to continue as a going concern. We do not currently intend to record a liability for a potential disallowance of this interest expense deduction. In addition, non-United States holders of our IDSs units could be subject to withholding taxes on payments of interest that are treated by the IRS or the courts as dividends on equity; this could subject us to additional liability for withholding taxes that we did not collect on such payments.

As discussed below in Material United States Federal Income Tax Consequences United States Holders Senior Subordinated Notes Characterization, the classification of an instrument as debt or equity for United States federal income tax purposes is not clearly defined by statute and is based on facts and circumstances developed in the case law. In light of the representations and determinations described in the section referred to above and their relevance to several of the factors analyzed in the case law, and taking into account the facts and circumstances relating to the issuance of the senior subordinated notes (including the separate issuance of senior subordinated notes in this offering), we (and our counsel) are of the view that the senior subordinated notes should be treated as debt for United States federal income tax purposes. We intend to take this position for all purposes, and therefore our financial statements will not reflect a tax liability related to this position. However, there can be no assurance that this position will be sustained if challenged by the IRS.

IDSs and Class B common stock. Our IDS units contain common stock and senior subordinated debt. In addition, the senior subordinated notes contain the embedded derivate features that may require bifurcation under FASB 133. The embedded derivative features include a call option and a change-of-control put option on the senior subordinated debt. Upon completion of this offering, proceeds from the issuance of the IDSs will be allocated, based upon relative fair value, to Class A common stock and the senior subordinated notes. If it is determined at the time of issuance that any of the embedded derivatives are required to be bifurcated and separately accounted for, a portion of the proceeds from the original issuance will also be allocated to these derivatives equal to the combined fair value of the embedded derivatives that require bifurcation. If a portion of the initial proceeds is allocated to any of the derivatives, the senior subordinated notes will initially be recorded at a discount or premium and accreted or amortized their redemption value as a component of interest expense using the effective interest method. Any such allocation will not effect the tax treatment of the IDSs.

The Class A common stock portion of the IDS unit will be included in stockholders equity, net of related transaction costs, and dividends paid on the Class A common stock will be recorded as a reduction to retained earnings when declared by us. The senior subordinated debt portion of the IDS unit will be included in long-term debt, and the related transaction costs will be capitalized as deferred financing costs and amortized to interest expense using the effective interest method. Interest on the senior subordinated notes will be charged to expense as accrued by us. The bifurcated derivatives will be recorded as an asset or a liability and will be marked to market with changes in fair value being recorded in earnings. We intend to determine the fair value of the Class A common stock, the senior subordinated debt and embedded derivatives through the utilization of a third party valuation firm, and the sale of the separate senior subordinated notes with the same terms that are part of this offering.

In connection with the reorganization, we will issue shares of Class B common stock to certain current equity holders, which may, subject to certain conditions, be exchanged for IDSs. The Class B common stock contains dividend features which are intended to replicate the yield on the IDS units. Any time a dividend is paid to the holders of Class A common stock, holders of the Class B common stock will be paid a dividend equal to the same amount per share as paid to the holders of the Class A common stock. In addition to any such dividend, holders of the Class B common stock will accrue dividends at a rate that will replicate the interest payable on the senior subordinated note component of the of IDS unit.

Following the second anniversary of the consummation of this offering, at the option of the holder of the shares, a share of Class B common stock may be exchanged for one IDS (as may be adjusted for stock splits, dividends, combinations or reclassifications), in connection with the sale of shares of Class B common stock. Accordingly, at the date of issuance, based on relative fair values, a pro rata portion of the Class B common stock exchangeable for senior subordinated debt will be classified as mezzanine equity and pro rata portion exchangeable for Class A common stock will be classified as permanent equity. If it is determined at the time of issuance the embedded exchange option is required to be bifurcated and separately accounted for, a portion of the proceeds from the original issuance of the Class B common stock will also be allocated to this derivative. If a portion of the initial proceeds is allocated to the derivative, the amount recorded in mezzanine equity will initially be recorded at a discount and accreted to the redemption value using the effective interest method. The bifurcated derivatives will be recorded as liabilities and will be marked to market with changes in fair value being recorded as a component of interest expense.

The dividends paid on the Class B common stock will be deducted from net income in the determination of net income available to Class A common stockholders for determination of earnings per share. At the time the holder exercises its exchange right, the portion of the Class B common stock included in mezzanine equity will be reclassified to debt and the associated interest payments will be included in interest expense.

In connection with the reorganization, management will receive IDSs in exchange for their outstanding equity interests. The resulting compensation expense will be based upon fair value of the IDSs received by management at the date of exchange.

Anticipated presentation of earnings per share. The holders of our Class A and Class B common stock being issued in this offering and in the reorganization are expected to have different rights with respect to the amount of dividends they will be entitled to receive under the dividend policy our Board of Directors is expected to adopt upon the closing of this offering. We intend to give effect to these different rights in the presentation of our earnings per share calculations in our periodic filings subsequent to this offering by applying the two-class method of computing earnings per share as provided for in SFAS 128 Earnings per Share. The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings.

Consolidated Results of Operations

Operating Revenues

The following table sets forth our total average revenue per access line:

	Year Ended December 31,			Three Months Ended March 31,	
	2001	2002	2003	2003	2004
Total revenue (in thousands)	$424,916	$479,883	$497,334	$122,119	$125,852
Average access lines	552,316	574,922	564,027	570,121	557,012
Average revenue per access line per month	$ 64.11	$ 69.56	$ 73.48	$ 71.40	$ 75.31

Local Service We derive revenues from providing local exchange telephone services to both residential and business customers, including monthly recurring charges from basic service such as local dial-tone and enhanced services such as caller identification, voicemail and call waiting and non-recurring charges for service activation and reconnection of service.

Data Services Revenues are derived from monthly recurring charges for DSL, private lines, Internet and other data related services.

Long Distance Services Revenues are derived from usage charges assessed on long distance and local toll calls and from revenue on flat rate calling plans.

Access Services Network access revenues include switched access, special access, and end user charges. Switched access represents use sensitive charges to long distance companies for access to our network in connection with the completion of interstate and intrastate long-distance calls. Special access represents dedicated circuits, which are typically purchased by long distance companies. End user charges are monthly flat-rate charges assessed on access lines.

Universal Service Fund, or USF We receive monthly payments from state and federal government-sponsored support associated with providing basic telephone services generally in rural, high cost areas.

Other Services Other revenues primarily represent sales of customer premise equipment, or CPE, directory advertising, unbundled network elements and billing and collection fees.

The following table sets forth our revenues for the periods shown:

	Year Ended December 31,			Three Months Ended March 31,	
	2001	2002	2003	2003	2004
			(Dollars in thousands)		
Local service	$132,514	$147,130	$156,369	$ 39,003	$ 38,844
Data services	17,927	20,741	20,990	4,979	5,937
Long distance services	14,652	22,961	30,816	6,434	8,762
Access services	119,421	133,037	132,047	33,400	33,047
Universal service fund	116,305	121,607	119,727	29,938	30,077
Other services	24,097	34,407	37,385	8,365	9,185
	$424,916	$479,883	$497,334	$122,119	$125,852

The following table sets forth several key metrics:

	As of December 31,			As of March 31,	
	2001	2002	2003	2003	2004
Total access lines	551,599	571,308	556,745	568,933	557,278
Long distance subscribers	62,234	130,622	188,526	153,313	197,303
Penetration rate of total access lines	11%	23%	34%	27%	35%
DSL subscribers	511	3,510	8,779	4,433	10,019
Penetration rate of total access lines	0%	1%	2%	1%	2%

Consolidated Revenues

Our consolidated revenues increased $3.7 million, or 3.0% in the first three months of 2004, as compared to the same period in 2003. In addition, our consolidated revenues increased $17.5 million, or 3.6%, in 2003 and $55 million, or 12.9%, in 2002. Excluding the effect of the KCC acquisition, which occurred in January 2002, revenues increased $29.5 million, or 6.9%, in 2002. Telephone access lines are an important element of our business. The monthly recurring revenue we generate from end users, the amount of traffic that traverses our network and related access charges generated from other carriers, the amount of USF revenue received, and most other revenue streams are directly related to the number of access lines in service. Excluding the effect of the KCC acquisition, we have lost access lines in each of the last two years. We have been able to generate increases in our revenue in each of the last two years by executing a strategy of selling additional services to existing customers and increasing average revenue per line through a combination of new product offerings and bundling of various services. New product offerings include DSL, long distance and other enhanced calling features. The increases in revenue related to this strategy have more than offset the declines in revenue that we have experienced from access line losses. If we continue to lose access lines or if we are unable to continue to successfully execute our strategy, it could slow the rate of our revenue growth or cause our revenue to decline, either of which could have an adverse effect on our results of operations and financial condition.

Competition from wireless service providers is intensifying as the coverage of their networks improves and the price of their product offerings continues to become more attractive to consumers in our markets. In addition, as voice over internet protocol, or VoIP, becomes a more viable product, new competitors could

Table of Contents

enter our markets and existing competitors could become more formidable. More specifically, cable television operators in some of our markets already offer a broadband product in the form of a high-speed cable modem. VoIP could allow them to offer telephony services to our customers that would bypass our network altogether. If these cable television operators or any other competitors were to successfully offer a VoIP product in any of our markets, we could lose a significant amount of our access lines and revenues in those markets.

For a more extensive discussion of risks related to loss of access lines, see Risk Factors Risks Relating to Our Business.

Three Months Ended March 31, 2004 Compared to Three Months Ended March 31, 2003

Local Service Revenues. Local service revenue decreased $0.2 million to $38.8 million in 2004 from $39.0 million in 2003. Revenue from the provision of basic service decreased $0.5 million primarily as a result of access line loss. This access line related loss was partially offset by an increase of $0.3 million from various other items.

Data Services Revenues. Data services revenues increased $1.0 million, or 19%, to $5.9 million in 2004 from $4.9 million in 2003. DSL revenues increased $0.7 million and other data revenue increased $0.3 million. The number of DSL subscribers grew to 10,019 at March 31, 2004. This represents a 126% increase compared to the number of DSL subscribers at March 31, 2003.

Long Distance Services Revenues. Long distance services revenue increased $2.3 million, or 36%, to $8.7 million in 2004 from $6.4 million in 2003. Our flat rate plans and direct-dialed long-distance products increased $1.4 million as a result of adding 44,000 subscribers and $1.3 million as a result of an increase to the monthly recurring rate. These increases were partially offset by a reduction in local toll calling or switching to alternate lower cost service providers and lower calling card revenue of $0.1 million.

Access Services Revenues. Access services revenues decreased $0.4 million, or 1% to $33.0 million in 2004 from $33.4 million in 2003. Switched access revenue decreased $1.0 million, which was primarily attributable to lower access rates. Lower switched access revenue was partially offset by higher special access revenue of $0.3 million and end user revenues of $0.3 million.

USF Revenues. USF Revenues increased $0.2 million to $30.1 million in the first three months of 2004 from $29.9 million in the first three months of 2003. Texas State USF declined $0.3 million in the first three months of 2004 from $25.9 million in the first three months of 2003.

Other Services Revenues. Other services revenue increased $0.8 million, or 10% to $9.2 million in 2004 from $8.4 million in 2003. $0.2 million of this increase was related to the leasing of additional facilities by competitive local telephone companies to service their customers in our markets. The remaining $0.6 million increase was due to other miscellaneous items.

Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

Local Service Revenues. Local service revenue increased $9.3 million, or 6%, to $156.4 million in 2003 from $147.1 million in 2002, despite declining access lines during the period. Revenue from the provision of basic service decreased $2.3 million primarily as a result of access line loss. This access line related loss was more than offset by an increase of $9.0 million in enhanced services, primarily resulting from our bundle strategy. The remainder of the increase was from activation and reconnection charges.

Data Services Revenues. Data services revenues improved 1% in 2003 to $21.0 million from $20.7 million in 2002. DSL revenues increased $1.8 million and other data revenue increased $1.7 million. The number of DSL subscribers grew by 5,269 during the year. The increase in the number of DSL subscribers represents a 150% increase from 2002. We have been able to grow our data services revenue despite the loss of substantially all the revenue from one of our large Internet service provider customers. The loss of this customer represented a $3.2 million decrease in revenue during 2003.

Long Distance Services Revenues. Long distance services revenue increased $7.8 million, or 34%, to $30.8 million in 2003 from $23.0 million in 2002. Our flat rate plans and direct-dialed long-distance products increased $10.1 million. This increase was partially offset by a reduction in local toll revenue of $2.3 million, or 37%, compared to the previous year. This results primarily from customers switching to one of our new plans offering toll-free local calling or switching to alternate lower cost service providers.

Access Services Revenues. Access services revenues declined $1.0 million to $132.0 million in 2003 from $133.0 million in 2002. Switched access revenue decreased approximately $4.8 million, which was primarily attributable to lower access rates. Lower switched access revenue was partially offset by higher special access and end user revenues. Special access revenues increased by $1.6 million as the demand for special circuits ordered by interexchange carriers to transport their customers voice and data traffic continue to improve. End user revenues increased by $2.2 million, of which $3.8 million was due to an increase in rates, offset by a $1.6 million reduction resulting from a loss in access lines.

USF Revenues. USF revenues declined $1.9 million, or 2%, to $119.7 million in 2003 from $121.6 million in 2002. Texas State USF declined $1.1 million in 2003 compared to 2002 as a result of a loss in access lines.

Other Services Revenues. Other services revenue increased $3.0 million, or 9%, to $37.4 million. $2.4 million of this increase was related to competitive local telephone companies leasing additional facilities to service their customers in our markets. The remaining $0.6 million increase was due primarily to higher directory advertising and other miscellaneous items.

Year Ended December 31, 2002 Compared to Year Ended December 31, 2001

Local Service Revenues. Local service revenue increased $14.6 million, or 11%, to $147.1 million in 2002 from $132.5 million in 2001. Comparing access lines at December 31, 2002 to December 31, 2001, access lines increased 19,709. $4.9 million of the revenue increase and 27,537 of the access line increase was related to our acquisition of Kerrville Communications Corporation, or KCC, in 2002.

Excluding the effects of the KCC acquisition, access lines declined 7,828, or 1.4%, most of which occurred near the end of the year. As a result, this decline had a minimal effect on our 2002 revenues. Revenues excluding the acquisition of KCC increased $9.7 million, or 7.3%. $4.2 million of this increase was related to sales of enhanced services, primarily as a result of our bundled products which we began marketing during 2002. Other increases to local service revenues include $3.4 million in activation and reconnection charges and $2.1 million of other miscellaneous increases.

Data Services Revenues. Data services revenues increased $2.8 million, or 16%, to $20.7 million in 2002 from $17.9 million in 2001. $2.5 million of the increase was related to our acquisition of KCC in 2002. The remaining increase was due substantially to our efforts to increase the number of DSL subscribers in our markets and sales of other data products.

Long Distance Services Revenues. Long distance services revenue increased $8.3 million, or 57%, to $23.0 million in 2002 from $14.7 million in 2001. $1.7 million of the revenue increase and approximately 8,400 of the long distance subscriber increase was related to our acquisition of KCC in 2002.

Excluding the effects of the KCC acquisition, revenue from our flat rate plans and direct-dialed long-distance products increased $8.7 million as a result of the number of long distance subscribers increasing by 96% to 122,257 from 62,234 at the end of 2001. This increase was partially offset by a reduction in local toll revenue of $2.1 million. This reduction in local toll results primarily from customers switching to one of our new plans offering toll-free local calling or switching to alternate lower cost service providers.

Table of Contents

Access Services Revenues. Access services revenues increased $13.6 million, or 11%, to $133.0 million from $119.4 million for 2002 and 2001, respectively. $8.3 million of the revenue increase was attributable to the acquisition of KCC.

Excluding the effects of the KCC acquisition, access services revenues increased $5.3 million in 2002 as compared to 2001. Higher special access revenues contributed $7.9 million of the increase as inter-exchange carriers purchased special circuits to transport their customers voice and data traffic and from fulfilling pent-up demand for circuits in our exchanges. Adding to the increases in access services revenue in 2002 were higher subscriber line charges of $3.6 million. These increases were offset by lower switched access revenue. Switched access revenue declined by $6.2 million, or 10%, compared to the previous year.

USF Revenues. USF revenues increased $5.3 million, or 5%, to $121.6 million in 2002 from $116.3 million in 2001. $4.1 million of the increase was related to our acquisition of KCC in 2002. The remaining $1.2 million increase was due primarily to higher net federal USF support, partially offset by lower Texas state USF as a result of our declining access lines in Texas.

Other Services Revenues. Other services revenue increased $10.3 million, or 43%, to $34.4 million in 2002 from $24.1 million in 2001. $4.0 million of the increase was related to our acquisition of KCC in 2002. Equipment sales increased $4.0 million from a mix of sales of large systems to business customers, sales of individual phone sets, and other small items. Other miscellaneous items contributed the remaining increase of $2.3 million.

Operating Expenses

Cost of Service. Cost of service includes operational costs of owning and operating our facilities, cost of leasing other facilities to interconnect our network, access charges paid to third parties to transport and terminate toll calls, and the cost of sales of customer premise equipment.

Selling, General and Administrative. Selling, general and administrative expenses represent the cost of billing our customers, operating our call centers, performing sales and marketing activities in support of our efforts to grow revenues, and other general corporate support activities.

Depreciation and Amortization. Depreciation and amortization includes depreciation of our communications network and equipment and amortization of goodwill through December 31, 2001. The following table sets forth operating expenses for the periods shown:

	Year Ended December 31,			Three Months Ended March 31,	
	2001	2002	2003	2003	2004
			(Dollars in thousands)		
Cost of service	$ 105,357	$ 113,891	$ 106,527	$ 24,887	$ 26,579
Selling, general and administrative	105,418	133,468	126,896	31,263	32,930
Depreciation and amortization	110,843	73,273	81,638	19,950	20,827
	$ 321,618	$ 320,632	$ 315,061	$ 76,100	$ 80,336

Consolidated Operating Expenses

Our consolidated operating expenses increased by $4.2 million, or 5.6% in the first three months of 2004 as compared to the same period in 2003. This increase was primarily attributable to a $1.7 million increase in our cost of service in part resulting from increased access charges paid to third parties and a $1.6 million increase in our selling, general and administrative expenses.

Our consolidated operating expenses decreased $5.6 million, or 1.7%, in 2003 primarily due to our recovery of previously written off receivables associated with MCI Worldcom s bankruptcy and improvements in maintenance and operating costs resulting from improvements we have made to our network infrastructure.

Table of Contents

Our consolidated operating expenses were essentially flat in 2002 compared to 2001. There were substantial increases in some categories of operating expenses in 2002 primarily caused by our January 2002 acquisition of KCC, increased bad debt expense we incurred on receivables we wrote off resulting from MCI Worldcom s 2002 bankruptcy filing, the staffing of personnel in our call centers, and access charges paid to third parties to transport and terminate long distance calls. These expense increases were offset by a reduction of $53.9 million in amortization expense due to the adoption of FASB 142 in 2002. FASB 142 directed companies to annually test goodwill for impairment rather than amortize goodwill systematically to earnings.

There are a number of factors that could cause our operating expenses to increase in the future, including but not limited to:

- If we were to determine that our goodwill were to become impaired we would be required to write-off the impaired amount under the provisions of FASB 142;
- Our ability to successfully negotiate a new collective bargaining agreement with the Local 6171 and Local 7019 of the Communications Workers of America. The current contracts expire on February 28, 2005 and February 14, 2006;
- Increasing costs of providing healthcare and postretirement benefits to our existing and former employees;
- Increased costs associated with our financial responsibilities under our defined benefit pension plan; and
- The increased presence of competitors in our markets and incremental costs we might incur to retain our existing customers or implement new product offerings.

Our inability to effectively manage any or all of these items could cause our operating expenses to increase in the future and have an adverse effect on our results of operations and financial condition.

Three Months Ended March 31, 2004 Compared to Three Months Ended March 31, 2003

Cost of Service. Cost of service increased $1.7 million, or 7%, to $26.6 million from $24.9 million. The increase was primarily attributable to higher access charges paid to third parties related to the increase in usage from our growing long distance subscriber base and unlimited long distance plans.

Selling, General and Administrative. Selling, general and administrative expenses increased $1.6 million, or 5%, to $32.9 million in 2004 from $31.3 million in 2003. In the first quarter of 2003, we recovered $1.6 million of previously written-off receivables related to MCI s 2002 bankruptcy. This recovery resulted in a reduction of bad debt expense in the three-month period ended March 31, 2003.

Depreciation and Amortization. Depreciation and amortization expense increased by $0.9 million, or 4%, to $20.8 million during 2004 as compared to 2003. Higher depreciation expense resulted from our spending on capital projects to improve our network infrastructure.

Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

Cost of Service. Cost of service decreased $7.4 million, or 6%, to $106.5 million from $113.9 million. Costs for external circuits and network capacity declined $5.4 million as a result of efficiencies gained from upgrades we made to our network. Costs to maintain and operate our network declined $6.6 million as a result of the investment we made in our telecommunications infrastructure. Additionally, cost of goods sold for customer premise equipment decreased $2.1 million as sales for this equipment slowed during 2003. These decreases were partially offset by higher access charges of $7.4 million paid to third parties related to the increase in usage from our increasing long distance subscriber base. Other miscellaneous items contributed the remaining decrease of $0.7 million.

Table of Contents

Selling, General and Administrative. Selling, general and administrative expenses decreased $6.6 million, or 5%, to $126.9 million in 2003 from $133.5 million in 2002. We recorded a $5 million charge during 2002 as a result of one of our largest customers, MCI, declaring bankruptcy. In 2003, we sold the receivables related to the charge and negotiated setoff of amounts owed by us to MCI against amounts owed by MCI to us, recovering approximately $3.4 million. The effect of these transactions decreased our expense in 2003 as compared to 2002 by $8.4 million. Offsetting this reduction in expense was an increase of $1.8 million of various other miscellaneous expenses.

Depreciation and Amortization. Depreciation and amortization expense increased by $8.4 million, or 11%, to $81.6 million during 2003 as compared to 2002. Higher depreciation expense resulted from our spending on capital projects to improve our network infrastructure.

Year Ended December 31, 2002 Compared to Year Ended December 31, 2001

Cost of Service. Cost of service increased $8.5 million, or 8%, to $113.9 million in 2002 from $105.4 million in 2001. $5.8 million of the increase was related to our acquisition of KCC in 2002. Of the remaining $2.7 million increase, higher access charges of $4.3 million were paid to third parties related to the increased usage from our increasing long distance subscriber base, and higher cost of goods sold for $2.0 million primarily resulted from large equipment system sales in late 2002. These increases were offset by a reduction of $3.6 million, primarily from lower costs for external circuits and network capacity as a result of efficiencies gained from upgrades we made to our network.

Selling, General and Administrative. Selling, general and administrative expenses increased $28.1 million, or 27%, to $133.5 million in 2002 from $105.4 million in 2001. $7.1 million of the increase was from our 2002 acquisition of KCC. Of the remaining $21.0 million, $5.3 million was due principally to headcount increases in our call centers. This was done to eventually shift reliance away from third parties to generate sales and to increase the overall effectiveness of our customer service function. Sales and marketing expense increased $6.4 million as a result of efforts to generate sales of bundle products and long distance. We wrote off approximately $5.0 million of receivables when one of our largest customers, MCI, declared bankruptcy in 2002. Of the remaining $4.3 million increase, $1.4 million was due to a restructuring charge taken in the fourth quarter of 2002 for elimination of 81 positions and $2.9 million was from various other miscellaneous increases.

Depreciation and Amortization. Depreciation and amortization expense decreased $37.5 million to $73.3 million in 2002 from $110.8 million in 2001. $53.9 million of this decrease resulted from our adoption of SFAS 142, which required that goodwill no longer be amortized. Excluding the effects of SFAS 142, depreciation and amortization expense increased $16.4 million. $4.1 million of the increase was related to our acquisition of KCC in 2002. The remaining $12.3 million increase in depreciation expense results from our spending on capital projects to improve our network infrastructure.

Interest Expense

The following table sets forth interest expense:

	Year Ended December 31,			Three Months Ended March 31,	
	2001	**2002**	**2003**	**2003**	**2004**
			(Dollars in thousands)		
Interest expense	$133,156	$127,365	$119,185	$31,926	$27,730

Interest expense decreased $4.2 million to $27.7 million in the three months ended March 31, 2004 from $31.9 in the three months ended March 31, 2003. Interest expense also decreased $8.2 million to $119.2 million in 2003 from $127.4 million in 2002. In each case our decrease in interest expense was due to lower average principal outstanding on our senior debt.

Excluding the effects of the borrowings for the KCC acquisition, our interest expense decreased $10.9 million to $122.3 million in 2002 from $133.2 million in 2001, as a result of our paying down debt. This decrease was partially offset by an increase of deferred interest on our subordinated notes and lower capitalized interest as spending for projects declined in 2002 compared to 2001.

Loss on Interest Rate Hedging Arrangements

The following table sets forth our loss on interest rate hedging arrangements:

	Year Ended December 31,			Three Months Ended March 31,	
	2001	2002	2003	2003	2004
	(Dollars in thousands)				
Loss on interest rate hedging arrangements	$(14,292)	$(12,348)	$(2,113)	$(1,229)	$(342)

The adjustment to mark our hedging arrangements to market value resulted in non-cash income of $2.4 million and $1.4 million for the three months ended March 31, 2004 and 2003, respectively, and $8.5 million during 2003 and non-cash expense of $2.7 million in 2002 and $9.9 million in 2001. The remaining loss relates to cash settlements during the periods. These hedging arrangements will be terminated and replaced in connection with our reorganization.

Earnings from Unconsolidated Cellular Partnerships and Other Income and Expense

The following table sets forth other income and expense for the periods shown:

	Year Ended December 31,			Three Months Ended March 31,	
	2001	2002	2003	2003	2004
	(Dollars in thousands)				
Earnings from unconsolidated cellular partnerships	$	$2,757	$3,258	$783	$325
Other income and (expense)	$358	$ (268)	$ (62)	$ 40	$(70)

Earnings from unconsolidated cellular partnerships are our share of the earnings in the equity interest of the two cellular partnerships acquired in 2002 as part of the KCC acquisition. In 2002, 2003 and three months ended March 31, 2004, we recorded $2.8 million, $3.3 million and $0.3 million, respectively, for these equity earnings. Other income and (expense) represents various other miscellaneous income and expense items, including interest income on our cash balances held at financial institutions.

Income Taxes

The following table sets forth income taxes for the periods shown:

	Year Ended December 31,			Three Months Ended March 31,	
	2001	2002	2003	2003	2004
	(Dollars in thousands)				
Income taxes	$0	$1,649	$2,478	$758	$567

The income taxes represent those of Valor Telecommunications Southwest II, LLC, which has elected to be taxed as a corporation for federal income tax purposes. (See Note 2,   Summary of Significant Accounting Policies   and Note 10,   Income Taxes   of our consolidated financial statements for an expanded discussion of income taxes.)

Table of Contents

Minority Interest

The following table sets forth the minority interest for the periods shown:

	Year Ended December 31,			Three Months Ended March 31,	
	2001	2002	2003	2003	2004
	(Dollars in thousands)				
Minority interest	$3,595	$(615)	$(3,568)	$(770)	$(1,518)

Minority interest reflects the share of income and loss of minority shareholders in Valor Telecommunications Southwest, LLC and Valor Telecommunications Southwest II, LLC.

Discontinued Operations

The following table sets forth discontinued operations for the periods shown:

	Year Ended December 31,			Three Months Ended March 31,	
	2001	2002	2003	2003	2004
	(Dollars in thousands)				
Discontinued operations	$(8,443)	$(3,461)	$108	$	$

We sold our competitive local exchange carrier in Texas during April 2002 to NTS Communications for $0.2 million. In accordance with the provisions of SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, which was effective for us on January 1, 2002, the revenue, costs and expenses and cash flows of our competitive local exchange business have been excluded from the respective captions in our Consolidated Statements of Operations and Consolidated Statements of Cash Flows, and have been reported through their respective dates of separation as Net income (loss) from discontinued operations and as Net cash used in discontinued operations.

In connection with the sale, we recorded a liability of approximately $2.0 million related to certain employee termination benefits and other exit costs such as non-cancelable leases. As of December 31, 2003 and 2002, approximately $0.1 million and $0.4 million, respectively, of the $2.0 million had not been paid. As of March 31, 2004, a de minimis amount remained unpaid. These amounts have been classified as current liabilities in the Consolidated Balance Sheets. Income from discontinued operations of $0.1 million in 2003 represents a revision to the estimates we made in 2002 for recording certain employee termination benefits and other exit costs.

Cumulative Effect of Change in Accounting Principle

SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, or SFAS 133, as amended by SFAS No. 137, Accounting for Derivative Instruments and Hedging Activities-Deferral of the Effective Date of FASB Statement No. 133, and by SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, which became effective for our company on January 1, 2001, established accounting and reporting standards that required every derivative instrument be recorded in the balance sheet as either an asset or liability measured at fair value, with changes in fair value reflected in the statement of operations.

We entered into interest rate hedge contracts to adjust the interest rate profile of our debt obligations (see Interest Rate Risk below). In addition, our credit arrangements include provisions that require interest rate protection (hedge agreements) for a portion of our variable debt. We entered into interest rate hedging agreements with certain financial institutions to reduce the financial impact of changes in interest rates on our debt. Our interest rate swap and collar agreements do not qualify for hedge accounting under SFAS 133 and therefore are carried at fair market value and included in Deferred credits and other liabilities in the Consolidated Balance Sheets. The transitional unrealized loss on the interest rate hedging

Table of Contents

arrangements at January 1, 2001 is reflected as the Cumulative effect of change in accounting principle on the Consolidated Statements of Operations. Changes in the fair market value and settlements are recorded as Loss on hedging arrangements each quarter.

Financial Condition and Liquidity

Current Financial Condition. At March 31, 2004, we had net debt of $1,435.9 million and $65.5 million of common owners equity, compared to net debt of $1,469.2 million and $49.9 million of common owners equity at December 31, 2003, and net debt of $1,544.2 million and $5.6 million of common owners deficit at December 31, 2002. Historically, we have used excess cash generated through operations to pay down long-term debt. As a result, we generally maintain a negative working capital balance. We had a negative working capital balance of $46.2 million and $59.3 million at March 31, 2003 and 2004, respectively, and $29.3 million and $46.2 million at December 31, 2002 and 2003, respectively.

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

Cash Flows

	For the Years Ended December 31,			For the Three Months Ended March 31,	
	2001	2002	2003	2003	2004
	(Dollars in thousands)				
Net cash provided by operating activities	$ 100,301	$ 150,383	$ 166,065	$ 41,485	$ 50,109
Net cash used in investing activities	(106,614)	(216,773)	(66,299)	(14,178)	(16,723)
Net cash provided by (used in) financing activities	8,117	71,015	(99,465)	(26,484)	(31,041)
Net cash used in discontinued operations	(8,373)	(3,662)	(176)	(88)	(9)
Net (decrease) increase in cash and cash equivalents	$ (6,569)	$ 963	$ 125	$ 737	$ 2,336

We began making semi-annual cash payments related to our 10% senior subordinated notes in 2003, which is discussed in Outstanding Senior Subordinated Notes below.

Net cash provided by continuing operations of $50.1 million in the first three months of 2004, was generated primarily by $15.6 million of income from continuing operations, adjusted to exclude non-cash items of $23.6 million. Net cash provided by continuing operations of $166.1 million in 2003, was generated primarily by $58.1 million of income from continuing operations, adjusted to exclude non-cash items of $102.7 million. The most significant non-cash items in 2003 were depreciation and amortization expense of $81.6 million and non-cash interest expense related items of $17.4 million, which includes amortization of debt issuance costs, unrealized gain on hedging arrangements, and non-cash interest expense on our senior subordinated debt.

Net cash provided by continuing operations of $150.4 million in 2002, was generated primarily by $19.8 million of income from continuing operations, adjusted to exclude non-cash items of $124.8 million. The most significant non-cash items were depreciation and amortization expense of $73.3 million, non-cash interest expense related items of $42.2 million, and $11.4 million of bad debt expense. Cash flows from continuing operations were also favorably impacted by working capital improvements of $3.3 million. The growth in cash flows from continuing operations from 2001 to 2002 relates primarily to the acquisition of KCC in 2002, as well as the unfavorable working capital requirements in 2001.

Net cash provided by continuing operations of $100.3 million in 2001, resulted from a $44.9 million of net loss from continuing operations, adjusted to exclude non-cash items of $168.0 million and working capital requirements of $29.9 million. The most significant non-cash items were depreciation and amortization expense of $110.8 million, non-cash interest expense related items of $49.4 million, and $11.4 million of bad debt expense.

Table of Contents

Cash used in investing activities was $16.7 million for the first three months of 2004, compared to $14.2 million for the three months of 2003, $66.3 million in 2003, $216.8 million in 2002, and $106.6 million in 2001. The investing activities during 2002 include the cash paid of $128.1 million to acquire all the outstanding common stock, preferred stock and common stock equivalents of KCC. Our investing activities consisted primarily of capital expenditures for property, plant and equipment. We fund capital expenditures to deploy new network services, modernize our property, plant and equipment, position our network infrastructure for future growth, and to meet regulatory obligations.

Capital expenditures for the years ended 2001, 2002, 2003 and the first three months of 2004 were $107.9 million, $89.5 million, $69.9 million and $16.7 million, respectively. The decreases in capital spending from 2002 to 2003 and from 2001 to 2002 reflect the completion of certain switch upgrades in 2002, as well as continued improvement in the overall plant condition. For the period from April 1, 2004 to December 31, 2004, we expect capital expenditures to be approximately $ million, and we anticipate that future capital expenditures will be at, or slightly below, current levels. Cash used for capital expenditures was partially offset by distributions of $3.5 million in 2003, and $1.9 million in 2002, received from our equity investment in two wireless partnerships. Future cash distributions from these equity investments are uncertain.

Cash used by financing activities was $31.0 million in the first three months of 2004 and $99.5 million in 2003, compared to cash provided by financing activities of $71.0 million in 2002, and $8.1 million in 2001. These changes are principally due to the net incremental repayments of long-term debt of $33.8 million in the three months ended March 31, 2004 and $100.0 million in 2003, and net incremental borrowings of $39.2 million in 2002, and net incremental repayments of $2.2 million in 2001, respectively. Cash provided by financing activities in 2002 includes the proceeds from partner capital contribution of $46.1 million, which together with the additional borrowings of $82.0 million, was used primarily to acquire all the outstanding common stock, preferred stock and common stock equivalents of KCC.

Historically, we have managed our cash on hand through the use of revolving credit facilities to maximize the amount of debt repayment. Of the total net debt repayments of $100.0 million in 2003, $58.9 million were required principal payments and $41.1 million were optional principal payments.

Outstanding Debt and Existing Financing Arrangements

At December 31, 2003 we had various financing arrangements outstanding with a total borrowing capacity of $ million. Of this total borrowing capacity, $ million was available to fund future contractual obligations and $ million was outstanding as debt (refer to Note 8 to the consolidated financial statements for more details on outstanding debt):

	Total Borrowing Capacity	Unused Capacity(1)	Outstanding Debt
	(Dollars in thousands)		
Senior credit facilities			
Revolver	$	$	$
Bank term loans			
Rural Telephone Finance Cooperative, or RTFC, term loans			
10% Senior Subordinated Notes			
Capitalized leases and other			
	$	$	$

(1) Unused capacity is reduced by an outstanding letter of credit in the amount of $0.1 million.

The agreements for the senior credit facilities limit, among other things, additional borrowings, transactions with affiliates, capital expenditures and the payment of dividends and require us to maintain certain financial ratios including debt to cash flow ratios, interest coverage and fixed charge coverage. We expect to replace these facilities with a new senior credit facility that contains substantially similar covenants.

Table of Contents

Outstanding Senior Subordinated Notes

As of March 31, 2004, Valor Telecommunications Southwest, LLC had $314.3 million aggregate principal amount of 10% Senior Subordinated Notes due 2010 outstanding. Until our pro forma fixed charge coverage equals or exceeds one to one, our 10% Senior Subordinated Notes do not pay cash interest, but accrue interest at 12.0% per annum and is converted into additional note principal. During the years ended December 31, 2002 and 2003, we converted $32.6 million and $17.8 million, respectively, of interest into additional note principal. During 2003, we began making cash interest payments on our 10% Senior Subordinated Notes.

All our outstanding senior subordinated notes are held by our equity sponsors, and we will repay all our outstanding senior subordinated notes as part of our reorganization. We will repay the equity sponsors for our outstanding senior subordinated notes in cash with the proceeds of this offering and borrowings under our new credit facility.

New Credit Facility

We intend to enter into a $ million new senior secured credit facility with a syndicate of financial institutions. We expect that the new credit facility will be comprised of a senior secured revolving credit facility of up to $ million, which we refer to as the new revolver, and a senior secured term loan facility in an aggregate principal amount of $ million, which we refer to as the new term loan. We expect that the new revolver and the new term loan will each have an approximately five-year maturity with no amortization of principal prior to maturity. We expect that the new credit facility will have several provisions similar to credit facilities of this nature, including but not limited to: interest rate and fees, mandatory prepayments, voluntary prepayments, affirmative and negative covenants, restrictions on collateral and events of default. See Description of Certain Indebtedness New Credit Facility .

Contractual and Other Obligations

In addition to the above financing arrangements, we have commitments under certain contractual arrangements to make future payments for goods and services. These commitments secure the future rights to various assets and services to be used in the normal course of operations. For example, we are contractually committed to make certain minimum lease payments for the use of property under operating lease agreements. In accordance with current accounting rules, the future rights and obligations pertaining to such firm commitments are not reflected as assets or liabilities on the consolidated balance sheet. The following table summarizes our contractual and other obligations at December 31, 2003, and the effect such obligations are expected to have on liquidity and cash flow in future periods:

Payments Due by Period(1)

	2004	2005-2006	2007-2008	Thereafter	Total
			(Dollars in thousands)		
Contractual obligations(2)	$ 50,786	$ 72,204	$ 713	$	$ 123,703
Long-term debt obligations(3)	$154,074	$306,511	$686,909	$867,307	$2,014,801
Capital lease obligations(4)	$ 1,777	$ 2,551	$ 397	$	$ 4,725
Operating lease obligations(5)	$ 2,257	$ 4,400	$ 3,644	$ 2,873	$ 13,174
Total contractual cash obligations	$208,894	$385,666	$691,663	$870,180	$2,156,403

(1) The table above does not include an estimate for income taxes, obligations to preferred equity holders, cash contributions to our pension plan and cash contributions to our post-retirement medical plan which we are required to make but not required to include above.
(2) Our contractual obligations represent our required capital investment in New Mexico, officers salaries under employment agreements, capital expenditure commitments and payments to third party service providers.
(3) The long-term debt obligations represent our cash debt service obligations, including both principal and interest.

(4) The capital lease obligations represent our future rental payments for vehicles leased under five year terms.
(5) Operating lease obligations represent the future minimum rental payments required under the operating leases that have initial or remaining non-cancelable lease terms in excess of one year as of December 31, 2003.

On April 9, 2004, we entered into an agreement with our former Chief Executive Officer, or CEO. In conjunction with his retirement and the restructuring of his prior employment agreement, we paid our former CEO a transition bonus of $5 million on April 15, 2004 and further agreed to pay him a $1.5 million cash payment if the proposed offering of IDSs is consummated on or before April 9, 2005. (See Note 11 Subsequent Events to Condensed Consolidated Financial Statements for more information.)

On April 20, 2004, we entered into an agreement with a group of the individual investors who owned direct equity interests in the company s wholly owned subsidiaries. This agreement provides for us to repurchase all of outstanding equity interests of this group of individual investors for $18,646,305 in cash. We made this cash payment to the group of individual investors on April 20, 2004. (See Note 11 Subsequent Events to Condensed Consolidated Financial Statements for more information.)

Other than the transactions described above, there have been no material changes outside of the ordinary course of business to our contractual and other obligations as of March 31, 2004.

Off-Balance Sheet Arrangements

Except as noted in the table above under Contractual obligations and Operating lease obligations, we have no material off-balance sheet obligations.

Risk Management

Interest Rate Risk. We are exposed to market risk from changes in interest rates on our long-term debt obligations. To manage our interest rate risk exposure and fulfill a requirement of our credit facility, we entered into two agreements with investment grade financial institutions in 2000, an interest rate swap and an interest rate collar. Each of these agreements covered a notional amount of $100 million. As a further hedge against interest rate exposure, we elected a fixed rate option for some of our senior debt during the year ended December 31, 2003.

The fair value of our fixed-rate long-term debt is sensitive to changes in interest rates. Interest rate changes would result in gains or losses in the market value of the debt due to differences between the market interest rates and rates at the incurrence of the obligation.

Inflation. Historically, we have mitigated the effects of increased costs by recovering certain costs applicable to our regulated telephone operations through the ratemaking process over time. Possible future regulatory changes may alter our ability to recover increased costs in our regulated operations. As inflation raises the operating expenses in our non-regulated lines of business, we will attempt to recover rising costs by raising prices for our services.

Derivatives. Except for the interest rate swap and interest rate collar agreements described above, we generally do not use derivative financial instruments.

Following our reorganization and the consummation of this offering, we anticipate that we will employ similar methods to reduce our exposure to interest rate fluctuations and inflation.

Recent Accounting Pronouncements

In June 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities . This statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue No. 94-3, Liability Recognition for

Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31, 2002. We adopted this statement on January 1, 2003. The adoption of this standard did not have a material impact on our financial position or the results of operations.

Financial Accounting Standards Board Interpretation (FIN) No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others an Interpretation of FASB Statements No. 5, 57, and 107 and Rescission of FIN No. 34 was issued in November 2002 and became effective for disclosures made in December 31, 2002 financial statements. The interpretation requires expanded disclosures of guarantees. In addition, the interpretation requires recording the fair value of guarantees upon issuance or modification after January 1, 2003. While we have various guarantees included in contracts in the normal course of business, these guarantees do not represent significant commitments or contingent liabilities related to the indebtedness of others.

In January 2003, the FASB issued FIN No. 46, Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51 (ARB 51) , which clarifies the consolidation accounting guidance in ARB 51, Consolidated Financial Statements, as it applies to certain entities in which equity investors who do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entities to finance their activities without additional subordinated financial support from other parties. Such entities are known as variable interest entities (VIEs). FIN No. 46 requires that the primary beneficiary of a VIE consolidates the VIE. FIN No. 46 also requires new disclosures for significant relationships with VIEs, whether or not consolidation accounting is used or anticipated. In December 2003, the FASB revised and re-released FIN No. 46 as FIN No. 46(R). The provisions of FIN No. 46(R) are effective for periods ending after March 15, 2004. However, we have elected to adopt FIN No. 46(R) as of December 31, 2003. The adoption of FIN No. 46(R) did not have a material impact on our financial position or the results of operations.

In May 2003, the FASB issued SFAS No. 150 Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability because that financial instrument embodies an obligation of the issuer. This Statement is effective for periods beginning after June 15, 2003. We have included the redeemable preferred interests as part of total liabilities as of December 31, 2002 and 2003.

In January 2004, FASB Staff Position (FSP) No. 106-1, Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003 was issued. FSP No. 106-1 permits the deferral of recognizing the effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) in the accounting for post-retirement health care plan under SFAS No. 106, Employers Accounting for Postretirement Benefits Other Than Pensions, and in providing disclosures related to the plan required by SFAS No. 132 (revised 2003), Employers Disclosures about Pensions and Other Postretirement Benefits. The deferral of the accounting for the Act continues to apply until authoritative guidance is issued on the accounting for the federal subsidy provided by the Act or until certain other events requiring plan remeasurement. We have elected the deferral provided by this FSP and are evaluating the magnitude of the potential favorable impact of this FSP on our results of operations and financial position. See Note 11 to our financial statements included elsewhere in this prospectus for further discussion of postretirement benefits.

Quantitative and Qualitative Disclosures about Market Risk

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

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

At December 31, 2003, the fair value of our fixed rate long-term debt was estimated to be $700.1 million based on the overall weighted average rate of our fixed rate long-term debt of 7.7% and an overall weighted maturity of 5.8 years, compared to terms and rates currently available in long-term financing markets. Market risk is estimated as the potential loss in fair value of our long-term debt resulting from a hypothetical increase of 10% in interest rates. Such an increase in interest rates would result in approximately $18.3 million decrease in the fair value of our long-term debt. At December 31, 2003, we had approximately $564.8 million of variable rate debt. If market interest rates increase 100 basis points in 2004 over the rates in effect at December 31, 2003, interest expense would increase $4.9 million.

To manage our interest rate risk exposure and fulfill a requirement of our credit facility, we entered into two agreements with investment grade financial institutions in 2000, an interest rate swap and an interest rate collar. Each of these agreements covers a notional amount of $100 million and effectively converts this portion of our variable rate debt to fixed rate debt. Our interest rate swap and collar agreements do not qualify for hedge accounting under SFAS No. 133; therefore, they are carried at fair market value and are included in Deferred credits and other liabilities on the Consolidated Balance Sheets. We do not hold or issue derivative financial instruments for trading or speculative purposes.

With respect to these hedges, market risk is estimated as the potential loss in the fair value of the hedge resulting from a hypothetical 10% change in the forward rates used to determine the fair value. A hypothetical 10% decrease in the forward rates would result in a $0.1 million decrease in the fair value of our swap agreement. A hypothetical 10% decrease in the forward rates would result in a $0.1 million decrease in the fair value of our collar agreement.

Table of Contents

Business

Overview

We are one of the largest providers of telecommunications services in rural communities in the southwestern United States and, based on the number of telephone lines we have in service, the seventh largest independent local telephone company in the country. We operate approximately 550,000 telephone access lines in primarily rural areas of Texas, Oklahoma, New Mexico and Arkansas. The geographic concentration of our assets has enabled us to create operational efficiencies. We believe that in many of our markets we are the only service provider that offers customers an integrated package of local and long distance voice, high-speed data and Internet access, and enhanced services such as voicemail, call waiting, caller identification and call forwarding. For the year ended December 31, 2003, we generated revenues of $497.3 million.

We offer a wide range of telecommunications services to residential, business and government customers. Our services include: local exchange telephone services, which covers basic dial-tone service as well as enhanced services, such as caller identification, voicemail and call waiting; long distance services; and data services, such as providing digital subscriber lines. We also provide access services that enable inter-exchange carriers to complete interstate and intrastate long distance calls. In addition to the services we provide, we received 24.1% of our 2003 revenue from Universal Service Fund, or USF, payments from the State of Texas and the federal government to support the high cost of providing local telephone service in rural areas.

We formed our company in 2000 in connection with the acquisition of select telephone assets from GTE Southwest Corporation, which is now part of Verizon. In January 2002, we acquired the local telephone company serving Kerrville, Texas from BA Capital Company and individual shareholders. The rural telephone businesses that we own have been operating in the markets we serve for over 75 years.

Since our inception, we have invested substantial resources to improve and expand our network infrastructure to provide high quality telecommunications services and superior customer care. This capital investment, in combination with a focused selling effort, has contributed to an increase in our revenue of $72.4 million, or 17% from 2001 through 2003. We believe that we are well positioned for future revenue and cash flow growth through both expanded service offerings and acquisitions.

We operate our business through telephone company subsidiaries that qualify as rural local exchange carriers under the Telecommunications Act of 1996. Like many rural telephone companies, our business is characterized by stable operating results, revenue and cash flow and a relatively favorable regulatory environment. In addition, we are entitled to exemptions from certain interconnection regulatory requirements. We have historically experienced less competition than regional Bell operating companies because of the low customer density and high residential component of our customer base. In Texas, where our largest customer base is located, we serve an average of 9.23 access lines per square mile, which is approximately half the national average of access lines per square mile served by other rural telephone companies. Since a majority of our customer base is located in areas that are less densely populated than areas served by other rural telephone companies, we believe that we are more insulated from competitive pressures than many other local telecommunications providers.

Our company culture values and promotes diversity among our employees and in our supplier base. We have made a strong commitment to ensuring inclusion of minority, women-owned, veteran-owned and disabled-owned enterprises in our contracts as an intelligent business strategy in view of the markets we serve. We believe that this commitment to diversity has created value for our company by increasing customer loyalty, enhancing recruitment and promotion of highly qualified employees, and helping to grow our revenue base.

Table of Contents

Our Strengths

We believe that our key strengths will enable us to continue to experience stable and growing streams of revenue and cash flows. Our principal strengths include:

Ability to Generate Consistent Cash Flows. We have increased our operating cash flow in each year since our inception. We have accomplished this by growing revenues through providing additional services to our customers, reducing expenses by improving operating efficiencies and negotiating favorable terms with our suppliers and contractors and optimizing our capital expenditures. Historically, we have been able to increase our cash flow by using excess cash to repay outstanding indebtedness and reduce our interest expense. Furthermore, rural telephone companies in general have been able to attain predictable and stable cash flow from operations due to a steady demand for telecommunications services in rural areas and public policies that support universal, affordable local telephone service.

Leading Market Position. In the markets we serve, we are the leading provider of telecommunications services. We generally face less competition from wireless providers, cable television operators and other local exchange carriers than other industry participants because competitive entry into our markets is less attractive due to the generally lower population density and primarily residential customer base. In addition, access line loss has generally been less for rural telephone companies than other industry participants due to several reasons, including fewer competitive alternatives and incomplete wireless coverage. With a lower rate of line loss, we are not required to expend as much to replace customers as some other industry participants. Furthermore, our customer base is located in areas that are generally less densely populated than areas served by other rural telephone companies, which helps insulate us from competitive pressures. These factors allow us to focus on offering additional services and provide opportunities to increase revenue per customer. We reinforce our market position by providing reliable customer service, offering a full range of voice and data services and maintaining a strong local presence in the communities we serve.

Scalable, State-of-the-Art Network Infrastructure. We invested more than $300 million since our inception in 2000 to improve and expand our network infrastructure. These initiatives have enabled us to provide additional services to our customers and improve the overall quality of our network, as demonstrated by reductions in trouble reports and service outages and our surpassing all applicable statewide regulatory service quality measures in 2003. In all our markets we have implemented a technologically advanced switching network that has the capacity to accommodate future technologies. While our competitors do offer some voice and data services in some of our markets, many providers of potentially competing platforms in our markets operate on older analog equipment and are less able to provide a reliable, high grade of voice and data services to our customers. The rural nature of our markets creates substantial costs to transport voice and Internet connectivity to central network connection points. By implementing our state-of-the-art networks, we have been able to minimize these costs and service our markets in a cost effective manner. We believe that our prior capital investment in our network, combined with our focus on the quality of our service, leaves us well positioned for future cash flow growth.

Wide Array of Integrated Services. We believe that we are the only telecommunications service provider in many of the markets we serve that has the ability to provide an integrated package of local, long distance, high-speed data and Internet access as well as a variety of enhanced services such as voicemail and caller identification. By offering a bundled package of services we have improved our long distance and enhanced services penetration, resulting in increased revenue and higher margins.

Experienced and proven management team. We have a highly experienced senior management team that has an average of over 20 years of experience in the local telecommunications industry. Our senior executives have a solid track record of managing the expansion of public telecommunications companies through both internal growth and integration of acquisitions. Our operating results demonstrate that our management team can successfully generate revenue and decrease costs while integrating and consolidating an expanding business in an evolving, regulated and increasingly competitive industry. Our management team has instilled a corporate culture that focuses on revenue opportunities, reducing costs and providing

Table of Contents

quality service. We reinforce this culture and these objectives through specifically targeted incentive bonus and employee recognition programs that motivate our employees to seek opportunities to expand our customer base, augment subscriptions for services and reduce costs. In addition, we measure performance at all levels for the purposes of these incentive programs by employing a wide range of performance tracking metrics. Upon completion of our reorganization, members of our management team will hold a significant investment in IDSs.

Business Strategy

Our business strategy is to be the leading provider of telecommunications services to the rural communities that we serve. We strive to grow our revenues, control our expenses and deploy our capital in a manner that maximizes our earnings and free cash flow. In order to achieve this goal, we have formulated the following strategy:

Increase Penetration of Higher Margin Services. We intend to capitalize on our ability to offer higher margin enhanced calling and data services as a bundled package. We have been aggressively marketing enhanced services to our customers, and we have witnessed an increasing demand for data services. The wide array of enhanced services such as voicemail and caller identification, generally produce higher margins than basic telephone service. We also offer dial-up Internet access and DSL broadband services, as well as satellite television services through a resale arrangement with a satellite operator. We believe there is significant opportunity to continue to increase our revenue per customer by cross-selling data services and enhanced services as a bundled package.

Provide Superior Service and Customer Care. We seek to build long-term customer relationships by offering a wide range of telecommunications services and consistent customer support. We believe that our service-driven customer relationship strategy leads to high levels of customer satisfaction and will lead to an increase in demand for enhanced and ancillary services. We currently provide personalized customer care through three call centers that support our business and residential customers. These call centers are located in the rural areas we serve and are staffed with customer representatives with knowledge of our local markets. We recently installed an interactive voice response system that has automated many of our customer service functions and expanded our customers ability to interact with our company 24 hours a day, 365 days a year. Customers can now receive answers to many frequently asked questions without having to speak with a customer care representative. In addition, in 2003 we surpassed all applicable statewide service quality standards imposed by the regulators in all of the states in which we operate. In each year since 2001, we have experienced a substantial year-over-year improvement in our service quality.

Improve Operating Efficiency and Profitability. We strive for greater efficiencies and improved profit margins by consolidating corporate functions, negotiating favorable terms with our suppliers and contractors and focusing capital expenditures on projects that exceed our internal rate of return thresholds. Our investment in customer service and focus on implementing a high level of customer support has substantially reduced the number of customer service calls that we receive since 2001, with a resulting reduction in related cash operating costs. These initiatives have led to increases in our profitability. In addition, our capital investments have provided us with a state-of-the-art scalable network that has resulted in a significantly decreased number of service outages and significantly reduced the number of overtime calls that our service technicians had to make since 2001. We also seek to increase our profitability by using all our excess cash to pay down the principal balance of our long-term indebtedness, and thus reducing interest expense. We consider this an important strategy because we will have approximately $ million of total debt upon the completion of this offering. This strategy generally leads to negative working capital, which as of March 31, 2004 was $59.3 million.

Pursue Selective Strategic Acquisitions. We believe that a key to the long-term growth of our business will be the successful acquisition of telecommunications assets to increase the size of our business and capitalize on the state-of-the-art network that we have built. We believe that our network infrastructure and labor force can support significant growth through strategic acquisitions. Selective acquisitions can

Table of Contents

drive growth by increasing revenue and improving profit margins through cost synergies and by expanding service offerings. Our management team has a solid track record of evaluating, purchasing and successfully integrating rural telephone company assets. We seek to acquire companies that could generate significant internal rates of return on investment and will be accretive to cash flows, as well as increase penetration, broaden our target areas and add to our offering of services.

Industry Overview

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

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

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

Families or small groups of individuals own many rural telephone companies. We believe that the owners of many of these rural telephone companies may be interested in selling such companies as the growing technical, administrative and regulatory complexities of the local telephone business challenge the capabilities of the existing management. In addition, a number of large telephone companies are selling many of their rural telephone assets to focus their attention on their major metropolitan operations that generate the bulk of their revenue. As a result, we believe that we may have opportunities to acquire additional rural telephone assets.

Our Services

We offer a wide range of high quality telecommunications and related services to residential, business and government customers and transport services to end users and other data and voice carriers. We locally manage our service offerings to serve the needs of each community effectively and efficiently. We are committed to a high standard of service and have dedicated sales and customer service representatives with local market knowledge positioned in each of the states in which we operate. Based on our understanding of our local customers needs, we offer bundled services that are designed to simplify the

Table of Contents

customer s selection and use of our services. Offering bundled services allows us to capitalize on our network infrastructure by offering a full suite of integrated communications services in voice, high-speed data, fiber transport, Internet access and long distance services, as well as enhanced services, such as voicemail and caller identification, all on one bill.

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

The following chart summarizes each component of our revenue sources (percentages are based on revenues for the three months ended March 31, 2004):

Revenue Source	Percent of Revenue	Description
Local Services	30.9%	We derive revenue from providing local exchange telephone services to both residential and business customers, including monthly recurring charges from basic services such as local dial tone and enhanced services such as caller identification, voicemail and call waiting.
Data Services	4.7%	We receive revenues from monthly recurring charges for services, including DSL, special access, private lines, Internet and other data related services.
Long Distance Services	6.9%	We receive revenues for intrastate and interstate long distance services provided to our retail users by reselling the services of wholesale long distance carriers.
Access Services	26.3%	We receive network access charges from inter-exchange carriers in connection with the completion of interstate and intrastate long-distance calls and for special access services, including dedicated circuits purchased by long distance telephone companies.
Universal Service Fund:		We receive Universal Service Fund, or USF, payments from
Texas	20.2%	the State of Texas and from the federal government to support
Federal	3.7%	the high cost of providing local telephone service in rural locations. The funds are allocated and distributed to us from pools of funds generated by surcharges on telecommunications services.
Other Services	7.3%	We generate revenues from selling telecommunications equipment, selling advertisements in directories and for billing and collecting long distance fees for other carriers, and other miscellaneous services.

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

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

Data Services. We provide Internet access services to approximately 10,000 dial-up Internet subscribers. Our dial-up Internet service provides customers, primarily residential customers, with a local dial-up number they can use to establish a connection to the Internet over their existing phone lines for a flat, monthly fee. We also provide high speed Internet access with our DSL products to 8,779 customers for a monthly fee. Currently, our network is capable of providing DSL service to 35% of our customers at downstream speeds of up to 1.5 MB per second. Our Internet access services also enable customers to establish an email account and to send and receive email.

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

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

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

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

Universal Service Fund

Texas USF. The Texas Universal Service Fund commenced payments in January 2000, pursuant to rules enacted by the Public Utility Commission of Texas, or TPUC, in 1998. It was designed to offer competitively neutral assistance so that telecommunications companies could provide basic local telecommunications services at affordable rates to customers in high cost-rural areas and to qualifying low-income and disabled customers. By order of the TPUC, the Texas USF pays eligible carriers servicing areas identified as high cost, on a per-line basis. Customers of telecommunications services in Texas fund the Texas USF through monthly surcharges on their bills.

We receive disbursements from the Texas USF in the amounts specified in the order establishing the fund payments to our predecessor, GTE Southwest, Inc. In 2003, we received $103.1 million from the Texas USF, representing 20.7% of total revenues for that year, and in the first three months of 2004, we received $25.5 million, or 20.3%, of our total revenues, from the Texas USF. The receipt of funds is dependent on the number of eligible access lines served by the company, and therefore is impacted by economic and competitive factors. If a line is removed from service, state universal service funding for that line is discontinued.

The TPUC s rules provide for a review of the Texas USF every three years. The TPUC recently completed this review, the first since the fund was established. The TPUC received comments from interested parties regarding changes to the fund, and upon review, the TPUC staff has recommended no changes to the fund at this time. The TPUC will undertake its next review in late 2005. The regulation under which the Texas USF is promulgated will become subject to review and renewal in late 2005. We expect that the Texas Legislature will renew the regulation or replace it with a regulation that does not materially change the benefits we receive under the current regulatory structure.

Federal USF Revenue. The federal USF supplements the amount of local service revenue that we receive to ensure that basic local service rates for customers in high cost rural areas are comparable to rates charged in lower cost urban and suburban areas. The federal USF, which is funded by monthly fees paid by long distance carriers and local telephone companies, distributes funds to us on a monthly basis based upon our embedded costs for providing local service. Federal USF payments represented approximately 3.4% of our revenues for the year ended December 31, 2003 and 3.6% of our revenues for the three months ended March 31, 2004. This mostly reflects the changes in the universal service support as a result of the CALLS plan that moved the implicit support from access charges and made it explicit. See Regulation Promotion of Universal Service.

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

Sales and Marketing

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

We, or our predecessors, have been serving our established markets for over 75 years. Our sales force makes direct calls to prospective and existing business customers and conducts analyses of business customers usage histories and service needs, and demonstrates how our service package will improve a customer s communications capabilities and costs. Our network engineers work closely with our various sales groups to design service products and applications, such as high-speed data and wholesale transport services, for our customers. Our technicians survey customer premises to assess building entry, power and space requirements and coordinate delivery, installation and testing of equipment.

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

Network Architecture and Technology

Our network consists of central office hosts and remote sites with advanced digital switches, primarily manufactured by Nortel, Lucent and Siemens, generally operating with the most current software. The outside plant consists of transport and distribution delivery networks connecting our host central office with remote central offices and ultimately with our customers. As of March 31, 2004, we maintained over 46,000 route miles of copper plant. Our network also includes approximately 3,700 route miles of local and long-haul fiber optic cable predominantly based in the four state area we serve. We own fiber optic cable, which has been deployed throughout our current network and is the primary transport technology between our host and remote central offices and interconnection points with other incumbent carriers. We also lease fiber optic capacity from other major carriers.

In our markets, DSL-enabled integrated access technology is being deployed to provide significant broadband capacity to our customers. We continue to remove any network impediments to ensure we can offer DSL service to as many customers as possible, however, we only equip central offices with DSL enabling equipment to the extent a demonstrated customer demand exists. As of March 31, 2004, we had invested approximately $4.5 million to deploy DSL technology, reaching over 196,000 potential broadband customers.

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

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

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

Information Technology and Support Systems

We have a full suite of proven operational support systems, or OSS, and customer care/billing systems that allow us to meet or exceed our customers expectations. Our OSS and billing systems include automated provisioning and service activation systems, mechanized line record and trouble reporting systems, inter-company provisioning and trading partner electronic data exchange systems. The bulk of these OSS and billing services are provided through the use of systems contracted or leased from ALLTEL. We employ an Internet service provider provisioning system and helpdesk database software to assist new data customers and to communicate with them when necessary. Our approach to OSS and billing systems focuses on implementing best-of-class applications that allow consistent communication and coordination throughout our entire organization. Our objective is to improve profitability by reducing individual company costs through the sharing of best practices, centralization or standardization of functions and processes, and deployment of technologies and systems that provide for greater efficiencies and profitability.

Competition

While the telecommunications industry as a whole is extremely competitive, competition has been comparatively limited for rural telephone companies because they have historically operated in markets with:

- low population densities;
- significant distance to competitive urban areas;
- relatively low business customer base;
- limited competitive commercially viable substitution alternatives; and
- reduced interconnection, resell or unbundled network element platform requirements.

These factors render uneconomic most business plans for developing a facilities-based network to compete against a rural telephone company. Nonetheless, we have experienced moderate competition from rural telephone cooperatives, edging out from the territories where they are incumbent carriers, as well as from

Table of Contents

wireless providers and other intermodal competitors, including cable television operators. In Broken Arrow, Oklahoma, where we operate approximately 64,000 access lines, Cox Communications, or Cox, a cable television operator, has requested interconnection with our network. Cox has adopted an existing Valor interconnection agreement which may indicate that Cox, which currently provides broadband services in Broken Arrow, may intend to enter into this market and offer voice telecommunications services. The interconnection agreement is pending state regulatory approval in Oklahoma. In addition, future technological changes could negatively impact our competitive position. For example, as Voice over Internet Protocol, or VoIP, develops, some wholesale customers may be able to bypass network access charges.

Properties

Our corporate headquarters are located in Irving, Texas. We lease over 67,000 square feet of office space for our headquarters in Irving pursuant to a lease that will expire in August 2010. In addition, we lease an aggregate of over 100,000 square feet with respect to three call centers in New Mexico and Texas pursuant to leases that expire at various times between June 2005 and April 2010. We own all of the other properties that are material to our business. Our other properties include maintenance facilities, rolling stock, central office and remote switching platforms and transport and distribution network facilities in the states in which we operate our business. Our administrative and maintenance facilities are generally located in or near the rural communities we serve and our central offices are often within the administrative building and outlying customer service centers. Auxiliary battery or other non-utility power sources are at each central office to provide uninterrupted service in the event of an electrical power failure. Mobile generators are located near our central offices in the event of a major power outage that continues for a long period of time. Transport and distribution network facilities include fiber optic backbone and copper wire distribution facilities, which connect customers to remote switch locations or to the central office and to points of presence or interconnection with the incumbent long distance carrier. These facilities are located on land pursuant to permits, easements, rights of way or other agreements.

Employees

As of March 31, 2004, our work force consisted of 1,469 full time employees. Approximately 984 of our employees are subject to collective bargaining agreements with the Communications Workers of America, or CWA. Most of our union employees work in our call centers and in technical positions related to the operation of our network and provision of service to our customers. Our labor agreement with the CWA, which covers our non-Kerrville employees, was renegotiated during 2002 for a three-year period that ends in February 2005. Our labor agreement with the CWA relating to employees of our Kerrville operations was renegotiated in 2003 and will expire in 2006. We believe that our relations with our employees are good.

Legal Proceedings

We are involved in various claims, legal actions and regulatory proceedings arising in the ordinary course of our business. In the opinion of our management, the resolution of these matters will not have a material adverse effect on our financial condition, results of operations or cash flows.

Table of Contents

Regulation

The following summary of the regulatory environment in which our business operates does not describe all present and proposed federal, state and local legislation and regulations affecting the telecommunications industry. Some legislation and regulations are currently the subject of judicial proceedings, legislative hearings and administrative proposals that could change the manner in which this industry operates. We cannot predict the outcome of any of these matters or their potential impact on our business. Regulation in the telecommunications industry is subject to rapid change, and any such change may have an adverse effect on us in the future. See Risk Factors Regulatory Risks and Risks Relating to Our Business.

Overview

The telecommunications services we provide and from which we derive a large majority of our revenue are subject to federal, state and local regulation. At the federal level, the FCC generally exercises jurisdiction over our facilities and services used to provide, originate, or terminate interstate or international communications. State regulators in Texas, Oklahoma, New Mexico and Arkansas exercise jurisdiction over our facilities and services used to provide, originate or terminate intrastate communications. Local governments often regulate the public rights-of-way necessary to install and operate our networks and, in some of our states, local governments may require us to enter into franchise agreements that compensate the local government for use of their rights-of-way. State and federal regulators share responsibility for implementing and enforcing the policies of the Telecommunications Act of 1996 intended to foster competition in local telecommunications services. We believe that the competition we have experienced to date in our markets has not been substantial as compared to that experienced by other local exchange carriers. Competition in our markets may increase in the future as a result of the Telecommunications Act and subsequent decisions by regulators implementing the Telecommunications Act.

Promotion of Universal Service

The universal service fund, or USF, payments we receive from the Texas and federal USF Funds are intended to support the high cost of our operations in rural markets. Texas USF support payments represented approximately 20.7% of our revenues for the year ended December 31, 2003 and 20.3% of our revenues in the three months ended March 31, 2004. In 2003, we received $16.7 million, or 3.4% of our total revenues, in federal USF support and in the first three months of 2004, we received $4.6 million, or 3.6% of our total revenues, in federal USF support. We also collect charges from our customers to support these funds.

The purpose of the TUSF is to implement a competitively neutral mechanism to assist telecommunications providers in providing basic local telecommunications services at reasonable prices to customers in high cost rural areas and to qualifying low-income and disabled customers. By order of the TPUC, the Texas USF pays eligible carriers serving areas identified as high cost, on a per-line basis. Texas USF support payments are based on actual lines in service and therefore are subject to reduction if customers discontinue service or migrate from our lines to a competitive carrier.

All customers of telecommunications services in Texas fund the Texas USF through the payment of a monthly surcharge on their bills. AT&T has challenged the TPUC rule that makes all telecommunications services offered in Texas subject to surcharge to support the Texas USF. AT&T contends that only intrastate services should be subject to surcharge to support the Texas USF. Following a lower court decision in favor of AT&T, this matter is pending decision in the appellate courts. We do not believe that the outcome of this appeal will impact the amount of Texas USF we receive.

The rules governing the Texas USF provide for a review of the Texas USF every three years starting in 1999. In September 2002, the TPUC undertook its first review. Interested parties provided the TPUC with comments on whether there should be changes made to the Texas USF. In September 2003, the TPUC staff recommended no changes be made to the Texas USF at this time. The TPUC will undertake its next review of the rules in September 2005. In addition, the Texas USF rules provide that the TPUC must open an investigation within 90 days after any changes are made to the federal USF. We do not expect any material change in the Texas USF methodology or the manner in which the amount of support we receive is calculated under our current Texas regulations.

The Texas regulatory structure under which we operate, including the enabling statute for the Texas USF, will become subject to legislative review and renewal in late 2005. The current Texas USF rules will not expire with their enabling statute in 2005, but if the enabling statute changes as part of the 2005 review, the TPUC would have to amend the Texas USF rules to comply with the statute. We believe that there is strong support of the Texas USF in its current form from a variety of constituents, and we do not believe it is likely that there will be any material change in the current USF enabling statute during the Legislative review period. However, such changes are possible and may be adverse to our revenues.

The federal USF revenue we receive helps to offset interstate access charges, defrays the high fixed switching costs in areas with fewer than 50,000 access lines and provides support where our average cost per line exceeds 115% of the national average cost per line. The amount of support we receive may be limited by the national cap on the federal USF adopted by the FCC. Funding for the federal USF comes from surcharges on interstate and international telecommunications services. Providers pass these charges through to their customers on the customers monthly bills. In May 2001, the FCC adopted a proposal to reform universal service support for rural areas. The FCC has indicated that, for the period after July 1, 2006, it will develop a comprehensive plan for high-cost support mechanisms for rural and non-rural carriers that may rely on a different cost methodology than currently is applied. We are unable to predict whether and to what extent we would be eligible to receive any federal high-cost support under such a plan. However, the federal high cost support we receive today is only one component of the federal USF support that we receive and constitutes less than one percent of our total revenues.

Federal USF payments are only available to carriers that are designated as eligible telecommunications carriers, by a state regulatory body. Competitive providers that have been granted eligible telephone carrier status are eligible to receive the same amount of universal service support per customer as the local exchange carrier serving the same area. Under current federal rules, the payment of federal universal service funds to a competitor qualifying as an eligible telephone carrier in an area served by an local exchange carrier is not intended to reduce significantly any federal universal support payable to the local exchange carrier. The FCC, however, could promulgate rules that reduce universal service support for local exchange carriers under such conditions. Currently, five competitive carriers have received eligible telephone carrier designation in our markets in Texas and New Mexico and draw support.

The FCC has requested comment on the standards for eligible telephone carrier designations, as well as whether and how it might limit USF support payments in markets where competitive eligible telephone carriers have been designated. A federal-state joint board recently made recommendations to the FCC on these issues, including creating tighter standards for eligible telephone carrier designation and limiting federal USF support to only one primary line per location. The FCC has until February 27, 2005 to act on these recommendations. We cannot predict the outcome of these proceedings. In addition, Congress may address universal service issues in legislation, but we cannot predict the occurrence, timing or effects of such legislation.

State Regulation

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

Intrastate Rate Regulation. State regulators in our states regulate the prices we charge for intrastate services, including our prices for local, intrastate long distance and intrastate access services paid by providers of intrastate long distance services. In Texas, most of our intrastate operations are subject to price caps, while regulators in Arkansas employ rate-of-return regulation to set our prices and we are regulated as a rural telephone company in Oklahoma. Our subsidiaries in New Mexico operate under an alternative regulation plan whereby prices are fixed through the term of the plan, which expires in 2006. See Management s Discussion and Analysis of Financial Condition and Results of Operations Regulatory Matters State Regulation.

Table of Contents

New Mexico Investment. In New Mexico, we operate under an Alternative Form of Regulation Plan, or Plan. Adopted in 2000, the Plan provides for a freeze on the prices of our intrastate telecommunications services during the term of the Plan, requires us to invest $83 million in capital in New Mexico during the term of the plan, provides for streamlined tariff approval process and prescribes quality of service standards, including penalties for failure to meet certain service levels. This Plan expires on March 31, 2006. As of March 31, 2004, we have invested approximately $50.9 million of the $83 million capital investment commitment. At this time, we believe that we can substantially complete our investment commitment by the end of the Plan within our current projected capital expenditures.

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

Competition. State regulators have a number of duties in implementing the Telecommunications Act of 1996, including mediating or arbitrating disputed issues in interconnection agreements, setting the prices of unbundled network elements, and designating eligible telephone carriers.

Acquisitions. Our state regulators may review sales, acquisitions or transfers of control directly involving local exchange carriers certified to provide intrastate telecommunications services within our states. Therefore, if we seek to acquire companies that provide intrastate telecommunications services, or engage in other activities by which a change in control occurs, we may have to report or seek approval of state regulators in connection with such activities. State regulators may deny, delay or impose conditions on such transactions.

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

Federal Regulation

We must comply with the Communications Act of 1934, as amended, and FCC rules which require, among other things, that we offer interstate services at just and reasonable prices and on non-discriminatory terms and conditions. The Telecommunications Act of 1996 significantly changed and is expected to continue to change the telecommunications industry.

Rural Telephone Company. The Telecommunications Act of 1996 prescribes different regulatory requirements for local exchange carriers that meet the definition of a rural telephone company. We have certified as a rural telephone company in each of the states in which we operate. A wireless carrier has challenged our certification at the FCC on two occasions, and these challenges have been pending since 2000 and 2003. We do not believe that the challenges have merit, and we do not expect the FCC to conclude we fail to meet the rural telephone company definition.

Interconnection. A central aim of the Telecommunications Act of 1996 was to open local telecommunications marketplaces to competition while enhancing universal service. Pursuant to the Telecommunications Act, most local exchange carriers have obligations to open their networks to competitors, including:

- negotiate in good faith with any carrier requesting interconnection;
- provide interconnection for the transmission and routing of telecommunications at any technically feasible point in its network on just, reasonable and nondiscriminatory rates, terms and conditions;
- provide access to unbundled network elements, such as local loops, switches and trunks, or combinations of unbundled network elements at nondiscriminatory, cost-based rates;
- offer retail local telephone services to resellers at discounted wholesale rates; and

provide physical collocation, which allows a competitor to install and maintain its network termination equipment in an local exchange carrier s central office, or to obtain functionally equivalent forms of interconnection.

Competitors are required to compensate local exchange carriers for the cost of providing these services.

Because we qualify as a rural local exchange carrier, or rural telephone company, under the Telecommunications Act, we may rely on a statutory exemption from these additional interconnection requirements until we receive a *bona fide* request for interconnection and the applicable state regulator lifts the exemption. To lift the exemption, the state regulator must find that competitive entry would not impose an undue economic burden on us, is technically feasible and will not harm universal service. We have agreed not to exercise the rural exemption in Oklahoma, where we were classified as a non-rural carrier prior to July 1, 2003. In Texas and New Mexico, we agreed to continue providing interconnection to those competitive carriers that had interconnections agreements with GTE at the time we acquired the GTE properties and we continue to provide interconnection to these carriers today. Notwithstanding these agreements, we may request suspension or modification of certain interconnection requirements in all states, including Oklahoma, by petition to the state regulator and upon the demonstration of certain statutory factors.

Since the passage of the Telecommunications Act, we have experienced a modest amount of competition from small rural telephone companies serving adjacent markets, other competitive local carriers, resellers and wireless service providers. Many of these competitors were already providing competitive services in our markets when we acquired the business in 2000. As of March 31, 2004, we had 31 interconnection agreements with 19 competitive local exchange carriers and 33 resale agreements with 22 resellers. Many of these competitors have agreements in more than one of our states, and not all of these competitors currently offer competitive local services in our markets.

In Broken Arrow, Oklahoma, Cox Communications, the cable television provider, has requested interconnection with our network. Cox adopted an existing Valor interconnection agreement which may indicate that Cox, which currently provides broadband services in Broken Arrow, may intend to offer voice telecommunications services there as well. Approval of the adopted interconnection agreement is pending decision of the Oklahoma Corporation Commission.

In its Triennial Review order released in August 2003, the FCC eliminated some of the obligations imposed on local exchange carriers under prior rules, and redefined some of the standards used to determine what parts of its network an local exchange carrier must make available to competitors. The United States Court of Appeals for the District of Columbia Circuit recently overturned significant aspects of the Triennial Review Order. Further appellate and FCC proceedings are expected.

In addition, the FCC is reexamining its pricing standard for unbundled network elements and may reconsider other aspects of its new rules. Congress may consider legislation that may modify some aspects of the Telecommunications Act or these rules. We cannot predict the outcome of any of these proceedings or of any action taken by our state regulatory commissions pursuant to the new rules.

The FCC recently ruled that we and other local exchange carriers must port our telephone numbers to requesting wireless carriers, so-called wireline-to-wireless local number portability, or LNP. Local exchange carriers operating in the country s largest urban areas were required to make LNP capability available to wireless carriers by November 24, 2003. We have LNP available to wireless carriers in our Broken Arrow exchange, which is part of the Tulsa metropolitan area. Since deploying LNP, we have had only a few requests to port one of our numbers to a wireless carrier. Rural telephone companies serving rural areas have to make LNP available to wireless carriers on May 24, 2004 or six months after a bona fide request from a wireless carrier. The FCC still has under consideration a number of technical and cost recovery issues associated with deployment of LNP.

We have received bona fide requests for LNP in some of our exchanges. We estimate that upgrading our switches to provide LNP will cost approximately $3.2 million in capital expenditures. We have filed petitions before the New Mexico Public Regulation Commission, the Oklahoma Corporation Commission, and the Texas Public Utility Commission, requesting that these regulators suspend our obligation to deploy

Table of Contents

LNP until at least March 31, 2005 in order to provide time for the FCC to issue orders on the open technical and cost recovery issues and we have stipulated implementation timetables in Oklahoma and Texas, but have not entered into any final agreement that has been approved by the appropriate regulatory body in either state. In New Mexico, we are awaiting a decision from the hearing examiner from whom we requested a one year delay.

End-User and Access Charges. The FCC regulates the prices that we charge for the use of our local telephone facilities in originating or terminating interstate telecommunications services. The FCC has structured these prices as a combination of flat monthly charges paid by the end-users and usage sensitive charges or flat rated facilities charges paid by long distance carriers, also referred to as access charges. The FCC regulates the levels of interstate access charges we charge by imposing price caps on those charges. In 2000, the FCC adopted an integrated interstate access reform and universal service framework for price cap local telephone companies called the CALLS Plan, which allowed end user rates to rise, but forced substantial decreases in access charges billed to long distance carriers. The CALLS Plan will expire in mid-2005 unless extended by the FCC.

The CALLS Plan provides for a low-end adjustment to increase prices to achieve a 10.25% annual return, if needed, to address a situation where a local telephone company s earnings drops below 10.25%. In essence, this is a protection against unreasonably low earnings. We requested and were granted low-end adjustment relief pursuant to FCC rules for our Texas study area in 2001, 2002 and 2003, and we expect to request and obtain such relief in our 2004 annual tariff filing. We also obtained a waiver in 2002 that delayed a price decrease in access charges until July 2004. We currently have pending a petition for reconsideration of an order denying our request to make the 2002 waiver permanent.

The FCC has made, and is continuing to consider, various changes to the existing access charge price structure. The FCC has sought comment on how it should change inter-carrier compensation, including interstate access charges, reciprocal compensation for local calling between competitors, and intrastate access charges. Specifically, the FCC proposed to adopt for all inter-carrier compensation a bill and keep mechanism in which carriers would exchange traffic at no charge to each other, and recover their costs from their own end users. Carrier charges would be limited to compensation for transporting traffic to another carrier s network. If implementation of such a proposal raises the prices paid by end users to the point where the prices are unaffordable, the FCC proposed that a universal service mechanism would be used to compensate a carrier for costs in excess of what could be recovered through affordable rates. The FCC stated that the proposed mechanism would not be adopted until after expiration of the CALLS plan. This matter has been pending at the FCC for three years. It is not known what kind of changes, if any, the FCC will adopt pursuant to this rulemaking, but the FCC could significantly alter inter-carrier compensation as early as 2005.

Interstate Long Distance Services. The FCC does not actively regulate the prices, terms or facilities of our interstate long distance services. However, we must comply with the general requirement that our prices and terms be just, reasonable and nondiscriminatory. Also, we must comply with FCC rules regarding unauthorized switching of a customer s long distance service provider, or slamming; the FCC has recently levied substantial fines on some carriers for slamming. In addition, our long distance carrier must post the prices, terms and conditions of its interstate service on its Internet web site and engage in other public disclosure activities.

Acquisitions. The FCC generally must approve in advance most transfers of control and assignments of operating authorizations by FCC-regulated entities. Therefore, if we seek to acquire companies that hold FCC authorizations, in most instances we will be required to seek approval from the FCC prior to completing those acquisitions. The FCC may deny, delay or impose conditions on such transactions.

Compliance and Penalties. The FCC has the authority to condition, modify, cancel, terminate or revoke operating authority for failure to comply with applicable federal laws or rules, regulations and policies of the FCC. Fines or other penalties also may be imposed for such violations.

Communications Assistance for Law Enforcement Act. Under the Communications Assistance for Law Enforcement Act, or CALEA, and related federal statutes, we are required to provide law enforcement officials with call content and call identifying information under a valid electronic surveillance warrant and to reserve a sufficient number of circuits for use by law enforcement officials in executing court-authorized electronic surveillance. We believe we are in compliance with those laws and regulations.

Local Government Authorizations

We may be required to obtain permits from municipal authorities for street opening and construction or operating franchises to install and expand fiber optic facilities in certain rural communities. Some of these franchises may require the payment of franchise fees. We have obtained such municipal franchises in some parts of Texas, Oklahoma, New Mexico and Arkansas.

Potential Internet Regulatory Obligations

In connection with our Internet access offerings, we could become subject to laws and regulations as they are adopted or applied to the Internet. To date, the FCC has treated Internet service providers, or ISPs, as enhanced service providers, rather than common carriers, and therefore ISPs are exempt from most federal and state regulation, including the requirement to pay access charges or contribute to the federal USF. As Internet services expand, federal, state and local governments may adopt rules and regulations, or apply existing laws and regulations to the Internet. The FCC is currently reviewing the appropriate regulatory framework governing broadband access to the Internet through telephone and cable television operators   communications networks. At this time, we cannot estimate what regulatory changes may occur as a result of the FCC s review, or what impact any such changes would have on our operations or revenues.

In February 2004, the FCC determined that a particular entirely Internet-based Voice over Internet Protocol, or VoIP, service is an information service and exempt from such regulatory obligations. Also in February 2004, the FCC launched a comprehensive rulemaking to determine the appropriate types of regulation, including such matters as intercarrier compensation and contributions to USF, to which ISPs offering or enabling different types of services, including VoIP, should be subject. We cannot predict the outcome of these proceedings or the effect of FCC decisions in this area on our business.

Environmental Regulations

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

Management

Executive Officers and Directors

The following table sets forth information with respect to our executive officers and directors and other key employees of Valor as of March 31, 2004.

Name	Age	Position
Anthony J. de Nicola	39	Chairman, Director
Kenneth R. Cole	56	Vice Chairman
John J. Mueller	47	Chief Executive Officer and President
John A. Butler	42	Executive Vice President Chief Financial Officer
William M. Ojile, Jr.	43	Senior Vice President Chief Legal Officer and Secretary
W. Grant Raney	43	Senior Vice President Operations, Engineering and Customer Service
Cynthia B. Nash	39	Senior Vice President and Chief Information Officer
Keith D. Terreri	39	Vice President Treasury and Corporate Development
Julie Burnett	49	Vice President Marketing
Cynthia T. Cruz	44	Vice President Corporate Communications
Randal S. Dumas	34	Vice President Accounting and Controller
Ben Muro	57	Vice President Human Resources
Sanjay Swani	37	Director
Todd Khoury	38	Director

Anthony J. de Nicola has served as a director of our company since February 2004 and as Chairman since April 2004. Mr. de Nicola is currently a general partner of Welsh, Carson, Anderson & Stowe, which is one of our existing equity holders. He joined Welsh, Carson, Anderson & Stowe in 1994 and focuses on investments in the information business services and communications industries. Before joining Welsh, Carson, Anderson & Stowe, he worked for four years in the private equity group at William Blair & Company. Previously, Mr. de Nicola worked at Goldman Sachs & Co. in the Mergers and Acquisitions Department.

Kenneth R. Cole has served as our Vice Chairman since April 2004. Prior to then, Mr. Cole served as our Chief Executive Officer from January 2002 to April 2004. Mr. Cole joined our company at its inception in January 2000 as President and Chief Operating Officer. Prior to joining our company, Mr. Cole had a 26-year career at CenturyTel, Inc., culminating in his service as Chief Operating Officer from May 1999 to January 2000.

John J. Mueller has served as our Chief Executive Officer and President since April 2004 and was previously our President and Chief Operating Officer since November 2002. Mr. Mueller joined us in April 2002 as Executive Vice President and Chief Operating Officer. Prior to joining our company, Mr. Mueller spent 23 years at Cincinnati Bell Inc. including serving as General Manager Consumer Markets from February 1999 to May 1999, President Business Units from May 1999 to November 1999 and President of the Cincinnati Bell Telephone Company from November 1999 to October 2001.

John A. Butler has served as our Executive Vice President and Chief Financial Officer since joining us in March 2000. Before joining our company, Mr. Butler served as Executive Vice President and Chief Financial Officer of Commonwealth Telephone Enterprises, Inc. starting in 1998. Prior to 1998, he was a director at First Union Capital Markets (Wachovia) in the Media and Communications Group. Mr. Butler has over 18 years of experience in the finance and telecommunications industries. Mr. Butler began his career at Arthur Andersen & Co. and is a licensed, certified public accountant.

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

W. Grant Raney has served as our Senior Vice President Operations and Engineering since January 2001. In February 2000, Mr. Raney joined our company as Vice President Operations. Prior to joining our company, from March 1999 to February 2000, Mr. Raney was Division Vice President at Spectra Communications Group, a partnership of CenturyTel, Inc. Starting March 1979 at CenturyTel, Mr. Raney has gained 25 years of experience in the telecommunications industry in a variety of roles of increasing responsibility.

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

Keith D. Terreri has served as our Vice President Treasury and Corporate Department since July 2001. Prior to joining our company, Mr. Terreri was Vice President and Treasurer of RCN Corporation from December 1999 to June 2001 and Director of Finance from January 1998 to December 1999. Mr. Terreri has over 6 years experience in the telecommunications industry. Mr. Terreri began his career at Deloitte & Touche LLP and is a certified public accountant.

Julie Burnett has served as our Vice President Marketing since May 2002. Prior to that, she served as our Vice President Long Distance and Emerging Markets starting in April 2000. Prior to joining our company, Ms. Burnett worked at CenturyTel, Inc. starting in 1979, where, from November 1999 until joining our company, she was Vice President Long Distance Operations.

Cynthia T. Cruz has served as our Vice President Corporate Communications since June 2000. Prior to joining our company, Ms. Cruz was Senior Manager, Public Affairs, for Levi Strauss & Company from 1998 to 2000.

Randal S. Dumas has served as our Vice President Controller since July 2003. He joined our company in January 2001 as Director Accounting, and he added the responsibility of Controller in June 2002. Prior to joining our company, Mr. Dumas worked for Citizens Communications starting in 1994, where he was Revenue Accounting Manager from January 1997 to January 2000, Director of General Accounting from January to June 2000 and Director of Financial Operations from June 2000 until January 2001. Mr. Dumas is a certified public accountant.

Ben Muro has served as our Vice President Human Resources since February 2000. Prior to joining our company, Mr. Muro was Senior Vice President of Human Resources for Parkland Health and Hospital System in Dallas from March 1991 to February 2000.

Sanjay Swani has served as a director of our company since February 2004. Mr. Swani is currently a general partner of Welsh, Carson, Anderson & Stowe, which is one of our existing equity holders. He joined Welsh, Carson, Anderson & Stowe in 1999 and focuses on investments in the information business services and communications industries. Previously, he was a director of Fox Paine & Company, a San Francisco-based private equity firm. Mr. Swani also spent four years in the Mergers, Acquisitions & Restructuring Department and two years in the Debt Capital Markets Department of Morgan Stanley Dean Witter & Co.

Todd Khoury has served as a director of our company since February 2004. Mr. Khoury is currently a managing director of Vestar Capital Partners, which is one of our existing equity holders. Prior to joining Vestar in 1993, Mr. Khoury joined Vestar in 1993. Previously, he was a member of the Corporate Finance Group of Salomon Brothers Inc.

Table of Contents

Our board of directors will consist of at least members. Within one year of the consummation of this offering, a majority of our board of directors will be independent. The term of office for each director will be until his successor is elected or appointed, with elections for each directorship being held annually.

Board Committees

Prior to the consummation of this offering, we intend to establish an audit committee, a nominating committee, a compensation committee and a pension committee. Each committee will consist of three persons, at least one of whom is not an employee of, and has no business relationships with, Valor. Within one year of the consummation of this offering, all the members of our audit committee, nominating committee and compensation committee will be independent as defined by the rules of the New York Stock Exchange.

The audit committee will be responsible for reviewing our internal accounting procedures and consulting with and reviewing the services provided by our independent accountants. The nominating committee will evaluate the qualifications of potential nominees to our board of directors and make recommendations to the board as to which candidates should be nominated for election to our board of directors. The compensation committee will be responsible for reviewing and recommending to the board of directors the compensation and benefits of all our officers and directors, including stock compensation and loans and establishing and reviewing general policies relating to the compensation and benefits of our employees. The pension committee will be responsible for reviewing the quality of services provided by our pension and savings plan advisors and administrators.

Compensation Committee Interlocks and Insider Participation

The current compensation of our executive officers was determined by the compensation committee of Valor Telecommunications Southwest, LLC. Prior to the consummation of this offering, we plan to form a compensation committee of our board of directors to oversee executive compensation issues. We anticipate that no member of our compensation committee will serve as a member of the board of directors or compensation committee of an entity that has one or more executive officers serving as a member of our board of directors or compensation committee.

Director Compensation

Non-employee members of our board of directors will receive compensation for their services as directors of $ per meeting of the board of directors that they attend. Directors will also be reimbursed for out-of-pocket expenses for attending board and committee meetings.

Limitations on Directors Liability and Indemnification

Our amended and restated certificate of incorporation limits the liability of directors to the maximum extent permitted by Delaware law. Delaware law provides that directors of a corporation will not be personally liable for monetary damages for breach of their fiduciary duties as directors, except liability for:

- any breach of their duty of loyalty to the corporation or its stockholders;
- acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law;
- unlawful payments of dividends or unlawful stock repurchases or redemptions; or
- any transaction from which the director derived an improper personal benefit.

The limitation of liability does not apply to liabilities arising under the federal securities laws and does not affect the availability of equitable remedies such as injunctive relief or rescission.

Our amended and restated certificate of incorporation provide that we will indemnify our directors and officers and may indemnify our employees and other agents to the fullest extent permitted by law. We believe that indemnification under our amended and restated certificate of incorporation covers at least

Table of Contents

negligence and gross negligence on the part of indemnified parties. Our amended and restated certificate of incorporation also permit us to secure insurance on behalf of any officer, director, employee or other agent for any liability arising out of his or her actions in his or her capacity as an officer, director, employee or other agent.

The limited liability and indemnification provisions in our amended and restated certificate of incorporation may discourage stockholders from bringing a lawsuit against our directors for breach of their fiduciary duty and may reduce the likelihood of derivative litigation against our directors and officers, even though a derivative action, if successful, might otherwise benefit us and our stockholders. A stockholder s investment in us may be adversely affected to the extent we pay the costs of settlement or damage awards against our directors and officers under these indemnification provisions.

At present, there is no pending litigation or proceeding involving any of our directors, officers or employees in which indemnification is sought, nor are we aware of any threatened litigation that may result in claims for indemnification.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted for directors, officers and controlling persons of us pursuant to the foregoing provisions or otherwise, we have been advised that in the opinion of the Securities and Exchange Commission, or SEC, such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable.

Table of Contents

Executive Compensation

Summary Compensation Table. The following table sets forth the compensation earned, awarded or paid for services rendered to us in all capacities for the fiscal year ended December 31, 2003, by our Chief Executive Officer and our four next most highly compensated executive officers who earned more than $100,000 in salary and bonus during the fiscal year ended December 31, 2003, to whom we refer in this prospectus collectively as the named executive officers:

Summary Compensation Table

		Annual Compensation		Long-Term Compensation	
	Fiscal Year	Salary	Bonus	Securities Underlying Options(2)	All Other Compensation
Kenneth R. Cole Vice Chairman(1)	2003	$525,000	$800,000		$30,761(3)
John J. Mueller Chief Executive Officer and President	2003	$325,000	$550,000		$28,238(4)
John A. Butler Executive Vice President and Chief Financial Officer	2003	$284,625	$482,000	200,000	$22,004(5)
W. Grant Raney Senior Vice President of Operations, Engineering and Customer Service	2003	$232,875	$279,279	150,000	$18,580(6)
William M. Ojile, Jr. Senior Vice President, Chief Legal Officer and Secretary	2003	$207,000	$225,138		$22,169(7)

(1) Mr. Cole served as our Chief Executive Officer from January 2002 through April 2004.

(2) Represents options to purchase equity interests of Valor Telecommunications Southwest LLC, or VTS, under VTS s 2000 Equity Incentive Non-Qualifying Option Plan. To the extent that the value of the option exceeds the strike price, these options may be exchanged for as part of our reorganization.

(3) Consists of $20,003 of insurance premiums ($7,365 for medical insurance; $7,623 for life insurance; and $5,015 for Long-Term Disability), $1,758 for related medical exams, and a $9,000 company contribution to our 401(k) plan.

(4) Consists of $16,905 of insurance premiums ($8,046 for medical insurance; $1,649 for life insurance; and $7,210 for Long-Term Disability), $2,333 for related medical exams, and a $9,000 company contribution to our 401(k) plan.

(5) Consists of $10,839 of insurance premiums ($7,364 for medical insurance; $1,260 for life insurance; and $2,215 for Long-Term Disability), $2,165 for related medical exams, and a $9,000 company contribution to our 401(k) plan.

(6) Consists of $7,141 of insurance premiums ($5,064 for medical insurance; $1,033 for life insurance; and $1,044 for Long-Term Disability), $2,439 for related medical exams, and a $9,000 company contribution to our 401(k) plan.

(7) Consists of $10,710 of insurance premiums ($8,043 for medical insurance; $808 for life insurance; and $1,859 for Long-Term Disability), $2,459 for related medical exams, and a $9,000 company contribution to our 401(k) plan.

Table of Contents

Employment and Severance Agreements

We have entered into employment, confidentiality and non-competition agreements with Messrs. Cole, Mueller, Butler, Ojile and Raney, the material terms of which are discussed below. We also have agreements with other key employees at the director level and above that provide for an agreement not to compete with us for a maximum period of up to twelve months, in return for the payment of severance benefits for involuntary termination without cause.

Agreement with Kenneth R. Cole. We entered into an agreement with Kenneth C. Cole that will remain in effect until March 31, 2007 pursuant to which Mr. Cole will receive an annual base salary of $300,000, medical and other benefits. Mr. Cole shall devote at least 25% of his professional time, efforts and attention to the duties outlined in the agreement, including serving as Vice Chairman of our company.

In connection with this offering, we entered into a letter agreement with Mr. Cole on April 9, 2004 pursuant to which Mr. Cole received a one-time transition bonus of $5.0 million. Furthermore, Mr. Cole shall also receive a one-time cash payment of $1.5 million if we consummate this offering on or before April 9, 2005.

Agreement with John J. Mueller. We entered into an employment agreement with John J. Mueller on April 9, 2004 that will remain in effect until the later of March 31, 2007 or the second anniversary of the completion of this offering and can be renewed for successive one year periods thereafter. Mr. Mueller currently receives an annual base salary of $500,000, an annual incentive bonus and medical and other benefits. Mr. Mueller s annual bonus is targeted to be one times his base salary for the appropriate year. For the year ended December 31, 2003, Mr. Mueller received a bonus of $550,000.

If we terminate Mr. Mueller s employment without cause or if he resigns for Good Reason, as such term is defined in his employment agreement, he will be entitled to receive severance benefits consisting of his annual base salary and continued medical and other benefits for one year following the date of his termination, plus the full amount of his target bonus for the year in which his employment terminates and life insurance and medical benefits for various periods. Mr. Mueller s employment agreement provides that he will be restricted from engaging in competitive activities for one year after the termination of his employment although this restriction may be extended for an additional twelve months under certain circumstances.

Agreement with John A. Butler. We entered into an employment agreement with John A. Butler in 2000. The agreement provides for automatic one-year extensions of the employment term unless either party provides written notice of its intention not to review the agreement within 90 days of the expiration of the then current term. Mr. Butler currently receives an annual base salary of $315,000, an annual incentive bonus and medical and other benefits. Mr. Butler s annual bonus is targeted to be one-half his base salary for the appropriate year. For the year ended December 31, 2003, Mr. Butler received a bonus of $482,000.

If we terminate Mr. Butler s employment without cause or if he resigns for Good Reason, as such term is defined in his employment agreement, he will be entitled to receive severance benefits consisting of his annual base salary and continued medical and other benefits for one year following the date of his termination, plus the pro rata portion of the annual bonus he would have received had he been employed by our company for the full fiscal year. Mr. Butler s employment agreement provides that he will be restricted from engaging in competitive activities for one year after the termination of his employment. Mr. Butler may not solicit employees for one year following termination of his employment with our company.

Agreement with William M. Ojile, Jr. We entered into an employment agreement with William M. Ojile in 2000. The agreement provides for automatic one-year extensions of the employment term unless either party provides written notice of its intention not to review the agreement within 90 days of the expiration of the then current term. Mr. Ojile currently receives an annual base salary of $250,000, an annual incentive bonus and medical and other benefits. Mr. Ojile s annual bonus is targeted to be one-half his base salary for the appropriate year. For the year ended December 31, 2003, Mr. Ojile received a bonus of $225,138.

Table of Contents

If we terminate Mr. Ojile s employment without cause or if he resigns for Good Reason, as such term is defined in his employment agreement, he will be entitled to receive severance benefits consisting of his annual base salary and continued medical and other benefits for one year following the date of his termination, plus the pro rata portion of the annual bonus he would have received had he been employed by our company for the full fiscal year. Mr. Ojile s employment agreement provides that he will be restricted from engaging in competitive activities for one year after the termination of his employment. Mr. Ojile may not solicit employees for one year following termination of his employment with our company.

Agreement with W. Grant Raney. We entered into an employment agreement with W. Grant Raney in 2000. The agreement provides for automatic one-year extensions of the employment term unless either party provides written notice of its intention not to review the agreement within 90 days of the expiration of the then current term. Mr. Raney currently receives an annual base salary of $257,000, an annual incentive bonus and medical and other benefits. Mr. Raney s annual bonus is targeted to be one-half his base salary for the appropriate year. For the year ended December 31, 2003, Mr. Raney received a bonus of $279,279.

Under certain circumstances, the termination of Mr. Raney s employment with our company will entitle him to receive severance benefits consisting of his annual base salary and continued medical and other benefits for one year following the date of his termination, plus the pro rata portion of the annual bonus he would have received had he been employed by our company for the full fiscal year. Mr. Raney s employment agreement provides that he will be restricted from engaging in competitive activities for one year after the termination of his employment. Mr. Raney may not solicit employees for one year following termination of his employment with our company.

Transaction Bonus

Upon the consummation of this offering, we will award to members of our senior management team in recognition of their efforts in connection with our reorganization and this offering. The awards will be as follows: Kenneth R. Cole, $1.5 million; John J. Mueller, $1.0 million; John A. Butler, ; William M. Ojile, ; W. Grant Raney, ; Cynthia B. Nash and an aggregate of to other members of our management team. See Related Party Transactions.

Bonus and Incentive Plans

Long-Term Incentive Plan. Our officers, other senior executives and other key employees to be identified by the compensation committee of our board of directors will be eligible to participate in the Long-Term Incentive Plan, or the LTIP. The purpose of the LTIP will be to attract, retain, motivate and reward executives and key employees by making a significant portion of their incentive compensation directly dependent upon achieving key strategic, financial and operational objectives that are critical to our ongoing growth and profitability. The LTIP will be administered by our compensation committee, which shall also have the power to amend or terminate the LTIP at any time.

The LTIP will provide for cash payments out of an incentive pool that may be earned by and paid to selected participants based on the achievement, over multiple-year performance periods, of objective performance goals established by our compensation committee and based on certain minimum and maximum target amounts that a participant may earn through the allocation of the incentive pool, as well as require that the participants remain employed with us for some period of time in order to vest in such amounts. The performance goals will have the effect of aligning the interests of management with those of the holders of IDSs.

We intend for the LTIP to be a performance-based compensation arrangement within the meaning of Section 162(m) of the Internal Revenue Code, in order to ensure the full deductibility of all payments made under the LTIP to our executive officers and other key employees whose compensation could otherwise be subject to the limitations on deductibility under Section 162(m).

Table of Contents

Annual Incentive Compensation Plan. We maintain an incentive compensation plan whereby certain management and supervisory personnel qualify for incentive payments if our company and executives both meet or exceed certain financial performance targets.

Individual awards are paid to participants in lump sum payments within 60 days following the end of the fiscal year, subject to withholding of applicable federal, state and local taxes. Individual awards are paid annually but we may choose to make semi-annual payments if we are meeting or exceeding financial objectives and the outlook for the remaining half of the year is favorable. Participants may also qualify for a separate mid-year award at our management s discretion. Our chief executive officer, in consultation with the board of directors, may adjust or eliminate any incentive payment that would otherwise be earned under the incentive compensation plan based on such factors as they may determine in their sole discretion. Our chief executive officer, in consultation with the board of directors, may also amend or cancel the bonus plan at any time for any reason.

In January 2004, our chief executive officer, with the approval of our compensation committee, authorized bonus amounts for fiscal year 2003 for members of our management team eligible to participate in the incentive compensation plan that qualified for payment.

Savings Plan. We sponsor the Valor Telecommunications Southwest, LLC Savings Plan, a tax qualified plan in which our eligible employees may participate. Subject to certain limitations, participants in our 401(k) plan may elect to make pre-tax contributions up to 16% of their annual base salary each year. At our discretion, we make matching contributions equal to a percentage of a participant s contributions. Matching contributions fully vest after two years of employment with our company.

Pension Plan. We also sponsor the Valor Telecommunications Enterprises, LLC Pension Plan, a defined benefit plan, in which qualified employees may participate. This plan is offered only to union employees and is not available for management. Former employees of GTE Southwest Corporation, or GTE, who participated in the pension plan of GTE and became our employees upon our acquisition of assets from GTE also participate in our pension plan. We contribute the full cost of the pension plan to a pension trust fund. The average annual compensation and accredited service determines the amount of payments an employee receives under the pension plan.

Table of Contents

Principal and Selling Stockholders

The following table shows information regarding the beneficial ownership of shares of our Class A common stock and Class B common stock immediately prior to completion of this offering and shows the number of and percentage owned by:

each person who is known by us to own beneficially more than 5% of our capital stock;

each person who will sell IDSs in the offering if the underwriters exercise their over-allotment option;

each member of our board of directors;

each of our named executive officers;

each of our nominees to our board of directors; and

all members of our board of directors and our executive officers as a group.

Both prior to and after completion of this offering, there will be no shares of Class C common stock outstanding. Except as indicated in the footnotes to this table (1) each person has sole voting and investment power with respect to all shares attributable to such person and (2) each person s address is c/o Valor Communications Group, Inc., 201 E. John Carpenter Freeway, Suite 200, Irving, Texas 75062.

	Shares Beneficially Owned				**Shares Offered Hereby(2)**		**Shares Beneficially Owned Following this Offering(2)**			
	Class A		**Class B**				**Class A**		**Class B**	
	Number	**Percent(1)**	**Number**	**Percent(1)**	**Class A**	**Class B**	**Number**	**Percent(3)**	**Number**	**Percent(3)**
Welsh, Carson, Anderson & Stowe(4)										
Vestar Capital Partners(5)										
Citicorp Venture Capital(6)										
Kenneth R. Cole										
John J. Mueller										
John A. Butler										
William M. Ojile, Jr.										
W. Grant Raney										
Anthony J. de Nicola(7)										
Sanjay Swani(7)										
Todd Khoury(8)										
All directors and executive officers as a group (9 persons)										

(1) The respective percentages of beneficial ownership are based on shares of Class A common stock and shares of Class B common stock outstanding immediately prior to the completion of the offering.

(2) The selling stockholders shall sell shares of common stock in connection with this offering only to the extent the underwriters exercise the over-allotment.

(3) The respective percentages of beneficial ownership are based on shares of Class A common stock and shares of Class B common stock as of the completion of this offering.

(4) Shares are held by the following affiliates of Welsh, Carson, Anderson & Stowe: SCD Sharing Partnership, LP, SCE Sharing Partnership, L.P. and WCA Management Corporation. Welsh, Carson, Anderson & Stowe disclaims beneficial ownership of such shares. WCAS VIII

Associates LLC, a limited liability company and affiliate of Welsh, Carson, Anderson & Stowe, exercises voting and investment control over the shares held by SCD Sharing Partnership, LP as general partner Voting and investment control over the shares held by WCAS VIII Associates LLC. is determined by an affirmative vote of two thirds of its managing members. The shareholders of WCA Management Corporation exercise voting and investment control over the shares held by WCA Management Corporation. As members of WCAS VIII Associates LLC, Mr. de Nicola and Mr. Swani may be deemed to share beneficial ownership of the shares held by WCAS VIII Associates LLC. Mr. de Nicola and Mr. Swani disclaim beneficial ownership of such shares. The address of Welsh, Carson, Anderson & Stowe is 320 Park Avenue, Suite 2500, New York, NY 10022.

(5) Shares are held by the following affiliates of Vestar Capital Partners: Vestar Capital Partners III, L.P., Vestar Capital Partners IV, L.P. and Vestar/ Valor LLC. Vestar Capital Partners disclaims beneficial ownership of such shares. Vestar Capital Partners III, L.P. is a limited partnership, the general partner of which is Vestar Associates III, L.P. As general partner of Vestar Associates III, L.P., Vestar Associates Corporation III, a corporation affiliated with Vestar Capital Partners, exercises voting and investment control over shares held by Vestar Capital Partners III, L.P. Vestar Capital Partners IV, L.P. is a limited partnership, the general partner of which is Vestar Associates IV, L.P. As general partner of Vestar Associates IV, L.P., Vestar Associates Corporation IV, a corporation and affiliate of Vestar Capital Partners, exercises voting and investment control over shares held by Vestar Capital Partners IV, L.P. Vestar/ Valor LLC is a limited liability company, the managing

member of which is Vestar Capital Partners IV, LP. As general partner of Vestar Associates IV, LP, Vestar Associates Corporation IVexercises voting and investment control over the shares held by Vestar/ Valor LLC. The address of Vestar Capital Partners is 245 Park Avenue, 41st Floor, New York, NY 10167.

(6) Shares are held by the following affiliates of Citicorp Venture Capital: Citicorp Venture Capital Ltd and CCT Partners VI, L.P. Citicorp Venture Capital disclaims beneficial ownership of such shares. The address of Citicorp Venture Capital is 299 Park Avenue, New York, NY 10022.

(7) As members of WCAS VIII Associates LLC, Mr. de Nicola and Mr. Swani may be deemed to share beneficial ownership of the shares held by WCAS VIII Associates LLC. Mr. de Nicola and Mr. Swani disclaim beneficial ownership of such shares and any shares held by affiliates of Welsh, Carson, Anderson & Stowe.

(8) As a member of Vestar Associates Corporation III, Mr. Khoury may be deemed to share beneficial ownership of the shares held by Vestar Associates Corporation III. Mr. Khoury disclaims beneficial ownership of such shares and any shares held by affiliates of Vestar Capital Partners.

Related Party Transactions

Equity Sponsors

Repurchase of Existing Subordinated Notes with Proceeds from this Offering. On July 1, 2000 and September 1, 2000 we issued senior subordinated notes to our existing equity investors in order to finance the acquisition of our business from GTE Southwestern Corporation (now Verizon). The notes mature on August 31, 2010 and accrue interest at a rate of 10.0% per annum. Upon the consummation of this offering, we will repay the $314.3 aggregate amount of principal and interest outstanding on the subordinated notes held by affiliates of Welsh, Carson, Anderson & Stowe, or WCAS, Vestar Capital Partners, or Vestar, and Citicorp Venture Capital, or CVC. In connection with the repayment of the subordinated notes, WCAS will receive $ million, Vestar will receive $ million and CVC will receive $ million of the proceeds from this offering. Anthony J. de Nicola and Sanjay Swani, two members of our board of directors, may receive or be deemed to have received a portion of WCAS proceeds by virtue of their affiliation with WCAS. In addition, Todd N. Khoury, a member of our board of directors, may receive or be deemed to have received a portion of the Vestar proceeds by virtue of his affiliation with Vestar.

Management Fees. Pursuant to the limited liability company operating agreement of our subsidiary, Valor Telecommunications, LLC, or VTC, each of WCAS and Vestar provides management services to us. In return for these services we paid management fees of $571,430 to an affiliate of WCAS in each of 2000, 2001, 2002 and 2003, and $428,570 to an affiliate of Vestar in each of fiscal 2000, 2001, 2002 and 2003. For the first three months of 2004, we accrued an aggregate of $250,000 of management fees payable to WCAS and Vestar. We will cease paying these fees upon the closing of the offering. We also paid a transaction fee of $714,288 to an affiliate of WCAS and a $535,713 transaction fee to an affiliate of Vestar in connection with our acquisition of Kerville Communications Corporation in 2002. In addition, we will pay $ in the aggregate to affiliates of WCAS and to affiliates of Vestar in professional fees and expenses associated with our redemption of existing indebtedness.

Investor Rights Agreement. We will enter into an investor rights agreement with our existing equity investors which, subject to the following conditions, allows them to cause us to exchange with a transferee of their shares of Class B common stock, such Class B common stock for IDSs:

- we must be permitted by the indenture to issue the additional notes to be included in such IDSs, which requires, among other things, that:
  - no event of default or deferral of interest on the senior subordinated notes has occurred and is continuing;
  - we have obtained a solvency opinion from an independent appraisal firm; and
  - our board of directors has determined that such new notes should be treated as debt for United States federal income tax purposes;
- such transaction must comply with applicable laws, including, without limitation, securities laws, laws relating to redemption of equity and laws relating to the issuance of debt;
- such issuance of IDSs must occur pursuant to an effective registration statement;
- such transaction must not conflict with or cause a default under any material financing agreements; and
- we must have received at least 30 but not more than 60 days notice of such transaction.

In addition to the conditions above, we will only be required to effect conversions of the Class B common stock at intervals of six months beginning with the second anniversary of the date of the recapitalization, unless % of the holders of the Class B common stock request a conversion with respect to % of

Table of Contents

their shares of Class B common stock. In the event of such request, we will provide notice to all the holders of the Class B common stock of our receipt of such request through a release to any appropriate and customary news agency and, subject to the conditions above, effect the conversion within days of such request. See Related Party Transactions.

In the event that the IDSs are automatically separated as a result of the continuance of a payment default on the senior subordinated notes for 90 days, or the redemption or maturity of any senior subordinated notes, at such time we will amend our bylaws to delete the restriction that we may only issue shares of Class A common stock in offerings registered with the Securities and Exchange Commission and each share of Class B common stock will automatically be exchanged for one share of Class A common stock and one senior subordinated note.

In addition, the investor rights agreement will contain the following registration rights:

- our existing equity investors will collectively have demand registration rights relating to the IDSs into which shares of our Class B common stock may be exchanged, as well as the shares of our Class A common stock and senior subordinated notes represented by the IDSs subject to the requirement that the securities covered by each demand registration have an aggregate public offering price of at least $ million if registered pursuant to a long-form registration statement, or $ million if registered pursuant to a short-form registration statement; provided that an existing equity investor must beneficially own more than twenty percent of our outstanding shares of Class A common stock, senior subordinated notes, or IDSs, as the case may be, to initiate a demand for registration; provided, further, that an existing equity investor may exercise a demand right for less than an aggregate public offering price of $ million if registered pursuant to a long-form registration statement, or $ million if registered pursuant to a short-form registration statement; if such proposed offering is for all of the remaining shares of Class A common stock, senior subordinated notes or IDSs held by the existing equity investor; and

- the existing equity investors and certain other existing equity investors will have the right to include in our future public offerings of securities the shares of our Class A common stock, senior subordinated notes or IDSs held by each of them as well as the IDSs into which shares of Class B common stock may be exchanged.

The existing equity investors may only require the listing of the Class A common stock in connection with an exercise of their demand registration rights with respect to their Class A common stock once our Class A common stock is listed on the New York Stock Exchange. If the existing equity investors exercise their demand registration rights, we will file a registration statement or prospectus and undertake an offering in the United States and Canada, as requested by the equity sponsors. The registration rights are transferable by the existing equity investors and certain other existing equity investors.

We have agreed to pay all costs and expenses in connection with each such registration, except underwriting discounts and commissions applicable to the securities sold, and to indemnify the equity sponsors and certain other existing equity investors that have included securities in such offering against certain liabilities, including liabilities under the Securities Act and any Canadian securities laws.

Furthermore,