

FRONTIER COMMUNICATIONS CORP

Form 10-Q

May 08, 2014

FRONTIER COMMUNICATIONS CORPORATION

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2014

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2014

or

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

For the transition period from _____ to _____

Commission file number: 001-11001

FRONTIER COMMUNICATIONS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

3 High Ridge Park
Stamford, Connecticut

06-0619596
(I.R.S. Employer Identification No.)

06905

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(Address of principal executive offices) (Zip Code)

(203) 614-5600

(Registrant's telephone number, including area code)

N/A

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares outstanding of the registrant's Common Stock as of May 2, 2014 was 1,002,282,000.

FRONTIER COMMUNICATIONS CORPORATION AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

FRONTIER COMMUNICATIONS CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(\$ in thousands)

	(Unaudited) March 31, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 954,241	\$ 880,039
Accounts receivable, less allowances of \$70,094 and \$71,362, respectively	463,081	479,210
Restricted cash	11,412	11,411
Prepaid expenses	62,547	68,573
Income taxes and other current assets	108,133	179,606
Total current assets	1,599,414	1,618,839
Restricted cash	2,000	2,000
Property, plant and equipment, net	7,190,258	7,255,762
Goodwill	6,337,719	6,337,719
Other intangibles, net	1,139,041	1,214,932
Other assets	200,442	206,232
Total assets	\$ 16,468,874	\$ 16,635,484
LIABILITIES AND EQUITY		
Current liabilities:		
Long-term debt due within one year	\$ 365,625	\$ 257,916
Accounts payable	218,022	327,256
Advanced billings	135,246	137,319
Accrued other taxes	81,076	66,276
Accrued interest	202,324	188,639
Other current liabilities	329,583	324,181
Total current liabilities	1,331,876	1,301,587

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Deferred income taxes	2,396,448	2,417,108
Pension and other postretirement benefits	713,777	725,333
Other liabilities	266,429	262,308
Long-term debt	7,762,672	7,873,667
Equity:		
Common stock, \$0.25 par value (1,750,000,000 authorized shares, 1,002,281,000 and 999,462,000 outstanding, respectively, and 1,027,986,000 issued, at March 31, 2014 and December 31, 2013)	256,997	256,997
Additional paid-in capital	4,181,483	4,321,056
Retained earnings	115,382	76,108
Accumulated other comprehensive loss, net of tax	(257,491)	(260,530)
Treasury stock	(298,699)	(338,150)
Total equity	3,997,672	4,055,481
Total liabilities and equity	\$ 16,468,874	\$ 16,635,484

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

PART I. FINANCIAL INFORMATION (Continued)

FRONTIER COMMUNICATIONS CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE THREE MONTHS ENDED MARCH 31, 2014 AND 2013

(\$ in thousands, except for per-share amounts)

(Unaudited)

	2014	2013
Revenue	\$ 1,154,046	\$ 1,205,396
Operating expenses:		
Network access expenses	107,092	109,398
Other operating expenses	528,926	541,499
Depreciation and amortization	281,407	303,675
Acquisition and integration costs	10,596	-
Total operating expenses	928,021	954,572
Operating income	226,025	250,824
Investment and other income, net	1,395	4,654
Interest expense	170,957	171,420
Income before income taxes	56,463	84,058
Income tax expense	17,189	33,275
Net income	39,274	50,783
Less: Income attributable to the noncontrolling interest in a partnership	-	2,643
Net income attributable to common shareholders of Frontier	\$ 39,274	\$ 48,140
Basic and diluted net income per common share attributable to common shareholders of Frontier	\$ 0.04	\$ 0.05

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

FOR THE THREE MONTHS ENDED MARCH 31, 2014 AND 2013

(\$ in thousands)

(Unaudited)

	2014	2013
Net income	\$ 39,274	\$ 50,783
Other comprehensive income, net of tax (see Note 13)	3,039	6,746
Comprehensive income	42,313	57,529
Less: Income attributable to the noncontrolling interest in a partnership	-	(2,643)
Comprehensive income attributable to the common shareholders of Frontier	\$ 42,313	\$ 54,886

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

PART I. FINANCIAL INFORMATION (Continued)

FRONTIER COMMUNICATIONS CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EQUITY

FOR THE THREE MONTHS ENDED MARCH 31, 2013, THE NINE MONTHS ENDED DECEMBER 31, 2013
AND THE THREE MONTHS ENDED MARCH 31, 2014

(\$ and shares in thousands)

(Unaudited)

	Shareholders' Equity of Frontier				Accumulated Other Comprehensive Loss	Treasury Stock Shares	Treasury Stock Amount	Noncontrolling Interest	Total Equity
	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings					
Balance									
January 1, 2013	1,027,986	\$ 256,997	\$ 4,639,563	\$ 63,205	\$ (483,576)	(29,576)	\$ (368,593)	\$ 11,675	\$ 4,119,700
Stock plans	-	-	(3,094)	-	-	(279)	2,888	-	(206)
Dividends on common stock	-	-	(99,812)	-	-	-	-	-	(99,812)
Net income	-	-	-	48,140	-	-	-	2,643	50,783
Other comprehensive income, net of tax	-	-	-	-	6,746	-	-	-	6,746
Distributions	-	-	-	-	-	-	-	(6,400)	(6,400)
Balance March 31, 2013	1,027,986	256,997	4,536,657	111,345	(476,830)	(29,855)	(365,705)	7,918	4,070,000
Stock plans	-	-	(15,577)	-	-	1,331	27,555	-	11,979
Dividends on common stock	-	-	(200,024)	(99,932)	-	-	-	-	(299,956)
Net income	-	-	-	64,695	-	-	-	-	64,695
Pension settlement costs, net of tax	-	-	-	-	27,381	-	-	-	27,381

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Other comprehensive income, net of tax	-	-	-	-	188,919	-	-	-	188,919
Distributions	-	-	-	-	-	-	-	-	-
Sale of Mohave partnership interest	-	-	-	-	-	-	-	(7,918)	(7,918)
Balance December 31, 2013	1,027,986	256,997	4,321,056	76,108	(260,530)	(28,524)	(338,150)	-	4,055,937
Stock plans	-	-	(39,345)	-	-	2,819	39,451	-	106
Dividends on common stock	-	-	(100,228)	-	-	-	-	-	(100,228)
Net income	-	-	-	39,274	-	-	-	-	39,274
Other comprehensive income, net of tax	-	-	-	-	3,039	-	-	-	3,039
Balance March 31, 2014	1,027,986	\$ 256,997	\$ 4,181,483	\$ 115,382	\$ (257,491)	(25,705)	\$ (298,699)	\$ -	\$ 3,997,000

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

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PART I. FINANCIAL INFORMATION (Continued)

FRONTIER COMMUNICATIONS CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE THREE MONTHS ENDED MARCH 31, 2014 AND 2013

(\$ in thousands)

(Unaudited)

	2014	2013
Cash flows provided by (used in) operating activities:		
Net income	\$ 39,274	\$ 50,783
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	281,407	303,675
Pension/OPEB costs	3,053	5,018
Stock based compensation expense	6,151	3,885
Other non-cash adjustments	10,140	1,710
Deferred income taxes	(22,479)	(10,133)
Change in accounts receivable	16,129	48,951
Change in accounts payable and other liabilities	(70,663)	(84,756)
Change in prepaid expenses, income taxes and other current assets	49,852	40,159
Net cash provided by operating activities	312,864	359,292
Cash flows provided from (used by) investing activities:		
Capital expenditures - Business operations	(135,059)	(189,009)
Capital expenditures - Integration activities	(10,348)	-
Network expansion funded by Connect America Fund	(6,380)	(1,815)
Grant funds received for network expansion from Connect America Fund	3,748	5,998
Cash transferred from (to) escrow	-	(11)
Other assets purchased and distributions received, net	14,217	528
Net cash used by investing activities	(133,822)	(184,309)
Cash flows provided from (used by) financing activities:		
Long-term debt borrowing	10,706	-
Long-term debt payments	(14,479)	(517,129)
Dividends paid	(100,228)	(99,812)

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Repayment of customer advances for construction, distributions to noncontrolling interests and other	(839)	(7,279)
Net cash used by financing activities	(104,840)	(624,220)
(Decrease)/Increase in cash and cash equivalents	74,202	(449,237)
Cash reclassified to assets held for sale	-	(1,386)
Cash and cash equivalents at January 1,	880,039	1,326,532
Cash and cash equivalents at March 31,	\$ 954,241	\$ 875,909
Supplemental cash flow information:		
Cash paid (received) during the period for:		
Interest	\$ 145,620	\$ 168,095
Income taxes (refunds), net	\$ (4,928)	\$ 947

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

PART I. FINANCIAL INFORMATION (Continued)

FRONTIER COMMUNICATIONS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(1) Summary of Significant Accounting Policies:

(a) Basis of Presentation and Use of Estimates:

Frontier Communications Corporation and its subsidiaries are referred to as “we,” “us,” “our,” “Frontier,” or the “Company” in this report. Our interim unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) and should be read in conjunction with the consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2013. All significant intercompany balances and transactions have been eliminated in consolidation. These interim unaudited consolidated financial statements include all adjustments (consisting of normal recurring accruals) considered necessary, in the opinion of Frontier’s management, to present fairly the results for the interim periods shown. Revenues, net income and cash flows for any interim periods are not necessarily indicative of results that may be expected for the full year. For our interim financial statements as of and for the period ended March 31, 2014, we evaluated subsequent events and transactions for potential recognition or disclosure through the date that we filed this quarterly report on Form 10-Q with the Securities and Exchange Commission (SEC).

Frontier had a 33 % controlling general partner interest in a partnership entity, the Mohave Cellular Limited Partnership (Mohave). Mohave’s results of operations were included in our consolidated financial statements through its date of disposal on April 1, 2013. The minority interest of the limited partners was reflected in the consolidated statements of operations as “Income attributable to the noncontrolling interest in a partnership.” On April 1, 2013, the Company sold its partnership interest in Mohave and received proceeds of \$17.8 million. The Company recognized a gain on sale of approximately \$14.6 million before taxes in the second quarter of 2013.

The preparation of our interim financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect (i) the reported amounts of assets and liabilities at the date of the financial statements, (ii) the disclosure of contingent assets and liabilities, and (iii) the reported amounts of revenue and expenses during the reporting period. Actual results may differ from those estimates. Estimates and judgments are used when accounting for revenue recognition, including the allowance for doubtful accounts, impairment of long-lived assets, intangible assets, depreciation and amortization, income taxes, contingencies, and pension and other postretirement benefits, among others. Certain information and footnote disclosures have been excluded and/or condensed pursuant to SEC rules and regulations.

(b) Revenue Recognition:

Revenue is recognized when services are provided or when products are delivered to customers. Revenue that is billed in advance includes: monthly recurring network access services (including data services), special access services and monthly recurring voice, video and related charges. The unearned portion of these fees is initially deferred as a component of "Advanced billings" on our consolidated balance sheet and recognized as revenue over the period that the services are provided. Revenue that is billed in arrears includes: non-recurring network access services (including data services), switched access services, non-recurring voice and video services. The earned but unbilled portion of these fees is recognized as revenue in our consolidated statements of operations and accrued in accounts receivable in the period that the services are provided. Excise taxes are recognized as a liability when billed. Installation fees and their related direct and incremental costs are initially deferred and recognized as revenue and expense over the average term of a customer relationship. We recognize as current period expense the portion of installation costs that exceeds installation fee revenue.

As required by law, the Company collects various taxes from its customers and subsequently remits these taxes to governmental authorities. Substantially all of these taxes are recorded through the consolidated balance sheet and presented on a net basis in our consolidated statements of operations. We also collect Universal Service Fund (USF) surcharges from customers (primarily federal USF) that we have recorded on a gross basis in our consolidated statements of operations and included within "Revenue" and "Other operating expenses" of \$29.9 million and \$29.8 million for the three months ended March 31, 2014 and 2013, respectively.

PART I. FINANCIAL INFORMATION (Continued)

FRONTIER COMMUNICATIONS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(c) Goodwill and Other Intangibles:

Goodwill represents the excess of purchase price over the fair value of identifiable tangible and intangible net assets acquired. We undertake studies to determine the fair values of assets and liabilities acquired and allocate purchase prices to assets and liabilities, including property, plant and equipment, goodwill and other identifiable intangibles. We annually (during the fourth quarter) or more frequently, if appropriate, examine the carrying value of our goodwill and trade name to determine whether there are any impairment losses. We test for goodwill impairment at the “operating segment” level, as that term is defined in U.S. GAAP. Our four operating segments consist of the following regions: Central, East, National and West. Our regional operating segments are aggregated into one reportable segment.

The Company amortizes finite-lived intangible assets over their estimated useful lives and reviews such intangible assets at least annually (during the fourth quarter) to assess whether any potential impairment exists and whether factors exist that would necessitate a change in useful life and a different amortization period.

(2) Recent Accounting Literature:

Internal Control – Integrated Framework

On May 14, 2013, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) issued its updated Internal Control – Integrated Framework (the 2013 Framework) and related illustrative documents. COSO will continue to make available its original Framework during the transition period extending to December 15, 2014. The Company currently utilizes COSO’s original Framework, which was published in 1992 and is recognized as the leading guidance for designing, implementing and conducting internal controls over external financial reporting and assessing its effectiveness. The 2013 Framework is expected to help organizations design and implement internal control in light of many changes in business and operating environments since the issuance of the original Framework, broaden the application of internal control in addressing operations and reporting objectives, and clarify the requirements for determining what constitutes effective internal control. We plan to adopt the 2013 Framework during 2014 and do not expect that it will have a significant impact on the Company.

(3) The Transactions:

The 2010 Transaction

On July 1, 2010, the Company acquired the defined assets and liabilities of the local exchange business and related landline activities of Verizon Communications Inc. (Verizon) in 14 states (the Acquired Territories), including Internet access and long distance services and broadband video provided to designated customers in the Acquired Territories (the 2010 Acquired Business). Frontier was considered the acquirer of the 2010 Acquired Business for accounting purposes. All integration activities for the 2010 Transaction were completed as of the end of 2012.

The AT&T Transaction

On December 17, 2013, the Company announced that it entered into an agreement to acquire the wireline properties of AT&T Inc. (AT&T) in Connecticut (the AT&T Transaction) for a purchase price of \$2.0 billion in cash, with adjustments for working capital. Upon completion of the AT&T Transaction, Frontier will operate AT&T's wireline business and fiber optic network that provides services to residential, commercial and wholesale customers in Connecticut. The Company will also acquire AT&T's U-verse® video and satellite TV customers in Connecticut.

The Company will account for the AT&T Transaction in accordance with the guidance included in ASC Topic 805. We incurred \$10.6 million of acquisition and integration related costs in connection with the AT&T Transaction during the three months ended March 31, 2014. Such costs are required to be expensed as incurred and are reflected in "Acquisition and integration costs" in our consolidated statements of operations.

PART I. FINANCIAL INFORMATION (Continued)

FRONTIER COMMUNICATIONS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(4) Accounts Receivable:

The components of accounts receivable, net are as follows:

(\$ in thousands)	March 31, 2014	December 31, 2013
Retail and Wholesale	\$ 474,278	\$ 498,717
Other	58,897	51,855
Less: Allowance for doubtful accounts	(70,094)	(71,362)
Accounts receivable, net	\$ 463,081	\$ 479,210

We maintain an allowance for doubtful accounts based on our estimate of our ability to collect accounts receivable. Bad debt expense, which is recorded as a reduction to revenue, was \$12.9 million and \$16.2 million for the three months ended March 31, 2014 and 2013, respectively.

(5) Property, Plant and Equipment:

Property, plant and equipment, net is as follows:

(\$ in thousands)	March 31, 2014	December 31, 2013
Property, plant and equipment	\$ 14,984,356	\$ 14,850,697
Less: Accumulated depreciation	(7,794,098)	(7,594,935)
Property, plant and equipment, net	\$ 7,190,258	\$ 7,255,762

Depreciation expense is principally based on the composite group method. Depreciation expense was \$205.5 million and \$216.7 million for the three months ended March 31, 2014 and 2013, respectively. As a result of an independent study of the estimated remaining useful lives of our plant assets, we adopted new estimated remaining useful lives for certain plant assets as of October 1, 2013, with an immaterial impact to depreciation expense.

(6) Goodwill and Other Intangibles:

The components of goodwill by the reporting units in effect as of both March 31, 2014 and December 31, 2013 are as follows:

(\$ in thousands)	
Central	\$ 1,815,498
East	2,003,574
National	1,218,113
West	1,300,534
Total Goodwill	\$ 6,337,719

PART I. FINANCIAL INFORMATION (Continued)

FRONTIER COMMUNICATIONS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The components of other intangibles are as follows:

(\$ in thousands)	March 31, 2014			December 31, 2013		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Other Intangibles:						
Customer base	\$ 2,427,648	\$ (1,412,743)	\$ 1,014,905	\$ 2,427,648	\$ (1,336,852)	\$ 1,090,796
Trade name and license	124,136	-	124,136	124,136	-	124,136
Total other intangibles	\$ 2,551,784	\$ (1,412,743)	\$ 1,139,041	\$ 2,551,784	\$ (1,336,852)	\$ 1,214,932

Amortization expense was \$75.9 million and \$87.0 million for the three months ended March 31, 2014 and 2013, respectively. Amortization expense represents the amortization of intangible assets (primarily customer base) that were acquired in the 2010 Transaction based on a useful life of nine years for the residential customer base and 12 years for the business customer base, amortized on an accelerated method.

(7) Fair Value of Financial Instruments:

The following table summarizes the carrying amounts and estimated fair values for long-term debt at March 31, 2014 and December 31, 2013. For the other financial instruments including cash, accounts receivable, long-term debt due within one year, accounts payable and other current liabilities, the carrying amounts approximate fair value due to the relatively short maturities of those instruments. Other equity method investments, for which market values are not readily available, are carried at cost, which approximates fair value.

The fair value of our long-term debt is estimated based upon quoted market prices at the reporting date for those financial instruments.

(\$ in thousands)	March 31, 2014		December 31, 2013	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term debt	\$ 7,762,672	\$ 8,343,979	\$ 7,873,667	\$ 8,191,744

PART I. FINANCIAL INFORMATION (Continued)

FRONTIER COMMUNICATIONS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(8) Long-Term Debt:

The activity in our long-term debt from December 31, 2013 to March 31, 2014 is summarized as follows:

(\$ in thousands)	December 31, 2013	Three months ended March 31, 2014		March 31, 2014	Interest Rate at March 31, 2014 *
		Payments and Retirements	New Borrowings		
Senior Unsecured Debt	\$ 8,107,066	\$ (14,375)	\$ -	\$ 8,092,691	7.95%
Other Secured Debt	13,550	-	10,706	24,256	3.54%
Rural Utilities Service Loan Contracts	8,930	(104)	-	8,826	6.15%
Total Long-Term Debt	\$ 8,129,546	\$ (14,479)	\$ 10,706	\$ 8,125,773	7.94%
Less: Debt (Discount)/Premium	2,037			2,524	
Less: Current Portion	(257,916)			(365,625)	
	\$ 7,873,667			\$ 7,762,672	

* Interest rate includes amortization of debt issuance costs and debt premiums or discounts. The interest rates at March 31, 2014 represent a weighted average of multiple issuances

PART I. FINANCIAL INFORMATION (Continued)

FRONTIER COMMUNICATIONS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Additional information regarding our Senior Unsecured Debt is as follows:

(\$ in thousands)	March 31, 2014		December 31, 2013	
	Principal Outstanding	Interest Rate	Principal Outstanding	Interest Rate
Senior Notes and Debentures Due:				
5/1/2014	200,000	8.250%	200,000	8.250%
3/15/2015	105,026	6.625%	105,026	6.625%
4/15/2015	96,872	7.875%	96,872	7.875%
10/14/2016 *	445,625	3.035% (Variable)	460,000	3.045% (Variable)
4/15/2017	606,874	8.250%	606,874	8.250%
10/1/2018	582,739	8.125%	582,739	8.125%
3/15/2019	434,000	7.125%	434,000	7.125%
4/15/2020	1,021,505	8.500%	1,021,505	8.500%
7/1/2021	500,000	9.250%	500,000	9.250%
4/15/2022	500,000	8.750%	500,000	8.750%
1/15/2023	850,000	7.125%	850,000	7.125%
4/15/2024	750,000	7.625%	750,000	7.625%
11/1/2025				