

UBS Investment Research

Frontier Communications Corp

Frontier to more than triple access lines

■ Frontier to acquire 4.8M access lines for \$8.6B

Frontier will be acquiring 4.8M access lines in mostly rural areas in 14 states from Verizon for \$8.6B – more than tripling the size of the company. This equates to roughly ~\$1,800/line and compares to Verizon's March 2008 sale of lines to FairPoint for ~\$1,300/line.

■ Synergies of \$500M; Pursuing an investment-grade rating

Management expects annual synergies of \$500M, representing 21% of cash operating expenses compared to the expected 10% savings of the CTL/EQ merger. Additionally, the combined company would have a leverage ratio of 2.6x based on '08 numbers vs 3.8x for Frontier alone. Mgmt commented that it has changed its policy toward debt and plans to pursue an investment-grade rating.

■ Cutting the dividend by 25%

Frontier also announced a reduction of its dividend to \$0.75 from \$1.00, effective after the close of the transaction, lowering its payout ratio to 49% from 65% on a standalone basis. We believe the deal and dividend cut positions the company as one of 2 major RLECs likely to continue the consolidation of the RLEC space.

■ Valuation: Maintain Neutral

Based on pro forma estimates (excluding synergies), Frontier is currently trading at 5.2x 2009E EBITDA vs. 4.9x for CenturyTel/Embarq. Our current 12-month price target is based on our long-term model and DCF analysis (9% WACC; 0.5% FCF growth in perpetuity).

Highlights (US\$m)	12/07	12/08	12/09E	12/10E	12/11E
Revenues	2,288	2,237	2,123	2,032	1,968
EBIT (UBS)	705	642	642	729	711
Net Income (UBS)	215	183	193	241	213
EPS (UBS, US\$)	0.66	0.55	0.62	0.78	0.68
Net DPS (UBS, US\$)	1.00	1.00	1.00	1.00	0.00

Profitability & Valuation	5-yr hist av.	12/08	12/09E	12/10E	12/11E
EBIT margin %	29.3	28.7	30.2	35.9	36.1
ROIC (EBIT) %	12.2	12.6	13.4	15.7	15.7
EV/EBITDA (core) x	7.1	6.5	5.8	5.9	6.0
PE (UBS) x	28.6	19.3	11.8	9.4	10.7
Net dividend yield %	8.2	9.4	13.7	13.7	0.0

Source: Company accounts, Thomson Financial, UBS estimates. (UBS) valuations are stated before goodwill-related charges and other adjustments for abnormal and economic items at the analysts' judgement.

Valuations: based on an average share price that year, (E): based on a share price of US\$7.29 on 13 May 2009 19:16 EDT

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Global Equity Research

Americas

Fixed-Line Communications

12-month rating **Neutral**
Unchanged

12m price target **US\$7.50**
Unchanged

Price **US\$7.29**

RIC: FTR.N BBG: FTR US

14 May 2009

Trading data

52-wk range	US\$12.94-5.39
Market cap.	US\$2.26bn
Shares o/s	310m (COM)
Free float	97%
Avg. daily volume ('000)	1,372
Avg. daily value (US\$m)	9.6

Balance sheet data 12/09E

Shareholders' equity	US\$0.44bn
P/BV (UBS)	5.2x
Net Cash (debt)	(US\$4.42bn)

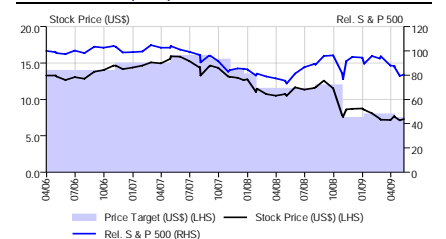
Forecast returns

Forecast price appreciation	+2.9%
Forecast dividend yield	13.7%
Forecast stock return	+16.6%
Market return assumption	5.9%
Forecast excess return	+10.7%

EPS (UBS, US\$)

	12/09E		12/08 Actual
	UBS	Cons.	
Q1	0.12	0.12	0.14
Q2E	0.14	0.13	0.17
Q3E	0.17	0.17	0.15
Q4E	0.19	0.17	0.11
12/09E	0.62	0.59	
12/10E	0.78	0.65	

Performance (US\$)



Source: UBS

www.ubs.com/investmentresearch

This report has been prepared by UBS Securities LLC

ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 6.

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Summary. Frontier announced an agreement to acquire 4.8M access lines from Verizon for \$8.6B, valuing the assets at roughly \$1,800 per access line or an estimated 4.8x 2009E EBITDA. Frontier also announced a 25% reduction of its dividend to \$0.75, effective after the transaction closes. That will lower its payout ratio to 49% from 65% on a stand-alone basis. Management suggested that the dividend cut was partly due to additional investments related to the transaction.

The combined company will have roughly 7.0M access lines, just behind the 7.5M access lines of the combined CenturyTel/Embarq. Of the 4.8M access lines, just 60% have broadband availability. This provides Frontier with an opportunity to grow revenue in these markets. Based on pro forma estimates (excluding synergies), Frontier is currently trading at 5.2x 2009E EBITDA vs 4.9x for CenturyTel/Embarq.

We believe that the de-leveraging nature of the deal, the dividend and the relative size of the new company, squarely positions Frontier as one of the two large consolidators of the rural exchange market. Windstream at 3.0M access lines looks destined to be an acquiree as does Qwest. We believe Qwest is attempting to break the company up and sell off the pieces, starting with the divestiture of its long haul segment.

Transaction details. The 4.8M access lines that Frontier is acquiring span mostly rural areas in 14 states. This equates to roughly ~\$1,800/line and is nearly 50% higher than Verizon's March 2008 sale of New England lines to FairPoint for ~\$1,300/line. The \$8.6B consideration includes \$5.3B in Frontier shares and \$3.3B of assumed debt. Following the transaction, Verizon shareholders will own ~68-70% of the new Frontier. Verizon shareholders will receive ~0.24 Frontier shares for each Verizon share owned. Subject to a collar adjustment, Frontier will issue approximately 677M new shares, for a total of 989M shares.

Combined company details. Pro forma for the transaction, the combined company would have generated \$6.5B in revenue, \$3.1B of EBITDA (ex-synergies), and \$1.4B in FCF in 2008 vs revenue of \$2.2B, EBITDA of \$1.2B, and FCF of \$450M for Frontier on a stand-alone basis. The combined company would have a leverage ratio of 2.6x vs 3.8x for Frontier alone based on 2008 numbers. Management commented that as part of this transaction, it has changed its policy regarding its balance sheet and plans to pursue an investment-grade rating.

Management expects annual synergies of \$500M, representing 21% of cash operating expenses. This compares to the expected 10% savings of the CenturyTel/Embarq merger. From December 2005 to July 2007, synergies from telco consolidations have come in between 17-29% of operating expenses. Additionally, management expects to spend roughly \$192M in non-recurring integration costs.

Both Frontier and Verizon looked to assuage concern created in the wake of the disastrous Verizon-FairPoint. First, this deal is a de-leveraging transaction and, with the dividend cut, meaningfully improves the company's financial position. Frontier also made it clear that management has substantial experience in integrating assets, having done this before with the old Frontier and Commonwealth assets. Lastly, Verizon will run this business as a separate entity

until close, converting over the one state that is not on the same billing system before the transaction is executed. These 3 points should help allay fears that the new company heads down the same path.

The merger is expected to close in 12 months. The deal must be approved by the FCC, SEC, IRS (regarding the tax-free nature of the transaction), 10 state commissions and Frontier shareholders. We believe that the de-leveraging nature of the transaction, the company's focus on expanding broadband availability and commentary regarding increased investment in the properties will help this deal get a warm reception from regulators. The debt is not committed at this point and will be raised at the time of close. Management suggested that the close could be delayed on a month-to-month basis for up to 5 months to account for potential financing hurdles. The maximum rate Frontier expects to pay on any financing is 9.5%.

Frontier Communications Corp

Income statement (US\$m)	12/04	12/05	12/06	12/07	12/08	12/09E	% ch	12/10E	% ch	12/11E	% ch
Revenues	2,015	2,001	2,025	2,288	2,237	2,123	-5.1	2,032	-4.3	1,968	-3.2
Operating expenses (ex deprecn)	(903)	(896)	(906)	(1,037)	(1,033)	(984)	-4.8	(930)	-5.4	(900)	-3.2
EBITDA (UBS)	1,112	1,106	1,120	1,251	1,204	1,139	-5.4	1,102	-3.2	1,067	-3.1
Depreciation	(548)	(517)	(476)	(546)	(562)	(497)	-11.5	(373)	-24.9	(357)	-4.5
Operating income (EBIT, UBS)	563	589	643	705	642	642	-0.1	729	13.5	711	-2.4
Other income & associates	(44)	17	82	18	9	15	61.5	10	-36.0	3	-68.0
Net interest	(374)	(337)	(334)	(381)	(363)	(349)	-3.7	(355)	1.8	(375)	5.6
Abnormal items (pre-tax)	0	0	0	0	0	0	-	0	-	0	-
Profit before tax	145	269	392	343	289	307	6.3	383	24.5	339	-11.5
Tax	(38)	(84)	(136)	(128)	(106)	(114)	7.0	(142)	24.2	(125)	-11.5
Profit after tax	107	184	255	215	183	193	5.9	241	24.6	213	-11.5
Abnormal items (post-tax)	(42)	52	95	(7)	0	0	-	0	-	0	-
Minorities / pref dividends	(5)	(3)	(3)	0	0	0	-	0	-	0	-
Net income (local GAAP)	61	233	347	207	183	193	5.9	241	24.6	213	-11.5
Net Income (UBS)	103	181	252	215	183	193	5.9	241	24.6	213	-11.5
Tax rate (%)	26	31	35	37	37	37	0.7	37	-0.2	37	0.0
Pre-abnormal tax rate (%)	26	31	35	37	37	37	0.7	37	-0.2	37	0.0
Per share (US\$)	12/04	12/05	12/06	12/07	12/08	12/09E	% ch	12/10E	% ch	12/11E	% ch
EPS (local GAAP)	0.20	0.69	1.08	0.63	0.55	0.62	12.0	0.78	25.9	0.68	-11.8
EPS (UBS)	0.35	0.54	0.78	0.66	0.55	0.62	12.0	0.78	25.9	0.68	-11.8
Net DPS	2.50	1.00	1.00	1.00	1.00	1.00	0.0	1.00	0.0	0.00	-
Cash EPS	2.19	2.15	2.26	2.32	2.24	2.20	-1.9	1.98	-10.1	1.84	-7.2
BVPS	4.72	3.07	3.31	2.99	1.56	1.41	-10.1	1.30	-7.4	1.09	-16.7
Balance sheet (US\$m)	12/04	12/05	12/06	12/07	12/08	12/09E	% ch	12/10E	% ch	12/11E	% ch
Cash and equivalents	164	266	1,041	226	164	303	85.4	352	16.2	900	155.4
Other current assets	307	276	232	298	304	282	-7.2	274	-3.0	265	-3.1
Total current assets	471	542	1,273	524	468	586	25.2	626	6.9	1,165	86.1
Net tangible fixed assets	3,336	3,186	2,984	3,335	3,240	3,148	-2.8	3,060	-2.8	2,945	-3.8
Net intangible fixed assets	2,626	2,480	2,350	3,182	3,002	2,857	-4.8	2,816	-1.5	2,796	-0.7
Investments / other assets	236	203	185	214	179	179	0.0	179	0.0	179	0.0
Total assets	6,668	6,412	6,791	7,256	6,889	6,770	-1.7	6,681	-1.3	7,085	6.0
Trade payables & other ST liabilities	411	389	386	443	379	362	-4.4	352	-2.7	347	-1.5
Short term debt	6	228	39	2	4	760	19604.4	760	0.0	760	0.0
Total current liabilities	418	617	426	446	383	1,122	193.2	1,112	-0.9	1,107	-0.5
Long term debt	4,267	4,099	4,561	4,737	4,722	3,961	-16.1	3,953	-0.2	4,476	13.2
Other long term liabilities	522	654	747	1,075	1,265	1,246	-1.5	1,211	-2.8	1,164	-3.8
Total liabilities	5,206	5,370	5,733	6,258	6,370	6,328	-0.6	6,276	-0.8	6,748	7.5
Equity & minority interests	1,462	1,042	1,058	998	519	441	-15.0	405	-8.3	337	-16.7
Total liabilities & equity	6,668	6,412	6,791	7,256	6,889	6,770	-1.7	6,681	-1.3	7,085	6.0
Cash flow (US\$m)	12/04	12/05	12/06	12/07	12/08	12/09E	% ch	12/10E	% ch	12/11E	% ch
Net income	61	233	347	207	183	193	5.9	241	24.6	213	-11.5
Depreciation	548	517	476	546	562	497	-11.5	373	-24.9	357	-4.5
Net change in working capital	(290)	83	142	47	(12)	(3)	-71.9	(37)	963.8	(43)	17.3
Other (operating)	388	7	(139)	21	7	31	334.4	32	4.8	30	-7.5
Net cash from operations	711	844	829	822	739	718	-2.9	610	-15.0	557	-8.7
Capital expenditure	(276)	(268)	(269)	(316)	(288)	(263)	-8.7	(244)	-7.4	(221)	-9.1
Net (acquisitions) / disposals	0	0	0	0	0	0	-	0	-	0	-
Other changes in investments	57	44	0	0	0	0	-	0	-	0	-
Cash from investing activities	(219)	(224)	(269)	(316)	(288)	(263)	-8.7	(244)	-7.4	(221)	-9.1
Increase/(decrease) in debt	(596)	(6)	315	(28)	(7)	(5)	-	(7)	-	523	-
Share issues / (repurchases)	545	(202)	(108)	(236)	(199)	1	-	0	-	0	-
Dividends paid	(781)	(337)	(323)	(333)	(317)	(310)	-2.4	(310)	0.1	(311)	0.2
Other cash from financing	(835)	336	322	332	5	0	-	0	-	0	-
Cash from financing activities	(1,672)	(214)	204	(266)	(518)	(314)	-39.4	(317)	0.9	212	-
Cash flow chge in cash & equivalents	(1,179)	406	764	240	(67)	140	-	49	-	548	-
FX / non cash items	759	(304)	11	(1,055)	4	0	-	0	-	0	-
Bal sheet chge in cash & equivalents	(420)	102	775	(815)	(63)	140	-	49	-	548	-
Core EBITDA	1,112	1,106	1,120	1,251	1,204	1,139	-5.4	1,102	-3.2	1,067	-3.1
Maintenance capital expenditure	(276)	(268)	(269)	(316)	(288)	(263)	-8.7	(244)	-7.4	(221)	-9.1
Maintenance net working capital	28	0	0	0	0	0	-	0	-	0	-
Operating free cash flow, pre-tax	863	837	851	935	916	876	-4.4	858	-2.0	846	-1.4

Source: Company accounts, UBS estimates. (UBS) valuations are stated before goodwill-related charges and other adjustments for abnormal and economic items at the analysts' judgement. Note: For some companies, the data represents an extract of the full company accounts.

Global Equity Research

Americas

Fixed-Line Communications

12-month rating

Neutral

12m price target

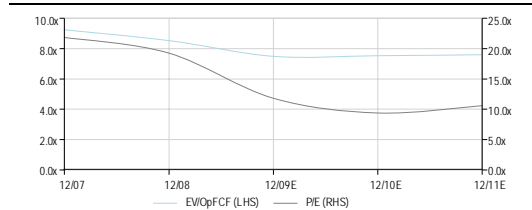
US\$7.50

Frontier Communications Corp

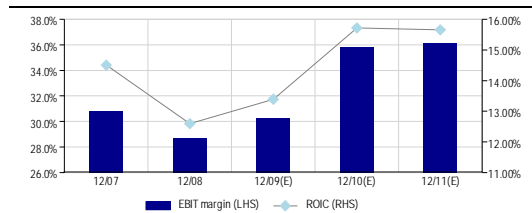
Company profile

Frontier Communications is a rural local exchange carrier that operates 2.3 million access lines in 24 states. Two-thirds of the company's access lines are located in Arizona, California, Minnesota, and New York. In the past two years, Frontier has acquired about 1.5 million predominantly rural lines.

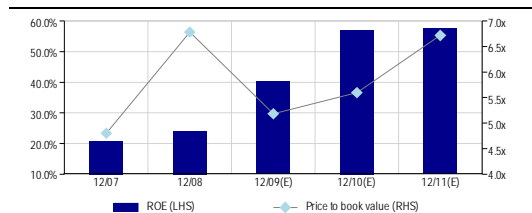
Value (EV/OpFCF & P/E)



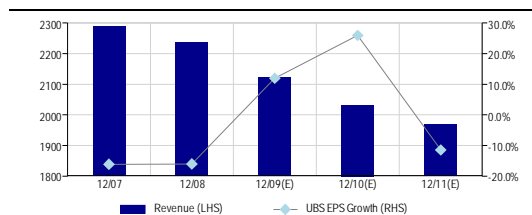
Profitability



ROE v Price to book value



Growth (UBS EPS)



Valuation (x)	5Yr Avg	12/07	12/08	12/09E	12/10E	12/11E
P/E (local GAAP)	27.0	22.6	19.3	11.8	9.4	10.7
P/E (UBS)	28.6	21.9	19.3	11.8	9.4	10.7
P/CEPS	5.8	6.2	4.7	3.3	3.7	4.0
Net dividend yield (%)	8.2	7.0	9.4	13.7	13.7	0.0
P/BV	3.6	4.8	6.8	5.2	5.6	6.7
EV/revenue (core)	3.9	3.8	3.5	3.1	3.2	3.3
EV/EBITDA (core)	7.1	6.9	6.5	5.8	5.9	6.0
EV/EBIT (core)	13.3	12.3	12.2	10.2	8.9	9.0
EV/OpFCF (core)	9.9	9.2	8.5	7.5	7.5	7.6
EV/op. invested capital	1.6	1.8	1.5	1.4	1.4	1.4

Enterprise value (US\$m)	12/07	12/08	12/09E	12/10E	12/11E
Average market cap	4,614	3,460	2,257	2,257	2,257
+ minority interests	0	0	0	0	0
+ average net debt (cash)	4,036	4,537	4,490	4,389	4,349
+ pension obligations and other	0	0	0	0	0
- non-core asset value	0	(179)	(179)	(179)	(179)
Core enterprise value	8,650	7,819	6,568	6,468	6,427

Growth (%)	5Yr Avg	12/07	12/08	12/09E	12/10E	12/11E
Revenue	2.9	13.0	-2.2	-5.1	-4.3	-3.2
EBITDA (UBS)	2.9	11.7	-3.8	-5.4	-3.2	-3.1
EBIT (UBS)	6.7	9.7	-8.9	-0.1	13.5	-2.4
EPS (UBS)	24.7	-16.1	-16.0	12.0	25.9	-11.5
Cash EPS	0.3	2.8	-3.4	-1.9	-10.1	-7.2
Net DPS	-	0.0	0.0	0.0	0.0	-
BVPS	-12.0	-9.7	-47.6	-10.1	-7.4	-16.7

Margins (%)	5Yr Avg	12/07	12/08	12/09E	12/10E	12/11E
EBITDA / revenue	55.0	54.7	53.8	53.7	54.2	54.3
EBIT / revenue	29.3	30.8	28.7	30.2	35.9	36.1
Net profit (UBS) / revenue	7.9	9.4	8.2	9.1	11.9	10.8

Return on capital (%)	5Yr Avg	12/07	12/08	12/09E	12/10E	12/11E
EBIT ROIC (UBS)	12.2	14.5	12.6	13.4	15.7	15.7
ROIC post tax	-	9.1	8.0	8.4	9.9	9.9
Net ROE	14.5	20.9	24.1	40.3	57.0	57.5

Coverage ratios (x)	5Yr Avg	12/07	12/08	12/09E	12/10E	12/11E
EBIT / net interest	1.7	1.9	1.8	1.8	2.0	1.9
Dividend cover (UBS EPS)	-	0.7	0.6	0.6	0.8	-
Div. payout ratio (% , UBS EPS)	-	152.5	181.6	162.2	128.8	-
Net debt / EBITDA	3.5	3.6	3.8	3.9	4.0	4.1

Efficiency ratios (x)	5Yr Avg	12/07	12/08	12/09E	12/10E	12/11E
Revenue / op. invested capital	0.4	0.5	0.4	0.4	0.4	0.4
Revenue / fixed assets	0.3	0.4	0.4	0.3	0.3	0.3
Revenue / net working capital	NM	NM	NM	NM	NM	NM

Investment ratios (x)	5Yr Avg	12/07	12/08	12/09E	12/10E	12/11E
OpFCF / EBIT	1.3	1.3	1.4	1.4	1.2	1.2
Capex / revenue (%)	13.6	13.8	12.9	12.4	12.0	11.3
Capex / depreciation	0.5	0.6	0.5	0.5	0.7	0.6

Capital structure (%)	5Yr Avg	12/07	12/08	12/09E	12/10E	12/11E
Net debt / total equity	NM	NM	NM	NM	NM	NM
Net debt / (net debt + equity)	77.1	81.9	89.8	90.9	91.5	92.8
Net debt (core) / EV	49.96	46.7	58.0	68.4	67.9	67.7

Source: Company accounts, UBS estimates. (UBS) valuations are stated before goodwill-related charges and other adjustments for abnormal and economic items at the analysts' judgement.

Valuations: based on an average share price that year, (E): based on a share price of US\$7.29 on 13 May 2009 19:16 EDT Market cap(E) may include forecast share issues/buybacks.

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■ **Frontier Communications Corp**

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■ **Statement of Risk**

Risks include operational and financial leverage, potentially adverse regulatory rulings, changes in technology, increasing competition, and exposure to economic cycles.

■ **Analyst Certification**

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UBS Investment Research: Global Equity Rating Allocations

UBS 12-Month Rating	Rating Category	Coverage ¹	IB Services ²
Buy	Buy	51%	36%
Neutral	Hold/Neutral	37%	31%
Sell	Sell	12%	22%
UBS Short-Term Rating	Rating Category	Coverage ³	IB Services ⁴
Buy	Buy	less than 1%	43%
Sell	Sell	less than 1%	36%

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 31 March 2009.

UBS Investment Research: Global Equity Rating Definitions

UBS 12-Month Rating	Definition
Buy	FSR is > 6% above the MRA.
Neutral	FSR is between -6% and 6% of the MRA.
Sell	FSR is > 6% below the MRA.
UBS Short-Term Rating	Definition
Buy	Buy: Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.
Sell	Sell: Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

Short-Term Ratings reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case.

EXCEPTIONS AND SPECIAL CASES

UK and European Investment Fund ratings and definitions are: Buy: Positive on factors such as structure, management, performance record, discount; Neutral: Neutral on factors such as structure, management, performance record, discount; Sell: Negative on factors such as structure, management, performance record, discount.

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UBS Securities LLC: Batya Levi; John C. Hodulik, CFA; Marc Albanese.

Company Disclosures

Company Name	Reuters	12-mo rating	Short-term rating	Price	Price date
Frontier Communications Corp ^{2, 4, 5, 6, 16}	FTR.N	Neutral	N/A	US\$7.29	13 May 2009

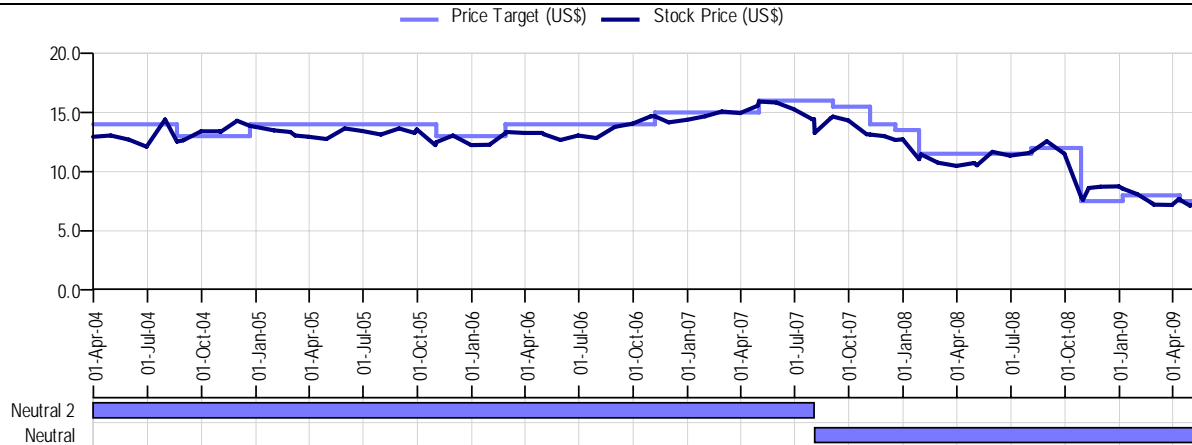
Source: UBS. All prices as of local market close.

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Frontier Communications Corp (US\$)



Source: UBS; as of 13 May 2009

Note: On August 4, 2007 UBS revised its rating system. (See 'UBS Investment Research: Global Equity Rating Definitions' table for details). From September 9, 2006 through August 3, 2007 the UBS ratings and their definitions were: Buy 1 = FSR is > 6% above the MRA, higher degree of predictability; Buy 2 = FSR is > 6% above the MRA, lower degree of predictability; Neutral 1 = FSR is between -6% and 6% of the MRA, higher degree of predictability; Neutral 2 = FSR is between -6% and 6% of the MRA, lower degree of predictability; Reduce 1 = FSR is > 6% below the MRA, higher degree of predictability; Reduce 2 = FSR is > 6% below the MRA, lower degree of predictability. The predictability level indicates an analyst's conviction in the FSR. A predictability level of '1' means that the analyst's estimate of FSR is in the middle of a narrower, or smaller, range of possibilities. A predictability level of '2' means that the analyst's estimate of FSR is in the middle of a broader, or larger, range of possibilities. From October 13, 2003 through September 8, 2006 the percentage band criteria used in the rating system was 10%.

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