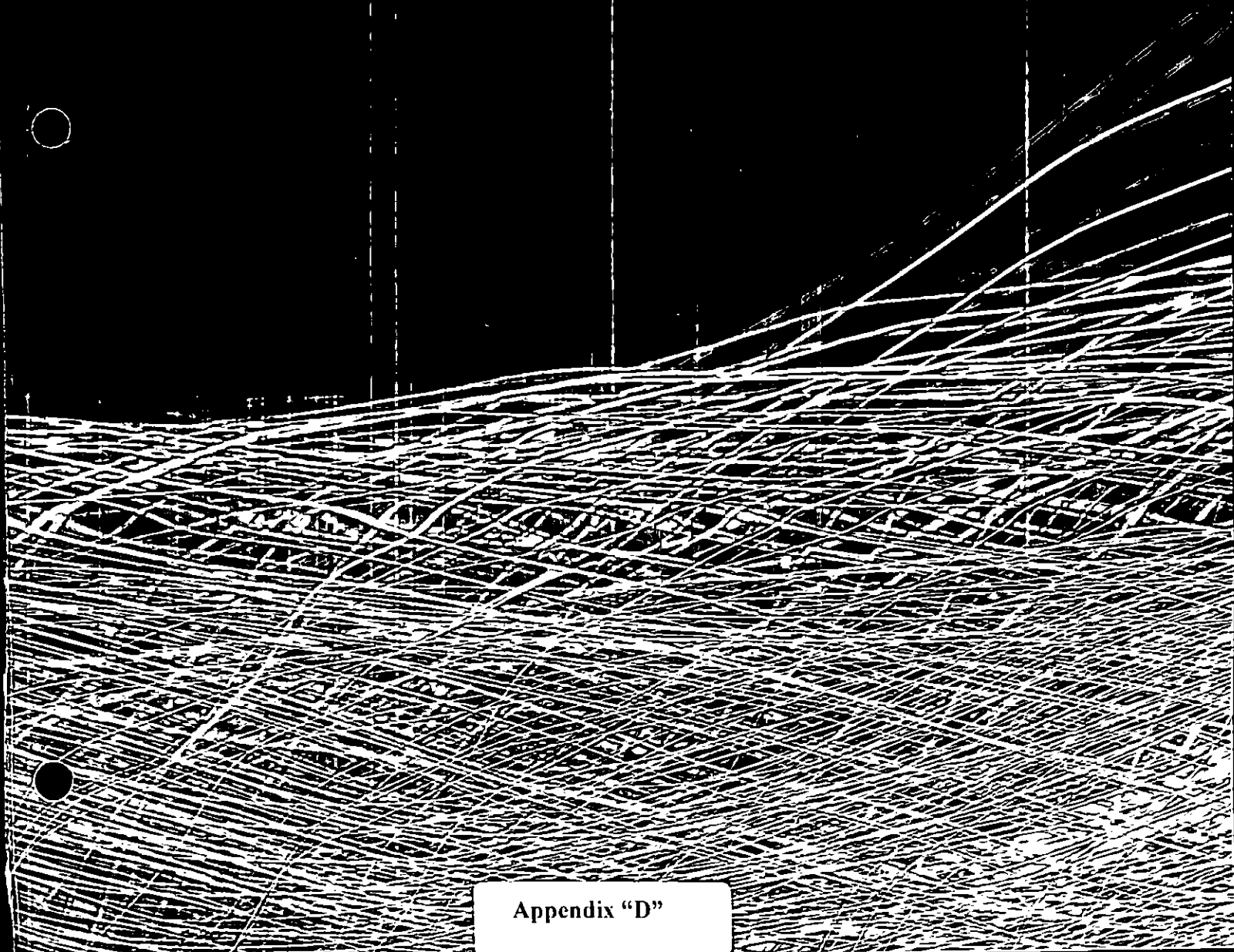


COMMONWEALTH TELEPHONE ENTERPRISES, INC.

2005 ANNUAL REPORT



Appendix "D"

ABOUT CTE

Headquartered in Dallas, PA, Commonwealth Telephone Enterprises, Inc. ("CTE"), serves business and residential customers with a full array of technologically advanced data and voice telecommunications products and services, including broadband data services and high-speed Internet access, delivered over its 100% digitally switched, fiber-rich network. CTE's primary operating segments are: Commonwealth Telephone Company ("CT"), the nation's eighth largest publicly held independent local exchange carrier, which has been operating in various rural Pennsylvania markets since 1897; and, CTSI, LLC ("CTSI"), a local exchange carrier operating in competitive markets outside CT's territory, that formally commenced operations in 1997. CTE deploys broadband DSL (digital subscriber line) technology to offer high-speed Internet access in the CT and CTSI service territories. In addition, CTE operates support businesses that provide products, services and expertise to its two principal operating segments. These businesses are reported as "Other" in CTE's results. Information about Commonwealth Telephone Enterprises, Inc., can be found at the web site address: www.ct-enterprises.com.

COMMONWEALTH TELEPHONE COMPANY

- 323,555 switched access lines in service at year-end 2005, a reduction of 3% versus year-end 2004
- Revenues of \$228.5 million in 2005, a growth rate of 0.4% versus 2004
- Operating income of \$111.9 million in 2005, a growth rate of 11% versus 2004
- 25,598 DSL subscribers at year-end 2005

CTSI, LLC

- 137,696 switched access lines in service at year-end 2005, a reduction of 0.8% versus year-end 2004
- Revenues of \$86.5 million in 2005, an increase of 4% versus 2004
- Operating income of \$12.9 million in 2005, versus \$10.4 million in 2004
- 3,664 DSL subscribers at year-end 2005

OTHER

- epix[®] Internet Services (www.epix.net), one of the Northeast's largest rural dial-up Internet service providers, had 22,415 dial-up Internet subscribers at year-end 2005
- Commonwealth Communications, a provider of telecommunications equipment and facilities management services

FINANCIAL HIGHLIGHTS

CTE Reported Consolidated Results

(\$ in Millions except Earnings Per Share)	FY05	FY04	% Inc./[Dec.] FY05 v. FY04	FY03	% Inc./[Dec.] FY04 v. FY03
Access Lines	461,251	471,842	(2%)	477,129	(1%)
Revenues	\$333.9	\$335.8	(1%)	\$335.7	-
Operating Income	\$112.1	\$106.4	5%	\$103.4	3%
Depreciation and Amortization	\$ 57.9	\$ 71.0	(18%)	\$ 71.1	-
Capital Expenditures	\$ 43.9	\$ 43.5	1%	\$ 49.5	(12%)
Reported Diluted Earnings Per Share	\$ 2.71	\$ 2.60	4%	\$ 2.92*	(11%)

* Includes a one-time, after-tax gain of \$13.2 million, or \$0.51 per diluted share, in connection with the adoption of new accounting rules on asset retirement obligations under SFAS 143 (Statement of Financial Accounting Standards No. 143), which were effective January 1, 2003.

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements. Certain information included in this annual report is forward-looking. Such forward-looking information involves important risks and uncertainties that could significantly affect results expressed in any forward-looking statements made in this annual report. These risks and uncertainties include, but are not limited to, uncertainties related to CTE's ability to further penetrate its markets and the related costs of that effort, economic conditions, acquisitions and divestitures, government and regulatory policies, the pricing and availability of equipment, materials and inventories, technological developments, changes in the competitive environment in which CTE operates and receipt of necessary regulatory approvals.

TO OUR SHAREHOLDERS:

We are pleased to report to you that 2005 marked another successful year for Commonwealth Telephone Enterprises, Inc.

We produced solid operating and financial results in 2005, while we also made significant progress in the areas of broadband deployment, bundling and new product introductions. Further, we returned significant cash to our shareholders by paying a \$13.00 per share special dividend and initiating a \$2.00 per share annual dividend.

Broadband Moves Rapidly to the Forefront

One area in which we made great strides in 2005 was in our broadband network and product deployment.

Within the network footprint of Commonwealth Telephone Company ("CT"), we began 2005

with just under 80% of our households and business establishments being capable of receiving DSL from us. Of this addressable market, we had achieved just under 11% DSL penetration. By year-end 2005, we reached 86% capability and a 16% DSL penetration level.

We grew our consolidated DSL subscriber base by a record 57% – adding 10,650 net subscribers during the year. In fact, we ended the year by adding more subscribers in the 2005 fourth quarter – 3,125 – than in any other quarter since we launched our DSL product back in 1999. Most notably, the fourth quarter was our *eleventh* consecutive quarter in which we added more incremental net DSL subscribers versus the

number added in the comparable prior-year-same-quarter. We served 29,262 DSL subscribers at year-end.

Broadband is significant to our company's future, as it represents an attractive growth opportunity. The "need for speed" to efficiently access and transport higher bandwidth streaming video, music, digital photography and large data files on the Internet is driving growing consumer demand. Our network strategy is geared to take advantage of increasing broadband demand and future applications.

Consistent with our record of prudent capital expenditures, we plan to make appropriately timed network and product investments that are economically viable and, therefore, value enhancing over time.

We grew our consolidated DSL subscriber base by a record 57% – adding 10,650 net subscribers...

Bundling – Responding to Our Customers

In 2005, we continued to develop and refine our

bundled data and voice product offerings. While we have had bundled product offerings for the last few years, we continue our efforts to be responsive to our customers' needs. In 2005, we provided customers greater choice – increasing the flexibility of both enhanced services and long-distance options – and customer response was excellent. In fact, at CT, we *more than doubled* the number of customers choosing a bundled product offering from us versus the end of 2004.

Our goal is to continue to migrate more of our customers into bundles, in order to strengthen our customer relationships and reduce churn to competitors.

Successful New Product Launches

Part of the natural progression of our bundle development has been to initially offer certain services outside the bundle as attractive "add-ons," then look to potentially include them in the bundle value proposition as they gain market acceptance.

This past year, we successfully launched two new products that complement our bundles.

In May, we began offering the DISH Network™ satellite digital video service as an attractive "add-on" product to our bundles – a strategy aimed at increasing customer loyalty, while making us a formidable "triple play" competitor

versus the cable companies in our service territory.

The key advantages we offer customers include

one bill and one point of contact for data, video and voice services. Our alliance with EchoStar Communications to offer DISH Network™ satellite digital video services provided a low capital investment means to enter our market with a video product.

In December, we launched Internet-based electronic games offerings to our residential customers throughout the combined footprint of CT and CTSI, as well as to our epix® Internet Services customers. These new

services are provided through agreements with two premium game companies: Zone4Play, Inc., a developer of interactive software and technology for the gaming industry; and Exent Technologies, the global market leader in secure digital delivery of video games. The addition of Internet-based games brings an exciting entertainment component to our full suite of data, voice and video services. Further, our games offerings are a great example of value-added services that can be delivered over our broadband network.

Returning Value Through Cash Dividends

In May 2005, we announced a one-time special dividend of \$13.00 per share, and a \$0.50 per share quarterly dividend in connection with our announced ongoing \$2.00 per share annual dividend.

For some time, we had been evaluating various alternatives to put our cash to work

to increase the value of our equity for our investors – and we concluded that the launching of our dividend plan would create strong shareholder value.

At the time we announced our dividend, we took several concurrent steps to further enhance our financial flexibility and increase the value of our common stock.

First, we announced an exchange offer for our Convertible Notes, which resulted in our reducing the potential dilutive effect on our common stock of future conversions of notes by up to 21%.

Our primary focus is to expand our broadband capabilities, which will drive increased broadband penetration and support our bundling initiatives...

We also announced that we were putting in place a new revolving credit facility, which provided us with an additional \$50 million of untapped borrowing capacity.

Further, we expressed our intention to continue to be opportunistic with respect to our authorized common share repurchase program, as well as to assess the feasibility of additional common share repurchases beyond our current authorized plan.

Throughout 2005, we have continued our ongoing focus on enhancing our financial strength and flexibility, ending the year with a strong balance sheet with relatively low leverage and a solid cash position. We believe that our balance sheet strength positions us to increase shareholder value in the future, including the option to be on either side of a value enhancing M&A transaction.

In addition to M&A, other potential future uses for our cash may include common stock repurchases, increased dividends, debt retirements and investments in new products and services.

As has been our established practice, the decision criteria we will use to determine the future use of our cash will be our best judgment regarding maximizing the total return of our common equity over the long term.

We believe that our combination of a significant dividend payout ratio with our ongoing financial flexibility – along with our record of solid operating and financial performance that has generated consistent cash flow – favorably positions us in the rural local exchange carrier segment of the telecom industry.

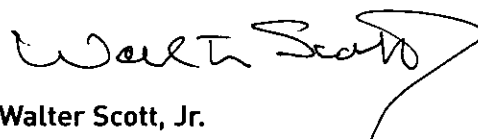
Focused on 2006

As we move into 2006, we remain financially strong and well positioned for the future.

Our primary focus is to expand our broadband capabilities, which will drive increased broadband penetration and support our bundling initiatives throughout our operations.

We are confident that we possess the people, the assets, the financial strength and the plans to achieve success in the markets in which we operate.

We appreciate your interest and support of our company, and we look forward to continuing our record of solid operating and financial performance in 2006 and beyond.



Walter Scott, Jr.
Chairman



Michael J. Mahoney
President and Chief Executive Officer

BOARD OF DIRECTORS

Walter Scott, Jr.^{1*}
Chairman of the Board of Directors
Commonwealth Telephone Enterprises, Inc.,
and Level 3 Communications, Inc.

Michael J. Mahoney¹
President and Chief Executive Officer
Commonwealth Telephone Enterprises, Inc.

John R. Birk
Operating Executive
Evercore Partners

James Q. Crowe^{2*}
Chief Executive Officer
Level 3 Communications, Inc.

Frank M. Henry⁴
Chairman
Frank Martz Coach Company

Richard R. Jaros^{1,3}
Private Investor

Daniel E. Knowles²
President
Cambridge Human Resources

David C. Mitchell^{1,3,4*}
Former President—Telephone Group
Rochester Telephone Corporation

Eugene Roth, Esq.^{2,4}
Counsel
Rosenn, Jenkins and
Greenwald, L.L.P.

John J. Whyte^{3*}
Managing Director
WorldWide PCE LLC

¹ Executive Committee
² Compensation/Pension Committee
³ Audit Committee
⁴ Corporate Governance Committee
* Committee Chair

EXECUTIVE OFFICERS

Michael J. Mahoney
President and Chief Executive Officer

Eileen O'Neill Odum
Executive Vice President
and Chief Operating Officer

Donald P. Cawley
Executive Vice President
and Chief Accounting Officer

Raymond B. Ostroski
Senior Vice President, General Counsel
and Corporate Secretary

Scott Burnside
Senior Vice President — Regulatory
and Government Relations

David G. Weselcouch
Senior Vice President — Investor Relations
and Corporate Communications

Darryl Varnado
Vice President — Human Resources

EXECUTIVE MANAGEMENT OF CTE OPERATING SUBSIDIARIES

Kevin M. O'Hare
Group Vice President — Strategic Development

Rita M. Brown
Senior Vice President and General Manager
CTSI, LLC

James F. Samaha
Senior Vice President and General Manager
Commonwealth Telephone Company
and epix[®] Internet Services

Steven J. Letts
Vice President and General Manager
Commonwealth Communications

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-K

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

For the fiscal year ended December 31, 2005

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File No. 0-11053

Commonwealth Telephone Enterprises, Inc.
(Exact name of registrant as specified in its charter)

Pennsylvania
(State or other jurisdiction of
incorporation or organization)

23-2093008
(I.R.S. Employer
Identification No.)

100 CTE Drive, Dallas, Pennsylvania 18612-9774
(Address of principal executive offices) (Zip Code)

Registrant's telephone number including area code: 570-631-2700

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value \$1.00 per share
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

Number of shares of the Registrant's Stock (\$1.00 par value) outstanding at February 28, 2006:

21,848,859 Shares of Common Stock

Aggregate market value of Registrant's voting stock held by non-affiliates at June 30, 2005 computed by reference to the closing price as reported by Nasdaq for Common Stock (\$41.91 per share), is as follows:

\$913,185,121

The market value is based on the value of the Common Stock that was outstanding on June 30, 2005.

Documents Incorporated by Reference

1. Proxy Statement for 2006 Annual Meeting of Shareholders is incorporated by reference into Part I and Part III of this Form 10-K.

COMMONWEALTH TELEPHONE ENTERPRISES, INC.

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"CTE," "the Company," "we," "us" and "our" refer to Commonwealth Telephone Enterprises, Inc.

"Our RLEC" and "CT" refer to Commonwealth Telephone Company, a rural incumbent local exchange carrier and a subsidiary of Commonwealth Telephone Enterprises, Inc.

The segment "CT" includes the results of our RLEC; Commonwealth Long Distance Company ("CLD"), a long-distance reseller; and the portion of our broadband data service that uses digital subscriber line ("DSL") technology to offer high-speed Internet access, that is in CT's territory.

"Our CLEC," "RLEC 'edge-out'" and "CTSI" refer to CTSI, LLC, a competitive local exchange carrier and a subsidiary of Commonwealth Telephone Company.

PART I

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act and we intend that such forward-looking statements be subject to these safe harbors. These statements are generally accompanied by words such as “intend,” “anticipate,” “believe,” “estimate,” “expect” or similar statements. Our forward-looking statements involve risks and uncertainties that could significantly affect expected results in the future differently than expressed in any forward-looking statements we have made. These risks and uncertainties include, but are not limited to:

- uncertainties relating to our ability to further penetrate our markets and the related cost of that effort;
- economic conditions, acquisitions and divestitures;
- government and regulatory policies;
- the pricing and availability of equipment, materials and inventories;
- technological developments;
- reductions in rates or traffic that is subject to access charges;
- changes in the competitive environment in which we operate; and
- receipt of necessary regulatory approvals.

Additional factors that could cause or contribute to such differences are set forth in the section entitled “Risk Factors” and are discussed elsewhere in this report. Although we believe that the assumptions underlying our forward-looking statements are reasonable, any of the assumptions could prove inaccurate; and, therefore, we cannot provide any assurance that the results contemplated in such forward-looking statements will be realized. The inclusion of this forward-looking information should not be regarded as a representation by us or any other person that the future events, plans or expectations that we contemplate will be achieved. Furthermore, past performance in operations and share price is not necessarily predictive of future performance.

Item 1. Business

General

We are a telecommunications company providing telephony and related services in Pennsylvania markets as a rural incumbent local exchange carrier, or RLEC. We also operate as a competitive local exchange carrier, or CLEC, in three regional Pennsylvania markets that border CT’s markets, which we refer to as our RLEC “edge-out” markets. CT is the nation’s eighth largest non-Bell incumbent local exchange carrier, serving over 323,500 switched access lines as of December 31, 2005. CTSI served over 137,600 competitive switched access lines as of December 31, 2005. For the years ended December 31, 2005 and 2004, we had consolidated revenues of \$333.9 million and \$335.8 million, respectively.

CT, founded in 1897, operates in a rural, approximately 5,000-square-mile territory with a population of approximately 450,000 people, and a line density of approximately 65 access lines per square mile. Approximately three quarters of CT’s switched access lines serve residential customers. CT generated revenues of \$228.5 million and \$227.7 million, and operating income of \$111.9 million and \$100.4 million for the years ended December 31, 2005 and 2004, respectively. CT ranks among the industry leaders in penetration of residential additional lines. CT’s penetration of residential additional lines was 33% at December 31, 2005. Our residential additional line penetration rate is decreasing, partially as a result of our digital subscriber line (“DSL”) success. We continue to counter residential additional line erosion with bundled service offerings, some of which include an additional line as part of the bundle.

CTSI formally began operating in our “edge-out” markets in 1997 and currently provides a full array of competitive voice and data telecommunications services mainly to business customers. CTSI serves the three regional Pennsylvania “edge-out” markets of Wilkes-Barre/Scranton/Hazleton, Harrisburg and Lancaster/Reading/York. In the “edge-out” markets, CTSI generated revenues of \$86.5 million and \$83.6 million, and operating income of \$12.9 million and \$9.6 million for the years ended December 31, 2005 and 2004, respectively.

We also own and operate other telecommunications-related support businesses that all operate in deregulated segments of the telecommunications industry and that support the operations of our two primary operating companies. These businesses are epix® Internet Services, one of the northeast's largest rural dial-up Internet service providers with approximately 22,400 dial-up Internet access subscribers as of December 31, 2005; and Commonwealth Communications, a provider of telecommunications equipment and facilities management services. Our "Other" business segment includes these support businesses, as well as our corporate entity. Financial information about our segments is included in Note 3 of Notes to Consolidated Financial Statements on page F-37 to F-39 of this report.

A web site featuring current information regarding Commonwealth Telephone Enterprises, Inc., can be found on the Internet at www.ct-enterprises.com. However, the information on our web site is not part of this annual report. Our periodic and current reports are available on our web site as soon as reasonably practicable after such material is electronically filed with, or furnished to, the Securities and Exchange Commission.

Business Strategy

We strive to grow our revenues, control our expenses and deploy our capital in a manner that maximizes our operating income. In order to achieve this goal, we have formulated the following business strategy:

Introduction of Bundled Offerings and Maximizing Revenue per Customer

As noted earlier, we have introduced various bundled offerings at CT aimed at increasing take rates on DSL and our long-distance products, as well as slowing erosion in our additional line penetration level and retaining customers. In 2004, we announced our alliance with EchoStar Communications Corporation to provide their DISH Network™ satellite TV service to all households in our current territory. This enabled the Company to offer its customers digital television programming beginning in mid-2005. In April of 2005, we announced that we had signed agreements with two leading game providers: Zone4Play, Inc. and Exent Technologies. In the fourth quarter of 2005, we began offering Internet-based electronic games to our residential customers in the current territories of CT and CTSI, as well as to epix® customers. We are assessing the feasibility of adding additional products to our service bundles in the future such as Voice over Internet Protocol ("VoIP").

CT offers an array of enhanced services such as caller identification, voice mail and custom calling services, such as call-forwarding, call waiting and three-way calling. These services generally produce higher margins than basic telephone service. Our RLEC's network is 100% digitally-switched and all upgrades to provide these additional services to our entire customer base have been substantially completed. We have increased our efforts to market enhanced services through bundled offerings to our customers and believe we can achieve higher penetration rates that are more in line with industry averages.

During 2005, CT filed and received Pennsylvania Public Utility Commission ("PUC") approval of an amended plan to revise its price adjustment formula to eliminate the 2% annual offset to inflation, and to provide universal availability of broadband services within CT's service territory no later than December 31, 2008. Under the amended plan, CT could be required to refund some of its increased revenues to customers if it fails to meet its commitment to deploy broadband services. The alternative regulation plan, under which we operated before this amendment, permitted CT to increase its overall rates for regulated intrastate services annually by an amount equal to inflation minus 2%.

Leverage CT's Brand, Reputation and Expertise to Further Penetrate CTSI's Markets

In the CTSI markets, we seek to increase our penetration rate by targeting business customers who have traditionally been underserved by Verizon and by offering competitive service packages that compare favorably to those being offered by Verizon. We believe our strong Commonwealth Telephone brand, reputation and expertise provide us with important competitive advantages in these markets and will allow us to continue to gain new customers and increase our market share at a low marginal operating cost.

Increase Sales of Data Products and Services

We intend to capitalize on an increasing demand for business and residential data services, including demand for high bandwidth connectivity, in all of the markets we serve. We offer dial-up Internet access through epix® Internet Services and digital subscriber line, or DSL, broadband services as well as high-capacity point-to-point and virtual private network (“VPN”) circuits. We believe there is additional opportunity to increase sales of our data services at a favorable marginal operating cost in all of the markets in which we operate.

Continue to Provide Superior Service and Customer Care

We intend to continue to capitalize on our customer service capabilities to provide superior service and customer care. Our RLEC has achieved the lowest level of “justified complaints,” as defined by the PUC, among Pennsylvania’s largest local exchange carriers, as well as the state’s two largest competitive exchange carriers, in ten of the past eleven years, including the last eight consecutive years. In our CTSI markets, our customer account managers provide personalized customer care to business customers, and our centralized call center operates 24 hours a day, 7 days a week to support our business and residential customers. By building on our strong service record, we plan to further differentiate ourselves from our competitors.

Selectively Pursue Strategic Acquisitions

To continue the growth of our business, we will seek to selectively acquire companies that offer a strategic fit with our existing businesses. This may include companies that could help us deepen our industry focus, further penetrate or broaden our target markets or increase the breadth of services we offer.

CT Operations

Our RLEC, CT, offers local, toll, network access and enhanced services in a rural, mountainous market located primarily in the eastern third of Pennsylvania.

Network Strategy

CT utilizes a technologically-advanced, fiber-rich network that is based on 100% digital-switching, integrated DWDM-Sonet transport and host/remote (TR 303 Standards Based) architecture. It was the first telephone company to deploy fiber optics in a toll application and was one of the first local exchange carriers in the nation to deploy a network of all digitally-switched central offices. CT operates its own Signaling System 7, STP based network, which provides efficient call set-up and routing of telephone calls. Throughout its market, CT has 11 digital host switches and about 500 remotes. All of the trunks between the hosts and the remote wire centers are connected with fiber optic cable. Connection to our customers, or the “last mile,” is provided over our RLEC’s copper outside plant. Our network architecture provides for short loop lengths in our copper plant, which allows CT to aggregate customer lines at the remotes for transport, and concentrates costly network intelligence in a small number of host offices. Additionally, our RLEC operates a network control center, which monitors network performance 24 hours a day, 7 days a week and allows us to maintain high network performance standards. CT has undertaken a three-year network upgrade initiative that will deliver broadband to 100% of households and businesses in the CT service area by year-end 2008.

Customer Service

CT has long been recognized as a customer service leader in Pennsylvania. Each year, the Pennsylvania Public Utility Commission issues a study that measures the customer service results, based on customer complaints, of the state’s five largest local exchange service providers, as well as the state’s two largest competitive local exchange carriers, which includes Alltel, MCI Local, Verizon Pennsylvania (formerly Bell Atlantic), Verizon North, Inc. (formerly GTE North, Inc.), Sprint (formerly United) and Comcast Digital Phone. CT has achieved the lowest level of justified complaints, as defined by the Pennsylvania Public Utility Commission, among Pennsylvania’s largest local exchange carriers in ten of the past eleven years, including the last eight consecutive years.

Regulatory Environment

CT is subject to regulation by the PUC for intrastate rate-making purposes, which includes rates for basic local services, intraLATA toll services and access services for the origination and termination of in-state long-distance calls. CT has entered into an alternative regulatory framework with the PUC for all of its intrastate operations, under which it has agreed to meet certain broadband service delivery parameters in exchange for a price cap formula, rather than rate of return regulations. During 2005, the PUC approved an amendment to CT's plan that eliminated the previous 2% yearly offset in its price adjustment formula. Under the amended formula, CT may adjust its intrastate prices each year by an amount equal to inflation, although CT could be required to refund the additional revenues collected due to this amendment if it fails to meet its commitment to deliver broadband service capability to all customers by December 31, 2008. Additionally, CT has the ability to request relief on a dollar-for-dollar basis for certain events deemed outside of its control that result in reduced revenues or increased expenses. This may include changes in revenues that may result from portions of interstate access charge reform.

The PUC must also approve any issuance of stock, incurrence of long-term debt or acquisition or sale of material utility assets by CT. In addition, the PUC must approve any change in control of either CT or its holding company. The PUC defines a "change in control" as either an acquisition or disposition of the largest single voting interest in a company, if that interest exceeds 20%.

CT is subject to the jurisdiction of the Federal Communications Commission ("FCC") with respect to interstate rates, services, access charges and other matters, including the prescription of a uniform system of accounts. Interstate services, for the purpose of determining FCC jurisdiction, are communications that originate in one state and terminate in another state or a foreign country, including the use of CT's local telephone network to originate or terminate such communications. Prices for CT's interstate services, consisting primarily of subscriber line charges and access charges for interstate toll calls, which accounted for approximately 32.0% of our RLEC's 2005 revenues, are regulated by the FCC based on "average schedule" formulas. The formulas use the costs of other telephone companies to "simulate" the costs of the average schedule companies. Under the FCC rules, the National Exchange Carrier Association ("NECA") is required to review these formulas annually. In December 2005, NECA proposed formula changes to the FCC that, if adopted, could reduce CT's interstate revenues by approximately \$1.2 million (\$2.4 million annually) in the second half of 2006. In addition, NECA proposed a phased-in structural change to the formulas that would reduce CT's settlements by approximately \$0.4 million in 2006, \$2.2 million in 2007, \$3.9 million in 2008 and \$4.2 million thereafter. These structural changes result primarily from changes in the formula used to estimate common line (or local loop) costs and special circuit settlements. It is possible that future changes to the formulas or FCC disallowance of the phase-in may cause additional changes (either increases or decreases) in CT's interstate access revenues.

The FCC has an open rulemaking proceeding in which it is considering major changes to its rules governing interstate access charges and other forms of intercarrier compensation. We are unable to predict how any FCC action in this proceeding may affect CT's revenues. CT also receives funding from the federal Universal Service Fund, under rules established by the FCC. The FCC is considering changes in the universal service mechanism, affecting both the collection and distribution of these funds that could affect CT's prices and revenues. In addition, the FCC must also approve any sale or "transfer of control" of CT or of its holding company.

Competitive Environment

Our RLEC has faced very limited competition, except for in-region toll service, during the first decade after the Telecommunications Act was passed in 1996. Part of the reason for this is that CT maintains a rural exemption from the provisions of the Telecommunications Act, including, but not necessarily limited to, unbundling, colocation and rate discounts, for all of its access lines in Pennsylvania. The rural exemption requires prospective competitors who seek resale discounts, colocation, total element long run incremental cost ("TELRIC") pricing and unbundled network elements to go through a formal review by the Pennsylvania PUC before receiving approval. The PUC may grant such approval only if it finds that the competitor's proposal is not unduly economically burdensome, is technically feasible and is consistent with the universal service provisions of the Telecommunications Act. To date, no carrier has sought such a review by the Pennsylvania PUC. In addition, competition in our markets is somewhat mitigated due to the low population density, rural nature and mountainous topography of our markets.

However, the rural exemption does not preclude competitors from providing telephone services within CT's service area entirely over their own facilities, or over the facilities of third parties. Further, the Act's general requirement that telecommunications carriers interconnect networks for the exchange of traffic does apply to CT. CT has received several requests for network interconnection for the exchange of traffic between its network and the networks of other facilities-based telecommunications providers, and has entered into interconnection and reciprocal compensation agreements with several national wireless carriers and wireline carriers for exchange of traffic between its network and theirs. Sprint has filed to provide facilities-based CLEC service in CT's territory; however, CT is protesting the application. It is CT's contention that Sprint is not the actual end user and, therefore, the application should be denied. In addition, Core Communications, Inc. has filed an application for the purpose of expanding its local service authority to include the service territory of CT. Service Electric Telephone Company, LLC. ("SET") filed an application for the purpose of expanding its local service authority to include the remaining service territory of CT. SET received authority to offer facilities based local exchange telecommunications services in a limited portion of CT's service area in 2001. CT is protesting both of these applications. It is not possible to predict the outcome of any of these proceedings at this time.

A variety of other factors contribute to our RLEC's relative insulation from competition. These factors include its service territory's high-cost of facilities-based entry due to low population density, the lack of concentration of any large business customers (as its top 10 business customers account for less than 5% of its revenues), its customer service record and level of customer satisfaction and its favorable regulatory environment.

Competition has, however, been increasing in recent years, due to increased marketing of calling packages by wireless carriers and the entry of new types of voice service providers. We now face competition from national ISPs such as Time Warner (AOL), from cable providers offering a cable modem product, and from providers of voice over Internet services (such as Vonage, Skype and others) who do not require access to CT's telephone network for their competitive offerings.

DSL

In the second half of 1999, we began offering our DSL service. We offer this service through our own facilities in the majority of CT's territory and on an "on-net" and an "off-net" basis in selected areas of CTSI's markets. As of December 31, 2005, most of our installed DSL lines are in CT's territory.

CLD

Since 1990, Commonwealth Long Distance Company ("CLD") has conducted the business of providing long-distance telephone services. Commonwealth Long Distance provides long-distance services to CT's customers. CLD purchases long-distance minutes on a wholesale basis from third-party providers.

CTSI Operations

We offer competitive local, toll, network access, long-distance, enhanced services, broadband data services and high-speed Internet access services in three regional "edge-out" markets, which encompass cities and surrounding areas that have total populations between 250,000 and 500,000, as well as a significant concentration of business and industry. The geographic area represented by these three markets is roughly one-third the size of CT's service territory, or about 1,750 square miles, with a population of approximately 1.4 million and approximately 600 access lines per square mile.

Network Strategy

CTSI's network strategy is to own the majority of the key elements of the local exchange network. These elements include the host switches, the remote switches and the facilities connecting the host switches to the remote switches, including both the fiber optic cable and the transport electronics. In addition, where economically viable, CTSI builds copper distribution facilities between the remote switch and customer premises. Our network strategy allows us to provide high-quality, reliable service, reduce customer churn and generate attractive margins. CTSI builds, owns and operates digitally-switched, fiber intensive networks that are DSL-capable in each of its three regional edge-out markets. As of December 31, 2005, CTSI had approximately 99% of its access lines connected to its own switches and approximately 54% of its access lines completely on its own network.

Customer Service

CTSI strives to provide its customers with exceptional service and uses the same customer care procedures that have proven successful for our 109-year-old RLEC. We operate a customer service center, which takes calls 24 hours a day, 7 days a week, to handle all customer requests. We are also proficient in other customer service aspects of operating in a CLEC environment and have developed an efficient provisioning interface with the incumbent local exchange carrier. Because we own and operate a significant portion of our own network elements, we are not solely dependent upon the incumbent local exchange carrier for provisioning and maintenance resolution. We deploy leading-edge network management and support systems to support proactive fault and performance management to deliver the highest quality of service to our customers.

Sales Organization

We utilize direct sales channels to target potential business, carrier and residential customers. Our direct channels include sales teams based in local offices, which are exclusively focused on selling to potential business customers with more than five lines. Each team consists of customer account managers and specialists that focus on retaining and growing accounts after the initial sale. In addition, our inside sales team is focused on residential and business customers with fewer than five lines.

Regulatory Environment

The Pennsylvania PUC exercises jurisdiction over CTSI's intrastate telephone services, including basic local exchange service, intrastate access services, and intraLATA toll services. Under the PUC's current practices, CTSI's rates and services are generally subject to much less regulatory scrutiny than those of the dominant local telephone company in its markets (*i.e.*, Verizon). Additionally, municipalities and other local government agencies may regulate limited aspects of CTSI's business, such as its use of rights-of-way.

At the federal level, the FCC has jurisdiction over interstate services, including access charges, as well as long-distance services. CTSI's rates, terms, and conditions of service are filed with the FCC in tariffs and are subject to the FCC's complaint jurisdiction. The FCC has established rules limiting the rates CTSI and other competitive local exchange carriers can charge for origination and termination of long-distance calls (switched access), and for termination of local calls to Internet service providers (ISP traffic).

The Telecommunications Act of 1996 gives CTSI rights to interconnect its network with Verizon, to exchange traffic with Verizon and to obtain unbundled access to elements of Verizon's network at regulated rates based on Verizon's forward-looking costs, which may include a reasonable profit. Under this law, Verizon and CTSI may negotiate the prices and other terms and conditions of these arrangements, but in the event of an impasse, the Pennsylvania PUC has authority to arbitrate any disputes. Future rulings by the Pennsylvania PUC, or changes in the FCC rules under which the Pennsylvania PUC resolves these issues, may have a material effect on CTSI's costs and profitability.

CTSI purchases access to various network elements from Verizon under FCC rules that require the Pennsylvania PUC to determine rates for these elements based upon forward-looking incremental costs. The FCC adopted significant changes in October 2003 and February 2005 to its rules requiring incumbent carriers, like Verizon, to offer unbundled access to network elements to competing carriers, like CTSI. We believe that the new rules are not likely to have a material impact on CTSI's use of unbundled voice-grade loops. These rules remain subject to judicial review and to further FCC proceedings, which could affect the terms on which CTSI obtains access to voice-grade loops and other components of Verizon's network. We cannot offer any assurance that CTSI will continue to be able to obtain this access on favorable terms.

Competitive Environment

CTSI competes principally with the services offered by the incumbent local exchange carrier, Verizon. Incumbent local exchange carriers, such as Verizon, have relationships with their customers, have the potential to subsidize services from their regulated service revenues and benefit from certain favorable state and federal regulations. Verizon is larger and has greater financial resources than CTSI. In light of the passage of the Telecommunications Act and concessions by some of the regional Bell companies, federal and state regulatory initiatives may provide increased business opportunities to CLECs, but incumbent carriers may obtain increased pricing flexibility for their services as competition increases. If, in the future, incumbent carriers are permitted by

regulators to lower their rates substantially, engage in significant volume and term discount pricing practices for their customers or charge CLECs significantly higher fees for interconnection to the incumbent carriers' networks, CTSI's competitive position would be adversely affected.

CTSI also faces, and will continue to face, competition from other current and potential future market entrants, including other CLECs, long-distance companies (MCI), cable television companies, electric utilities, microwave carriers, wireless telecommunications providers, Internet providers (XO and Level 3) and private networks built by large end users. The edge-out markets served by CTSI are served by one or more other CLECs including XO Communications, Telcove, Choice One Communications, D&E Communications and others. We expect competition from CLECs and other companies to continue in the future.

Other Operations

Commonwealth Communication, LLC

Commonwealth Communications provides telecommunications equipment and technical services, and designs, installs and manages telephone systems for businesses, hospitals and universities located primarily in Pennsylvania. Commonwealth Communications also undertakes premises distribution systems projects (cabling projects) primarily for hospitals and educational institutions.

epix® Internet Services

epix® Internet Services ("epix®"), founded in 1994, is our Internet service provider. epix® primarily provides dial-up Internet access at a flat rate for residential users and also provides dedicated access for business users and associated services such as web page hosting and design. epix® provides a competitive Internet product for CT and CTSI and other customers, along with network support, technical support and customer service to our DSL product. epix® had approximately 22,400 dial-up subscribers as of December 31, 2005.

Employees

We employed a total of 1,107 employees as of December 31, 2005. Approximately 38% of our employees are covered under collective bargaining agreements. Commonwealth Telephone Company bargaining employees labor contract with the Communications Workers of America expired on November 30, 2005. Currently, the Company and the union are working under the terms of the old contract. Also, in December 2005, Commonwealth Communications bargaining employees ratified a labor contract between the Company and the Communications Workers of America that will remain in effect until June 29, 2009.

Item 1A. Risk Factors

Risks related to regulation of the telecommunications industry

The telecommunications industry is subject to extensive regulation at the federal, state and local levels. The costs of complying with this regulation, delays or failures to receive required regulatory approvals, or the enactment of new, adverse regulatory requirements may have a material adverse effect upon our business. The risks presented by the regulatory environment we face include the following:

The amounts we can charge for most of our services are subject to regulatory restrictions. Our financial results have been adversely affected by recent reductions in access rates and may be further adversely affected by future regulatory decisions.

Approximately 14.1% of our consolidated revenues for both of the years ended December 31, 2005 and 2004 were from local service fees paid by customers of our RLEC. These fees, and other charges imposed by our RLEC for in-state services, are currently subject to an alternative regulation plan approved by the PUC. We believe that this regulatory arrangement is more favorable to us than traditional rate of return regulation.

On November 30, 2004, the Governor of Pennsylvania signed legislation that authorized CT to amend its alternative regulation plan to include a commitment to deliver broadband service to all customers by December 31, 2008. Under the legislation, this commitment entitles CT to eliminate the 2% yearly offset in its price adjustment formula, although CT could be required to refund the additional revenues collected due to this amendment if it fails to meet its broadband commitment.

Under the amended plan that is now in effect, CT can change its in-state rates, in the aggregate, based on changes in inflation or for events deemed outside of CT's control that result in reduced revenues or increased expenses. These increases may not be sufficient to cover increases in our costs.

Additionally, approximately 43.2% and 42.6% of our consolidated revenues for the years ended December 31, 2005 and 2004, respectively, came from charges paid to us by other carriers for services CT and CTSI provided in originating and terminating intrastate and interstate toll calls, and terminating local calls received from wireless carriers and other telephone companies. The payments that we receive for these services are regulated by the FCC and the Pennsylvania PUC. The amounts charged by both CT and CTSI for these services have been reduced by recent regulatory decisions.

CT currently receives its interstate access revenues pursuant to average cost schedules established by NECA. If CT should lose its average schedule status, or if NECA should make changes in its cost schedules or methodology, we could incur a significant loss of interstate access revenue.

We cannot predict whether any additional FCC or Pennsylvania PUC rules will be passed that will result in further reductions in the revenues we receive, although the FCC is currently considering proposals that could significantly change the interstate access charge system. Additionally, these agencies' current rules may change as a result of judicial review or changes in legislation.

If any of the favorable regulatory provisions from which CT currently benefits were to be unfavorably modified or terminated, we could experience higher costs and lower revenues.

Because of its status as a rural telephone company under the Telecommunications Act of 1996, or the Act, CT is not currently required to comply with that Act's provisions requiring an incumbent carrier to unbundle its network, provide colocation, provide resale discounts, provide interconnection at rates based on forward-looking incremental costs or other items. If this limitation were to change, more competitors could enter our RLEC markets than we currently expect. CT might have to provide these competitors with access to our facilities at rates lower than what we currently charge our customers for use of those facilities. We could also incur additional administrative and regulatory expenses as a result of such newly imposed requirements. The Pennsylvania PUC has authority under the Act to terminate CT's rural exemption if it receives a request to do so from another telecommunications carrier. To date, no other carrier has made such a request to the Pennsylvania PUC, but we have no assurance that CT's rural exemption will remain in effect indefinitely.

Loss of our access to network elements from incumbent telephone companies or an increase in the prices we must pay for such elements would adversely affect CTSI's business.

Approximately half of CTSI's customers are served, at least in part, by network elements leased primarily from Verizon. CTSI's business, therefore, depends in large part on our ability to provide service to our customers by leasing various elements of the incumbent telephone company's network to provide local service. The Act, and FCC and state commission rulings under the Act, require incumbent telephone companies to lease network elements. If these rules are changed by the FCC or state commissions, or are struck down by the courts, our ability to provide service in a cost-effective manner could be adversely affected. For example, the FCC could remove one or more of the necessary elements that the incumbent telephone company is required to provide to us, or permit substantial increases in the amounts the incumbent company can charge CTSI. If incumbent telephone companies were no longer required to provide unbundled network elements on favorable terms, CTSI's operating margins would be reduced and it might not be able to effectively compete.

The FCC has made several significant changes in recent years to its rules governing access to unbundled network elements. Under the new rules, Verizon is required to continue to offer access to unbundled voice-grade loops. However, we cannot assure you that these rules will not change in the future.

Regulatory requirements could delay or prevent our ability to take actions we consider beneficial to our business.

Pennsylvania law requires us to secure consent from the Pennsylvania PUC before CT or CTSI may issue capital stock, incur long-term debt or sell or otherwise dispose of material utility assets. Both the FCC and the PUC must review any transaction that results in a "change of control" of a regulated entity or of a holding

company of a regulated entity. The approval process for these transactions can be lengthy and could restrict our ability to offer services, set prices, obtain financing, affect mergers or otherwise arrange a sale of the Company or take other steps that we may believe to be in our best interest.

Risks related to the competitive nature of the telecommunications industry

The telecommunications industry is highly competitive. We face actual or potential competition from many existing and emerging companies, including other incumbent and competitive local telephone companies, long-distance carriers and resellers, wireless telephone companies, Internet service providers, satellite companies and cable companies. We may not be able to successfully anticipate and respond to various competitive factors affecting the industry, including regulatory changes that may affect our competitors and us differently, new technologies and services that may be introduced, changes in consumer preferences, demographic trends and discount pricing strategies by competitors. Also, recent consolidation in the telecommunications industry (for example, Verizon and MCI) can result in the rerouting of traffic off of our network to other carriers that could adversely effect our results of operations. The risks to our business from competition include the following:

Verizon, as the incumbent local carrier in CTSI's markets, has competitive advantages over us which adversely affect our operating margins.

As the incumbent carrier in CTSI's markets, Verizon enjoys competitive advantages, including its wireline connection to virtually all of our customers and potential customers, its established brand name and its substantial financial resources. As a competitive local carrier, we are effectively required to discount our services to win potential customers and to pay substantial amounts to Verizon to lease elements of its networks. These factors result in lower operating margins for CTSI, and make us especially vulnerable to any discount pricing policies that Verizon may adopt to exploit its lower-cost structure and greater financial resources. Additionally, Verizon offers in-region long-distance services to its Pennsylvania customers, which allows it to offer attractive service packages to its customers in the markets we serve, including DSL. Verizon has recently acquired MCI, another competitor in the markets we serve, which may increase Verizon's advantages.

We face intense competition in our markets for long-distance, Internet access and other ancillary services that are important to our business and to our growth strategy.

An important part of our business strategy is to sell additional services to local customers in both the CT and CTSI markets. The markets for these ancillary services, however, are extremely competitive, and in some cases, are dominated by companies far larger than our own with lower costs and greater name recognition and technical and financial resources, than ours. Our competitors for these services include, in addition to Verizon, long-distance companies like AT&T, Verizon Business and Sprint, and, in the Internet service provider business, Time Warner (AOL) and discounted service providers, regional Internet service providers and cable companies such as Service Electric, Blue Ridge and Comcast. In addition, as with most telephone providers today, the low-cost telephony and long-distance products being offered by Vonage and other VoIP providers are starting to have a nominal impact on our residential and business wireline service at this time. Telcove also enjoys a competitive advantage in CT and CTSI territory as a result of winning a contract with the state of Pennsylvania to provide telecommunications and data services to state government agencies, selected Pennsylvania colleges and universities and other businesses that fall under the Pennsylvania state government contract, that remains in place until 2011. To compete against these established companies, we expect to have to offer both lower prices and superior service to our customers, and we may not be able to do so on profitable terms. If we are unable to maintain a competitive offering of long-distance, Internet access and other ancillary services, we may lose local customers who prefer to obtain a package of services from one telecommunications provider.

Technological developments could increase our costs and cause a decline in demand for our services.

The telecommunications industry is subject to rapid and significant changes in technology. If we do not replace or upgrade technology and equipment that becomes obsolete, we will be unable to compete effectively as we will not be able to meet the needs or expectations of our customers. Additionally, replacing or upgrading our infrastructure in the future could result in significant capital expenditures.

Our wireline telecommunications services are also in competition, or potential competition, with numerous alternative technologies, including, in particular, wireless communications. The wireless telecommunications industry is experiencing significant technological change. Wireless carriers are improving the capacity and

quality of digital wireless technology, and are also expected to continue to reduce the prices for their services. These developments could reduce customer demand for our services and the prices that we will be able to charge for these services, particularly in CTSI's markets where a number of wireless providers are established competitors and in certain areas of CT's territory. We believe that future technological developments are likely to result in further improvements in wireless telecommunications services, as well as in other telecommunications technologies, and are likely to result in increased competition for our various businesses.

Voice over Internet Protocol, also known as VoIP, is a service that could cause a decrease in demand for our traditional telephone services, including the demand for additional lines. VoIP is gaining market share among business users who look to Internet telephone systems to cut costs or improve efficiency. It is also possible for residential users to use VoIP as a replacement for a traditional telephone line (for example, by obtaining Internet access over a cable television system). We cannot predict which of many possible future technologies, products or services will be significant to our competitive position or what expenditures will be required to develop and provide these technologies, products or services.

Some of our competitors have superior resources that may place us at a cost and price disadvantage.

Some of our current and potential competitors have market presence, technical and marketing capabilities and financial, or other resources substantially greater than ours. These competitors may be able to develop and expand their communications and network infrastructures more quickly, adapt more swiftly to new or emerging technologies and changes in customer requirements, take advantage of acquisition and other opportunities more readily and devote greater resources to the marketing and selling of their products and services than we can. Additionally, the greater brand name recognition of some competitors, such as Verizon, requires us to price CTSI's services at lower levels in order to win business. Finally, the cost advantages of some competitors may give them the ability to reduce their prices for an extended period of time if they so choose.

Other business risks

A substantial portion of CTSI's revenues are derived from Internet service providers, or ISPs. A decline in these ISP customers or their customer base could negatively impact our financial results.

CTSI derives a substantial portion of its revenues directly and indirectly from ISPs. ISPs represented approximately 15.1% and 17.1% of CTSI's revenues for the years ended December 31, 2005 and 2004, respectively. These high-margin revenues include services provided directly to ISPs, including local dial tone and transport (cap-type) services, and indirect services such as reciprocal compensation, and trunking from Verizon as a result of Verizon's customers accessing these ISPs. Industry-wide trends towards declining usage of dial-up Internet access threaten the profitability or viability of our ISP customers. If we lose a large customer or a significant number of customers that are providing Internet services, or if a significant portion of these customers are unable to pay amounts owed to us, our financial results could be negatively impacted.

Changes in the jurisdictional mix of CTSI's traffic have adversely affected its results.

CTSI's revenues from access charges and reciprocal compensation are affected by the mix of traffic delivered to us by other carriers for termination to CTSI's customers. In late 2003, Verizon notified CTSI of a reduction in the proportion of its delivered traffic that is subject to intrastate access charges, and a corresponding increase in the proportion that is subject to reciprocal compensation rates. Because the reciprocal compensation rates are significantly lower than intrastate access charges, this change in traffic mix permanently reduced CTSI's revenues by approximately \$700,000 per month. CTSI was notified in early 2005 by Verizon North (formerly GTE), requesting a change in the PLU factor. As a result of this request, CTSI is using a direct measurement billing approach instead of a PLU factor. The effect on CTSI's revenue and operating income was a reduction of approximately \$50,000 per month beginning April 2005 based on the actual traffic mix.

Demand for our traditional dial-up Internet access services has matured.

Within the total Internet access market, the market for traditional, narrowband dial-up access services is shrinking. Our traditional dial-up Internet service provided by epix® Internet Services has been declining since its peak at nearly 50,000 subscribers in 2001. As of December 31, 2005, epix® had approximately 22,400 dial-up subscribers. Continued decline in these services will adversely affect our results.

Demand for some of our services may be adversely affected by a downturn in the U.S., Pennsylvania or local economies in which we operate.

Demand for some of our services may be adversely affected by a downturn in the U.S., Pennsylvania or local economies in which we operate. As a result, we may experience lower than expected revenues for some of our businesses. If current general economic conditions worsen, the revenues, cash flow and earnings of our company as a whole could be adversely affected.

Our future switched access lines in service will likely be lower than our historical, and this decline may adversely affect our results.

Additional line penetration in CT's markets has been declining. Regulatory actions in the area of intercarrier compensation could result in increases in CT's monthly per-line charges, which may discourage customers from purchasing or keeping additional lines. In addition, some customers who use an additional line for dial-up Internet access choose to cancel their additional line when they upgrade to DSL. To the extent that additional line penetration continues to decline, our ability to generate additional revenues from this source, which has been very important to our results in recent years, will decrease. Residential lines have also declined slightly due to wireless substitution.

Our growth strategy will require us to invest significant capital in services that may not achieve the desired returns.

We plan to continue to invest capital into services such as DSL. This business is highly competitive (with cable modem being the primary competitor), and we cannot be assured that we will be able to achieve the returns on investment that we have historically earned. Additionally, even if we are successful in our efforts to develop this new business, its operating results and margins will likely be lower than those of our core lines of business. Moreover, we expect that any success we experience in selling DSL service will, to some extent, be offset by reduced demand for additional lines when customers have been using their additional line for dial-up Internet access.

Any disruption in our services could potentially expose us to a loss of customers or claims for damages.

Because our services are critical to many of our customers' businesses, any significant interruption in our services could result in a loss of customers or claims by our customers for indirect or consequential damages. Although the standard terms and conditions of our tariffs and customer contracts disclaim our liability for any such damages, a customer could still bring a lawsuit against us claiming lost profits or other consequential damages as the result of a service interruption or other web site or application problems that the customer may ascribe to us. We cannot assure you that a court would enforce any limitations on our liability. In such cases, we could be liable for substantial damage awards.

We depend on third parties, over whom we have no control, to deliver our services.

Because of the interconnected nature of the telecommunications industry, we depend heavily on other local telephone companies, long-distance carriers and numerous other third parties to deliver our services. CTSI is particularly dependent on cooperation from Verizon in order to provide local service to a portion of its customers, slightly less than half of whom are not exclusively served by our network. We do not have a long-term agreement with Verizon to provide us with the network connections we need, and the terms of our relationship with Verizon are subject to change as the result of regulatory agency and court decisions. In addition, we are dependent on easements, franchises and licenses from various private parties such as established telephone companies and other utilities, railroads, long-distance companies, state highway authorities, local governments and transit authorities, for access to aerial pole space, underground conduits and other rights-of-way in order to construct and operate our networks. The failure to maintain the necessary third party arrangements on acceptable terms would have an adverse effect on our ability to conduct our business.

If future acquisitions or business combinations are not successful, we could suffer an adverse effect on our business and results of operations.

From time to time we consider acquisitions of other businesses, some of which could be material to us. To the extent that we make acquisitions in the future, we may issue common stock that would dilute the ownership of our shareholders, incur debt, assume liabilities or incur large and possibly immediate write-offs. Acquisition transactions require a significant commitment of resources and are accompanied by a number of risks, including:

- the difficulty of assimilating the operations and personnel of the acquired companies;
- the potential disruption of our ongoing business and distraction of management;
- unanticipated expenses related to technology integration;
- the maintenance of uniform standards, controls, procedures and policies;
- the impairment of relationships with employees and customers as a result of any integration of new management personnel; and
- potential unknown liabilities or risks associated with acquired businesses.

We cannot be sure that we will succeed in addressing these risks or any other problems encountered in connection with potential business combinations and acquisitions.

As a holding company, we will require dividends from subsidiaries to meet our cash requirements.

We are a holding company whose principal assets are the shares of capital stock of our subsidiaries, and we do not generate any significant operating revenues of our own. Consequently, we depend on dividends, advances and payments from our subsidiaries (primarily CT) to fund our activities and meet our cash needs, including our debt service requirements. Our subsidiaries are separate and distinct legal entities. The ability of our subsidiaries to make certain payments or advances to us will depend on their operating results and will be subject to existing debt covenants, various business considerations and applicable laws and regulations. Accordingly, we cannot assure you that our subsidiaries will be able to, or be permitted to, make distributions to enable us to make payments in respect to our indebtedness.

The restrictive terms imposed by our current CoBank indebtedness may prevent us from achieving some of our business objectives.

CT's CoBank indebtedness contains various covenants that limit its ability to engage in the following activities:

- borrow and place liens on assets;
- make investments or make certain other restricted payments;
- enter into transactions with affiliates; and
- sell assets, make acquisitions or merge with or into other companies.

Our ability to modify or comply with these covenants can be affected by events beyond our control. A breach of any of these covenants could also result in a default even if we are able to pay our debt. A default under these covenants or covenants under other financing arrangements we enter into could result in the acceleration of required payments or the inability to receive financing in the future.

Risks relating to our common stock

Our governing documents and applicable laws and regulations may discourage a takeover attempt.

Provisions contained in our articles of incorporation and by-laws, Pennsylvania law and industry regulations could make it difficult for a third party to acquire us, even if doing so might be beneficial to our shareholders. For example, our certificate of incorporation and by-laws impose various procedural and other requirements that could make it difficult for shareholders to affect certain corporate actions. In addition, federal and Pennsylvania regulations regarding changes of control in our business are very restrictive. These provisions could limit the price that certain investors might be willing to pay in the future for shares of our common stock and may have the effect of delaying or preventing a change in control that current shareholders deem beneficial.

If we sell shares of our common stock the market price of our common stock could decline.

The market price of our common stock could decline as a result of sales of a large number of shares of our common stock, or the perception that such sales could occur. These sales, or the possibility that these sales may occur, also might make it more difficult for us to sell equity securities in the future at a time and at a price that we deem appropriate.

Item 1B. Unresolved Staff Comments

None

Item 2. Properties

Our property consists principally of central office equipment, telephone lines, telephone instruments and related equipment and land and buildings related to telephone operations. This plant and equipment is maintained in good operating condition by CT and CTSI operations. We own substantially all of our central office buildings, administrative buildings, warehouses and storage facilities. All of the telephone lines are located either on private or public property. Locations on private land are governed by easements or other arrangements. We are not aware of any environmental liabilities which would have a material impact on our financial position or results of operations.

Item 3. Legal Proceedings

In the normal course of business, there are various legal proceedings outstanding, including both commercial and regulatory litigation. We do not believe these proceedings will have a material adverse effect on our results of operations or financial condition. Additionally, there are no other legal matters pending that we expect to have a material impact on our financial condition or results of operations.

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

None

EXECUTIVE OFFICERS OF THE REGISTRANT

<u>Name</u>	<u>Age</u>
<p>Michael J. Mahoney</p> <p>President and CEO as well as Director of CTE since July 2000; Telecommunications consultant from October 1999 to July 2000; Director of CTE (formerly C-TEC Corporation) from June 1995 to October 1999; President and Chief Operating Officer of C-TEC Corporation from February 1994 to September 1997; and Director, President and Chief Operating Officer of RCN Corporation from September 1997 to October 1999.</p>	55
<p>Eileen O'Neill Odum</p> <p>Executive Vice President and Chief Operating Officer of CTE since July 2004; President—National Operations, the domestic wireline telecom group of Verizon Communications, Inc., from 2000 to 2004; Region President—Northwest, of GTE Corporation's domestic wireline telephone operations from 1994 to 2000; Assistant Vice President of Business Sales and Services of GTE Telephone Operations from 1992 to 1994; Vice President/General Manager—Texas Region of GTE Mobilnet from 1990 to 1992; Vice President of Marketing of GTE Mobilnet from 1988 to 1990.</p>	51
<p>Donald P. Cawley</p> <p>Executive Vice President of CTE since September 2003; Senior Vice President of CTE from June 2000 to September 2003; Chief Accounting Officer of CTE since May 1999; Vice President and Controller of CTE from September 1997 to June 2000; Vice President and Controller of Commonwealth Telephone Company from February 1996 to September 1997; and Controller of Commonwealth Telephone Company from March 1992 to February 1996.</p>	47
<p>Kevin M. O'Hare</p> <p>Group Vice President of Strategic Development of CTE since January 2006; President and Chief Executive Officer of Lightship Telecom from January 1998 to May 2005; President and Chief Executive Officer of US WATS, Inc., from December 1996 to November 1997; Executive Vice President of C-TEC Corporation from May 1995 to December 1996; Network Engineering Director of ACC Long Distance Corp., from February 1994 to April 1995.</p>	45
<p>Rita M. Brown</p> <p>Senior Vice President and General Manager of CTSI, LLC ("CTSI"), since October 2004; Vice President of Strategic Initiatives of CTE from January 2004 to September 2004; Vice President of Operations of Commonwealth Telephone Company from 2002 to December 2003; Vice President of Corporate Engineering of CTE from 2001 to 2002; Vice President and General Manager of epix® Internet Services from 2000 to 2001; Vice President and General Manager of Residential Markets of CTSI during 2000; Vice President and General Manager of Commonwealth Communications from 1998 to 2000; and various positions with CTE from 1973 to 1998.</p>	54
<p>Scott Burnside</p> <p>Senior Vice President of Regulatory and Government Relations of CTE since May 2003; Senior Vice President of Regulatory and Government Affairs of RCN Corporation from June 1997 to May 2003; Vice President of Regulatory Affairs of C-TEC Corporation from 1985 to June 1997; and various positions with Commonwealth Telephone Company from January 1978 to 1985.</p>	61
<p>Thomas M. Davis</p> <p>Vice President of Information Technology of CTE since February 2001; Senior Vice President of Software Engineering and Vice President of Solutions Delivery of Intertech Management Group, Inc., from February 1999 to February 2001; President of Dapro, Inc., from April 1992 to February 1999; Applications Development Manager at Alltel Information Services, Inc., from September 1988 to April 1992; and various positions with Nabisco Brands, Inc., C-TEC Corporation and Pennsylvania Gas and Water Company from 1982 to 1988.</p>	49
<p>J. Christine Feeley</p> <p>Vice President of Marketing of CTE since March 2005; Director of Marketing of Valor Communications Group, Inc., from April 2001 to January 2004; Vice President of Rapp Collins Worldwide from May 2000 to February 2001; National Consultant from December 1992 to May 2000; Promotions Manager of Berry Brown Advertising, Inc., from January 1991 to December 1992.</p>	44

EXECUTIVE OFFICERS OF THE REGISTRANT—(Continued)

<u>Name</u>	<u>Age</u>
DG Gulati	56
<p>Senior Vice President of Operations Strategy and Development of CTE since April 2005; Senior Vice President of Corporate Development of CTE from 2002 to April 2005; Senior Vice President of Operations and Engineering of RCN Corporation from 2000 to 2002; Senior Vice President of Network Engineering of RCN Corporation from 1997 to 2000; Vice President of Business Operations of C-TEC Corporation from 1995 to 1997; Director of Telecommunications of Cablevision Industries from 1994 to 1995; Assistant Vice President of Network Services of Warwick Valley Telephone Company from 1993 to 1994; and various positions with Rochester Telephone Corporation from 1982 to 1993.</p>	
Todd T. Hanson	44
<p>Senior Vice President of Network Services and Technology of CTE since September 2004; Senior Vice President of Engineering and Operations of CTE from January 2004 to September 2004; Vice President of Engineering of CTE from April 2003 to January 2004; President of Qwest Communications International Inc., Local Broadband—Eastern Region from 1999 to 2002; Vice President of Network Engineering and Field Operations of Electric Lightwave, LLC (wholly-owned subsidiary of Citizens Communications), from 1995 to 1999; Vice President of Network Planning, Engineering and Project Management of MFS Telecom, Inc., from 1993 to 1995; and various management positions with AT&T Canada, Inc. (formerly Unitel Communications Inc.), and Sprint Corporation from 1986 to 1993.</p>	
Steven J. Letts	48
<p>Vice President and General Manager of Commonwealth Communications since December 2002; Vice President of Sales—Advanced Building Networks of WorldCom, Inc. (“WorldCom”) from 2001 to 2002; Vice President of Shared Tenant Sales of WorldCom from 2000 to 2001; Vice President and General Manager of Integrated Communications Services (“ICS”) Division of WorldCom from 1997 to 2000; Vice President of Service and Support—ICS Division of Metropolitan Fiber Systems, Inc. (“MFS”), from 1996 to 1997; Director of Operations—Central Region of MFS from 1995 to 1996; General Manager—Texas Region of Realcom Inc., from 1993 to 1995; various positions with Intecom, Inc., from 1985 to 1993; and United States Marine Corps Officer from 1980 to 1985.</p>	
Raymond B. Ostroski	51
<p>Senior Vice President, General Counsel and Corporate Secretary of CTE since February 2003; Vice President, General Counsel and Corporate Secretary of CTE from December 2002 to February 2003; Senior Corporate Counsel and Assistant Corporate Secretary of CTE from January 2002 to November 2002; Legal Consultant with RBO Consulting from January 1998 to December 2001; Executive Vice President, General Counsel and Corporate Secretary of RCN Corporation from October 1997 to December 1997; Executive Vice President, General Counsel and Corporate Secretary of C-TEC Corporation from February 1991 to September 1997; Corporate Counsel and Assistant Corporate Secretary of C-TEC Corporation from August 1988 to February 1991; Associate Counsel of C-TEC Corporation from August 1985 to August 1988; and Attorney at the law firm of Hoegen & Marsh, PC from August 1983 to August 1985.</p>	
James F. Samaha	40
<p>Senior Vice President and General Manager of Commonwealth Telephone Company and epix® Internet Services since January 2004; Senior Vice President and General Manager of Commonwealth Telephone Company from August 2001 to January 2004; Senior Vice President of Internet and Data Services of CTE from December 2000 to August 2001; Senior Vice President of Business Development of CTE from July 2000 to December 2000; Vice President and General Manager of Jack Flash® from June 1999 to July 2000; Vice President of CTE Finance from March 1998 to June 1999; Director of Corporate Development, and other management positions with AT&T Local Services (formerly Teleport Communications Group) from 1993 to 1998.</p>	
Darryl Varnado	53
<p>Vice President of Human Resources of CTE since January 2006; Leadership Consultant of Lee Hecht Harrison, Inc., from 2005 to January 2006; Vice President and Managing Director of Human Resources of The Nature Conservancy from 2001 to 2005; Director of Global Human Resources Strategy and Design of US Airways, Inc., from 1998 to 2001; Operations Manager of Compensation and Benefits of The Coca-Cola Company from 1995 to 1998; Manager of U.S. Compensation and Employee Rewards of The Coca-Cola Company from 1994 to 1995; Director of Compensation and Employee Rewards of Tennessee Valley Authority from 1993 to 1994.</p>	
David G. Weselcouch	50
<p>Senior Vice President of Investor Relations and Corporate Communications of CTE since June 2000; Vice President of Investor Relations and Corporate Communications of CTE from March 1999 to June 2000; Vice President of Investor Relations of CTE from 1998 to 1999; Director—Investor Relations of GTE Corporation from 1993 to 1998; Manager—Capital Markets Development and Administration of GTE Corporation from 1989 to 1993.</p>	

PART II

Item 5. *Market for Registrant's Common Equity and Related Shareholder Matters*

Our Common Stock is traded on the Nasdaq National Market (Symbol: CTCO).

There were approximately 1,097 registered holders of the Company's Common Stock on February 28, 2006, based on the records of our transfer agent. Other information required under Item 5 of Part II is set forth in Management's Discussion and Analysis of Financial Condition and Results of Operations included on pages F-1 to F-22 of this report and Notes to Consolidated Financial Statements included on pages F-32 to F-54 of this report.

On April 24, 2003, we entered into a Recapitalization Agreement (the "Recapitalization Agreement") with Level 3 Communications, Inc. ("Level 3") and Eldorado Equity Holdings, Level 3's indirect, wholly-owned subsidiary. Under the terms of the Recapitalization Agreement, we agreed to amend our existing charter to: (i) reclassify and convert each outstanding share of CTE Class B Common Stock into 1.09 shares of CTE Common Stock; and (ii) eliminate from the existing charter the CTE Class B Common Stock, and all provisions related thereto, and certain miscellaneous inoperative provisions. Level 3 agreed, pursuant to the terms of the Recapitalization Agreement, to vote its shares in favor of the reclassification and the related charter amendments. On September 3, 2003, at the Annual Meeting, shareholders approved the proposal to reclassify and convert each outstanding share of CTE Class B Common Stock into 1.09 shares of CTE Common Stock. CTE now has only one class of common stock, with each share having one vote in corporate governance matters. As a result of the reclassification, Level 3's ownership was reduced to approximately 4.6% of the outstanding CTE Common Stock and correspondingly 4.6% of the voting power. Subsequently, on January 21, 2004, Level 3 announced the sale of all of its remaining CTE Common Stock to an institutional investor. In connection with this transaction, certain registration rights were assigned by Level 3 to the purchaser. As of December 31, 2005, Level 3 did not own any shares of CTE Common Stock.

In connection with the Recapitalization, the Class B common shares held as Treasury stock were retired and the shares are no longer authorized.

In July of 2003, we sold \$300 million principal amount of 3.25% convertible notes due July 15, 2023, unless earlier redeemed, repurchased or converted. On November 7, 2003, in connection with a registration rights agreement relating to the notes, we filed a resale shelf registration statement with the Securities and Exchange Commission.

On June 24, 2005, we launched an exchange offer pursuant to which we offered to exchange up to \$300 million of our then outstanding 3.25% convertible notes (the "Old Notes") for new 2005 Series A 3.25% convertible notes (the "New Notes") due 2023 in an equal principal amount plus an exchange fee of \$2.50 per \$1,000 principal amount of existing notes. The New Notes contain terms that provide us with the flexibility to settle conversions of the notes with cash, common stock or a combination of cash and common stock. The Old Notes require us to settle conversions of notes with shares of common stock. The terms of the New Notes maintain full dividend protection for the holders of the notes. The exchange offer closed on August 3, 2005, at which time a total of \$63,892,000 principal amount of New Notes were issued in exchange for the same principal amount of Old Notes and an exchange fee of \$160,000 was paid.

With respect to the New Notes and the Old Notes, interest is 3.25% per annum on the principal amount, payable semi-annually in arrears in cash on January 15 and July 15 of each year, beginning January 15, 2004. In addition, we will pay contingent interest for any six-month period from January 15 to July 14 and from July 15 to January 14, with the initial six-month period commencing July 15, 2008, if the trading price of the notes for each of the five trading days immediately preceding the first day of the applicable six-month period equals 120% or more of the principal amount of the notes. During any interest period when contingent interest shall be payable, the contingent interest payable per note will equal 0.25% of the average trading price of a note during the five trading days immediately preceding the first day of the applicable six-month interest period.

Holders of Old Notes may convert their notes into shares of our common stock and holders of New Notes may convert their notes with settlement, at our election, in our common stock, cash or a combination of cash and

our common stock prior to the close of business on the final maturity date under any of the following circumstances:

- during any fiscal quarter, but only during such fiscal quarter, if the closing sale price of our common stock exceeds 120% of the then-effective conversion price for at least 20 trading days in the 30 consecutive trading-day period ending on the last trading day of the preceding fiscal quarter;
- during the five business-day period after any five consecutive trading-day period in which the trading price per note for each day of such period was less than 98% of the product of the closing sale price of our common stock and the number of shares issuable upon conversion of \$1,000 principal amount of the notes;
- if the notes have been called for redemption; or
- upon the occurrence of specified corporate events.

We may redeem any of the Old Notes or New Notes beginning July 18, 2008, by giving holders at least 30 days' notice. We may redeem the notes either in whole or in part at a cash redemption price of 100% of their principal amount, plus accrued and unpaid interest, including contingent interest, if any, and additional interest, if any, to, but excluding, the redemption date.

If a designated event occurs prior to maturity, holders of Old Notes or New Notes may require us to repurchase all or part of their notes at a cash repurchase price equal to 100% of their principal amount, plus accrued and unpaid interest, including contingent interest, if any, and additional interest, if any, to, but excluding, the repurchase date.

Holders of Old Notes or New Notes may require us to repurchase all or part of their notes on July 15 of 2008, 2013 and 2018 at a cash repurchase price equal to 100% of their principal amount, plus accrued and unpaid interest, including contingent interest, if any, and additional interest, if any, to, but excluding, the repurchase date.

Item 5. (c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers

Effective November 13, 2003, our Board of Directors authorized a Stock Repurchase Program of up to \$100 million of CTE's Common Stock. On February 9, 2004, our Board of Directors increased the size of the total stock repurchase program to up to \$150 million of CTE Common Stock. No time limit has been set for the completion of the Stock Repurchase Program. The purchases have and will be made in open market, negotiated or block transactions. The transactions will be executed at CTE's discretion, based on ongoing assessments of our capital needs, and the market value of CTE Common Stock. Repurchased shares have and will be placed in Treasury and may be used for our employee benefit plans or for other general corporate purposes. The table below provides information regarding purchases of CTE Common Stock made by us during the fourth quarter of the fiscal year covered by this report:

<u>Period</u>	<u>Total Number of Shares Purchased</u>	<u>Average Price Paid per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Program</u>	<u>Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program (dollars in thousands)</u>
October 1, 2005—October 31, 2005	—	—	—	\$31,456
November 1, 2005—November 30, 2005	—	—	—	\$31,456
December 1, 2005—December 31, 2005	—	—	—	\$31,456

Notes

The \$100 million Stock Repurchase Program was announced on November 13, 2003; the \$50 million addition to the program was announced on February 10, 2004. The Stock Repurchase Program has no expiration date. We had no other stock repurchase plan or program expire during the period covered by the table. Also, no plans or programs were terminated prior to expiration. All purchases were made in accordance with the safe harbor in Rule 10b-18 under the Securities Exchange Act of 1934.

Item 6. Selected Financial Data

Information required under Item 6 of Part II is included on page F-23 of this report.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Information required under Item 7 of Part II is included on pages F-1 to F-22 of this report.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Information required under Item 7A of Part II is included on page F-15 to F-16 of this report. Additional information is contained in Note 14 "Off Balance Sheet Risk and Concentration of Credit Risk" of the Consolidated Financial Statements included on page F-52 of this report.

Item 8. Financial Statements and Supplementary Data

The Consolidated Financial Statements and supplementary data required under Item 8 of Part II are included on pages F-27 to F-54 of this report.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

During the two years preceding December 31, 2005, there has been neither a change of accountants of the Registrant nor any disagreement on any matter of accounting principles, practices or financial statement disclosures.

Item 9A. Controls and Procedures

The management of Commonwealth Telephone Enterprises, Inc. ("the Company"), under the supervision and with the participation of the Company's Chief Executive Officer and Chief Accounting Officer, conducted an evaluation of the Company's "disclosure controls and procedures" (as defined in Exchange Act Rules 13a-15(e) or 15d-15(e)) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Accounting Officer concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report. See Management's Report on Internal Control over Financial Reporting on page F-24.

During 2005, we engaged the tax consulting services of KPMG LLP to supplement our internal controls over income taxes.

There was no change in the Company's internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that occurred during the Company's last fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. Other Information

None

PART III**Item 10. Directors and Executive Officers of the Registrant**

The information required under Item 10 of Part III with respect to the Directors of the Registrant is set forth in the definitive proxy statement relating to the Registrant's Annual Meeting of Shareholders to be filed by the Registrant with the Commission pursuant to Section 14(a) of the Securities Exchange Act of 1934 (the "1934 Act") and is hereby specifically incorporated herein by reference thereto.

The information required under Item 10 of Part III with respect to the executive officers of the Registrant is set forth at the end of Part I hereof.

Additional information required under Item 10 of Part III with respect to the executive officers of the Registrant, if applicable, will be set forth in the definitive proxy statement relating to the Registrant's Annual Meeting of Shareholders to be filed by the Registrant with the Commission pursuant to Section 14(a) of the 1934 Act, and is hereby specifically incorporated herein by reference thereto.

The full text of our Code of Ethical Conduct is published on our web site at www.ct-enterprises.com. We intend to disclose future amendments to our Code of Ethical Conduct, and waivers of its provisions granted to executive officers and directors, on our web site within four business days following the date of such amendment or waiver.

Item 11. *Executive Compensation*

The information required under Item 11 of Part III is set forth in the definitive proxy statement relating to the Registrant's Annual Meeting of Shareholders to be filed by the Registrant with the Commission pursuant to Section 14(a) of the 1934 Act, and is hereby specifically incorporated herein by reference thereto.

Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters*

The information required under Item 12 of Part III is included in the definitive proxy statement relating to the Registrant's Annual Meeting of Shareholders to be filed by the Registrant with the Commission pursuant to Section 14(a) of the 1934 Act, and is hereby specifically incorporated herein by reference thereto.

Item 13. *Certain Relationships and Related Transactions*

The information required under Item 13 of Part III is included in the definitive proxy statement relating to the Registrant's Annual Meeting of Shareholders to be filed by the Registrant with the Commission pursuant to Section 14(a) of the 1934 Act, and is hereby specifically incorporated herein by reference thereto.

Item 14. *Principal Accountant Fees and Services*

The information required under Item 14 of Part III is included in the definitive proxy statement relating to the Registrant's Annual Meeting of Shareholders to be filed by the Registrant with the Commission pursuant to Section 14(a) of the 1934 Act, and is hereby specifically incorporated herein by reference thereto.

PART IV

Item 15. *Exhibits, Financial Statement Schedules*

Item 15. (a)(1) *Financial Statements*

Management's Discussion and Analysis of Financial Condition and Results of Operations (Unaudited)

Selected Financial Data (Unaudited)

Management's Report on Internal Control over Financial Reporting

Report of Independent Registered Public Accounting Firm

Consolidated Statements of Operations for Years Ended December 31, 2005, 2004 and 2003

Consolidated Balance Sheets—December 31, 2005 and 2004

Consolidated Statements of Cash Flows for Years Ended December 31, 2005, 2004 and 2003

Consolidated Statements of Changes in Common Shareholders' Equity for Years Ended December 31, 2005, 2004 and 2003

Notes to Consolidated Financial Statements

Item 15. (a)(2) *Financial Statement Schedules*

Description

Condensed Financial Information of the Registrant for Years Ended December 31, 2005, 2004 and 2003 (Schedule I)

Valuation and Qualifying Accounts and Reserves for Years Ended December 31, 2005, 2004 and 2003 (Schedule II)

All other financial statement schedules not listed have been omitted since the required information is included in the Consolidated Financial Statements or the Notes thereto, or is not applicable or required.

Item 15. (a)(3) Exhibits

Exhibits marked with an asterisk are filed herewith. The remaining exhibits have been filed with the Commission and are incorporated herein by reference.

(2) Plan of acquisition, reorganization, arrangement, liquidation or succession

2.1 Limited Liability Company Operating Agreement of CTSI, LLC dated June 30, 2001 is incorporated herein by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2001, (Commission File No. 0-11053).

2.2 Agreement and Plan of Merger between CTSI, Inc. and CTSI, LLC dated June 22, 2001 is incorporated herein by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2001, (Commission File No. 0-11053).

2.3 Limited Liability Company Operating Agreement of CTE Telecom, LLC dated December 2, 2002 is incorporated herein by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2002, (Commission File No. 0-11053).

2.4 Agreement and Plan of Merger between Commonwealth Long Distance Company and CTE Telecom, LLC dated December 31, 2002 is incorporated herein by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2002, (Commission File No. 0-11053).

2.5 Agreement and Plan of Merger between epix® Internet Services, Inc. and CTE Telecom, LLC dated December 31, 2002 is incorporated herein by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2002, (Commission File No. 0-11053).

2.6 Recapitalization Agreement dated April 24, 2003, by and among Commonwealth Telephone Enterprises, Inc., Level 3 Communications, Inc. and Eldorado Equity Holdings, Inc. is incorporated herein by reference to Exhibit 2.1 to the Company's Report on Form 8-K as filed with the Commission on April 25, 2003, (Commission File No. 0-11053).

(3) Articles of Incorporation and By-laws

3.1 Amended and Restated Articles of Incorporation dated September 3, 2003 is herein incorporated by reference to Exhibit 3.12 to the Company's Form S-1 Registration Statement as filed with the Commission on November 7, 2003, Registration No. 333-110325.

3.2 By-laws of Registrant, as amended and restated as of December 3, 2003 are incorporated herein by reference to Exhibit 3.1 to the Company's Report on Form 8-K as filed with the Commission on December 3, 2003, (Commission File No. 0-11053).

(4) Instruments Defining the Rights of Security Holders, Including Indentures

4.1 Loan Agreement dated as of March 29, 1994, made by and between Commonwealth Telephone Company and the National Bank for Cooperatives is incorporated herein by reference to the Company's Report on Form 10-Q for the quarter ended March 31, 1994, (Commission File No. 0-11053).

4.2 Line of Credit Agreement dated as of September 30, 1999 by and between Commonwealth Telephone Company as borrower and the CoBank, ACB is incorporated herein by reference to Exhibit 4(b) to the Company's Report on Form 10-Q for the quarter ended September 30, 1999, (Commission File No. 0-11053).

4.3 Line of Credit Amendment dated as of September 15, 2000 by and between Commonwealth Telephone Company as borrower and the CoBank, ACB is incorporated herein by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2000, (Commission File No. 0-11053).

4.4 Amended and Restated Line of Credit Agreement dated April 6, 2001 by and between Commonwealth Telephone Company as borrower and the CoBank, ACB is incorporated herein by reference to Exhibit 4 to the Company's Report on Form 10-Q for the quarter ended March 31, 2001, (Commission File No. 0-11053).

4.5 Second Amended and Restated Line of Credit Agreement dated June 4, 2002 by and between Commonwealth Telephone Company as borrower and the CoBank, ACB is incorporated herein by reference to Exhibit 4(a) to the Company's Report on Form 10-Q for the quarter ended June 30, 2002, (Commission File No. 0-11053).

4.6 Letter Agreement dated March 13, 2003 to amend the Loan Agreement dated as of March 29, 1994 and the Second Amended and Restated Line of Credit Agreement dated as of June 4, 2002 between Commonwealth Telephone Company and CoBank, ACB is incorporated herein by reference to Exhibit 4(a) to the Company's Report on Form 10-Q for the quarter ended March 31, 2003, (Commission File No. 0-11053).

4.7 Agreements Regarding Amendments to Loan Documents dated June 2, 2003 by and between Commonwealth Telephone Company as borrower and CoBank, ACB is incorporated herein by reference to Exhibit 4.1 to the Company's Report on Form 10-Q for the quarter ended June 30, 2003, (Commission File No. 0-11053).

4.8 Indenture for 3 1/4% Convertible Notes due 2023 dated July 18, 2003 between Commonwealth Telephone Enterprises, Inc. and the Bank of New York, as Trustee is incorporated herein to Exhibit 4.10 to the Company's Form S-1 Registration Statement as filed with the Commission on November 7, 2003, Registration No. 333-110325.

4.9 Form of 3 1/4% Convertible Notes due 2023 is incorporated herein to Exhibit 4.10 to the Company's Form S-1 Registration Statement as filed with the Commission on November 7, 2003, Registration No. 333-110325.

4.10 Registration Rights Agreement dated July 18, 2003 by and among Commonwealth Telephone Enterprises, Inc. and Morgan Stanley & Co. Incorporated, Legg Mason Wood Walker, Incorporated and Wachovia Capital Markets, LLC, as Initial Purchasers is incorporated herein by reference to Exhibit 4.11 to the Company's Form S-1 Registration Statement as filed with the Commission on November 7, 2003, Registration No. 333-110325.

4.11 Amendment to Line of Credit Agreement entered into as of May 20, 2004 by and between Commonwealth Telephone Company and CoBank, ACB is incorporated herein by reference to Exhibit No. 4.6 to the Company's Post Effective Amendment No. 4 to Form S-1 on Form S-3 Registration Statement as filed with the Commission on July 26, 2004, Registration No. 333-110325.

4.12 Indenture between Commonwealth Telephone Enterprises, Inc. and The Bank of New York, as Trustee, dated as of August 3, 2005 related to Series A 3 1/4% Convertible Notes due 2023 (including form of 2005 Series A 3 1/4% Convertible Notes due 2023) is incorporated herein to Exhibit 4.1 to the Company's Report on Form 10-Q for the quarter ended June 30, 2005, (Commission File No. 0-11053).

4.13 Third Amended and Restated Line of Credit Agreement entered into as of May 31, 2005 by and between Commonwealth Telephone Company and CoBank, ACB is incorporated herein by reference to Exhibit No. 10.1 to the Company's Report on Form 8-K dated May 31, 2005, (Commission File No. 0-11053).

(10) Material Contracts

10.1 C-TEC Corporation, 1994 Stock Option Plan is incorporated herein by reference to the Company's Report on Form 10-Q for the quarter ended March 31, 1994, (Commission File No. 0-11053).

10.2 C-TEC Corporation 1994 Stock Option Plan, as amended, is incorporated herein by reference to Form S-8 Registration Statement of Registrant filed with the Commission, Registration No. 33-64563.

10.3 C-TEC Corporation Executive Stock Purchase Plan is incorporated herein by reference to Form S-8 Registration Statement of Registrant filed with the Commission, Registration No. 33-64677.

10.4 Registration Rights Agreement dated October 23, 1998 among Registrant, Walter Scott, Jr., James Q. Crowe and David C. McCourt is incorporated herein by reference to Exhibit 10.1 to the Company's Form 8-K dated October 28, 1998, (Commission File No. 0-11053).

10.5 1997 Non-Management Directors' Stock Compensation Plan effective February 12, 1997, as amended is incorporated herein by reference to Exhibit 10 to the Company's Annual Report on Form 10-K for the year ended December 31, 1998, (Commission File No. 0-11053).

10.6 Commonwealth Telephone Enterprises, Inc. Executive Stock Purchase Plan as amended and restated, effective December 21, 1998 is incorporated herein by reference to Exhibit 99.1 to the Company's Report on Form 10-Q for the quarter ended September 30, 1999, (Commission File No. 0-11053).

10.7 1997 Non-Management Directors' Stock Compensation Plan effective February 12, 1997, as amended and restated, is incorporated herein by reference to Exhibit 10(a) to the Company's Report on Form 10-Q for the quarter ended March 31, 2000, (Commission File No. 0-11053).

10.8 Registration Rights Agreement dated February 7, 2002, between Registrant and Level 3 Communications, Inc. is incorporated herein by reference to Exhibit 10.13 of Form S-3 Registration Statement of Registrant filed with the Commission, Registration No. 333-82366.

10.9 Consulting Agreement dated March 1, 2002, by and between CTE Services, Inc. and James DePolo d/b/a Westminster Marketing Associates is incorporated herein by reference to Exhibit 10(n) to the Company's Report on Form 10-K for the year ended December 31, 2001, (Commission File No. 0-11053).

10.10 Amendment No. 1 effective May 15, 2002, to the CTE Equity Incentive Plan (formerly known as the C-TEC Corporation 1996 Equity Incentive Plan) is incorporated herein by reference to Exhibit 10(a) to the Company's Report on Form 10-Q for the quarter ended June 30, 2002, (Commission File No. 0-11053).

10.11 Commonwealth Telephone Enterprises, Inc. Bonus Plan is incorporated herein by reference to Exhibit 10(b) to the Company's Report on Form 10-Q for the quarter ended June 30, 2002, (Commission File No. 0-11053).

10.12 Commonwealth Telephone Enterprises, Inc. Executive Stock Purchase Plan as amended and restated, effective September 5, 2002 is incorporated herein by reference to Exhibit 10(a) to the Company's Report on Form 10-Q for the quarter ended September 30, 2002, (Commission File No. 0-11053).

10.13 Shelf Registration Agreement dated as of November 12, 2002 among Registrant, Level 3 Communications, Inc. and Eldorado Equity Holdings, Inc. is incorporated herein by reference to Exhibit 10.1 of Form S-3 Registration Statement of Registrant filed with the Commission, Registration No. 333-101127.

10.14 Amendment No. 1 to the Registration Rights Agreement dated April 23, 2003, by and among Commonwealth Telephone Enterprises, Inc., Level 3 Communications, Inc. and Eldorado Equity Holdings, Inc. is incorporated herein by reference to Exhibit 10.1 to the Company's Report on Form 8-K as filed with the Commission on April 25, 2003, (Commission File No. 0-11053).

10.15 Non-Management Directors' Stock Compensation Plan effective February 25, 2004, is incorporated herein by reference to Exhibit 10.2 to the Company's Report on Form 10-Q for the quarter ended June 30, 2004, (Commission File No. 0-11053).

10.16 Commonwealth Telephone Enterprises, Inc. Commonwealth Builder 401(k) Plan (As Amended 2004) is incorporated herein by reference to Exhibit 4.3 to Form S-8 Registration Statement of Registrant filed with the Commission, Registration No. 333-117450.

10.17 Agreement and Release dated as of July 20, 2004 entered into by and between Commonwealth Telephone Enterprises, Inc. and James DePolo is incorporated herein by reference to Exhibit No. 10.16 to the Company's Post Effective Amendment No. 4 to Form S-1 on Form S-3 Registration Statement as filed with the Commission on July 26, 2004, Registration No. 333-110325.

* (21) Subsidiaries of the Registrant

* (23) Consent of Independent Registered Public Accounting Firm

* (24) Powers of Attorney

* (31.1) Rule 13a-14(a) Certification of Chief Executive Officer

* (31.2) Rule 13a-14(a) Certification of Chief Accounting Officer

* (32) Section 1350 Certifications

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: March 10, 2006

COMMONWEALTH TELEPHONE ENTERPRISES, INC.

By: /s/ DONALD P. CAWLEY
 Donald P. Cawley
 Executive Vice President and
 Chief Accounting Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
PRINCIPAL EXECUTIVE AND ACCOUNTING OFFICERS:		
<u> /s/ MICHAEL J. MAHONEY </u> Michael J. Mahoney	President and Chief Executive Officer, principal executive officer	March 10, 2006
<u> /s/ DONALD P. CAWLEY </u> Donald P. Cawley	Executive Vice President and Chief Accounting Officer, principal financial officer, principal accounting officer	March 10, 2006

DIRECTORS:

<u> /s/ WALTER SCOTT, JR. </u> Walter Scott, Jr.		March 10, 2006
<u> /s/ MICHAEL J. MAHONEY </u> Michael J. Mahoney		March 10, 2006
<u> /s/ JOHN R. BIRK </u> John R. Birk		March 10, 2006
<u> /s/ JAMES Q. CROWE </u> James Q. Crowe		March 10, 2006
<u> /s/ FRANK M. HENRY </u> Frank M. Henry		March 10, 2006
<u> /s/ RICHARD R. JAROS </u> Richard R. Jaros		March 10, 2006
<u> /s/ DANIEL E. KNOWLES </u> Daniel E. Knowles		March 10, 2006
<u> /s/ DAVID C. MITCHELL </u> David C. Mitchell		March 10, 2006
<u> /s/ EUGENE ROTH </u> Eugene Roth		March 10, 2006
<u> /s/ JOHN J. WHYTE </u> John J. Whyte		March 10, 2006

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS
(Dollars in Thousands, Except Per Share Amounts)
(Unaudited)

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act, and we intend that such forward-looking statements be subject to these safe harbors. These statements are generally accompanied by words such as "intend," "anticipate," "believe," "estimate," "expect" or similar statements. Our forward-looking statements involve risks and uncertainties that could significantly affect expected results in the future differently than expressed in any forward-looking statements we have made. These risks and uncertainties include, but are not limited to:

- uncertainties relating to our ability to further penetrate our markets and the related cost of that effort;
- economic conditions, acquisitions and divestitures;
- government and regulatory policies;
- the pricing and availability of equipment, materials and inventories;
- technological developments;
- reductions in rates or traffic that is subject to access charges;
- changes in the competitive environment in which we operate; and
- the receipt of necessary regulatory approvals.

Additional factors that could cause or contribute to such differences are set forth in the section entitled "Risk Factors" and are discussed elsewhere in this report. Although we believe that the assumptions underlying our forward-looking statements are reasonable, any of the assumptions could prove inaccurate and, therefore, we cannot provide any assurance that the results contemplated in such forward-looking statements will be realized. The inclusion of this forward-looking information should not be regarded as a representation by us or any other person that the future events, plans or expectations that we contemplate will be achieved. Furthermore, past performance in operations and share price is not necessarily predictive of future performance.

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes thereto:

Overview

History

We began operations as Commonwealth Telephone in 1897 with the construction of a telephone line between two rural farms in Pennsylvania. In 1928, a prominent Pennsylvania family acquired Commonwealth Telephone and continued to grow the company through acquisition and internal growth. The company went public in 1952, but the family continued to hold a controlling stake. In the 1980's, the company expanded beyond wireline telephone into cable, cellular, paging and other telecommunications-related services through acquisition and business development. In 1986, the controlling family implemented a dual class voting structure in order to strengthen its control, with the common stock having one vote per share and Class B common stock having 15 votes per share. In 1993, the controlling family sold its ownership interest to a subsidiary of Peter Kiewit Sons', Inc., which has since become Level 3 Communications, Inc. ("Level 3"). In 1997, Commonwealth Telephone implemented a spin-off of certain operations into two new public companies, a bundled telecommunications provider (RCN Corporation) and a cable television operator (Cable Michigan, Inc.). At the conclusion of the spin-off, we became the public company that currently exists as Commonwealth Telephone Enterprises, Inc. ("CTE," "the Company," "we," "us" or "our"). In April and December of 2002, Level 3 sold approximately 9,600,000 shares of our common stock in two registered secondary offerings, which resulted in a reduction from approximately 48% of the voting power of our equity securities to approximately 29%. In September 2003, we completed a transaction pursuant to which each outstanding share of our Class B Common Stock was converted into 1.09 shares of our Common Stock (the "Recapitalization Transaction"). Following the

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Recapitalization Transaction, the 1,017,061 shares of our Class B Common Stock that Level 3 beneficially owned prior to the Recapitalization Transaction, representing approximately 29% of the voting power of our equity securities, were converted into 1,108,596 shares of our Common Stock, representing approximately 4.6% of the voting power of our equity securities. In January 2004, Level 3 announced that it had closed a privately-negotiated sale of its remaining 1,108,596 shares of our Common Stock to an institutional investor.

Management's Overview

2005 Highlights

In July of 2003, we took advantage of favorable interest rates and sold \$300,000 of 3.25% convertible notes due in 2023. On June 24, 2005, we launched an exchange offer pursuant to which we offered to exchange any and all of the \$300,000 of our then outstanding 3.25% convertible notes (the "Old Notes") for new 2005 Series A 3.25% convertible notes (the "New Notes") due 2023 in an equal principal amount plus an exchange fee of \$2.50 per \$1,000 principal amount of existing notes. The New Notes contain terms that provide us with the flexibility to settle conversion of the notes with cash, common stock or a combination of cash and common stock. The Old Notes require us to settle conversion of notes with shares of common stock. The change to the terms of the notes allows us to reduce the dilutive effect on our common stock that would be caused by future conversion of the convertible notes. The terms of the New Notes maintain full dividend protection for the holders of the notes. The exchange offer closed on August 3, 2005, at which time a total of \$63,892 principal amount of New Notes were issued in exchange for the same principal amount of Old Notes and an exchange fee of \$160 was paid. We intend to continue to consider other options to further reduce or possibly eliminate the dilutive effect of future conversions, including common share repurchases depending on market conditions.

In November of 2003, taking advantage of our strong cash position and a relatively weak stock price, our Board of Directors authorized a Stock Repurchase Program of up to \$100 million of CTE Common Stock, which was subsequently increased to \$150 million. As of December 31, 2005, we had repurchased 3,047,244 shares, at a cost of \$118,544. We have approximately \$31,456 available for repurchases under the program. Future share repurchases will be executed at our discretion, based on ongoing assessments of our capital needs, and the market value of our common stock.

On November 30, 2004, the Governor of Pennsylvania signed legislation that authorized CT to amend its alternative regulation plan to include a commitment to deliver broadband service to all customers by December 31, 2008. Under the legislation, this commitment entitles CT to eliminate the 2% yearly offset in its price adjustment formula, although CT could be required to refund the additional revenues collected due to this amendment if it fails to meet its broadband commitment. CT filed an amended plan with the PUC incorporating these changes in December 2004, which the PUC approved on March 3, 2005. On May 3, 2005, CT filed notice with the PUC that it would seek approval to raise certain rates to recover approximately \$3,200 on an annualized basis, effective September 1, 2005, which reflects changes in the rate of inflation as provided for in its alternative regulation plan. On February 1, 2006, CT filed notice with the PUC that it would seek approval to raise certain rates to recover approximately \$4,100 on an annualized basis, effective May 16, 2006.

On May 2, 2005, our Board of Directors declared a special dividend of \$13.00 per share and a \$0.50 per share dividend for the quarter ended June 30, 2005; and on June 30, 2005, \$294,138 was paid. In addition, we announced the intention to provide an ongoing annual dividend of \$2.00 per share, which will be paid quarterly. The payment of cash dividends in the future will be at the discretion of our Board of Directors and will be based on a number of factors. Additionally, other indebtedness we incur may place significant restrictions on our ability to pay dividends. The payment of dividends results in a change in the conversion rate on our convertible notes. At the conversion price in effect at December 31, 2005, our convertible debt is convertible into 7,285,200 shares of our common stock.

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2005 Challenges and 2006 Expectations

We faced many challenges in 2005 that will continue into the future. Wireless carriers continue to increase their coverage area and Voice over IP is evolving. In addition, there are industry-wide trends toward declining usage of dial-up Internet access and wireline long-distance services.

The legislative and regulatory landscape continues to be a challenging one. FCC-mandated interstate access rate reductions reduced revenues in 2005 for CTSI. Also, a substantial portion of CTSI's revenues are derived directly and indirectly from ISPs. Loss of a major ISP customer or consolidation within the ISP industry due to their declining dial-up customer base, bankruptcy or a major network reconfiguration could negatively impact CTSI's results.

Our primary focus in 2006 will be on the execution of our business plan in the market place. This means defending our customer base, and we plan to do this by delivering value to our customers in our bundled product offerings, including DSL, and by providing customer service that is second to none. It also means continued focus on our costs and our margins.

Despite these challenges, our operations generate a significant amount of cash flow. Our strategic plan is designed to insure that we identify and capitalize on changing consumer preferences, market trends and technological developments. CT is actively bundling voice and data products to provide our customers with convenient, attractive packages in an effort to minimize churn to cable modem and wireless.

In 2005, the Company began offering its customers, in the territories of CT and CTSI, digital television programming through a strategic alliance with EchoStar Communications Corporation to provide their DISH Network[™] satellite TV service. By adding the DISH Network[™] satellite TV services to our product suite, we are now in the market with voice, video and data, the complete "triple play." In April of 2005, we announced that we signed agreements with two leading game providers: Zone4Play, Inc. and Exent Technologies. In the fourth quarter of 2005, we began offering Internet-based electronic games to our customers in the territories of CT and CTSI, as well as epix customers. Both CT and CTSI are exploring other alliances and partnerships with other providers in order to expand our product offerings and to capitalize on our strong sales capabilities, technologically-advanced network, loyal customer base and high-speed capacity.

Segments

Our two primary operations are Commonwealth Telephone Company ("CT"), which is a rural incumbent local exchange carrier ("RLEC"), and CTSI, LLC ("CTSI"), which we refer to as our RLEC "edge-out" operation, and is a competitive local exchange carrier ("CLEC"). The CT segment includes the results of Commonwealth Long Distance Company ("CLD"), a long-distance reseller; and the portion of our broadband data service that uses digital subscriber line ("DSL") technology to offer high-speed Internet access, that is in CT's territory. Our "Other" segment is comprised of telecommunications-related businesses that all operate in the deregulated segments of the telecommunications industry and support the operations of our two primary operating companies. These support businesses are epix[®] Internet Services ("epix"), a rural Internet service provider; and Commonwealth Communication, LLC ("CC"), a provider of telecommunications equipment and facilities management services. "Other" also includes our corporate entity.

As of December 31, 2005, CT served over 323,500 switched access lines. In 1997, we formally launched our facilities-based CLEC, CTSI. CTSI operates in three "edge-out" regional Pennsylvania markets that border CT's markets and that, we believe, offer attractive market demographics, such as higher population density and a higher concentration of businesses. CTSI served over 137,600 switched access lines as of December 31, 2005, which were mainly business customers.

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Revenue

CT's revenue is derived primarily from access, local service, enhanced services, local long-distance (intraLATA toll), long-distance service revenue and DSL. Access revenue consists primarily of charges paid by long-distance companies and other telecommunications carriers for access to our network in connection with the completion of long-distance telephone calls. Local service revenue consists of charges for local exchange telephone services, including monthly tariffs for basic local service. Enhanced services revenue is derived from service for special calling features, including, but not limited to, Caller ID and Call Waiting. Local long-distance (intraLATA toll) and long-distance revenues consist of charges for such services paid by CT's customers. DSL revenue consists of charges for high-speed Internet access provided to CT's customers.

CTSI's revenue is derived primarily from access, local service, competitive access, both dedicated and DSL Internet access, local long-distance (intraLATA toll) and long-distance service revenue. Access revenue consists primarily of charges paid by long-distance companies and other non-CLEC customers for access to our network in connection with the completion of long-distance telephone and local calls and the delivery of other services. Access revenue also includes recurring trunking revenue and reciprocal compensation. Local service revenue consists of charges for local exchange telephone services, including monthly recurring charges for basic services and special calling features. Competitive access revenue consists of charges for point-to-point connections. Internet access revenue consists of charges for dedicated Internet access provided to CTSI's customers. DSL revenue consists of charges for high-speed Internet access provided to CTSI's customers. Long-distance revenue consists of charges for long-distance service paid by CTSI's customers.

Our "Other" business segment includes the revenue from epix and CC. epix revenue for this segment consists primarily of dial-up Internet access revenue. CC generates revenue primarily from telecommunications projects, including installation and maintenance of telephone systems for business customers, cabling projects and telecommunications systems design. Other also includes our corporate entity.

Operating Costs

Our operating costs and expenses for each of our segments primarily include access charges and other direct costs of sales, payroll and related benefits, selling and advertising, software and information system services and general and administrative expenses. These costs have increased over time as we have grown our operations and revenues. We expect these costs to continue to increase, but generally at a slower rate. Operating costs also include depreciation and amortization. CTSI also incurs costs related to leased local loop charges associated with providing last mile access, circuit rentals, engineering costs, colocation expense, terminating access for local calls and long-distance expense. CLD also incurs long-distance expense associated with purchasing long-distance minutes on a wholesale basis from third party providers. CC also incurs expenses primarily related to equipment and materials used in the course of the installation and provisioning of service.

Capital Expenditures

We incur capital expenditures associated with expenditures for infrastructure and network upgrades in CT and CTSI territories. Under the revised Chapter 30 Plan that was approved by the Pennsylvania Public Utility Commission ("PUC"), CT committed to provide universal availability of broadband services throughout its territory by December 31, 2008. In addition, at CTSI, capital expenditures associated with access line installations and high capacity services, in order to provide Internet and cellular providers and interexchange carriers (IXCs) the ability to connect their networks into the public switched network system, comprise a significant portion of its overall capital spending.

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Selected Segment Data

Data Tables

We have included certain segment financial data in the tables below. Operating income (loss) is the primary measure used by our management to assess the performance of each segment.

	For the Years Ended December 31,		
	2005	2004	2003
Sales:			
CT	\$228,464	\$227,666	\$223,827
CTSI	86,495	83,568	85,336
Other	18,897	24,577	26,559
Total	<u>\$333,856</u>	<u>\$335,811</u>	<u>\$335,722</u>

	For the Years Ended December 31,		
	2005	2004	2003
Operating income (loss):			
CT	\$111,872	\$100,400	\$ 97,153
CTSI—edge-out	12,909	9,554	8,978
CTSI—restructuring reversals*	31	799	1,636
Total CTSI	<u>12,940</u>	<u>10,353</u>	<u>10,614</u>
Other	(12,731)	(4,306)	(4,386)
Total	<u>\$112,081</u>	<u>\$106,447</u>	<u>\$103,381</u>

* See Note 4 for additional details.

	As of December 31,		
	2005	2004	2003
Access lines:			
CT access lines	323,555	333,022	338,462
CTSI access lines	137,696	138,820	138,667
Total	<u>461,251</u>	<u>471,842</u>	<u>477,129</u>

2005 vs 2004

For the year ended December 31, 2005, our consolidated sales decreased \$1,955 and were \$333,856 and \$335,811 for the years ended December 31, 2005 and 2004, respectively. Lower sales at Other of \$5,680 contributed to the decrease, offset by an increase in CTSI sales of \$2,927 and an increase in CT sales of \$798. Consolidated costs and expenses increased \$4,725 primarily due to non-cash compensation expense of \$4,155 resulting from the dividends. This compensation is in the form of dividend equivalent units related to vested, deferred restricted stock units; amortization of unvested restricted stock units; vested, deferred Executive Stock Purchase Plan share units; amortization of unvested Executive Stock Purchase Plan share units; and unvested 401(k) shares. This charge was partially offset by a favorable sales and use tax settlement of \$2,764. Operating income increased \$5,634 as a result of decreased consolidated depreciation expense of \$13,082 related to our periodic review of asset retirement activity, salvage values and fixed asset lives and certain classes of assets becoming fully depreciated, partially offset by the decrease in sales and increase in operating expenses discussed above and a positive settlement in 2004 of \$799 associated with our 2000 restructuring charge as compared to \$31 in 2005. Consolidated net income was \$70,108 or \$2.71 per diluted share for the year ended

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December 31, 2005. Consolidated net income was \$62,031 or \$2.60 per diluted share for the year ended December 31, 2004. Contributing to the increase in net income is the increase in operating income, an increase in interest income primarily from higher interest rates and a decrease in interest expense primarily due to our repayment of debt, partially offset by an increase in other expenses primarily due to the special and quarterly dividend and exchange offer costs and an increase in the provision for income taxes.

CT

CT's sales were \$228,464 and \$227,666 for the years ended December 31, 2005 and 2004, respectively. The sales increase of \$798 or 0.4% is primarily due to increases in intraLATA toll and long-distance revenues and DSL revenue, partially offset by lower local and inside wire maintenance revenues.

CT's additional lines declined as customers switched to DSL and other high-speed Internet access alternatives. Primary residential lines declined due in part to wireless substitution. Company lines decreased as a result of the industry wide trend of epix customers' migrating to broadband services.

IntraLATA toll and long-distance revenues increased a combined total of \$1,997. The change is due to an increase in CLD revenues of \$3,912 as we continue to promote our long-distance product in our bundles. The increase at CLD was partially offset primarily by customers selecting alternate lower cost service providers, including CLD, and calling packages offered by several non-wireline providers in certain areas of CT's territory, decreasing revenue by \$1,878. Interstate access revenue decreased \$1,450 resulting from a decline in access lines of \$1,597, a decline in minutes of use of \$771 and certain revenue settlements that occurred in 2004 of \$572. These decreases were partially offset by an increase in the National Exchange Carrier Association ("NECA") average schedule settlements of \$963 (average schedule formulas are updated annually in July) and an increase in special access circuit revenue of \$804. State access revenue increased \$1,357 from increased state access settlement revenues of \$2,526 and a favorable effect of \$1,196 resulting from a certain access revenue settlement due to a jurisdictional shift in traffic to a high access rate. These increases were partially offset by a decrease of \$997 due to a decrease in minutes of use, a decrease of \$483 due to a reduction in access lines and wireless interconnection rate reductions of \$446. Local service revenue decreased \$216 primarily as a result of a decrease in access lines and the loss of an Internet service provider ("ISP") from our network, partially offset by a line rate increase of approximately \$1.00 per average line per month effective September 2005. Other revenue decreased \$779 as a result of a decrease in inside wire maintenance revenue of \$1,002, an increase in the provision for bad debt of \$1,006 and a lower message volume for billing and collection of \$492. These decreases were partially offset by an increase in DSL revenue of \$1,819 from an increase in subscribers, partially offset by a price reduction.

CT's costs and expenses, excluding depreciation and amortization, ("costs and expenses") were \$79,153 and \$79,219 for the years ended December 31, 2005 and 2004, respectively. Costs and expenses decreased \$66 or 0.1% due to a reversal of a sales and use tax accrual of \$2,764 in connection with the completion of a state audit focused on the taxability of wholesale purchases of Internet services, lower advertising expense of \$683 and lower terminating access expense of \$673 due to CT's lower intraLATA toll minutes. These lower costs were partially offset by higher material expense of \$733 primarily from DSL modems and higher payroll and benefits from salary increases, increases in insurance premiums and overtime.

Depreciation and amortization expense decreased \$10,608 or 22.1% for the year ended December 31, 2005. The change was the result of certain assets becoming fully depreciated and lengthening the estimated useful lives of certain asset classes after completing our periodic review in the second quarter of 2005 of asset retirement activity, salvage values and fixed asset lives.

CT's operating income increased \$11,472 or 11.4% to \$111,872 for the year ended December 31, 2005. The increase was a result of the items discussed above.

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CTSI

CTSI's sales were \$86,495 and \$83,568 for the years ended December 31, 2005 and 2004, respectively. The increase of \$2,927 primarily represents an increase in access revenue of \$1,479, and increases in customer point-to-point circuit revenues of \$1,013 and data revenues of \$727, partially offset by a decrease in long-distance revenue of \$288.

Access revenues increased due to a favorable effect of \$2,608 resulting from certain access revenue settlements, an increase of \$515 resulting from the FCC ruling that no longer enforces the cap on the number of minutes for which compensation on local telephone calls that terminate to ISPs can be collected and an increase in circuits of \$765. These increases were partially offset by the FCC rate ceilings, as further described in the Legislative and Regulatory section, which have reduced the revenues CTSI receives from interstate access charges. CTSI's revenues from access charges and reciprocal compensation are also affected by the mix of traffic delivered to it by other carriers for termination to CTSI customers. In addition, continued industry-wide trends towards declining usage of dial-up Internet access and of wireline long-distance services generally, will continue to have a negative impact on access revenues.

CTSI recorded approximately \$5,829 or 6.7% of its revenues from compensation revenue associated with Internet service provider ("ISP") traffic as compared to \$6,335 or 7.6% for 2004. Effective October 8, 2004, the FCC no longer enforces the cap on the number of minutes for which compensation can be collected, but continues to limit the rate that can be charged. At current traffic levels, this FCC decision has resulted in an increase in the amount of reciprocal compensation received by CTSI, although the order may be subject to court appeals, and we cannot predict the outcome of any such proceeding.

CTSI derives a substantial portion of its revenues directly and indirectly from ISPs. ISPs represented approximately 15.1% and 17.1% of CTSI's revenues (after excluding the effect of the previously mentioned access revenue settlements) for the years ended December 31, 2005 and 2004, respectively. These high-margin revenues include services provided directly to the ISP including local and high-capacity services and indirect services including reciprocal compensation and trunking from Verizon as a result of Verizon's customers accessing these ISPs. Industry-wide trends toward declining usage of dial-up Internet access threaten the profitability or viability of our ISP customers. If we lose a large customer or a significant number of customers that are providing Internet services, or if a significant portion of these customers are unable to pay amounts owed to us, our financial results could be negatively impacted.

The increase in point-to-point circuit revenue is due to Internet and cellular providers and IXC's using our network to connect their networks into the public switched network system. Data revenues increased due to subscriber growth. Long-distance revenue decreased due to a decrease in minutes of use and a decrease in the average blended rate per minute.

Costs and expenses were \$54,315 and \$53,809 for the years ended December 31, 2005 and 2004, respectively. The increase of \$506 is primarily due to an increase in high capacity circuit expense of \$683, an increase in DSL and Internet expense of \$611 due to an increase in customers and increased network circuit costs of \$410. These increases were partially offset by a reduction in the long-distance termination rate of \$458, reductions in rates for unbundled loops of \$441 and lower headcount in telemarketing and sales of \$327. Also, favorable effects of \$1,646 resulting from certain network costs settlements were partially offset by a reserve reversal in 2004 linked to network cost settlements of \$1,701.

Depreciation and amortization expense decreased \$934 or 4.6% to \$19,271 as a result of lengthening the estimated useful lives of certain asset classes after completing our periodic review of asset retirement activity, salvage values and fixed asset lives. The change was also the result of certain assets becoming fully depreciated. Restructuring reversals associated with our 2000 restructuring charge were \$768 lower for the year ended December 31, 2005 as compared to the year ended December 31, 2004.

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CTSI's operating income increased \$2,587 or 25.0% to \$12,940 for the year ended December 31, 2005. The increase was a result of the items discussed above.

Other

Other sales were \$18,897 and \$24,577 for the years ended December 31, 2005 and 2004, respectively. The decrease of \$5,680 or 23.1% is due to a decrease in CC and epix sales.

CC sales decreased \$3,013 or 20.1% to \$12,007 primarily due to a decrease in new installations of business systems due to sales personnel turnover and lower revenues from communications facilities management services. The operating results of CC are subject to fluctuations due to its less predictable revenue streams, market conditions and the effect of competition on margins. epix sales decreased \$2,667 or 27.9% to \$6,890 due to a decrease in dial-up subscribers as customers move to DSL or other high-speed products or lower-cost providers and a price reduction implemented in May 2005.

Costs and expenses in Other were \$30,446 and \$26,161 for the years ended December 31, 2005 and 2004, respectively. Expenses at the corporate entity increased primarily due to non-cash compensation expense of \$4,155 resulting from the dividends, reversal of certain health care accruals of \$1,513 in 2004 and increased restricted stock amortization of \$935. This increase was partially offset by decreased costs and expenses at CC of \$1,554 to \$12,039 for the year ended December 31, 2005. This change was primarily due to the decrease in sales and associated cost of goods sold. epix expenses decreased \$1,048 primarily as a result of lower transport costs due to a price reduction, line disconnects and lower advertising expense.

Depreciation and amortization expense decreased \$1,540 or 56.6% to \$1,182. The change was due to a smaller base of depreciable plant and certain assets, primarily at epix, becoming fully depreciated.

The operating loss in Other was (\$12,731) for the year ended December 31, 2005 as compared to (\$4,306) for the year ended December 31, 2004. The change was a result of the items discussed above.

Restructuring Charges (Reversals)

In December 2000, we announced that we would exit CTSI's five expansion markets launched over the preceding two years. Related to this strategy, we recorded an estimated restructuring charge of \$99,713 (pre-tax) and \$64,813 (after-tax), or (\$2.79) (after-tax) per common share (including effects of anti-dilutive options). At December 31, 2005, there is no remaining liability. See Note 4 to the Consolidated Financial Statements for additional information.

Interest and Dividend Income

Interest and dividend income was \$8,375 for the year ended December 31, 2005 as compared to \$5,773 for the year ended December 31, 2004. The increase of \$2,602 or 45.1% is primarily the result of higher interest rates, partially offset by lower average cash balances.

Interest Expense

Interest expense includes interest on our convertible notes, interest on CT's revolving credit facility with CoBank, ACB ("CoBank") and amortization of debt issuance costs. We employed an interest rate swap on \$35,000 of floating rate debt to hedge against interest rate exposure. Interest expense was \$14,084 for the year ended December 31, 2005 as compared to \$16,800 for the year ended December 31, 2004. The decrease of \$2,716 or 16.2% is primarily a result of repayment of high cost debt in 2004 and the resulting lower loan balances.

Income Taxes

Our effective tax rates were 35.5% and 37.6% for the years ended December 31, 2005 and 2004, respectively. The lower rate in 2005 is due to a detailed review of all deferred tax items and supporting schedules

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of net book vs net tax values that we performed in 2005. This review resulted in a net deferred tax benefit of approximately \$3,154 (\$2,239 impact to the fourth quarter) related to prior years that we recorded in the fourth quarter of 2005. We estimate that, excluding these corrections, our effective tax rate would have been approximately 38.4%. This adjustment did not have a material effect on the current or any prior period's financial statements. We anticipate our 2006 effective tax rate to be approximately 38% to 39%. For an analysis of the change in income taxes, see Note 11 to the Consolidated Financial Statements.

2004 vs 2003

For the year ended December 31, 2004, our consolidated sales increased \$89 and were \$335,811 and \$335,722 for the years ended December 31, 2004 and 2003, respectively. Higher sales at CT of \$3,839 contributed to the increase, offset by a decline in CTSI sales of \$1,768 and a decline in Other sales of \$1,982. Consolidated costs and expenses decreased \$3,651 primarily due to lower headcount (primarily at CTSI), lower transport costs of \$750 at epix, lower corporate spending of \$461 and network cost settlements of \$1,701 at CTSI which contributed to lower operating expenses of \$2,977. Operating income increased \$3,066 as a result of the increase in sales and the decrease in operating expenses discussed above. Consolidated net income was \$62,031 or \$2.60 per diluted share for the year ended December 31, 2004. Consolidated net income was \$72,865 or \$2.92 per diluted share for the year ended December 31, 2003, including a cumulative effect accounting adjustment of \$13,230 or \$0.51 per diluted share from the adoption of SFAS No. 143, "Accounting for Asset Retirement Obligations." Contributing to the decrease in net income is the cumulative effect accounting adjustment and an increase in interest expense due to the sale of convertible notes in July 2003, partially offset by the increase in operating income and an increase in interest income.

CT

CT's sales were \$227,666 and \$223,827 for the years ended December 31, 2004 and 2003, respectively. The sales increase of \$3,839 or 1.7% is primarily due to higher local, enhanced services, DSL and intraLATA toll and long-distance revenues, partially offset by lower access revenue and a recovery of \$965 of our WorldCom receivables in 2003 that did not recur in 2004. CT's primary residential lines declined slightly primarily due to wireless substitution. Additional lines declined as customers switched to DSL and other high-speed products, and customers look to find ways to lower personal spending.

Interstate access revenue increased \$3,319 primarily resulting from an increase in units that drive settlements of \$1,801, an increase in special access circuit revenue of \$998 and an increase in the NECA average schedule settlements of \$1,019. Due to a slight decline in the NECA average schedule formulas that was placed into effect July 1, 2004, the increase in interstate access revenue occurred during the first half of 2004; the average schedule formulas are updated annually. State access revenue decreased \$7,652 primarily as a result of the State Access Reform rate decrease of \$4,571, wireless interconnection rate reductions of \$1,311 and a decrease in minutes of use of \$438. Local service revenue increased \$3,916 primarily as a result of the State Access Reform rate increase. In addition, enhanced service revenue increased \$2,395 as a result of the State Access Reform price increase of \$1,801 and increases in custom calling, Caller ID and certain other enhanced services. IntraLATA toll and long-distance revenues increased \$931 due to an increase in revenue of \$3,910 resulting from an increase in subscribers from a long-distance product offering that began in early 2003. The increase was partially offset by lower market share in CT intraLATA toll due to customers selecting alternate lower cost service providers, including CLD, and calling packages offered by several non-wireline providers in certain areas of CT's territory, decreasing revenue by \$2,997, a trend we expect to continue. Other revenue increased \$934 as a result of an increase in DSL revenue of \$1,740 from an increase in subscribers, an increase in inside wire maintenance revenue of \$1,125 due to a price increase and price increases on other services as a result of State Access Reform of \$572. These increases were partially offset by a recovery of \$965 in 2003 related to a third party vendor assuming our WorldCom receivables that were previously written-off and a lower volume of non-recurring equipment sales and time and material work of \$1,664 due to a lower demand in 2004 as compared to 2003.

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CT's costs and expenses, excluding depreciation and amortization, ("costs and expenses") were \$79,219 and \$79,730 for the years ended December 31, 2004 and 2003, respectively. Costs and expenses decreased \$511 or 0.6% due to a decrease in corporate expenses due to decreased spending, lower material expense due to lower CPE equipment sales of \$545 and lower terminating access expense due to CT's lower intraLATA toll minutes. These lower costs were partially offset by higher expenses due to an increase in pole attachments and associated higher rates of \$783 and higher repairs and maintenance expense of \$423.

Depreciation and amortization expense increased \$1,103 or 2.3% for the year ended December 31, 2004. The increase was a result of capital expenditures in 2003 and 2004, partially offset by changes in CT's overall composite rate.

CT's operating income increased \$3,247 or 3.3% to \$100,400 for the year ended December 31, 2004. The increase was a result of the items discussed above.

CTSI

CTSI's sales were \$83,568 and \$85,336 for the years ended December 31, 2004 and 2003, respectively. The decrease of \$1,768 primarily represents a decrease in access revenue of \$5,046, partially offset by an increase in local service of \$884, from installed access lines; and increases in customer point-to-point circuit revenues of \$801 and data revenues of \$849. CTSI's sales include a \$760 Verizon trunking dispute settlement.

The FCC rate ceilings, as further described in the Legislative and Regulatory section, have resulted in reductions in the revenues CTSI receives from interstate access charges. In addition, continued industry-wide trends towards declining usage of dial-up Internet access and of wireline long-distance services generally, will have a negative impact on these revenues. CTSI's revenues from access charges and reciprocal compensation are also affected by the mix of traffic delivered to it by other carriers for termination to CTSI customers. In late 2003, Verizon notified CTSI of a reduction in the proportion of its delivered traffic that will be subject to intrastate access charges, and a corresponding increase in the proportion that will be subject to reciprocal compensation rates based on a revised Percent Local Usage ("PLU") factor. Because the reciprocal compensation rates are much lower than access charges, this change in traffic mix negatively affected CTSI's revenues by approximately \$700 per month.

In late 2004, CTSI was notified by Verizon North (formerly GTE) requesting a change in the PLU factor. As a result of this request, CTSI will be using a direct measurement billing approach instead of a PLU factor. The effect on CTSI's revenue and operating income is a reduction of approximately \$50 per month beginning April 2005.

CTSI recorded approximately \$6,335 or 7.6% of its revenues from compensation revenue associated with Internet service provider ("ISP") traffic as compared to \$12,258 or 14.4% for 2003. As was the case in 2003, all of the allowable billable minutes on local ISP reciprocal compensation above the 3 to 1 ratio available to be billed in 2004 were billed in the first quarter. Effective October 8, 2004, the FCC no longer enforces the cap on the number of minutes for which compensation can be collected, but will continue to limit the rate that can be charged.

CTSI derives a substantial portion of its revenues directly and indirectly from ISPs. ISPs represented approximately 17.1% and 23.2% of CTSI's revenues for the years ended December 31, 2004 and 2003, respectively. This percentage has decreased as a result of our approximately \$700 per month reduction in revenue from our revised PLU factor with Verizon. These high-margin revenues include services provided directly to the ISP including local and point-to-point circuit revenue and indirect services including reciprocal compensation and trunking from Verizon as a result of Verizon's customers calling these ISPs. Industry-wide trends toward

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declining usage of dial-up Internet access threaten the profitability or viability of our ISP customers. If we lose a large customer or a significant number of customers that are providing Internet services, or if a significant portion of these customers are unable to pay amounts owed to us, our financial results could be negatively impacted.

The decrease in revenue was partially offset by the increase in local service. At December 31, 2004, CTSI had 138,820 installed access lines as compared to 138,667 at December 31, 2003, an increase of 153 or 0.1%. Additionally, the increase in point-to-point circuit revenue is due to Internet and cellular providers and IXCs using our circuits to allow their networks to tie into the switched network system. The decrease in revenue was also partially offset by increases in DSL and Internet revenues of \$849 due to subscriber growth.

Costs and expenses were \$53,809 and \$55,610 for the years ended December 31, 2004 and 2003, respectively. The decrease of \$1,801 is primarily due to reserve reversals linked to network cost settlements of \$1,701, reductions in colocate power requirements of \$289 and a reduction in headcount, partially offset by an increase in long-distance minutes of \$297.

Depreciation and amortization expense decreased \$543 or 2.6% to \$20,205 as a result of certain assets becoming fully depreciated. Restructuring reversals associated with our 2000 restructuring charge were \$837 lower for the year ended December 31, 2004 as compared to the year ended December 31, 2003.

CTSI's operating income decreased \$261 or 2.5% to \$10,353 for the year ended December 31, 2004. The decrease was a result of the items discussed above.

Other

Other sales were \$24,577 and \$26,559 for the years ended December 31, 2004 and 2003, respectively. The decrease of \$1,982 or 7.5% is due to a decrease in epix and CC sales.

epix sales decreased \$1,631 or 14.6% to \$9,557 due to a decrease in dial-up subscribers as customers move to DSL or other high-speed products or lower cost dial-up providers. CC sales decreased \$351 or 2.3% to \$15,020 primarily due to lower revenues from communications facilities management services, a decrease in premises distribution systems sales and a decrease in drop shipments, partially offset by an increase in new installations of business systems. The operating results of CC are subject to fluctuations due to its less predictable revenue streams, market conditions and the effect of competition on margins.

Costs and expenses in Other were \$26,161 and \$27,500 for the years ended December 31, 2004 and 2003, respectively. epix expenses decreased \$1,502 primarily as a result of a decrease in subscribers, lower transport costs, lower headcount and lower bad debt expense. Expenses at the corporate entity decreased primarily due to certain expenses related to the Recapitalization Transaction in 2003 that did not recur, partially offset by a charge for severance expense incurred in the third quarter of 2004. This decrease was partially offset by increased costs and expenses at CC of \$624 to \$13,593 for the year ended December 31, 2004. This change was due to a favorable settlement of an outstanding project dispute of \$965 in 2003.

Depreciation and amortization expense decreased \$723 or 21.0% to \$2,722. The change was due to a smaller base of depreciable plant and certain assets becoming fully depreciated.

The operating loss in Other was (\$4,306) for the year ended December 31, 2004 as compared to (\$4,386) for the year ended December 31, 2003. The change was a result of the items discussed above.

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Restructuring Charges (Reversals)

In December 2000, we announced that we would exit CTSI's five expansion markets launched over the preceding two years. Related to this strategy, we recorded an estimated restructuring charge of \$99,713 (pre-tax) and \$64,813 (after-tax), or (\$2.79) (after-tax) per common share (including effects of anti-dilutive options). At December 31, 2004, we carried a liability of \$344 associated with certain outstanding liabilities. See Note 4 to the Consolidated Financial Statements for additional information.

Interest and Dividend Income

Interest and dividend income was \$5,773 for the year ended December 31, 2004 as compared to \$3,372 for the year ended December 31, 2003. The increase of \$2,401 or 71.2% is primarily the result of the higher temporary cash investment balances as a result of proceeds received from the \$300,000 convertible notes offering in July 2003 and a higher Rural Telephone Bank dividend rate of 6% versus 4.2% in 2003.

Interest Expense

Interest expense includes interest on our convertible notes, CT's mortgage note payable to CoBank, interest on revolving credit facilities and amortization of debt issuance costs. We employed an interest rate swap on \$35,000 of floating rate debt to hedge against interest rate exposure. Interest expense was \$16,800 for the year ended December 31, 2004 as compared to \$13,560 for the year ended December 31, 2003. The increase of \$3,240 or 23.9% is primarily a result of our issuance of convertible notes in July 2003, partially offset by lower expense due to repayment of high cost debt and the resulting lower loan balances.

Income Taxes

Our effective tax rates were 37.6% and 37.2% for the years ended December 31, 2004 and 2003, respectively. In December 2002, we reorganized our legal entity structure to allow the Pennsylvania state taxable losses of CLD and epix to be offset against state taxable income of CT, a benefit we realized in 2003. Also, we utilize various tax strategies to provide effective state income tax planning. For an analysis of the change in income taxes, see Note 11 to the Consolidated Financial Statements.

Liquidity and Capital Resources

	December 31,	
	2005	2004
Cash and temporary cash investments	\$104,968	\$312,260
Working capital	55,466	253,092
Long-term debt (including current maturities, notes payable and capital lease obligations)	335,360	336,082

Cash and temporary cash investments were \$104,968 at December 31, 2005, as compared to \$312,260 at December 31, 2004. We consider all highly liquid investments with an original maturity of three months or less to be temporary cash investments. Temporary cash investments are investments in high quality, diversified money market mutual funds. We monitor fund performance of money market mutual funds available to us on a quarterly basis to maximize returns and insure investment quality. Our working capital ratio was 1.52 to 1 at December 31, 2005, as compared to 3.08 to 1 at December 31, 2004. The net decrease in cash is primarily due to the dividend payments, partially offset by cash generated by operations and stock option exercises.

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We have the following financing arrangements in place:

	<u>December 31, 2005</u>		<u>December 31, 2004</u>	
	<u>Balance</u>	<u>Available</u>	<u>Balance</u>	<u>Available</u>
Revolving line of credit—CoBank	\$ 35,000	\$50,000	\$ 35,000	\$—
Convertible notes	300,000	—	300,000	—
Total	<u>\$335,000</u>	<u>\$50,000</u>	<u>\$335,000</u>	<u>\$—</u>

On July 18, 2003, we sold \$300,000 of 3.25% convertible notes due 2023. On June 24, 2005, we launched an exchange offer pursuant to which we offered to exchange up to \$300,000 of our then outstanding 3.25% convertible notes (the "Old Notes") for new 2005 Series A 3.25% convertible notes (the "New Notes") due 2023 in an equal principal amount plus an exchange fee of \$2.50 per \$1,000 principal amount of existing notes. The New Notes contain terms that provide us with the flexibility to settle conversion of the notes with cash, common stock or a combination of cash and common stock. The Old Notes require us to settle conversions of notes with shares of common stock. The change to the terms of the notes allows us to reduce the dilutive effect on our common stock that would be caused by future conversion of the convertible notes. The terms of the New Notes maintain full dividend protection for the holders of the notes. The exchange offer closed on August 3, 2005, at which time a total of \$63,892 principal amount of New Notes were issued in exchange for the same principal amount of Old Notes and an exchange fee of \$160 was paid. We intend to continue to consider other options to further reduce or possibly eliminate the dilutive effect of future conversions, including common share repurchases, depending on market conditions.

On June 30, 2005, we paid a special dividend of \$13.00 per share and a \$0.50 per share dividend for the quarter ended June 30, 2005 in the amount of \$294,138. In addition, we announced the intention to provide an ongoing annual dividend of \$2.00 per share, which will be paid quarterly. A \$0.50 per share dividend was paid for the quarters ended September 30, 2005 and December 31, 2005. On February 21, 2006, our Board of Directors declared a \$0.50 per share dividend payable March 31, 2006 to shareholders of record on March 15, 2006.

The payment of cash dividends in the future will be at the discretion of our Board of Directors. The declaration of any cash dividend and the amount thereof will depend on a number of factors, including our financial condition, capital requirements, funds from operations, the dividend taxation level, our stock price, future business prospects and such other factors as our Board of Directors may deem relevant. Additionally, other indebtedness we incur may place significant restrictions on our ability to pay dividends.

An amended \$85,000 revolving line of credit agreement with CoBank was entered into on May 31, 2005, which extended the availability of credit to May 2006. The aggregate amount outstanding on this commitment was \$35,000 and \$35,000 at December 31, 2005 and 2004, respectively. This agreement contains restrictive covenants, which, among other things, requires the maintenance of a specific debt to cash flow ratio at CT. We may refinance all or a portion of this line of credit when it becomes due in May 2006. As of December 31, 2005, we were in compliance with our CoBank debt covenants.

Our financing arrangements with CoBank entitle us to receive annual patronage dividends from CoBank. Approximately 60% of the patronage dividends are received in cash, with the balance in CoBank equity. Patronage dividends in the form of equity received to date have a future value totaling approximately \$6.2 million. We will receive cash in exchange for a portion of this equity once the value of the equity reaches certain targeted levels, which are calculated based upon the amount outstanding on our CoBank loan. We will recognize the CoBank equity dividend as it is received in cash, which we currently anticipate will not begin before 2007. The cash dividend received in 2005 of \$293 is included in interest and dividend income.

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We announced a \$100 million Stock Repurchase Program on November 13, 2003 and a \$50 million addition to the program on February 10, 2004. The Stock Repurchase Program has no expiration date. No stock repurchases have occurred for the year ended December 31, 2005. As of December 31, 2005, we had repurchased 3,047,244 shares with an average purchase price of \$38.902, including commissions, for a total repurchase of approximately \$118.5 million.

<u>Net cash provided by (used in):</u>	<i>As of December 31,</i>		
	2005	2004	2003
Operating activities	\$ 128,505	\$ 142,504	\$150,275
Investing activities	(40,567)	(39,864)	(43,736)
Financing activities	(295,230)	(126,415)	194,561

For the year ended December 31, 2005, our net cash provided by operating activities was \$128,505 comprised of net income of \$70,108, non-cash depreciation and amortization of \$57,892 and other non-cash items and working capital changes of \$505. Net cash used in investing activities of \$40,567 consisted primarily of additions to property, plant and equipment of \$43,875. Net cash used in financing activities of \$295,230 consisted primarily of dividends paid of \$315,877, partially offset by proceeds of stock option exercises of \$23,678.

In accordance with the terms of our prior mortgage notes and security agreements which we redeemed in 1993, we were required to purchase common stock of the Rural Telephone Bank ("RTB") equal to approximately 5% of the amount borrowed. Such class of stock is entitled to cash dividends. As part of the 2006 Agricultural Appropriations bill, the current Administration established a process and terms to implement a dissolution of the RTB, whereby stockholders will obtain a cash payout for their stock. Our original cash investment in the RTB was approximately \$6,409. In addition, we have received stock dividends with a face value of approximately \$23,600 in accordance with the provisions of our previous financing arrangement with the RTB. These stock dividends will be recognized as income and will be subject to the statutory federal and state income tax rates when the underlying security is redeemed for cash, which we received notification from the RTB will be no later than the end of the second quarter of 2006.

We expect to have adequate resources to meet our currently foreseeable obligations and development plans for our markets and customer demand for additional capacity and service. In addition to cash generated from operations, sources of funding for any additional capital requirements or acquisitions may include financing from public offerings or private placements of equity and/or debt securities and bank loans. There can be no assurance that additional financing will be available to us or, if available, that it can be obtained on a timely basis and on acceptable terms. Failure to obtain such financing could result in the delay or curtailment of our development plans and expenditures.

Off Balance Sheet Arrangements, Contractual Obligations and Commitments

We have contractual obligations and commercial commitments made in the ordinary course of business. The commercial obligations, financings and commitments made by us are customary transactions, similar to those of other comparable telecommunications providers.

The tables set forth below contain information with regard to disclosures about contractual obligations and commercial commitments. These disclosures are also included in the Notes to the Consolidated Financial Statements and cross referenced in the tables below.

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The following table discloses aggregate information about our contractual obligations as of December 31, 2005, and the periods in which payments are due:

<u>Contractual obligations</u>	<u>Total</u>	<u>Payments Due by Period</u>				<u>Footnote reference(1)</u>
		<u>Less than 1 year</u>	<u>1-3 years</u>	<u>4-5 years</u>	<u>More than 5 years</u>	
Debt maturing within one year	\$ 35,000	\$35,000	\$ —	\$ —	\$ —	8
Long-term debt	300,000	—	—	—	300,000	8
Interest on long-term debt	171,113	9,750	29,250	19,500	112,613	8
Pension and other postretirement benefits	2,213	373	812	395	633	10
Capital lease obligations(2)	398	398	—	—	—	12
Operating leases	19,258	2,688	5,762	3,042	7,766	12
Purchase obligations(3)	69,163	11,910	17,895	12,457	26,901	12
Total contractual obligations	<u>\$597,145</u>	<u>\$60,119</u>	<u>\$53,719</u>	<u>\$35,394</u>	<u>\$447,913</u>	

As of December 31, 2005, we have no letters of credit or other financial guarantees outstanding.

The following table discloses aggregate information about our derivative instruments, the source of fair value of these instruments and their maturities:

<u>Source of fair value</u>	<u>Fair Value of Contracts at Period-End</u>					<u>Footnote reference(1)</u>
	<u>Total Fair Value</u>	<u>Less than 1 year</u>	<u>1-3 years</u>	<u>4-5 years</u>	<u>After 5 years</u>	
Prices provided by external sources(4)	\$(194)	\$(194)	\$—	\$—	\$—	13

- (1) Refers to the Notes to our Consolidated Financial Statements included herein.
- (2) Represents total obligations, including interest components.
- (3) Purchase obligations include: outstanding purchase orders and commitments, committed software purchases and pole and conduit rental payments through 2015.
- (4) The fair value of the interest rate swap at December 31, 2005, was provided by the counterparty to the underlying contract.

Quantitative and Qualitative Disclosures about Market Risk

We are exposed to interest rate risk primarily through our borrowing activities. There is inherent rollover risk for borrowings as they mature and are renewed at current market rates. The extent of this risk is not quantifiable or predictable because of the variability of both future interest rates and our future financing requirements.

We measure the fair value of the convertible debt based upon current market prices or by obtaining quotes from dealers. The fair value of bank debt is estimated using discounted cash flow calculations. The table that follows summarizes the fair values of our fixed and variable rate debt. The table also provides a sensitivity analysis of the estimated fair values of these financial instruments assuming 100-basis-point upward and downward shifts in the weighted average interest rate.

<u>As of December 31, 2005</u>	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Fair Value Assuming +100 Basis Point Shift</u>	<u>Fair Value Assuming -100 Basis Point Shift</u>
Fixed rate long-term debt	\$300,000	\$294,382	\$288,909	\$300,008
Variable rate notes payable	35,000	35,000	34,860	35,141

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The table below provides information about our interest rate swap. Notional amounts are used to calculate the contractual payments to be exchanged under the contract. The estimated fair value amount has been provided to us by the financial institution with which we have the swap contract using appropriate and consistent valuation methodologies.

<u>Variable to Fixed:</u>	<u>Maturity Date</u>	<u>Interest Rate</u>	<u>Fixed Notional Amount</u>	<u>Approximate Fair Value as of December 31, 2005</u>
Interest rate swap	2006	5.40%	\$35,000	\$(194)

Critical Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Certain estimates require more subjectivity or judgment than others. We review the critical accounting estimates, judgments and degrees of subjectivity inherent in these estimates with the Company's Audit Committee. These critical accounting estimates are:

- We use the composite group remaining life method and straight-line composite rates to depreciate the assets of CT and CTSI. We periodically review data on asset retirement activity, salvage values and fixed asset lives in order to assess depreciation rates. If actual outcomes differ from our estimates and assumptions, we may be required to adjust depreciation, which could impact our earnings. The effect of increasing the average useful lives of our telephone plant by one year would result in a decrease in depreciation expense of approximately \$3.3 million; the effect of reducing the average useful lives of our telephone plant by one year would result in an increase in depreciation expense of approximately \$3.9 million.
- We calculate the costs of providing retiree benefits under the provisions of SFAS No. 87 and SFAS No. 106. The key assumptions used in making these calculations are disclosed in Note 10 to the Consolidated Financial Statements. The most significant of these assumptions are the discount rate used to value the future obligations and expected return on plan assets. We select discount rates commensurate with current market interest rates on high-quality, fixed-rate debt securities with terms similar to our estimated future pension distributions. The expected return on assets is based on our current view of the long-term returns on assets held by the plan, which is influenced by historical averages. Pension expense for 2005 would have increased approximately \$0.2 million if our expected return on plan assets were one quarter of one percent lower. The expense would have increased approximately \$0.4 million if our assumed discount rate were one quarter of one percent lower, and would have decreased \$0.4 million if our assumed discount rate were one quarter of one percent higher. The benefit obligation at December 31, 2005, would have been increased by approximately \$4.3 million if our assumed discount rate were one quarter of one percent lower.
- We recognize deferred tax assets and liabilities based on the differences between the financial statement carrying amounts and the tax bases of assets and liabilities. At the time deferred tax assets and liabilities are recorded, certain tax positions may require management to use judgment based on current facts and circumstances in order to develop our best estimate. We regularly review our deferred tax assets for recoverability and establish a valuation allowance based on historical taxable income, projected future taxable income and the expected timing of the reversals of existing temporary differences. The amount of the deferred tax asset valuation could change if estimates of future taxable income during the carryforward period are revised, or if the carryforward period or amounts for net operating losses in tax jurisdictions is changed.

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- The Company is routinely audited by federal, state and local taxing authorities. The outcome of these audits may result in our being assessed taxes in addition to amounts previously paid. Accordingly, we maintain tax contingency reserves for such potential assessments. The reserves are determined based upon our best estimate of possible assessments by the Internal Revenue Service ("IRS") or other taxing authorities and are adjusted, from time to time, based upon changing facts and circumstances.
- CT's interstate access charges are subject to a pooling process with the National Exchange Carrier Association. Final interstate revenues are based on nationwide average costs applied to certain demand quantities. We estimate revenues earned through this process, which are subject to adjustments that may either increase or decrease the amount of interstate access revenues and receivables.
- We review the valuation of accounts receivable on a periodic basis. The allowance for doubtful accounts is estimated based on historical experience and future expectations of conditions that may impact our ability to collect on our accounts receivable. If actual outcomes differ from our estimates and assumptions, or if our assumptions are revised based on additional or changed information, we may be required to make adjustments which could impact our earnings.
- Our determination of the treatment of contingent liabilities in the financial statements is based on our view of the expected outcome of the applicable contingency. We consult with legal counsel on matters related to litigation and other experts both within and outside the Company with respect to matters in the ordinary course of business. We record a liability if the likelihood of an adverse outcome is probable of occurrence and the amount is estimable. We disclose the matter if either the likelihood of an adverse outcome is only reasonably possible or an estimate is not determinable. If actual outcomes differ from our estimates and assumptions, or if our assumptions are revised based on additional or changed information, we may be required to make adjustments which could impact our earnings.
- Our revenues are also affected by the terms of our various carrier agreements by which certain interstate traffic is subject to a percent interstate usage ("PIU") factor and certain intrastate traffic is subject to a percent local usage ("PLU") factor. These factors may be updated based on actual traffic patterns. Revisions to the PIU and PLU factors could have an impact on our results of operations.

Related Parties

Related parties include members of the Board of Directors and their related companies, including Level 3 Communications, Inc. Three of our directors are also directors of Level 3. Our Chairman, Walter Scott, Jr. is also the Chairman of Level 3. Level 3 does not hold any equity ownership interest in the Company at this time. Related party revenues and expenses represent the telephony service provided and the fees paid to these related companies arising from the ordinary course of business.

Legislative and Regulatory Developments

Commonwealth Telephone Company

Prices for CT's (our RLEC) local and in-state long-distance services are regulated by the Pennsylvania Public Utility Commission ("PUC"). These prices are currently set under an alternative regulation plan approved by the PUC. Under this plan, among other things, CT is protected by an exogenous events provision that recognizes and accounts for certain state/federal regulatory, legislative changes or other unique changes in the telephone industry that affect revenues or expenses, thereby allowing CT to adjust rates to compensate for changes in revenues and/or expenses due to such exogenous events.

During 2005, CT filed and received PUC approval of an amended plan revising its price adjustment formula to eliminate the 2% annual offset to inflation, and proposing to provide universal availability of broadband

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services within CT's service territory no later than December 31, 2008. Under the amended plan, CT could be required to refund some of its increased revenues to customers if it fails to meet its commitment to deploy broadband services. Effective September 1, 2005, CT raised certain rates to recover approximately \$3,200 on an annualized basis, which reflects changes in the rate of inflation as provided in its alternative regulation plan. On February 1, 2006, CT filed notice with the PUC that it would seek approval to raise certain rates to recover approximately \$4,100 on an annualized basis, effective May 16, 2006.

The PUC is currently considering changes in intrastate switched access rates and Universal Service Funding ("USF") reform for independent local exchange carriers in Pennsylvania. This proceeding, which was begun in December 2004, primarily addresses the rates that CT charges to long-distance carriers for in-state toll calls that originate or terminate on CT's local telephone lines. In previous PUC orders, reductions in in-state access charges have been offset by revenue-neutral increases in our monthly local service rates. CT also receives funding from the state USF, which could be affected by the PUC's investigation. In August 2005, the PUC issued an order deferring this investigation for twelve months or until the FCC concludes its investigation of intercarrier compensation, whichever occurs earlier. At this time, we cannot predict either the timing or the outcome of the PUC's proceeding.

Prices for CT's interstate services (consisting primarily of subscriber line charges and access charges for interstate toll calls), which currently account for approximately 32.0% of its telephone service revenues, are regulated by the Federal Communications Commission ("FCC") based on the "average schedule" formulas proposed by NECA. The purpose of the average schedule formulas is to estimate the costs of smaller telephone companies, like CT, without requiring them to perform expensive cost studies. The formulas use the costs of other telephone companies to "simulate" the costs of the average schedule companies. Under the FCC rules, NECA is required to review these formulas annually. In December 2005, NECA submitted proposed formula changes to the FCC which, if approved, would result in a reduction in CT's interstate access revenues of approximately \$1.2 million (\$2.4 million annually) in the second half of 2006. In addition, NECA proposed a phased-in structural change to the formulas that would reduce CT's settlements by approximately \$0.4 million in 2006, \$2.2 million in 2007, \$3.9 million in 2008 and \$4.2 million thereafter. These structural changes result primarily from changes in the formulas used to estimate common line (or local loop) costs and special circuit settlements. It is possible that future changes to the formulas or FCC disallowance of the phase-in may cause additional changes (either increases or decreases) in CT's interstate access revenues.

CT also receives funding from the federal USF, under formulas adopted by the FCC. During the Fund's fiscal year ending June 30, 2006, CT is entitled to receive approximately \$20.0 million in interstate common line support ("ICLS"). Changes in the federal USF formulas could have a material effect on CT's revenues. The FCC currently is considering changes to the USF funding mechanism, but at this time we are unable to predict either the timing or the impact of any changes it may adopt.

The FCC is considering adopting proposed rules that would allow telephone companies such as CT to convert to a form of incentive regulation similar in some respects to CT's alternative regulation plan in Pennsylvania. We are unable to predict the timing or outcome of this proposed rulemaking at this time.

Since 2001, the FCC has been considering proposed changes to its rules to unify several existing systems of intercarrier compensation (intrastate access, interstate access, reciprocal compensation, EAS settlements, etc.) into a single coherent structure. The FCC has recently solicited comments from the public on a variety of proposed approaches to reforming intercarrier compensation. Some of these proposals, if adopted, would also affect CT's intrastate access charges, and the amount of USF funding it receives. CTE has been active in addressing these proposals through its industry association, the United States Telecom Association ("USTA"). The FCC had expressed a tentative preference for moving to a "bill and keep" regime, whereby carriers would exchange traffic with one another without payment of compensation, but may also consider alternative

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approaches. Since CT currently derives a significant portion of its revenues from intercarrier compensation, changes in these rules may have material effects on our revenues and earnings. However, any FCC ruling is likely to address the concerns of rural carriers like CT such as the ability to raise other rates to offset reductions in intercarrier compensation, a transition period and/or increased universal service funding. Until the FCC adopts a specific proposal, it is impossible to predict how changes in this area may affect CT.

CT, CTSI and CLD are required to make contributions to the federal USF, based on their end-user revenues for interstate and international telecommunications services. Each of these companies currently passes through the cost of these contributions to its end-user customers, either as a surcharge or as part of the price of its services. The FCC is currently considering changes to its USF regulations that, if adopted, would alter the basis upon which USF contributions are determined and the means by which such contributions may be recovered from customers. The FCC has not yet acted on these proposals and it is not clear whether the FCC will adopt any of these proposals. Based on the foregoing, the application and effect of the USF requirements (and comparable state contribution requirements) on the telecommunications industry cannot be definitively ascertained at this time.

Pursuant to the "rural exemption" provision of Section 251(f)(1) of the Telecommunications Act of 1996, CT is currently exempted from offering colocation, unbundled network elements ("UNEs"), wholesale discounts and other requirements of the Act that pertain to Regional Bell Operating Companies ("RBOCs") and non-rural incumbent LECs. The rural exemption does not preclude competitors from providing telephone services within CT's service area entirely over their own facilities. However, it requires prospective competitors who seek to interconnect with our network in order to resell services or lease unbundled network elements to go through a formal review by the Pennsylvania PUC before receiving approval. The Pennsylvania PUC may grant such approval only if it finds that the competitor's proposal is not unduly economically burdensome, is technically feasible and is consistent with the Universal Service provisions of the Telecommunications Act. To date, no carrier has sought such a review by the Pennsylvania PUC. On May 4, 2005, Sprint Communications Company L.P. ("Sprint") filed an Application with the PUC for "Approval of Authority to Offer, Render, Furnish or Supply Telecommunications Services to the Public in the Commonwealth of Pennsylvania" for the purpose of expanding its local service authority to include the service territory of CT. On June 6, 2005, CT filed a Protest and Motion to Dismiss with the PUC. On June 24, 2005, Sprint filed an Answer to CT's Protest and Motion to Dismiss. On May 27, 2005, Core Communications, Inc. filed an Application with the PUC for "Approval of Authority to Offer, Render, Furnish or Supply Telecommunications Services to the Public in the Commonwealth of Pennsylvania" for the purpose of expanding its local service authority to include the service territory of CT. On July 18, 2005, as part of a group comprised of several Pennsylvania Telephone Association member companies, CT filed a Protest and Motion to Dismiss with the PUC. On September 22, 2005, Service Electric Telephone Company, LLC. ("SET") filed an Application with the PUC for "Approval of Authority to Offer, Render, Furnish or Supply Telecommunications Services to the Public in the Commonwealth of Pennsylvania" for the purpose of expanding its local service authority to include the remaining service territory of CT. CT responded to this application in a similar manner to the others that have been filed. SET received authority to offer facilities based local exchange telecommunications services in a limited portion of CT's service area in 2001. It is not possible to predict the outcome of any of these proceedings at this time.

However, the Act's general requirement that telecommunications carriers interconnect networks for the exchange of traffic does apply to CT. CT has received several requests for network interconnection for the exchange of traffic between its network and the networks of other facilities-based telecommunications providers, and has entered into interconnection and reciprocal compensation agreements with several national wireless carriers and other competitive carriers providing for exchange of traffic between its network and theirs.

On September 23, 2005, the FCC adopted an order relaxing its regulation of broadband Internet access offered by incumbent local exchange carriers, such as CT. Under this order, telephone companies will have the

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option of offering broadband Internet access either as a tariffed telecommunications service or as a non-tariffed information service. Companies will not be required to provide unbundled broadband transmission services to third-party Internet access providers. This decision, which remains subject to judicial review, does not directly affect CT because CT does not currently offer Internet access as a regulated service; rather, its affiliate epix offers unregulated Internet access services. However, we believe this decision will give CT greater flexibility in the future should it choose to offer wireline broadband Internet access.

On February 24, 2005, the FCC adopted new rules, effective April 29, 2005, which prohibit incumbent LECs such as CT from enforcing tariffs that impose compensation obligations for traffic not subject to access charges upon commercial mobile radio service providers. This order may be subject to court appeals or agency reconsideration. We do not believe that this order affects CT's ability to collect compensation from commercial mobile radio service providers under individually negotiated contracts, such as those CT has entered into with several mobile carriers. However, we cannot predict whether the mobile carriers will challenge our ability to collect this compensation, or otherwise seek to re-open our compensation arrangements. Also, other carriers that have not yet entered into contracts with CT may seek compensation terms that are less favorable to CT. Therefore, the full impact of this FCC decision on CT cannot be determined at this time.

Pursuant to FCC requirements, CT has implemented local number portability, which enables customers to keep their number when switching between carriers, without regard to whether the new carrier is a wireline or wireless service provider. The implementation of wireless number portability could negatively impact our operations, as customers become able to transfer their residential or business telephone number to a wireless telephone. In this regard, the FCC is considering shortening the time interval allowed for porting to occur. At this time, no decision has been made by the FCC.

The FCC allows telecommunications carriers to recover over five years their carrier-specific costs of implementing local number portability. The order allows for such cost recovery in the form of a surcharge from customers to whom number portability is available. CT implemented this cost recovery mechanism in 2004 to offset its costs of implementing number portability.

On June 3, 2005, the FCC released new rules requiring providers of Voice over Internet Protocol ("VoIP") telephone services to provide access to E911 emergency services. This ruling does not directly affect either CT or CTSI because they do not provide VoIP services. This decision is expected to increase the costs of entry and ongoing operation for VoIP providers and therefore, may somewhat reduce the risk of competition that CT and CTSI face from these companies. The FCC ruling may be subject to agency reconsideration or judicial review.

CTSI, LLC

CTSI's prices are subject to regulation by the FCC and the PUC although, as a competitive provider, its rates are typically subject to much less scrutiny than those of CT, or those of Verizon as the dominant local telephone service provider. CTSI's costs are also affected by regulatory decisions, because CTSI relies in part on facilities and services purchased from incumbent telephone companies (primarily Verizon), including interconnection for the exchange of local traffic with other companies, in providing its services. CTSI has separate month-to-month interconnection and resale agreements with Verizon covering its former Bell Atlantic and former GTE operating areas in Pennsylvania.

The FCC has made several significant changes in recent years to its rules requiring incumbent carriers like Verizon to offer unbundled access to network elements to competing carriers like CTSI, most recently in February 2005. Under the new rules, Verizon is required to continue to offer access to unbundled voice-grade loops. Verizon is not, however, required to permit unbundled access to newly-constructed fiber optic facilities serving primarily residential premises. Verizon also will no longer be required to offer unbundled local

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switching, but CTSI does not use that element significantly. Verizon will also be required to provide some other network elements (including high-capacity loops and transport facilities) in many, but not all, of the markets it serves, but CTSI does not rely extensively on these elements.

During 2003, the FCC gave notice of a proposed rulemaking in which it is considering changing the formula used by state commissions, including the Pennsylvania PUC, to determine rates for access to Verizon network elements and for interconnection to Verizon's network. It is unknown at this time when the FCC will act on this proposal or what effects any changes in the rate formula will have on CTSI's costs.

Under the Telecommunications Act of 1996, the Pennsylvania PUC has authority to arbitrate any disputes over the terms and conditions of interconnection between CTSI and Verizon, and the prices of various unbundled network elements CTSI purchases from Verizon. The PUC has taken a number of actions over the past several years affecting the prices for network elements, as well as the terms and conditions under which these elements are provided. The PUC operates within a framework of national rules adopted by the FCC governing network element unbundling. During 2004, the PUC implemented changes in Verizon's rates for unbundled local loops (that is, circuits connecting business and residential users' premises to the Verizon central office), which resulted in a modest decrease in CTSI's cost to obtain local loops in Verizon's density cell 3 exchanges (where most CTSI customers are located), but an increase in the cost to serve customers in density cell 4. Further decisions by the PUC and the FCC regarding these interconnection and unbundling obligations may have a material effect on CTSI's costs and profitability.

The FCC has adopted rules limiting the amounts that CTSI can charge other carriers for access to its network for originating and terminating interstate calls (access charges). Under these rules, carriers such as CTSI are permitted to charge interstate access rates no higher than those charged by Verizon.

The FCC also has limited the right of competitive local carriers, such as CTSI, to collect reciprocal compensation on local telephone calls that terminate to ISPs. Under these rules, the amount of compensation payable to CTSI on calls to ISPs above a 3 to 1 ratio generally is limited to \$0.0007 per minute. In 2002, the U.S. Court of Appeals for the D.C. Circuit remanded the order in which the FCC adopted these rules, on the grounds that the FCC did not provide proper statutory authority for its order. The Court did not vacate the rules, however, and so the current compensation scheme will remain in effect pending the remand. To date, the FCC has taken no action in response to the Court's remand.

Although declining from historical levels, CTSI derives a substantial portion of its revenues from ISPs. We expect that this reliance will continue in the foreseeable future. ISPs represented approximately 15.1% and 17.1% of CTSI's revenues for the year ended December 31, 2005 and 2004, respectively. These revenues include services provided directly to the ISP such as local and transport services and indirect services such as reciprocal compensation, and trunking from Verizon as a result of Verizon's customers calling these ISPs. Industry-wide trends towards declining usage of dial-up Internet access threaten the profitability or viability of our ISP customers. If we lose a large customer or a significant number of customers that are providing dial-up Internet services, or if a significant portion of these customers are unable to pay amounts owed to us, our financial results could be negatively impacted.

The FCC rate ceilings have resulted in continued reductions in the revenues CTSI receives from interstate access charges and reciprocal compensation, both in dollar amount and as a percentage of total annual revenues. CTSI's revenues from access charges and reciprocal compensation are also affected by the mix of traffic delivered to it by other carriers for termination to CTSI customers. For the year ended December 31, 2005, CTSI recorded approximately \$5,829 or 6.7% of its revenues from compensation revenue from ISP traffic. This compares to \$6,335 or 7.6% for the same period in the previous year. Of these amounts, local reciprocal compensation associated with ISP traffic was \$3,331 or 1.0% and \$2,854 or 0.9% of our total consolidated revenues for the year ended December 31, 2005 and 2004, respectively. Revenues from interstate access charges represented approximately 0.3% and 0.5% of our consolidated revenues, for the year ended December 31, 2005

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and 2004, respectively. In addition, industry-wide trends towards declining usage of dial-up Internet access and of wireline long-distance services generally, may continue to have a negative impact on these revenues.

CTSI may also be affected by any changes in FCC rules governing intercarrier compensation, as discussed above with respect to CT.

CTSI has received several requests for network interconnection for the exchange of traffic between its network and the networks of other facilities-based telecommunications providers, and has entered into interconnection and reciprocal compensation agreements with several national wireless carriers providing for exchange of traffic between its network and theirs.

CTSI may also be affected by the introduction of wireless number portability in November 2003, for the same reasons discussed above with respect to CT. CTSI is permitted by applicable rules to recover the cost of implementing number portability from its end users.

In January 2005, Verizon Pennsylvania and CTSI reached a mutually satisfactory settlement of a dispute over transport facilities charges that had been the subject of a complaint filed with the Pennsylvania PUC.

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

SELECTED FINANCIAL DATA
(Thousands of Dollars, Except Per Share Amounts)
(Unaudited)

For the Years Ended December 31,

	2005	2004	2003	2002	2001
Sales	\$333,856	\$335,811	\$335,722	\$318,555	\$306,614
Net income	70,108	62,031	72,865	57,124	43,132
Diluted earnings per share	2.71	2.60	2.92	2.42	1.84
Dividends per share	14.50	—	—	—	—
Total assets as of period end	555,394	783,431	851,653	554,039	564,604
Long-term debt, net of current maturities as of period end ..	300,000	300,000	323,898	77,299	151,309

- 2003 includes the effects of SFAS No. 143, "Accounting for Asset Retirement Obligations."
- 2003 includes the issuance of \$300,000 of convertible notes.
- 2005 includes the payment of \$315,877 cash dividends.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal control over financial reporting, and for performing an assessment of the effectiveness of internal control over financial reporting as of December 31, 2005. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

Management performed an assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2005 based upon criteria in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on our assessment, management determined that the Company's internal control over financial reporting was effective as of December 31, 2005 based on the criteria in Internal Control—Integrated Framework issued by COSO.

Our management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2005 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

Dated March 10, 2006

/s/ Michael J. Mahoney
Michael J. Mahoney
President and
Chief Executive Officer

/s/ Donald P. Cawley
Donald P. Cawley
Executive Vice President and
Chief Accounting Officer

Report of Independent Registered Public Accounting Firm

To the Board of Directors and
Shareholders of Commonwealth Telephone Enterprises, Inc.:

We have completed integrated audits of Commonwealth Telephone Enterprises, Inc.'s 2005 and 2004 consolidated financial statements and of its internal control over financial reporting as of December 31, 2005, and an audit of its 2003 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements and financial statement schedules

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1) of this Form 10-K present fairly, in all material respects, the financial position of Commonwealth Telephone Enterprises, Inc. and its subsidiaries at December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedules listed in the index appearing under Item 15(a)(2) of this Form 10-K present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedules based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Internal control over financial reporting

Also, in our opinion, management's assessment, included in "Management's Report on Internal Control Over Financial Reporting" appearing under Item 15(a)(1) of this Form 10-K, that the Company maintained effective internal control over financial reporting as of December 31, 2005 based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control—Integrated Framework issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance

with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PRICEWATERHOUSECOOPERS LLP

PricewaterhouseCoopers LLP

Philadelphia, Pennsylvania

March 10, 2006

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Years Ended December 31,		
	2005	2004	2003
	(Thousands of Dollars, Except Per Share Amounts)		
Sales	\$ 333,856	\$ 335,811	\$ 335,722
Costs and expenses (excluding other operating expenses itemized below)	163,914	159,189	162,840
Depreciation and amortization	57,892	70,974	71,137
Restructuring reversals (see Note 4)	(31)	(799)	(1,636)
Operating income	112,081	106,447	103,381
Interest and dividend income	8,375	5,773	3,372
Interest expense	(14,084)	(16,800)	(13,560)
Other income (expense), net	(896)	686	(884)
Equity in income of unconsolidated entities	3,177	3,236	2,698
Income before income taxes	108,653	99,342	95,007
Provision for income taxes	38,545	37,311	35,372
Income before cumulative effect of accounting change	70,108	62,031	59,635
Cumulative effect of accounting change, net of tax (see Note 2)	—	—	13,230
Net income	70,108	62,031	72,865
Unrealized gain on derivative instruments, net of tax	703	1,660	1,632
Minimum pension liability adjustment, net of tax	(2,288)	—	2,839
Comprehensive net income	\$ 68,523	\$ 63,691	\$ 77,336
Basic earnings per share:			
Income before cumulative effect of accounting change	\$ 3.24	\$ 2.91	\$ 2.54
Cumulative effect of accounting change, net of tax	—	—	0.56
Net income	\$ 3.24	\$ 2.91	\$ 3.10
Weighted average shares outstanding	21,617,630	21,325,907	23,515,367
Diluted earnings per share:			
Income before cumulative effect of accounting change	\$ 2.71	\$ 2.60	\$ 2.41
Cumulative effect of accounting change, net of tax	—	—	0.51
Net income	\$ 2.71	\$ 2.60	\$ 2.92
Weighted average shares and common stock equivalents outstanding	28,592,549	26,779,685	26,105,917

See accompanying notes to Consolidated Financial Statements.

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(Thousands of Dollars, Except Par Value)

	December 31,	
	<u>2005</u>	<u>2004</u>
ASSETS		
Current assets		
Cash and temporary cash investments	\$104,968	\$ 312,260
Accounts receivable, net of allowance for doubtful accounts of \$1,362 in 2005 and \$2,185 in 2004	25,312	27,173
Unbilled revenues	11,216	12,916
Material and supply inventory, at average cost	5,395	6,071
Prepayments and other	3,435	2,734
Deferred income taxes	11,275	13,388
Total current assets	<u>161,601</u>	<u>374,542</u>
Property, plant and equipment, net of accumulated depreciation of \$550,007 in 2005 and \$506,711 in 2004	368,506	382,523
Investments	10,269	10,338
Other assets	15,018	16,028
Total assets	<u>\$555,394</u>	<u>\$ 783,431</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Capital lease obligation	\$ 360	\$ 721
Accounts payable	26,590	25,012
Notes payable	35,000	35,000
Advance billings and customer deposits	5,248	5,316
Accrued interest	5,083	5,995
Accrued restructuring expense	—	344
Accrued expenses	33,854	49,062
Total current liabilities	<u>106,135</u>	<u>121,450</u>
Long-term debt	300,000	300,000
Capital lease obligation	—	361
Deferred income taxes	72,490	77,279
Other liabilities	20,904	18,411
Commitments and contingencies (see Note 12)		
Common shareholders' equity		
Common Stock (\$1 par value, authorized: 85,000,000 and 85,000,000; issued: 24,226,482 and 24,172,376; outstanding: 21,842,918 and 21,123,262, in 2005 and 2004, respectively)	24,226	24,172
Additional paid-in capital	118,723	284,358
Deferred compensation	(16,861)	(10,093)
Accumulated other comprehensive loss	(2,415)	(830)
Retained earnings	26,327	86,931
Treasury stock at cost (2,383,564 and 3,049,114 shares in 2005 and 2004, respectively)	(94,135)	(118,608)
Total common shareholders' equity	<u>55,865</u>	<u>265,930</u>
Total liabilities and shareholders' equity	<u>\$555,394</u>	<u>\$ 783,431</u>

See accompanying notes to Consolidated Financial Statements.

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Thousands of Dollars)

	For the Years Ended December 31,		
	2005	2004	2003
Cash flows from operating activities:			
Net income	\$ 70,108	\$ 62,031	\$ 72,865
Adjustments to reconcile net income to net cash provided by operating activities:			
Cumulative effect of accounting change, net of tax	—	—	(13,230)
Depreciation and amortization	57,892	70,974	71,137
Deferred income taxes, net	(1,669)	137	14,791
Provision for loss on accounts receivable	712	736	1,230
Dividend and debt exchange fees	1,399	—	—
Equity in income of unconsolidated entities	(3,177)	(3,236)	(2,698)
Tax benefit on stock compensation	3,410	880	744
Non-cash compensation	10,203	4,671	3,145
Non-cash amortization of debt issuance costs	1,774	1,758	1,298
Non-cash restructuring (reversals) provisions	32	(332)	(790)
Gain on sale of expansion market assets	(63)	(467)	(846)
Other non-cash items	—	100	6
Net change in certain assets and liabilities:			
Accounts receivable	1,149	7,414	1,266
Accounts receivable/payable related parties	—	188	492
Unbilled revenues	1,700	1,803	(362)
Material and supply inventory	676	787	888
Income taxes receivable	—	—	30
Prepayments and other	(700)	17	(167)
Other assets	2,775	483	439
Accounts payable	1,578	(4,113)	(1,368)
Advance billings and customer deposits	(68)	104	(658)
Accrued expense—restructuring	(376)	(136)	(427)
Accrued expenses	(15,370)	726	4,376
Other liabilities	(3,480)	(2,021)	(1,886)
Net cash provided by operating activities	<u>128,505</u>	<u>142,504</u>	<u>150,275</u>
Cash flows from investing activities:			
Additions to property, plant and equipment	(43,875)	(43,519)	(47,372)
Proceeds on sale of expansion market assets	63	245	846
Other	3,245	3,410	2,790
Net cash used in investing activities	<u>(40,567)</u>	<u>(39,864)</u>	<u>(43,736)</u>
Cash flows from financing activities:			
Redemption of long-term debt	—	(29,521)	(56,788)
Proceeds from the exercise of stock options	23,678	9,136	3,881
Proceeds from borrowings of long-term debt	—	—	300,000
Redemption of short-term debt	—	(30,000)	—
Capital lease payments	(722)	(777)	(491)
Stock repurchases	—	(75,177)	(43,367)
Dividends paid	(315,877)	—	—
Dividend and debt exchange fees paid	(2,149)	—	—
Payment made for debt issuance costs	(160)	(76)	(8,674)
Net cash (used in)/provided by financing activities	<u>(295,230)</u>	<u>(126,415)</u>	<u>194,561</u>
Net (decrease)/increase in cash and temporary cash investments	\$(207,292)	\$ (23,775)	\$301,100
Cash and temporary cash investments at beginning of year	\$ 312,260	\$ 336,035	\$ 34,935
Cash and temporary cash investments at end of year	<u>\$ 104,968</u>	<u>\$ 312,260</u>	<u>\$336,035</u>
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest	\$ 12,035	\$ 14,246	\$ 8,228
Income taxes	\$ 45,506	\$ 26,923	\$ 20,904
Supplemental disclosures of non-cash information:			
Equipment acquired under capital lease obligation	\$ —	\$ —	\$ 2,163
Stock based compensation	\$ 14,008	\$ 7,482	\$ 6,576

See accompanying notes to Consolidated Financial Statements.

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN COMMON SHAREHOLDERS' EQUITY

For the Years Ended December 31, 2005, 2004 and 2003
(Thousands of Dollars)

	Common Par Value	Class B Par Value	Additional Paid-in Capital	Deferred Compensation	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Deficit)	Treasury Stock	Total Common Shareholders' Equity
Balance, December 31, 2002	\$21,489	\$ 5,818	\$ 256,594	\$ (2,676)	\$(6,961)	\$ 77,969	\$(131,243)	\$ 220,990
Net income						72,865		72,865
Restricted stock	163		6,091	(3,622)				2,632
Conversions	8	(8)						—
Stock option plan transactions	146		3,735					3,881
Executive stock purchase plan				(153)				(153)
Tax benefits related to stock options			744					744
Recapitalization	2,208	(2,026)	(182)					—
Retire treasury stock		(3,784)				(125,934)	129,718	—
Stock repurchases							(43,367)	(43,367)
Minimum pension liability adjustment, net of tax					2,839			2,839
Unrealized gain on derivative instruments, net of tax					1,632			1,632
Other			94				572	666
Balance, December 31, 2003	24,014	—	267,076	(6,451)	(2,490)	24,900	(44,320)	262,729
Net income						62,031		62,031
Restricted stock	(115)		7,298	(3,356)				3,827
Stock option plan transactions	273		8,863					9,136
Executive stock purchase plan				(286)				(286)
Tax benefits related to stock options			880					880
Stock repurchases							(75,177)	(75,177)
Unrealized gain on derivative instruments, net of tax					1,660			1,660
401(k) match			227				846	1,073
Other			14				43	57
Balance, December 31, 2004	24,172	—	284,358	(10,093)	(830)	86,931	(118,608)	265,930
Net income						70,108		70,108
Restricted stock	2		5,717	(982)			1,241	5,978
Stock option plan transactions	52		1,614				22,012	23,678
Executive stock purchase plan				266				266
Tax benefits related to stock options			3,410					3,410
Dividends			(176,538)	(6,052)		(130,712)	78	(313,224)
Minimum pension liability adjustment, net of tax					(2,288)			(2,288)
Unrealized gain on derivative instruments, net of tax					703			703
401(k) match			164				1,091	1,255
Other			(2)				51	49
Balance, December 31, 2005	\$24,226	\$ —	\$ 118,723	\$(16,861)	\$(2,415)	\$ 26,327	\$ (94,135)	\$ 55,865

See accompanying notes to Consolidated Financial Statements.

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN COMMON SHAREHOLDERS' EQUITY

COMMON STOCK
For the Years Ended December 31, 2005, 2004 and 2003

	<u>Shares Issued</u>	<u>Treasury Stock</u>	<u>Shares Outstanding</u>
Balance, December 31, 2002	21,488,697	44,484	21,444,213
Conversions	8,654	—	8,654
Stock option plan transactions	146,267	—	146,267
Restricted stock	162,625	—	162,625
Recapitalization	2,207,659	—	2,207,659
Stock repurchase program	—	1,179,200	(1,179,200)
Other	—	(16,668)	16,668
Balance, December 31, 2003	24,013,902	1,207,016	22,806,886
Stock option plan transactions	272,945	—	272,945
Restricted stock	(6,750)	—	(6,750)
Restricted stock conversion	(107,721)	—	(107,721)
Stock repurchase program	—	1,868,044	(1,868,044)
401(k) match	—	(24,646)	24,646
Other	—	(1,300)	1,300
Balance, December 31, 2004	24,172,376	3,049,114	21,123,262
Stock option plan transactions	52,106	(598,468)	650,574
Restricted stock	2,000	(35,888)	37,888
401(k) match	—	(29,794)	29,794
Other	—	(1,400)	1,400
Balance, December 31, 2005	<u>24,226,482</u>	<u>2,383,564</u>	<u>21,842,918</u>

CLASS B COMMON STOCK
For the Years Ended December 31, 2005, 2004 and 2003

	<u>Shares Issued</u>	<u>Treasury Stock</u>	<u>Shares Outstanding</u>
Balance, December 31, 2002	5,818,684	3,784,649	2,034,035
Conversions	(8,654)	—	(8,654)
Recapitalization	(2,025,381)	—	(2,025,381)
Retire treasury stock	(3,784,649)	(3,784,649)	—
Balance, December 31, 2003	—	—	—
Balance, December 31, 2004	—	—	—
Balance, December 31, 2005	<u>—</u>	<u>—</u>	<u>—</u>

See accompanying notes to Consolidated Financial Statements.

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in Thousands, Except Per Share Amounts)

1. Background and Basis of Presentation

The Consolidated Financial Statements of Commonwealth Telephone Enterprises, Inc. ("CTE," "the Company," "we," "us" or "our") include the accounts of Commonwealth Telephone Company ("CT"), a rural incumbent local exchange carrier ("RLEC"); CTSI, LLC ("CTSI"), our RLEC "edge-out" operation and a competitive local exchange carrier ("CLEC"); and other operations ("Other"). The CT segment includes the results of Commonwealth Long Distance Company ("CLD"), a reseller of long-distance services and the portion of our digital subscriber line ("DSL") product offering in CT's franchise area. Other includes Commonwealth Communication, LLC ("CC"), a provider of telecommunications equipment and facilities management services; epix® Internet Services ("epix"), which provides dial-up Internet services; and our corporate entity. All significant intercompany accounts and transactions are eliminated.

For comparative purposes, certain prior period amounts have been reclassified to conform to the current year presentation.

2. Summary of Significant Accounting Policies

Use of Estimates—The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. On an ongoing basis, we evaluate our estimates. Actual results could differ from these estimates under different assumptions or conditions.

Revenue Recognition—Local telephone service revenue is recorded based on tariffed rates. Telephone network access and long-distance service revenues are derived from access charges, toll rates and settlement arrangements. CT's interstate access charges are subject to a pooling process with the National Exchange Carrier Association ("NECA"). Final interstate revenues are based on nationwide average costs applied to certain demand quantities.

Internet access service revenues are recorded based on contracted fees.

Long-distance telephone service revenues are recorded based on minutes of traffic processed, tariffed rates or contracted fees.

Revenue from local telephone, Internet access and long-distance telephone services is earned and recorded when the services are provided.

Unbilled revenue represents revenue that has been earned, but has not yet been billed.

Access revenue consists primarily of charges paid by long-distance companies and other telecommunications carriers for access to our network in connection with the completion of long-distance telephone calls. If the Company determines that a portion of the amounts billed may not be realizable due to uncertainty surrounding the jurisdiction or rate applied to the billing, we defer recognition of this specific revenue because the carrier has the ability to dispute the billing within a certain timeframe depending on the jurisdiction. Upon expiration of the statute of limitations, these revenues are no longer subject to claim or refund and therefore the Company records the recognition of this revenue.

Our revenues are also affected by the terms of our various carrier agreements by which certain interstate traffic is subject to a percent interstate usage ("PIU") factor and certain intrastate traffic is subject to a percent local usage ("PLU") factor. These factors may be updated based on actual traffic patterns. Revisions to the PIU and PLU factors could have an impact (positive or negative) on our results of operations due to a shift of traffic to different jurisdictional rates.

We defer and amortize CT, CTSI and epix installation revenue as well as associated incremental service installation costs, not in excess of installation revenue, over their respective estimated customer lives that are estimated to be 7 years, 3.2 years and 1.5 years, respectively. We carry in the Consolidated Balance Sheets

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

deferred credits of \$6,154 and \$6,188 as of December 31, 2005 and 2004, respectively, in other liabilities representing the unamortized portion of installation revenue. Additionally, we have deferred charges of \$6,154 and \$6,188 as of December 31, 2005 and 2004, respectively, in other assets representing the unamortized portion of installation costs.

Contracts of Commonwealth Communications are accounted for on the percentage-of-completion method. Estimated sales and earnings are recognized as equipment is installed or contract services rendered, with estimated losses, if any, charged to income in the period the losses are identified.

Estimating Valuation Allowances—We must make estimates of the uncollectability of our accounts receivables. We specifically analyze accounts receivable and historic bad debts, customer concentrations, customer credit-worthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts.

Advertising Expense—Advertising costs are expensed as incurred. Advertising expense charged to operations was \$3,080, \$3,212 and \$3,027 in 2005, 2004 and 2003, respectively.

Stock-Based Compensation—We apply the intrinsic value method of Accounting Principles Board Opinion No. 25 “Accounting for Stock Issued to Employees” (“APB 25”) and the Financial Accounting Standards Board Interpretation No. 44 “Accounting for Certain Transactions Involving Stock Compensation” (“FIN 44”) in accounting for our stock plans. We have adopted the disclosure-only provisions of Statement of Financial Accounting Standards (“SFAS”) No. 123 “Accounting for Stock-Based Compensation” (“SFAS 123”).

At December 31, 2005, the Company had three common stock compensation plans as more fully described in Note 9 to the Consolidated Financial Statements.

Pro forma information regarding net income and earnings per share is required by SFAS 123, and has been determined as if we had accounted for our stock options under the fair value method of SFAS 123. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model. There were no options granted in 2005, 2004 and 2003; as a result, no Black-Scholes valuation was required to be made.

The following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of SFAS 123:

	For the Years Ended December 31,		
	2005	2004	2003
Net income—as reported	\$70,108	\$62,031	\$72,865
Add: stock-based employee compensation expense included in reported net income, net of related tax effects	6,436	3,045	2,192
Deduct: total stock-based employee compensation expense determined under fair-value based method for all awards, net of related tax effects	(8,294)	(5,797)	(5,517)
Net income—pro forma	\$68,250	\$59,279	\$69,540
Net income adjustment for interest on convertible debt, net of tax	7,491	7,480	3,369
Pro forma diluted earnings per share numerator	<u>\$75,741</u>	<u>\$66,759</u>	<u>\$72,909</u>
Net earnings per share:			
Basic earnings per share—as reported	\$ 3.24	\$ 2.91	\$ 3.10
Basic earnings per share—pro forma	3.16	2.78	2.96
Diluted earnings per share—as reported	2.71	2.60	2.92
Diluted earnings per share—pro forma	2.65	2.49	2.80

Earnings Per Share—Basic earnings per share amounts are based on net income divided by the weighted average number of shares of common stock outstanding during each year.

Diluted earnings per share are based on net income divided by the weighted average number of shares of common stock outstanding during each year after giving effect to dilutive common stock equivalents. Options that could potentially dilute basic earnings per share in the future that were not included in the computation of

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

diluted earnings per share because to do so would have been antidilutive for the periods presented, were approximately 3,508, 25,441 and 47,289 for the years ended December 31, 2005, 2004 and 2003, respectively.

In September 2004, the Emerging Issues Task Force (“EITF”) of the Financial Accounting Standards Board reached a consensus on “The Effect of Contingently Convertible Instruments on Diluted Earnings per Share” (“EITF 04-8”). EITF 04-8 requires that contingently convertible debt be included in diluted earnings per share computations regardless of whether the market price trigger has been met. EITF 04-8 is effective for reporting periods ending after December 15, 2004. Prior period diluted earnings per share amounts were restated to conform to this consensus.

	For the Years Ended December 31,		
	2005	2004	2003
<i>Basic earnings per share:</i>			
Income before cumulative effect of accounting change	\$ 70,108	\$ 62,031	\$ 59,635
Cumulative effect of accounting change, net of tax	—	—	13,230
Net income	<u>\$ 70,108</u>	<u>\$ 62,031</u>	<u>\$ 72,865</u>
Weighted average shares outstanding	21,617,630	21,325,907	23,515,367
Income before cumulative effect of accounting change	\$ 3.24	\$ 2.91	\$ 2.54
Cumulative effect of accounting change, net of tax	—	—	0.56
Net income per share	<u>\$ 3.24</u>	<u>\$ 2.91</u>	<u>\$ 3.10</u>
<i>Diluted earnings per share:</i>			
Income before cumulative effect of accounting change	\$ 70,108	\$ 62,031	\$ 59,635
Cumulative effect of accounting change, net of tax	—	—	13,230
Net income	70,108	62,031	72,865
Net income adjustment for interest on convertible debt, net of tax	7,491	7,480	3,369
Net income as adjusted	<u>\$ 77,599</u>	<u>\$ 69,511</u>	<u>\$ 76,234</u>
Weighted average shares outstanding	21,617,630	21,325,907	23,515,367
Dilutive shares resulting from common stock equivalents	262,390	190,608	182,469
Dilutive shares resulting from convertible debt	6,712,529	5,263,170	2,408,081
Weighted average shares and common stock equivalents outstanding	<u>28,592,549</u>	<u>26,779,685</u>	<u>26,105,917</u>
Income before cumulative effect of accounting change	\$ 2.71	\$ 2.60	\$ 2.41
Cumulative effect of accounting change, net of tax	—	—	0.51
Net income per share	<u>\$ 2.71</u>	<u>\$ 2.60</u>	<u>\$ 2.92</u>

Cash and Temporary Cash Investments—For purposes of reporting cash flows, we consider all highly liquid investments purchased with an original maturity of three months or less to be temporary cash investments. Temporary cash investments are stated at cost, which approximates market value. At times, our cash balances and temporary cash investments exceed FDIC insurance limits.

Property, Plant and Equipment and Depreciation—Property, plant and equipment reflects the original cost of acquisition or construction, including payroll and related costs, such as taxes, pensions and other fringe benefits and certain general administrative costs and assets held under capital lease. Major replacements and betterments are capitalized. Repairs of all property, plant and equipment are charged to expense as incurred.

Depreciation on telephone plant is based on the estimated remaining lives of the various classes of depreciable property and straight-line composite rates. The average rates were approximately 6.32%, 8.05% and 8.37% in 2005, 2004 and 2003, respectively. At the time telephone plant is retired, the original cost less salvage, is charged to accumulated depreciation. All other property, plant and equipment gain or loss is recognized on retirements and dispositions.

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

Late in the second quarter of 2005, we completed our periodic review of asset retirement activity, salvage values and fixed asset lives at our CT and CTSI segments. This review involved a detailed analysis of assets in our network and incorporated our expectations for expansion and customer demand for new technology. Also, the second quarter of 2005 review incorporated the results of the Chapter 30 Plan amendment that was approved by the Pennsylvania Public Utility Commission in March 2005, which prescribed the broadband capability we are required to provide to our customers by December 31, 2008, and which clarified our expectations with regard to future capital deployment requirements in CT's territory. Specifically, the revised Chapter 30 Plan allows us to build upon, in large part, our current network, which we believe justifies a longer useful life for such assets. As a result of this review, we revised the useful lives of certain classes of assets, primarily digital equipment electronic switching, digital circuit transmission and computers and software. The impact of these changes was a lengthening of useful lives that had the effect of reducing depreciation by \$7,248 (after-tax) or \$0.25 per diluted share for the twelve months ended December 31, 2005.

Effective January 1, 2003, we adopted SFAS No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143"). This statement provides the accounting for the cost of legal obligations associated with the retirement of long-lived assets. SFAS 143 requires that companies recognize the fair value of a liability for asset retirement obligations in the period in which the obligations are incurred and capitalize that amount as part of the book value of the long-lived asset. SFAS 143 also precludes companies from accruing removal costs that exceed gross salvage in their depreciation rates and accumulated depreciation balances if there is no legal obligation to remove the long-lived assets. For our outside plant accounts, such as telephone poles and cable, estimated cost of removal did exceed gross salvage.

We had historically included in our group depreciation rates estimated net removal costs associated with these outside plant assets in which estimated cost of removal exceeded gross salvage. These costs were reflected in the calculation of depreciation expense, which resulted in greater periodic depreciation expense and the recognition in accumulated depreciation of future costs of removal for existing assets. When the assets were actually retired and removal costs expended, the net removal costs were recorded as a reduction to accumulated depreciation.

In connection with the adoption of this standard, we were required to remove all existing accrued net costs of removal in excess of the related estimated salvage from our accumulated depreciation for those accounts. The adjustment is reflected in the income statement as a cumulative effect of accounting change, net of tax, which increased net income in 2003 by \$13,230 or \$0.56 per share (\$0.51 per share on a diluted basis).

The following pro forma amounts have been adjusted for the effect of retroactive application on depreciation and costs of removal expense and related income taxes which would have been made had the new method been in effect at the beginning of 2003:

	<u>For the Year Ended December 31, 2003</u>	
	<u>As Reported</u>	<u>Pro Forma</u>
Net income	\$72,865	\$59,635
Basic earnings per share	3.10	2.54
Diluted earnings per share	2.92	2.41

In March 2005, the FASB issued FASB Interpretation No. 47 ("FIN 47"), "Accounting for Conditional Asset Retirement Obligations—an Interpretation of FASB Statement No. 143." FIN 47 clarifies that an entity is required to recognize the liability for the fair value of a conditional asset retirement obligation when incurred if the liability's fair value can be reasonably estimated. FIN 47 clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. This Interpretation is effective no later than the end of fiscal years ending after December 15, 2005. The application of this Interpretation did not have a material effect on our results of operations or financial condition.

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

Leasehold Improvements—Leasehold improvements are amortized over the lesser of the leasehold improvement's useful life or the term of the underlying lease (including renewals that are deemed to be reasonably assured) at the date the leasehold improvement is purchased.

Derivative Instruments—We utilize interest rate swap agreements to reduce our exposure to interest rate fluctuation on our floating rate debt. The swap agreements are contracts to exchange floating rate for fixed interest payments periodically over the life of the agreements without exchange of the underlying notional amounts. The notional amounts of interest rate swap agreements are used to measure interest to be paid or received and do not represent the amount of exposure to credit loss. Amounts to be paid or received under interest rate swap agreements are accrued and recognized over the life of the swap agreements as an adjustment to interest expense.

The interest rate swaps meet the eligibility requirements for hedge accounting and are considered to be cash flow hedges. The fair value of the interest rate swaps is recorded in other liabilities on our Consolidated Balance Sheets. The effective portion of interest rate swap gains or losses is initially reported as a component of other comprehensive loss and subsequently reclassified into earnings as an adjustment to interest expense. The ineffective portion, if any, is reported as other income (expense). The fair values of the interest rate swaps at January 1, 2003, were (\$6,341). For the year ended December 31, 2003, we recorded an adjustment of \$2,511 to adjust the fair value of the swaps to (\$3,830). For the year ended December 31, 2004, we recorded an adjustment of \$2,554 to adjust the fair value of the swaps to (\$1,276). For the year ended December 31, 2005, we recorded an adjustment of \$1,082 to adjust the fair value of the swaps to (\$194). The adjustment of \$703, net of taxes of \$379 in 2005, the adjustment of \$1,660, net of taxes of \$894 in 2004 and the adjustment of \$1,632, net of taxes of \$879 in 2003 are reported as unrealized gains (losses) on derivative instruments in accumulated other comprehensive income (loss).

The interest rate swaps are highly effective in achieving the offset of changes in cash flows of the underlying debt. We calculate the excess in the present value of the cumulative change in cash flows relating to the floating leg of the swaps as compared to the present value of the cumulative changes in interest cash outflows on the debt to measure ineffectiveness. At December 31, 2005, the swaps were 100% effective. For the years ended December 31, 2005, 2004 and 2003, the ineffectiveness charged to earnings was \$0.

Other Assets—Other assets principally include the unamortized portion of installation costs, costs incurred to obtain financing, prepaid pension cost and pension intangible.

Income Taxes—We report income for federal income tax purposes on a consolidated basis. We use an asset and liability approach for financial accounting and reporting for income taxes. This approach requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between financial reporting basis and tax basis of assets and liabilities. If it is more likely than not that some portion or all of a deferred tax asset will not be realized, a valuation allowance is recognized.

Accounting for Impairments—Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In performing the review for recoverability, we estimate the net future cash flows expected to result from the use of the asset and its eventual disposition. If the sum of the expected net future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, an impairment loss is recognized. Measurement of an impairment loss for long-lived assets would be based on the excess of the carrying value of the asset over the fair value. Fair value would be determined using the anticipated cash flows discounted at a rate commensurate with the risk involved.

Recent Accounting Pronouncements—On December 16, 2004, the Financial Accounting Standards Board ("FASB") issued FASB Statement No. 123(R) ("FAS 123(R)", "Share-Based Payment." FAS 123(R) revises FASB Statement No. 123 ("FAS 123"), "Accounting for Stock-Based Compensation." Also, FAS 123(R) supersedes Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees,"

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

and amends FASB Statement No. 95, "Statement of Cash Flows." For public companies, FAS 123(R) was effective for periods beginning after June 15, 2005, however, in April of 2005, the SEC delayed the effective date. FAS 123(R) is effective for public companies for annual periods that begin after June 15, 2005.

FAS 123(R) requires companies to expense the fair value of employee stock options and other forms of stock-based compensation. Specifically, FAS 123(R) requires companies to (i) use fair value to measure stock-based compensation awards and (ii) cease using the "intrinsic value" method of accounting under APB 25 that resulted in no expense for many awards of stock options for which the exercise price of the option equaled the price of the underlying stock at the grant date. In addition, FAS 123(R) retains the modified grant date model from FAS 123 in that compensation cost is measured at the grant date fair value of the award and adjusted to reflect actual forfeitures and the outcome of certain conditions. The fair value of an award is not remeasured after its initial estimation on the grant date, except in certain cases. FAS 123(R)'s transition provisions provide a number of alternatives to address implementation issues and to increase the comparability of compensation cost.

On January 1, 2006, we adopted the "Modified Prospective Application" ("MPA") method, without restatement of prior interim periods. Under the MPA method without restatement approach, we recognize compensation cost for (1) awards that were granted or modified after the fiscal year beginning after December 15, 1994, (2) any portion of awards that have not vested by January 1, 2006, and (3) any outstanding liability awards. Compensation cost for the portion of awards for which the requisite service has not been rendered that are outstanding at January 1, 2006, is recognized using the measurement data and attribution method used in our FAS 123 pro forma disclosures as those services are received after January 1, 2006. In addition, we are required to estimate the compensation cost of awards that are likely to be forfeited during the remaining vesting period and record a cumulative effect adjustment effective January 1, 2006. These amounts will not be material to our results of operations or financial condition.

For restricted stock, we recognize compensation cost over the four-year vesting period (the "nominal vesting period approach"). For any employee that retires before the end of the vesting period, we would recognize any unamortized compensation cost at the date of retirement. With adoption of FAS 123(R), compensation cost is recognized immediately for awards granted to retirement eligible employees or over the period from the grant date to the date retirement eligibility is achieved (the "non-substantive vesting period approach"). If we had applied the non-substantive vesting period approach, compensation cost would have increased by \$0 for both of the years ended December 31, 2005 and 2004.

We have undergone an extensive study of our stock-based compensation plans in anticipation of the adoption of FAS 123(R) and recent changes in tax laws with regard to deferred compensation. Currently, we do not anticipate a change in our current compensation strategy or structure, but continue to look for ways to compensate individuals via avenues that align the interests of individuals with the interests of shareholders through ownership of company stock.

3. Segment Information

We operate in two principal business segments: Commonwealth Telephone Company ("CT"), a rural incumbent local exchange carrier ("RLEC"); and CTSI, LLC ("CTSI"), our RLEC "edge-out" operation, which formally commenced operations in 1997.

The CT segment includes the results of CLD, a reseller of long-distance services and the portion of the digital subscriber line ("DSL") product offering, in CT's franchise area. CT provides local and long-distance telephone service and DSL service to residential and business customers in a 19-county service territory in rural eastern and central Pennsylvania. CT also provides network access and billing/collection services to interexchange carriers and sells telecommunications products and services.

CTSI, which operates in three edge-out regional Pennsylvania markets that border CT's territory, is a competitive local exchange carrier, offering bundled local and long-distance telephone, DSL and enhanced services.

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

The Other segment includes the results of Commonwealth Communication, LLC (“CC”), a provider of telecommunications equipment and facilities management services; epix® Internet Services (“epix”), which provides dial-up Internet service; and CTE’s corporate entity.

No single external customer contributes ten percent or more of CTE’s consolidated revenues.

Operating income (loss) is the primary measure used by our management to assess the performance of each segment.

Financial information by business segment is as follows:

	For the Year Ended December 31, 2005			
	CT	CTSI	Other	Consolidated
Sales	\$251,066	\$ 86,954	\$ 18,948	\$356,968
Elimination of intersegment sales	22,602	459	51	23,112
External sales	228,464	86,495	18,897	333,856
Costs and expenses	79,153	54,315	30,446	163,914
Depreciation and amortization	37,439	19,271	1,182	57,892
Restructuring reversals	—	(31)	—	(31)
Operating income (loss)	111,872	12,940	(12,731)	112,081
Identifiable assets	337,795	138,521	79,078	555,394
Capital expenditures	27,174	15,320	1,381	43,875

	For the Year Ended December 31, 2004			
	CT	CTSI	Other	Consolidated
Sales	\$246,788	\$ 84,022	\$ 24,602	\$355,412
Elimination of intersegment sales	19,122	454	25	19,601
External sales	227,666	83,568	24,577	335,811
Costs and expenses	79,219	53,809	26,161	159,189
Depreciation and amortization	48,047	20,205	2,722	70,974
Restructuring reversals	—	(799)	—	(799)
Operating income (loss)	100,400	10,353	(4,306)	106,447
Identifiable assets	372,393	137,567	273,471	783,431
Capital expenditures	26,960	14,858	1,701	43,519

	For the Year Ended December 31, 2003			
	CT	CTSI	Other	Consolidated
Sales	\$237,257	\$ 86,040	\$ 26,638	\$349,935
Elimination of intersegment sales	13,430	704	79	14,213
External sales	223,827	85,336	26,559	335,722
Costs and expenses	79,730	55,610	27,500	162,840
Depreciation and amortization	46,944	20,748	3,445	71,137
Restructuring reversals	—	(1,636)	—	(1,636)
Operating income (loss)	97,153	10,614	(4,386)	103,381
Identifiable assets	374,903	156,616	320,134	851,653
Capital expenditures	26,448	19,198	1,726	47,372

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

The following table shows a reconciliation of operating income for the reportable business segments to income before taxes:

	<u>For the Years Ended December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Operating income from reportable segments	\$124,812	\$110,753	\$107,767
Other segment	(12,731)	(4,306)	(4,386)
Interest and dividend income	8,375	5,773	3,372
Interest expense	(14,084)	(16,800)	(13,560)
Other income (expense), net	(896)	686	(884)
Equity in income of unconsolidated entities	3,177	3,236	2,698
Consolidated income before income taxes	<u>\$108,653</u>	<u>\$ 99,342</u>	<u>\$ 95,007</u>

4. Restructuring Charges (Reversals)

In order to enhance CTSI's near-term cash flow and reduce CTSI's capital requirements, in December 2000 we announced our intention to exit five CTSI expansion markets: suburban Philadelphia, PA; Binghamton, NY; Syracuse, NY; Charleston/Huntington, WV; and Youngstown, OH. Related to this, we recorded an estimated restructuring charge of \$99,713 (\$64,813 after-tax), or (\$2.79) (after-tax) per common share (including effects of anti-dilutive options).

Payments were \$376, \$136 and \$427 for the years ended December 31, 2005, 2004 and 2003, respectively. Reversals (net of provisions) were (\$32), \$332 and \$790 for the years ended December 31, 2005, 2004 and 2003, respectively. In addition, assets that we had previously written off were sold returning a gain of \$63 in 2005 and \$245 in 2004. In 2004, we reversed \$222 of our reserve associated with disposal costs of exit market inventory. As of December 31, 2005, the balance in accrued restructuring expense is \$0.

5. Property, Plant and Equipment

Property, plant and equipment consists of the following:

	<u>Estimated Useful Lives in Years</u>	<u>December 31,</u>	
		<u>2005</u>	<u>2004</u>
Land		\$ 1,738	\$ 1,738
Building and leasehold improvements	3-40	37,286	36,819
Central office equipment	5-18	405,506	389,721
Outside communications plant	20-40	388,571	377,043
Furniture, vehicles and other equipment	3-25	85,412	83,913
Total property, plant and equipment		918,513	889,234
Less accumulated depreciation		<u>(550,007)</u>	<u>(506,711)</u>
Property, plant and equipment, net		<u>\$ 368,506</u>	<u>\$ 382,523</u>

Depreciation and amortization expense was \$57,892, \$70,974 and \$71,137 for the years ended December 31, 2005, 2004 and 2003, respectively.

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

6. Investments

Investments are as follows:

	December 31,	
	2005	2004
Rural Telephone Bank (“RTB”) Stock	\$ 6,409	\$ 6,409
Yellow Book, USA, L.P. Partnership	3,859	3,928
CoBank and other	1	1
Total investments	<u>\$10,269</u>	<u>\$10,338</u>

In accordance with the terms of our prior mortgage notes and security agreements which we redeemed in 1993, we were required to purchase common stock of the RTB equal to approximately 5% of the amount borrowed. Such class of stock is entitled to cash dividends which are included in interest and dividend income and were approximately \$1,700, \$1,800 and \$1,300 for the years ended December 31, 2005, 2004 and 2003, respectively. As part of the 2006 Agriculture Appropriations bill, the current Administration established a process and terms to implement a dissolution of the RTB, whereby stockholders will obtain a cash payout for their stock. We have received stock dividends with a face value of approximately \$23,600 in accordance with the provisions of our previous financing arrangements with the RTB. These stock dividends will be recognized as income and will be subject to the statutory federal and state income tax rates when the underlying security is redeemed for cash, which we believe will be no later than the end of the second quarter of 2006.

Our financing arrangements with CoBank entitle us to receive annual patronage dividends. Approximately 60% of the patronage dividends are received in cash, with the balance in CoBank equity. The cash portion is included in interest and dividend income and was \$293, \$197 and \$237 for the years ended 2005, 2004 and 2003, respectively. Patronage dividends in the form of equity received to date have a future value totaling approximately \$6.2 million. We will receive cash in exchange for a portion of this equity once the value of the equity reaches certain targeted levels, which are calculated based upon the amount outstanding on our CoBank loan. We will recognize the CoBank equity dividend as it is received in cash, which we currently anticipate will not begin before 2007.

CTE owns a 50% interest in the Yellow Book, USA, L.P. Partnership (“Yellow Book”), accounted for under the equity method. Yellow Book provides directory publishing services, including yellow page advertising sales, for eight telephone directories.

The Yellow Book, USA, L.P. Partnership accounts for its yellow page advertising revenue based on the delivery method, which recognizes revenue based on the directories delivered (to subscribers) as a percentage of the total directories (initial and secondary) estimated to be delivered.

7. Other Assets

Other assets consist of the following:

	December 31,	
	2005	2004
Unamortized debt issuance costs	\$ 4,596	\$ 6,210
Prepaid pension cost	—	3,419
Pension intangible	3,679	—
Unamortized installation costs	6,154	6,188
Other	589	211
Total other assets	<u>\$15,018</u>	<u>\$16,028</u>

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

8. Debt

a. *Long-term debt*—Long-term debt and capital lease obligations outstanding are as follows:

	December 31,	
	2005	2004
Convertible notes	\$300,000	\$300,000
Capital lease obligation	360	1,082
Due within one year	(360)	(721)
Total long-term debt and capital lease obligations	<u>\$300,000</u>	<u>\$300,361</u>

In July of 2003, we sold \$300,000 principal amount of 3.25% convertible notes due 2023. On June 24, 2005, we launched an exchange offer pursuant to which we offered to exchange up to \$300,000 of our then outstanding 3.25% convertible notes (the “Old Notes”) for new 2005 Series A 3.25% convertible notes (the “New Notes”) due 2023 in an equal principal amount plus an exchange fee of \$2.50 per \$1,000 principal amount of existing notes. The New Notes contain terms that provide us with the flexibility to settle conversion of the notes with cash, common stock or a combination of cash and common stock. The Old Notes require us to settle conversions of notes with shares of common stock. The change to the terms of the notes allows us to reduce the dilutive effect on our common stock that would be caused by future conversion of the convertible notes. The terms of the New Notes maintain full dividend protection for the holders of the notes. The exchange offer closed on August 3, 2005, at which time a total of \$63,892 principal amount of New Notes were issued in exchange for the same principal amount of Old Notes and an exchange fee of \$160 was paid. We intend to continue to consider other options to further reduce or possibly eliminate the dilutive effect of future conversions, including common share repurchases depending on market conditions.

Holders of Old Notes may convert their notes into shares of our common stock and holders of New Notes may convert their notes with settlement, at our election, in our common stock, cash or a combination of cash and our common stock prior to the close of business on the final maturity date under any of the following circumstances:

- during any fiscal quarter, but only during such fiscal quarter, if the closing sale price of our common stock exceeds 120% of the then-effective conversion price for at least 20 trading days in the 30 consecutive trading-day period ending on the last trading day of the preceding fiscal quarter;
- during the five business-day period after any five consecutive trading-day period in which the trading price per note for each day of such period was less than 98% of the product of the closing sale price of our common stock and the number of shares issuable upon conversion of \$1,000 principal amount of the notes;
- if the notes have been called for redemption; or
- upon the occurrence of specified corporate events.

We have applied the guidance provided in EITF Issue No. 96-19 “Debtor’s Accounting for a Modification or Exchange of Debt Instruments” and EITF Issue No. 05-7 “Accounting for Modifications to Conversion Options Embedded in Debt Securities and Related Issues” in accounting for the exchange offer. In this regard, we have determined that the exchange offer did not result in a substantial modification of terms and was not treated as an extinguishment of debt. Per the guidance, fees paid by the Company of \$160 to Holders will be amortized to the first put date, July 15, 2008, and costs incurred with third parties of approximately \$421 directly related to the exchange have been expensed as incurred.

The settlement terms of the Company’s 3.25% convertible notes were evaluated against the guidance in EITF Issue 01-6 “The Meaning of Indexed to a Company’s Own Stock” within the meaning of paragraph 11(a) of FASB Statement No. 133. As a result of this evaluation, the Company determined that the contingent interest

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

portion and the trading price condition feature do not pass the requirements of paragraph 11(a) because they are dual-indexed to the trading price of the Company's common stock and debt fair values. The contingent interest feature and the trading price condition feature are bifurcated and separated from the debt host contract and accounted for as a derivative instrument in accordance with the provisions in FASB Statement No. 133. Based on fair value estimates determined with the assistance of a third party, we have determined that the impact of these embedded derivatives was not material for the years ended December 31, 2005, 2004 and 2003.

b. Short-term debt—An amended \$85,000 revolving line of credit agreement with CoBank was entered into on May 31, 2005, with a \$35,000 balance outstanding. The line of credit is at interest rates that are based on a LIBOR rate or floating rate option. Interest payments are payable monthly. This agreement contains restrictive covenants, which, among other things, require the maintenance of a specified debt to cash flow ratio at CT. For all periods presented, we were in compliance with our covenants. As of December 31, 2005 the weighted average interest rate, not subject to an interest rate swap, was 4.69% on borrowings of \$35,000. The revolving line of credit agreement provides for the availability of credit to May 29, 2006. We may refinance all or a portion of this line of credit when it becomes due.

9. Common Stock Plans

The CTE Equity Incentive Plan, as amended, provides for the issuance of up to 5,350,000 shares of common stock pursuant to awards granted under the Plan. Awards granted under the Plan may include incentive stock options, nonqualified stock options, outperformance stock options, stock appreciation rights, performance share units, restricted stock, phantom stock units and other stock-based awards. Stock options currently granted under the Plan vest in increments of 20% commencing one year from the date of the grant and expire ten years from the date of the grant. Restricted stock awards (either in the form of restricted shares or units) currently granted under the Plan vest in increments of 25% commencing one year from the date of the grant. Restricted shares, whether or not voted, are entitled to vote and to receive dividends. Restricted share units do not give the holder any rights as a shareholder or record owner of any shares of common stock, although they are eligible to receive dividend equivalent units in an amount equal to any dividends of common stock.

Our Non-Management Directors' Stock Compensation Plan provides for the grant of up to 250,000 shares of common stock to all members of our Board of Directors who are not, as of the date of any award, our employees. Awards granted under this Plan may include nonqualified stock options, outperformance stock options, stock appreciation rights, performance share units, restricted stock, phantom stock units and other stock-based awards. The options are immediately exercisable and shall remain exercisable until the earlier of ten years from the date of grant and a period of one year from the date upon which the participant ceases to be a non-management director. Restricted stock awards (either in the form of restricted shares or units) vest fully commencing one year from the date of the grant. Restricted shares, whether or not voted, are entitled to vote and to receive dividends. Restricted share units do not give the holder any rights as a shareholder or record owner of any shares of common stock, although they are eligible to receive dividend equivalent units in an amount equal to any dividends on common stock.

In connection with the payment of the dividends on June 30, 2005, the exercise price and number of all outstanding options were adjusted such that each option had the same value to the holder after the dividend as it had before the dividend. In accordance with FASB Interpretation No. 44 "Accounting for Certain Transactions Involving Stock Compensation" and EITF 00-23 "Issues Related to the Accounting for Stock Compensation under APB No. 25 and FIN 44," there is no accounting consequence for changes made to the exercise price and the number of shares of a fixed stock option or award as a direct result of the June 2005 dividends due to the fact that the transaction was an equity restructuring. The range of exercise prices for options outstanding at December 31, 2005, was \$8.27 to \$40.47. For all options granted, the exercise price is equal to the market price of the common stock at the date of the grant.

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

Information relating to CTE stock options is as follows:

	<u>Number of Shares</u>	<u>Weighted Average Exercise Price</u>
Outstanding December 31, 2002	1,508,648	\$35.97
Granted	—	\$ —
Exercised	(146,267)	\$26.53
Canceled	<u>(53,000)</u>	<u>\$45.51</u>
Outstanding December 31, 2003	1,309,381	\$36.63
Granted	—	\$ —
Exercised	(272,945)	\$33.47
Canceled	<u>(31,100)</u>	<u>\$43.11</u>
Outstanding December 31, 2004	1,005,336	\$37.29
Granted (as a result of the dividend)	129,110	\$ —
Exercised	(650,574)	\$36.40
Canceled	<u>(27,313)</u>	<u>\$28.29</u>
Outstanding December 31, 2005	<u>456,559</u>	<u>\$28.56</u>
Shares exercisable December 31, 2003	<u>706,181</u>	<u>\$35.24</u>
Shares exercisable December 31, 2004	<u>645,636</u>	<u>\$36.98</u>
Shares exercisable December 31, 2005	<u>275,119</u>	<u>\$29.76</u>

<u>Range of Exercise Prices</u>	<u>Options Outstanding</u>			<u>Options Exercisable</u>	
	<u>Number Outstanding at December 31, 2005</u>	<u>Weighted Average Remaining Contractual Life</u>	<u>Weighted Average Exercise Price</u>	<u>Number Exercisable at December 31, 2005</u>	<u>Weighted Average Exercise Price</u>
\$8.27	939	1.2	\$ 8.27	939	\$ 8.27
\$18.35—\$28.91	323,376	5.2	25.99	141,936	25.04
\$29.95—\$40.47	<u>132,244</u>	4.4	34.99	<u>132,244</u>	34.99
Total/weighted average	<u>456,559</u>	<u>4.9</u>	<u>\$28.56</u>	<u>275,119</u>	<u>\$29.76</u>

As provided for in the CTE Equity Incentive Plan, the fair value of the restricted stock units to be recognized as compensation cost over the four year vesting period is recognized as deferred compensation, shown as a separate reduction of shareholders' equity.

<u>Year</u>	<u>Shares Issued</u>	<u>Shares Cancelled</u>	<u>Shares Vested</u>	<u>Grant Date Fair Value</u>	<u>Compensation Expense Year Ended December 31, 2005</u>	<u>Compensation Expense Year Ended December 31, 2004</u>	<u>Compensation Expense Year Ended December 31, 2003</u>
2000	155,000	33,750	121,250	\$7,333	\$ —	\$ 554	\$1,331
2003	162,125	24,250	74,562	6,206	1,561	1,401	1,230
2004	171,550	16,375	43,388	7,106	2,000	1,405	—
2005	157,995	325	—	7,487	1,922	—	—

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

Pursuant to the Non-Management Directors' Stock Compensation Plan, each non-employee director receives an annual grant of restricted common stock, in an amount determined by the Corporate Governance Committee, on the date of the Annual Meeting of Shareholders. The fair value of the restricted stock units is recognized as compensation cost over the one-year vesting period.

<u>Year</u>	<u>Shares Issued</u>	<u>Shares Cancelled</u>	<u>Shares Vested</u>	<u>Grant Date Fair Value</u>	<u>Compensation Expense Year Ended December 31, 2005</u>	<u>Compensation Expense Year Ended December 31, 2004</u>	<u>Compensation Expense Year Ended December 31, 2003</u>
2003	9,000	—	9,000	\$370	\$—	\$247	\$124
2004	9,000	—	9,000	376	157	219	—
2005	9,000	—	—	462	338	—	—

The table below contains information pertaining to equity compensation plans approved and not approved by security holders:

<u>Plan category</u>	<u>Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights</u>	<u>Weighted Average Exercise Price of Outstanding Options, Warrants and Rights</u>	<u>Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans</u>
Equity compensation plans approved by security holders	1,000,501	\$36.62	2,080,225
Equity compensation plans not approved by security holders	—	—	—
Total/weighted average	<u>1,000,501</u>	<u>\$36.62</u>	<u>2,080,225</u>

We also have a nonqualified stock purchase plan for certain key executives (the "Executive Stock Purchase Plan" or "ESPP"). Under the ESPP, participants may purchase shares of common stock in an amount between 1% and 20% of their annual base compensation and between 1% and 100% of their annual bonus compensation, provided, however, that in no event shall the participant's total contribution exceed 20% of their combined base and annual bonus compensation, as defined by the ESPP. Participants' accounts are credited with the number of share units derived by dividing the amount of the participant's contribution by the average price of a share of common stock at the time such contribution is made. The share units credited to a participant's account do not give such participant any rights as a shareholder or record owner of any shares of common stock. Participants will be credited with share units equal to the value of any dividend on common stock. Amounts representing share units that have been credited to a participant's account will be distributed to the participant following the earlier of the participant's termination of employment or three calendar years following the date on which the share units were initially credited to the participant's account. It is anticipated that, at the time of distribution, a participant will receive one share of common stock for each share unit being distributed.

Following the crediting of each share unit to a participant's account, we will issue a matching share of common stock held in escrow in the participant's name. Each matching share is subject to forfeiture as provided in the ESPP. A participant will be deemed to be the holder of, and may exercise all the rights of a record owner of, the matching shares issued to such participant while such matching shares are held in escrow. The matching shares vest three years from the date of the contribution.

At December 31, 2005, there were 116,425 ESPP shares arising from participants' contributions and 115,020 matching shares. The number of shares vested, including matching shares, at December 31, 2005, was 144,982. We recognize the cost of the matching shares over the vesting period. At December 31, 2005 and 2004, deferred compensation cost relating to matching shares was \$1,914 and \$1,232, respectively. Expense recognized in 2005, 2004 and 2003, was \$1,261, \$857 and \$688, respectively. Matching shares are included in weighted average shares outstanding for purposes of computing earnings per share.

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

10. Pension and Employee Benefits

Defined benefit pension plan:

Substantially all of our employees are included in a non-contributory defined benefit pension plan. The plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"), as amended. Upon retirement, employees are provided a monthly pension based on length of service and compensation.

Pension cost is as follows:

	For the Years Ended December 31,		
	2005	2004	2003
Service cost	\$ 3,746	\$ 3,303	\$ 2,853
Interest cost	5,742	5,452	5,231
Expected return on plan assets	(7,285)	(6,577)	(5,817)
Amortization of net (asset) obligation	—	—	(494)
Amortization of prior service cost	530	525	524
Recognized net actuarial loss	386	226	481
Total net periodic benefit cost	<u>\$ 3,119</u>	<u>\$ 2,929</u>	<u>\$ 2,778</u>

We estimate pension cost of approximately \$4,300 for 2006.

Plan assets include cash, equity, fixed income securities and pooled funds under management by a financial institution. The allocation of plan assets at December 31, 2005 and 2004 is:

<u>Asset Category</u>	<u>Target Allocations</u>	<u>Percentage of Plan Assets December 31,</u>	
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Equity securities	70%	72%	73%
Fixed income securities	30%	28%	27%
CTE Common Stock	—	—	—

The expected long-term rate of return assumption is based on the actual historical rates of return of published indices that are used to measure the plan's target asset allocation. The historical rates are then discounted to consider fluctuations in the historical rates as well as potential changes in the investment environment. The investment strategy for plan assets is to maintain a broadly diversified portfolio designed to achieve an average long-term rate of return of 8.5% effective with the 2006 plan year. Assets are strategically allocated between equity and fixed income securities in order to achieve a diversification level that mitigates wide swings in investment returns. Asset allocation target ranges are evaluated at least every three years with the assistance of an external consulting firm. Actual asset allocations are monitored quarterly and rebalancing actions are executed at least quarterly, if required.

The majority of the plan assets are invested in equity securities because equity portfolios have historically provided higher returns than debt portfolios over the long-term and are expected to do so in the future. Correspondingly, equity investments also carry greater risks than debt investments. The risk of loss in the plan's equity assets is mitigated by investing in a broad range of equity types; including large-cap and small-cap stock funds, and international equity funds.

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

The following table sets forth the defined benefit pension plan's funded status and amounts recognized in our Consolidated Balance Sheets:

	<u>December 31,</u>	
	<u>2005</u>	<u>2004</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	\$ 85,574	\$ 76,821
Actual return on plan assets	5,153	11,445
Employer contributions	—	2,070
Benefits paid	(4,370)	(4,762)
Fair value of plan assets at end of year	<u>\$ 86,357</u>	<u>\$ 85,574</u>
Change in benefit obligation:		
Benefit obligation at beginning of year	\$101,020	\$ 88,468
Service cost	3,746	3,303
Interest cost	5,742	5,452
Amendments	83	—
Actuarial loss	5,527	8,142
Benefits paid	(4,378)	(4,345)
Benefit obligation at end of year	<u>\$111,740</u>	<u>\$101,020</u>
Funded status	\$(25,383)	\$(15,446)
Unrecognized actuarial loss	22,004	14,738
Unrecognized prior service cost	3,679	4,127
Prepaid pension cost	<u>\$ 300</u>	<u>\$ 3,419</u>

The following table details expected benefit payments for the years 2006 through 2015:

<u>Year</u>	<u>Amount</u>
2006	\$ 4,402
2007	4,507
2008	4,709
2009	4,812
2010	4,888
2011-2015	30,149

Amounts recognized in the Consolidated Balance Sheets consist of:

	<u>December 31,</u>	
	<u>2005</u>	<u>2004</u>
Prepaid benefit cost	\$ —	\$3,419
Accrued benefit liability	(7,054)	—
Intangible asset	3,679	—
Accumulated other comprehensive loss	3,675	—
Net amount recognized	<u>\$ 300</u>	<u>\$3,419</u>

In the 2005 fourth quarter, in accordance with SFAS No. 87, "Employers' Accounting for Pensions," we recorded a minimum pension liability of \$7,054 representing the difference between the accumulated benefit obligation and the fair value of the Plan assets at December 31, 2005. Also, a pension intangible equal to the unrecognized prior service cost of \$3,679 was recognized. A charge to other comprehensive income (loss) in the amount of \$3,675 (\$2,288 after-tax) represents the excess of additional minimum pension liability over unrecognized prior service cost.

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

The accumulated benefit obligation was \$93,410 and \$84,003 at December 31, 2005 and 2004, respectively.

The following assumptions were used in the determination of the net benefit cost:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Weighted average discount rate	5.75%	6.25%	6.75%
Expected long-term rate of return on plan assets	8.75%	8.75%	9.00%
Weighted average rate of compensation increases	5.50%	5.50%	5.50%

The following assumptions were used in the determination of the benefit obligation:

	<u>December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Weighted average discount rate	5.50%	5.75%	6.25%
Weighted average rate of compensation increases	5.50%	5.50%	5.50%

The discount rate we used was determined using a spot rate yield curve, based on the rates on the Citigroup yield curve, constructed to replicate Aa-graded corporate bonds. The Plan's projected cash flows were matched to this yield curve to develop an appropriate discount rate. The expected return on plan assets is based on our asset allocation mix and our historical return, taking into account current market conditions and our best estimate of future economic conditions.

Our policy with respect to funding the plan is to fund at least the minimum required by ERISA, and not more than the amount deductible for tax purposes. No contributions were required to be made to the plan in 2005, and no contributions are required in 2006. We made a required minimum contribution to the plan of \$2,070 in the third quarter 2004 for the 2003 plan year with cash generated from operations.

Voluntary Retirement Program ("VRP") and postretirement benefits:

For former employees included in the VRP that took place in 2001 and 2002, we provide medical benefits until age 65. For employees retiring prior to 1993, we provide certain postretirement medical benefits. We also provide nominal postretirement life insurance benefits to all vested retirees.

Net periodic postretirement (benefit) cost is as follows:

	<u>VRP</u>			<u>Postretirement</u>		
	<u>For the Years Ended</u>			<u>For the Years Ended</u>		
	<u>December 31,</u>			<u>December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Service cost	\$—	\$—	\$—	\$—	\$—	\$—
Interest cost	28	37	52	49	49	72
Amortization of prior service cost	—	—	—	—	—	13
Recognized net actuarial gain	(40)	(50)	(60)	(85)	(109)	(101)
Total net periodic postretirement (benefit) cost	<u>\$ (12)</u>	<u>\$ (13)</u>	<u>\$ (8)</u>	<u>\$ (36)</u>	<u>\$ (60)</u>	<u>\$ (16)</u>

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

The following table sets forth the plans' funded status and amounts recognized in our Consolidated Balance Sheets:

	<u>VRP</u>		<u>Postretirement</u>	
	<u>December 31,</u>		<u>December 31,</u>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Change in plan assets:				
Fair value of plan assets at beginning of year	\$ —	\$ —	\$ —	\$ —
Employer contributions	210	258	135	147
Benefits paid	(210)	(258)	(135)	(147)
Fair value of plan assets at end of year	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>
Change in benefit obligation:				
Projected benefit obligation at beginning of year	\$ 503	\$ 706	\$ 834	\$ 1,143
Service cost	—	—	—	—
Interest cost	28	37	49	49
Amendments	—	—	—	(135)
Actuarial loss (gain)	100	18	128	(76)
Benefits paid	(210)	(258)	(135)	(147)
Projected benefit obligation at end of year	<u>\$ 421</u>	<u>\$ 503</u>	<u>\$ 876</u>	<u>\$ 834</u>
Funded status	\$(421)	\$(503)	\$ (876)	\$ (834)
Unrecognized actuarial gain	(112)	(252)	(863)	(1,075)
Unrecognized prior service cost	—	—	—	—
Accrued benefit cost	<u>\$(533)</u>	<u>\$(755)</u>	<u>\$(1,739)</u>	<u>\$(1,909)</u>

The following table details expected benefit payments for the years 2006 through 2015:

<u>Year</u>	<u>VRP</u> <u>Amount</u>	<u>Postretirement</u> <u>Amount</u>
2006	\$159	\$123
2007	116	116
2008	61	108
2009	40	100
2010	30	93
2011-2015	21	355

The accrued VRP and the postretirement benefit liabilities are included in other liabilities in the accompanying Consolidated Balance Sheets. The amounts recognized were \$533 and \$755 at December 31, 2005 and 2004, respectively for the VRP and \$1,739 and \$1,909 at December 31, 2005 and 2004, respectively for the post retirement plan.

The discount rate used in determining the accumulated VRP and postretirement benefit obligations was 5.50% in 2005 and 5.75% in 2004.

Our portion of the monthly premium for retirees included in the VRP and postretirement benefit obligation is limited, and any increase in medical costs is absorbed by the retiree. As such, a negative trend in healthcare costs will have no effect on the accumulated postretirement benefit obligation or the net periodic postretirement benefit cost.

We also have a nonqualified supplemental pension plan covering certain former employees which provides for incremental pension payments from us to the extent that income tax regulations limit the amount payable

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

from our defined benefit pension plan. The projected benefit obligation relating to this unfunded plan was approximately \$1,213, \$1,097 and \$1,075 at December 31, 2005, 2004 and 2003, respectively. Pension expense for the plan was \$67 in 2005, \$67 in 2004 and \$67 in 2003.

We provide certain postemployment benefits to former or inactive employees who are not retirees. These benefits are primarily short-term disability salary continuance. We accrue the cost of postemployment benefits over employees' service lives. We use the services of an enrolled actuary to calculate the expense. The net periodic cost (benefit) for postemployment benefits was \$371 in 2005, \$324 in 2004 and (\$224) in 2003.

We sponsor a 401(k) savings plan covering substantially all employees. For employees who are not covered by collective bargaining agreements, we contribute to the 401(k) plan based on a specified percentage of employee contributions. Contributions charged to expense were \$1,030, \$1,020 and \$964 in 2005, 2004 and 2003, respectively.

11. Income Taxes

The provision for income taxes is reflected in the Consolidated Statements of Operations as follows:

	<u>For the Years Ended December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Currently payable:			
Federal	\$35,837	\$32,066	\$10,548
State	4,376	5,108	1,984
Total current	<u>40,213</u>	<u>37,174</u>	<u>12,532</u>
Deferred, net:			
Federal	(9,246)	1,027	21,288
State	7,578	(890)	1,552
Total deferred	<u>(1,668)</u>	<u>137</u>	<u>22,840</u>
Total provision for income taxes	<u>\$38,545</u>	<u>\$37,311</u>	<u>\$35,372</u>

The following is a reconciliation of income taxes at the applicable U.S. federal statutory rate with income taxes recorded by us:

	<u>For the Years Ended December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Income before provision for income taxes	\$108,653	\$99,342	\$95,007
Federal tax provision at statutory rate	38,029	34,770	33,252
Increase (reduction) due to:			
State income taxes, net of federal effects	3,626	2,159	2,090
Stock offering costs	—	(37)	68
Plant acquisition costs	12	39	39
Charitable contribution of property	—	(153)	—
Income tax liability true-up, federal and state	(3,154)	618	—
Other, net	32	(85)	(77)
Provision for income taxes	<u>\$ 38,545</u>	<u>\$37,311</u>	<u>\$35,372</u>

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

Temporary differences and carryforwards that give rise to a significant portion of deferred tax assets and liabilities are as follows:

	December 31,	
	2005	2004
Net operating loss carryforwards	\$ 3,409	\$ 3,535
Employee benefit plans	9,677	3,606
Reserve for bad debts	449	760
Access settlements and network costs	8,067	10,805
Restructuring reserve	—	130
All other	3,907	3,343
Total deferred tax assets	<u>25,509</u>	<u>22,179</u>
Property, plant and equipment	(67,772)	(74,839)
Contingent convertible debt interest	(15,677)	(8,918)
All other	(811)	(585)
Total deferred tax liabilities	<u>(84,260)</u>	<u>(84,342)</u>
Subtotal	<u>(58,751)</u>	<u>(62,163)</u>
Valuation allowance	(2,464)	(1,728)
Net deferred taxes	<u><u>\$(61,215)</u></u>	<u><u>\$(63,891)</u></u>

In our opinion, based on the future reversal of existing taxable temporary differences, primarily depreciation, and expectations of future operating results, after consideration of the valuation allowance, we will more likely than not be able to realize substantially all of our deferred tax assets.

The net change in the valuation allowance for deferred tax assets during 2005 was an increase of \$736. The net change is due primarily to an analysis of the anticipated realization of the deferred tax assets related to state NOL carryforwards under existing state tax law.

As of December 31, 2005, we have cumulative state net operating losses of \$70,000 that can be utilized through 2025. The determination of the state net operating loss carryforward is dependent upon the subsidiaries' taxable income or loss, apportionment percentages and other respective state laws, which can change from year to year and impact the amount of such carryforward.

In 2005, we performed a detailed review of all deferred tax items and supporting schedules of net book vs net tax values. This review resulted in a net deferred tax benefit of approximately \$3,154 (\$2,239 impact to the fourth quarter) related to prior years that we recorded in the fourth quarter of 2005. This adjustment did not have a material effect on the current or any prior period's financial statements.

12. Commitments and Contingencies

a. Total rental expense, including pole and conduit rentals, was \$7,960, \$7,916 and \$7,172 in 2005, 2004 and 2003, respectively. At December 31, 2005, rental commitments under noncancelable leases, excluding annual pole and conduit rental commitments of approximately \$4,404 that are expected to continue indefinitely, are as follows:

<u>Year</u>	<u>Aggregate Amounts</u>
2006	\$2,633
2007	2,051
2008	1,857
2009	1,674
2010	1,463
After 2010	8,619

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

b. Effective July 2, 2004, we extended our agreement for the provision to us of data processing services including the general management of our data processing operations through December 31, 2005 (that was subsequently extended through January 31, 2006). The annual commitment, excluding annual increases based on increases in the Consumer Price Index, was \$7,479 in 2005. In the second half of 2005, the Company decided not to renew the agreement when it expired. These data processing services were brought in-house starting February 1, 2006.

c. In May 2001, CT entered into a fifteen-year, two-month agreement for the rental of a building in an area of a city qualifying for certain tax incentives offered by the state of Pennsylvania. The annual commitment through year ten is \$1,163. Annual rent for the last five years is subject to changes in the Consumer Price Index. In addition, CT also entered into a lease agreement for the rental of parking spaces for employees of the building, for a similar term. The annual commitment, excluding increases in the last five years based on increases in the Consumer Price Index, is \$168.

d. We had various purchase commitments at December 31, 2005, related to our 2006 capital budget. CTE's capital expenditures have averaged \$44,922 over the three years ended December 31, 2005.

e. In 2003, CT entered into a thirty-six month capital lease for the purchase of computer hardware. The annual commitment in 2006, excluding the interest component, is \$361.

In the normal course of business, there are various legal proceedings outstanding, including both commercial and regulatory litigation. In our opinion, these proceedings will not have a material adverse effect on our results of operations or financial condition.

13. Disclosures about Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

a. *Cash and temporary cash investments*—The carrying amount approximates fair value because of the short maturity of these instruments.

b. *Long-term investments*—Long-term investments consist primarily of investments accounted for under the equity method for which disclosure of fair value is not required, and Rural Telephone Bank ("RTB") Stock. It is not practicable to estimate the fair value of the RTB Stock because there is no quoted market price for the stock; it is issued only at par, and can be held only by recipients of RTB loans.

c. *Debt*—The fair value of bank debt was estimated using discounted cash flow calculations. The fair value of the convertible debt is based on quoted market prices or by obtaining quotes from dealers. The fair value of floating rate debt is considered to be equal to carrying value since the debt reprices at least every six months and we believe that our credit risk has not materially changed from the time the floating rate debt was borrowed.

d. *Interest rate swap*—The fair value has been calculated by the counterparty using appropriate valuation methodologies. The fair value of the interest rate swap is recorded in other liabilities on our Consolidated Balance Sheets. The fair value of the interest rate swaps at January 1, 2004, was (\$3,830). For the year ended December 31, 2004, we recorded an adjustment of \$2,554 (\$1,660 net of tax), to adjust the fair value of the swaps to (\$1,276). For the year ended December 31, 2005, we recorded an adjustment of \$1,082 (\$703 net of tax), to adjust the fair value of the swap to (\$194). The remaining interest rate swap expires in the second quarter of 2006.

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

The estimated fair value of our financial instruments is as follows:

	December 31,			
	2005		2004	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and temporary cash investments	\$104,968	\$104,968	\$312,260	\$312,260
Financial liabilities:				
Fixed rate long-term debt:				
Convertible notes	300,000	294,382	300,000	315,750
Floating rate debt:				
Revolving line of credit	35,000	35,000	35,000	35,000
Financial instruments:				
Interest rate swaps	(194)	(194)	(1,276)	(1,276)

14. Off Balance Sheet Risk and Concentration of Credit Risk

Certain financial instruments potentially subject us to concentrations of credit risk. These financial instruments consist primarily of trade receivables and cash and temporary cash investments.

We place our cash and temporary cash investments with high credit quality financial institutions and limit the amount of credit exposure to any one financial institution. We also periodically evaluate the credit worthiness of the institutions with which we invest. We do, however, maintain unsecured cash and temporary cash investment balances in excess of federally insured limits. We limit our exposure by diversifying among counterparties and investment categories to achieve a targeted mix of interest-bearing assets while maximizing after-tax returns.

Our trade receivables reflect a customer base primarily centered in eastern and central Pennsylvania. We assess the financial strength of our customers by performing credit evaluations and requiring deposits based on the results of these evaluations; as a result, credit risk is limited. Internet service providers represented approximately 15.1% and 17.1% of CTSI's revenues for the years ended December 31, 2005 and 2004, respectively. No single customer contributed more than 5% of its revenues.

We have an interest rate swap agreement to adjust the interest rate profile of our debt obligations and to achieve a targeted mix of floating and fixed rate debt. The counterparty to the interest rate swap agreement is a major financial institution. This financial institution has been accorded high ratings by primary rating agencies. We limit the dollar amount of contracts entered into with any one financial institution and monitor the credit ratings of counterparties. While we may be exposed to credit losses due to non-performance of the counterparty, we consider the risk remote and do not expect the settlement of this transaction to have a material effect on our financial condition or results of operations.

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

15. Quarterly Information (Unaudited)

	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>
2005				
Sales	\$83,529	\$83,018	\$83,784	\$83,525
Operating income	26,050	27,478	27,942	30,611
Net income	15,918	17,194	16,302	20,694
Basic earnings per share:				
Net income per share	\$ 0.75	\$ 0.80	\$ 0.74	\$ 0.94
Diluted earnings per share:				
Net income per share	\$ 0.67	\$ 0.66	\$ 0.62	\$ 0.77
Common Stock closing price:				
High	\$ 50.61	\$ 52.98	\$ 43.54	\$ 37.78
Low	46.50	40.19	37.22	33.48
	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>
2004				
Sales	\$84,380	\$84,014	\$83,776	\$83,641
Operating income	26,386	26,735	25,668	27,658
Net income	14,565	16,318	15,119	16,029
Basic earnings per share:				
Net income per share	\$ 0.66	\$ 0.77	\$ 0.72	\$ 0.76
Diluted earnings per share:				
Net income per share	\$ 0.60	\$ 0.68	\$ 0.64	\$ 0.67
Common Stock closing price:				
High	\$ 41.20	\$ 44.77	\$ 45.21	\$ 49.81
Low	36.79	41.24	43.19	43.99

16. Related Party Transactions

We had the following transactions with related parties:

	<u>For the Years Ended December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Purchases from Level 3 Communications, Inc.	\$1,254	\$ 93	\$ 418
Sales to Level 3 Communications, Inc.	410	144	24
Other related party revenues	2,163	2,635	2,316
Other related party expenses	9	382	1,638

At December 31, 2005, we had accounts receivable from related parties of \$0 and accounts payable to related parties of \$0.

Related parties include members of the Board of Directors and their related companies, including Level 3 Communications, Inc. Related party revenues and expenses represent the telephony service provided and the fees paid to these related companies arising from the ordinary course of business.

17. Common Stock

We have authorized 85,000,000 shares of \$1 par value CTE Common Stock at December 31, 2005, 2004 and 2003. At December 31, 2002, we had authorized 15,000,000 shares of \$1 par value CTE Class B Common Stock. On September 3, 2003, shareholders approved a proposal to reclassify and convert each outstanding share of CTE Class B Common Stock into 1.09 shares of CTE Common Stock. We now have only one class of common stock.

COMMONWEALTH TELEPHONE ENTERPRISES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Dollars in Thousands, Except Per Share Amounts)

In November of 2003, our Board of Directors authorized a Stock Repurchase Program of up to \$100 million of CTE Common Stock, which was subsequently increased to \$150 million. As of December 31, 2005, we had repurchased 3,047,244 shares, at a cost of \$118,544. We have approximately \$31,456 available for repurchases under the program. Future share repurchases will be executed at our discretion, based on ongoing assessments of our capital needs, and the market value of our common stock.

On May 2, 2005, our Board of Directors declared a special dividend of \$13.00 per share and a \$0.50 per share dividend for the quarter ended June 30, 2005 for which \$294,138 was paid. A \$0.50 per share dividend was paid for the quarters ended September 30, 2005 and December 31, 2005 for which \$10,823 and \$10,916 was paid in cash, respectively.

In connection with the payment of the special and initial quarterly dividend, the exercise price and number of all outstanding options were adjusted such that each option had the same value to the holder after the dividend as it had before the dividend. The conversion rate on our outstanding 3.25% convertible notes due 2023 was also adjusted to reflect all of the dividends based on the terms of the convertible notes. At the conversion price in effect at December 31, 2005, our convertible debt is convertible into 7,285,200 shares of our common stock.

Non-cash compensation, in the form of dividend equivalent units, of \$2,662 related to vested, deferred restricted stock units, vested, deferred Executive Stock Purchase Plan ("ESPP") share units and unvested 401(k) shares was recorded in 2005, in connection with the dividends. The dividends, in the form of dividend equivalent units, on unvested restricted stock and unvested ESPP share units of \$6,052 were recorded as deferred compensation in 2005 and will be recognized as compensation cost over the remaining vesting periods. For the year ended December 31, 2005, \$1,493 of this deferred compensation was recognized.

Schedule I

COMMONWEALTH TELEPHONE ENTERPRISES, INC.
CONDENSED FINANCIAL INFORMATION OF THE REGISTRANT
STATEMENTS OF OPERATIONS

	For the Years Ended December 31,		
	2005	2004	2003
	(Thousands of Dollars, Except Per Share Amounts)		
Income:			
Sales	\$ —	\$ 7,522	\$ 15,371
Interest income-other	—	(1)	15
Other	—	692	9,923
Total income	—	8,213	25,309
Expenses:			
Cost of goods sold	—	5,027	8,890
Interest expense on long-term debt, net	12,154	12,626	8,223
Interest expense, net on notes payable to subsidiaries	3,902	4,956	5,861
General and administrative expenses	1,380	3,003	4,756
Depreciation and amortization	—	106	294
Total expenses	17,436	25,718	28,024
Loss before income taxes and equity in net income of subsidiaries	(17,436)	(17,505)	(2,715)
Benefit for income taxes	(4,391)	(5,571)	(687)
Loss before equity in net income of subsidiaries	(13,045)	(11,934)	(2,028)
Net income of subsidiaries	83,153	71,964	72,195
Equity in income of unconsolidated entities	—	2,001	2,698
Net income	\$ 70,108	\$ 62,031	\$ 72,865
Unrealized gain on derivative instruments, net of tax	703	1,660	1,632
Minimum pension liability adjustment, net of tax	(2,288)	—	2,839
Comprehensive net income	\$ 68,523	\$ 63,691	\$ 77,336
Basic earnings per share:			
Net income	\$ 3.24	\$ 2.91	\$ 3.10
Weighted average shares outstanding	21,617,630	21,325,907	23,515,367

COMMONWEALTH TELEPHONE ENTERPRISES, INC.
CONDENSED FINANCIAL INFORMATION OF THE REGISTRANT
BALANCE SHEETS

	December 31,	
	2005	2004
	(Thousands of Dollars)	
ASSETS		
Current assets:		
Cash	\$ 2,134	\$ 3,029
Notes receivable affiliates	44,816	25,068
Interest receivable	352	175
Accounts receivable affiliates	24,885	15,038
Accounts receivable other	819	843
Prepayments	302	8
Materials and supply inventory	35	53
Deferred tax assets	654	—
Total current assets	73,997	44,214
Investment in subsidiaries (stated at equity)	443,948	674,945
Deferred tax assets and other	8,275	12,980
Total assets	\$526,220	\$ 732,139
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Note payable to affiliates	\$138,194	\$ 145,639
Accounts payable to affiliates	4,570	1,795
Accrued liabilities and other	7,974	8,692
Deferred income taxes—current	—	6,988
Total current liabilities	150,738	163,114
Long-term debt	300,000	300,000
Deferred income taxes and other deferred credits	12,563	3,095
Other liabilities	7,054	—
Common shareholders' equity:		
Common Stock, par value \$1, authorized 85,000,000 shares, issued 24,226,482 shares in 2005 and 24,172,376 shares in 2004	24,226	24,172
Additional paid-in capital	118,723	284,358
Deferred compensation	(16,861)	(10,093)
Accumulated other comprehensive loss	(2,415)	(830)
Retained earnings	26,327	86,931
Treasury stock at cost, 2,383,564 shares in 2005 and 3,049,114 shares in 2004	(94,135)	(118,608)
Total common shareholders' equity	55,865	265,930
Total liabilities and common shareholders' equity	\$526,220	\$ 732,139

Schedule I

COMMONWEALTH TELEPHONE ENTERPRISES, INC.
CONDENSED FINANCIAL INFORMATION OF THE REGISTRANT
STATEMENTS OF CASH FLOWS

	For the Years Ended December 31,		
	2005	2004	2003
	(Thousands of Dollars)		
Cash flows from operating activities:			
Net income	\$ 70,108	\$ 62,031	\$ 72,865
Depreciation and amortization	—	106	294
Deferred income taxes, net	6,501	6,350	8,283
Net change in certain assets and liabilities	(8,219)	4,911	(11,513)
Equity in income of subsidiaries	(83,153)	(71,964)	(72,195)
Equity in income of unconsolidated entities	—	(2,001)	(2,698)
Other	19,420	6,442	6,646
Net cash flow provided by operating activities	<u>4,657</u>	<u>5,875</u>	<u>1,682</u>
Cash flows from investing activities:			
Additions to property, plant and equipment	—	(59)	(141)
Dividends from subsidiaries	102,000	—	27,000
Capital contributions to subsidiaries	212,000	(205,758)	(470)
Other	—	1,983	(1)
Net cash provided by (used in) investing activities	<u>314,000</u>	<u>(203,834)</u>	<u>26,388</u>
Cash flows from financing activities:			
Redemption of long-term debt	—	—	(30,000)
Borrowings of long-term debt	—	—	300,000
Proceeds from the exercise of stock options	23,678	9,136	3,881
Increase in notes payable to affiliates	(7,445)	11,457	14,900
Decrease (increase) in notes receivable from affiliates	(19,748)	(24,122)	(721)
Stock repurchases	—	(75,177)	(43,367)
Dividends paid	(315,877)	—	—
Payment made for debt issuance costs	(160)	(76)	(8,674)
Net cash (used in) provided by financing activities	<u>(319,552)</u>	<u>(78,782)</u>	<u>236,019</u>
Net increase (decrease) in cash and temporary cash investments	<u>\$ (895)</u>	<u>\$ (276,741)</u>	<u>\$ 264,089</u>
Cash and temporary cash investments at beginning of year	<u>\$ 3,029</u>	<u>\$ 279,770</u>	<u>\$ 15,681</u>
Cash and temporary cash investments at end of year	<u>\$ 2,134</u>	<u>\$ 3,029</u>	<u>\$ 279,770</u>
Components of net change in certain assets and liabilities:			
Accounts receivable	\$ (10,000)	\$ 11,250	\$ (16,871)
Materials and supply inventory	18	2,372	267
Accounts payable	2,740	(4,448)	(960)
Prepayments	(294)	78	(1)
Accrued expenses	(683)	(4,341)	6,052
Net change in certain assets and liabilities	<u>\$ (8,219)</u>	<u>\$ 4,911</u>	<u>\$ (11,513)</u>
Supplemental disclosures of non-cash information:			
Non-cash contribution of assets to subsidiaries	\$ —	\$ (4,340)	\$ —

Schedule II

COMMONWEALTH TELEPHONE ENTERPRISES, INC.
VALUATION AND QUALIFYING ACCOUNTS AND RESERVES
For the Years Ended December 31, 2005, 2004 and 2003
(Thousands of Dollars)

<u>DESCRIPTION</u>	<u>BALANCE AT BEGINNING OF PERIOD</u>	<u>ADDITIONS</u>		<u>DEDUCTIONS/ REVERSALS</u>	<u>BALANCE AT END OF PERIOD</u>
		<u>CHARGED TO COSTS AND EXPENSE</u>	<u>CHARGED TO OTHER ACCOUNTS</u>		
ALLOWANCE FOR DOUBTFUL					
ACCOUNTS—DEDUCTED FROM					
ACCOUNTS RECEIVABLE IN THE					
CONSOLIDATED BALANCE SHEETS.					
2005	\$2,185	\$ 712	\$513	\$2,048	\$1,362
2004	\$2,329	\$ 736	\$578	\$1,458	\$2,185
2003	\$5,520	\$1,230	\$ 60	\$4,481	\$2,329
ALLOWANCE FOR DEFERRED TAX					
ASSETS—DEDUCTED FROM DEFERRED					
TAX ASSETS IN THE CONSOLIDATED					
BALANCE SHEETS.					
2005	\$1,728	\$ 736	\$—	\$ —	\$2,464
2004	\$2,320	\$ 210	\$—	\$ 802	\$1,728
2003	\$2,088	\$ 232	\$—	\$ —	\$2,320

Form 10-K Certification

I, Michael J. Mahoney, certify that:

1. I have reviewed the annual report on Form 10-K for the year ended December 31, 2005 of Commonwealth Telephone Enterprises, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal controls over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 10, 2006

/s/ Michael J. Mahoney

President and Chief Executive Officer

Form 10-K Certification

I, Donald P. Cawley, certify that:

1. I have reviewed the annual report on Form 10-K for the year ended December 31, 2005 of Commonwealth Telephone Enterprises, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal controls over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 10, 2006

/s/ Donald P. Cawley

Executive Vice President and
Chief Accounting Officer

March 10, 2006

Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Ladies and Gentlemen:

The certification set forth below is being submitted in connection with the Annual Report on Form 10-K for the period ended December 31, 2005 (the "Report") of Commonwealth Telephone Enterprises, Inc., for the purpose of complying with Rule 13a-14(b) under the Securities Exchange Act of 1934 and Section 1350 of Chapter 63 of Title 18 of the United States Code.

Michael J. Mahoney, the Chief Executive Officer and Donald P. Cawley, the Chief Accounting Officer of Commonwealth Telephone Enterprises, Inc., each certifies that, to the best of his knowledge:

1. such Report fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and
2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Commonwealth Telephone Enterprises, Inc.

/s/ Michael J. Mahoney

Michael J. Mahoney
Chief Executive Officer
(Principal Executive Officer)

/s/ Donald P. Cawley

Donald P. Cawley
Chief Accounting Officer
(Principal Financial Officer and
Principal Accounting Officer)

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signatures that appear in typed form within the electronic version of this written statement required by Section 906, has been provided to Commonwealth Telephone Enterprises, Inc. and will be retained by Commonwealth Telephone Enterprises, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

CORPORATE INFORMATION

Corporate Headquarters

Commonwealth Telephone Enterprises, Inc.
100 CTE Drive
Dallas, PA 18612-9774
(570) 631-2700
www.ct-enterprises.com

Transfer Agent and Registrar

Computershare Investor Services, LLC
Shareholder Services
2 North LaSalle Street
Chicago, IL 60602
(800) 697-7998 or (312) 360-5495
www.computershare.com

Shareholder Account Assistance

Questions about stock certificates, address changes, registration changes or other shareholder matters should be directed to the transfer agent and registrar listed above.

Independent Public Accountants

PricewaterhouseCoopers LLP
Two Commerce Square, Suite 1700
2001 Market Street
Philadelphia, PA 19103-7042
(267) 330-3000

Investor Information

Institutional investors, security analysts and other members of the financial community requesting information about CTE should contact:

David G. Weselcouch
*Senior Vice President —
Investor Relations and Corporate Communications*
Commonwealth Telephone Enterprises, Inc.
100 CTE Drive
Dallas, PA 18612-9774
Phone: (570) 631-2807
Fax: (570) 631-8114
e-mail: dwes@epix.net

Requests for Additional Financial Information

Documents such as Forms 10-K and 10-Q, which are filed with the U.S. Securities and Exchange Commission ("SEC"), are available through our web site, www.ct-enterprises.com, as well as at the SEC web site, www.sec.gov.

Printed copies of these documents can also be obtained by writing to the corporate headquarters, attention David G. Weselcouch, Senior Vice President — Investor Relations and Corporate Communications, at the contact address listed at left.

Common Stock

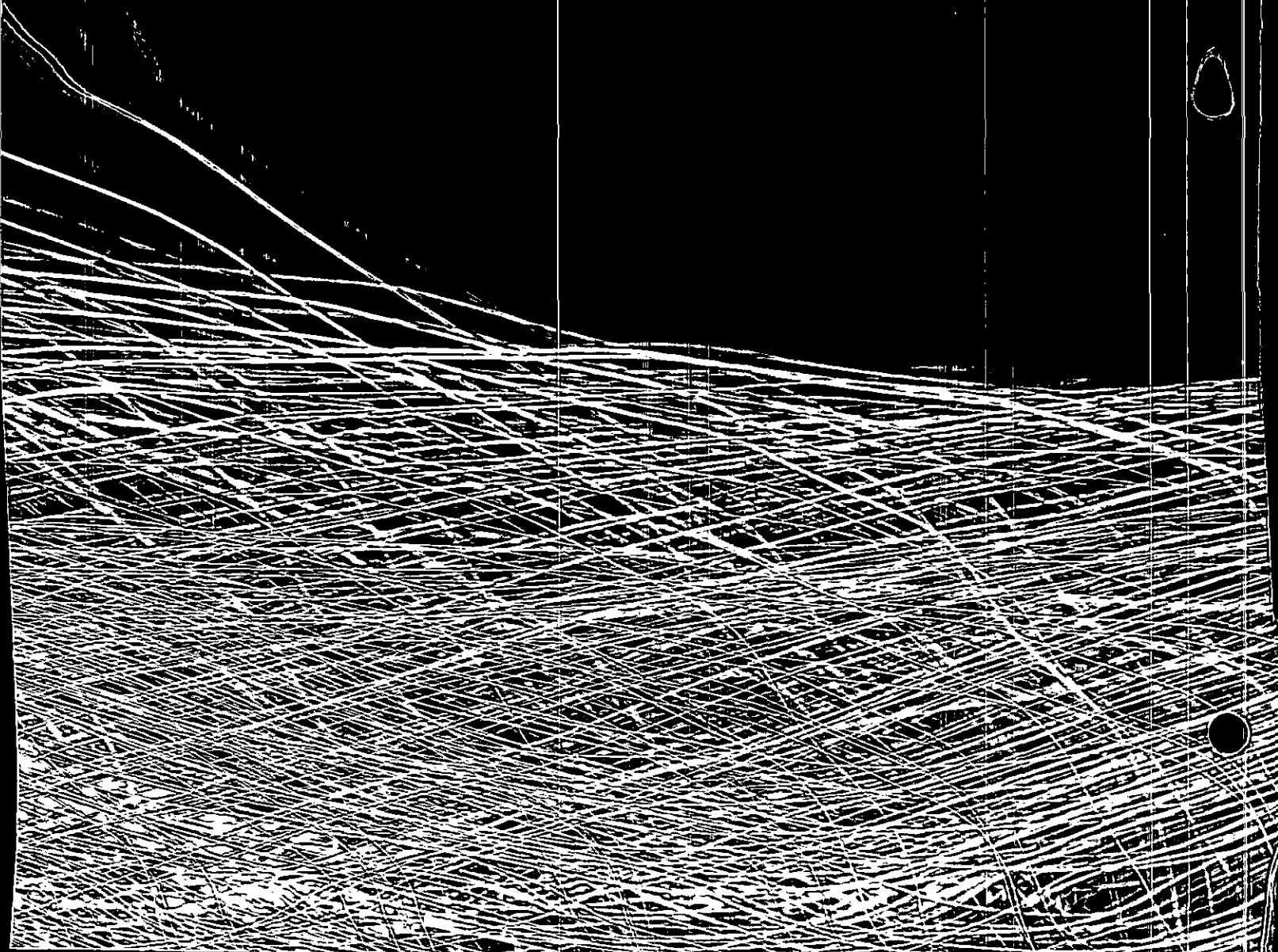
The Nasdaq National Market
Symbol: CTCO

Media Relations Information

Media inquiries should be directed to the attention of David G. Weselcouch, Senior Vice President — Investor Relations and Corporate Communications, at the contact address listed at left.



100 CTE Drive, Dallas, PA 18612-9774
(570) 631-2700
www.ct-enterprises.com



Certification of Resolutions

COMMONWEALTH TELEPHONE ENTERPRISES, INC.

I HEREBY CERTIFY, That at a meeting of the Board of Directors of Commonwealth Telephone Enterprises, Inc. (the "Company"), duly convened and held on the 17th day of September, 2006, at which a quorum for the transaction of business was present, the following resolutions, which have not been modified or rescinded and which are not contrary to or inconsistent with the Articles of Incorporation or By-Laws of the Company, were duly and regularly adopted:

"WHEREAS, the Board has determined that it is advisable and in the best interests of the Company and its shareholders to enter into the Agreement and Plan of Merger (the "**Merger Agreement**") among the Company, Citizens Communications Company, a Delaware corporation ("**Parent**"), and CF Merger Corp., a Delaware corporation ("**Merger Subsidiary**"), substantially in the form submitted to this meeting; and

WHEREAS, the Board has determined that it is advisable and in the best interests of the Company and its shareholders to consummate the transactions contemplated by the Merger Agreement.

NOW, THEREFORE, IT IS:

RESOLVED, that the form of the Merger Agreement submitted to this meeting is approved and adopted, and the President, each Executive Vice President and each Senior Vice President of the Company (the "**Authorized Officers**") be, and each of them hereby is, authorized in the name and on behalf of the Company to execute and deliver the Merger Agreement substantially in the form approved and adopted, with such changes as the officer executing the same may approve, such approval to be conclusively evidenced by the execution and delivery thereof;

RESOLVED, that the Merger (as defined in the Merger Agreement) and the other transactions contemplated by the Merger Agreement be, and each of them hereby is, authorized and approved;

RESOLVED, that the Board hereby determines that the Merger Agreement and the transactions contemplated thereby are advisable and in the best interests of the shareholders of the Company;

RESOLVED, that in furtherance of the transactions contemplated by the Merger Agreement, the Authorized Officers be, and each of them hereby is, authorized in the name and on behalf of the Company to prepare or cause to be prepared, to execute and to file or cause to be filed with any federal, state, local or other regulatory agencies any reports, filings, applications or other documents, and to seek all governmental or regulatory consents or approvals, required with respect to the Merger and the other transactions contemplated by the Merger Agreement (including, without limitation, those required by the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, the Federal Communications Commission and the Pennsylvania Public Utility Commission);

RESOLVED, that in furtherance of the Merger, the Authorized Officers be, and each of them hereby is, authorized in the name and on behalf of the Company to execute and to file or cause to be

filed articles of merger with the Department of State of the Commonwealth of Pennsylvania and a certificate of merger with the Secretary of State of the State of Delaware pursuant to the provisions of the Pennsylvania Business Corporation Law and the Delaware General Corporation Law, such articles of merger and certificate of merger, in each case, to be in the form approved by the officer executing the same, such approval to be conclusively evidenced by the execution and filing thereof, and, if appropriate, to execute and to file or cause to be filed any and all amendments thereto and any and all documents and information required to be filed by the Company with the Department of State of the Commonwealth of Pennsylvania and/or the Secretary of State of the State of Delaware, in each case, in the form approved by such officer, such approval to be conclusively evidenced by the execution and filing thereof;

RESOLVED, that the Board directs that the Merger Agreement and the Merger be submitted to the shareholders of the Company for their approval and adoption, and the Board recommends that the shareholders of the Company approve and adopt the Merger Agreement and the Merger;

RESOLVED, that the Chairman of the Board is hereby authorized in the name and on behalf of the Company to convene a meeting of shareholders of the Company in accordance with the provisions of the Merger Agreement, on such date and at such place as may be selected by the Chairman of the Board, for purpose of soliciting the vote of shareholders of the Company for approval and adoption of the Merger Agreement and the Merger;

RESOLVED, the Authorized Officers be, and each of them hereby is, authorized in the name and on behalf of the Company to prepare or cause to be prepared and to execute a proxy statement (the "Proxy Statement") for purpose of soliciting the vote of shareholders of the Company for approval and adoption of the Merger Agreement and the Merger, on such form or schedule as appropriate under the Securities Exchange Act of 1934, as amended, together with the rules and regulations thereunder, and thereafter to file or cause to be filed with the Securities and Exchange Commission such Proxy Statement and any necessary amendments or supplements thereto from time to time, in each case in such form as the officer executing the same may approve, such approval to be conclusively evidenced by the execution and delivery thereof;

RESOLVED, the Authorized Officers be, and each of them hereby is, authorized in the name and on behalf of the Company to prepare or cause to be prepared, to execute and to file or cause to be filed with the Securities and Exchange Commission any and all statements, schedules, forms, reports and documents concerning the Merger, the Merger Agreement or the transactions contemplated thereby or incidental thereto as shall be necessary or advisable, in each case in such form as the officer executing the same may approve, such approval to be conclusively evidenced by the execution and delivery thereof;

RESOLVED, that any and all actions heretofore taken by any of the Authorized Officers in connection with the retention of legal, financial, accounting or other advisors with respect to the Merger are hereby approved, ratified and confirmed in all respects as fully as if such actions had been presented to the Board for its approval prior to such actions being taken;

RESOLVED, that the Authorized Officers be, and each of them hereby is, authorized in the name and on behalf of the Company to retain such legal, financial, accounting or other advisors, including, without limitation, proxy solicitors, with respect to the Merger as such officers shall deem necessary, advisable or appropriate, and that the Company is authorized to pay any and all expenses and fees arising in connection therewith;

General Authorization

FURTHER RESOLVED, that the Authorized Officers be, and each of them hereby is, authorized in the name and on behalf of the Company to take or cause to be taken any and all actions, to execute and deliver or cause to be delivered any and all documents, agreements and instruments and to take or cause to be taken any and all steps deemed by any such Authorized Officer to be necessary, appropriate or desirable to carry out the purpose and intent of each of the foregoing resolutions, and all actions heretofore taken by any of them in furtherance thereof are hereby ratified and confirmed in all respects.”

IN WITNESS WHEREOF, I have hereunto set my hand and affixed the seal of Commonwealth Telephone Enterprises, Inc. this *20th* day of September, 2006.



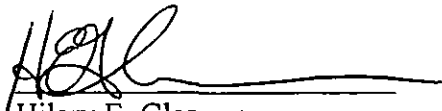
**Raymond B. Ostroski,
Senior Vice President, General
Counsel & Corporate Secretary**

(CORPORATE SEAL)

CITIZENS COMMUNICATIONS COMPANY
SECRETARY'S CERTIFICATE

I, Hilary E. Glassman, the duly elected Senior Vice President, General Counsel and Secretary of Citizens Communications Company, a Delaware corporation (the "Company"), do hereby certify that attached hereto as Exhibit A is a true and correct copy of the resolutions of the Board of Directors of the Company adopted at a meeting of the Board of Directors held on September 16, 2006, which resolutions are in full force and effect and have not been revoked.

IN WITNESS WHEREOF, I have hereunto signed my name this 27th day of September, 2006.



Hilary E. Glassman,
Senior Vice President, General
Counsel and Secretary

RESOLUTIONS OF THE
BOARD OF DIRECTORS
OF
CITIZENS COMMUNICATIONS COMPANY

Dated September 16, 2006

Agreement and Plan of Merger

RESOLVED, that the Board of Directors of the Company (the "Board of Directors") adopts, and deems it advisable and in the best interests of the Company that the Company enter into, the Agreement and Plan of Merger (as such agreement may be amended or modified as contemplated hereby, the "Merger Agreement") among the Company, CF Merger Corp., a Delaware corporation and a wholly-owned subsidiary of the Company ("Merger Sub"), and the company referred to as Reggie, a Pennsylvania corporation ("Reggie"), pursuant to which, among other things, Merger Sub will be merged with and into Reggie (the "Merger"), with Reggie continuing as the surviving corporation and a wholly-owned subsidiary of the Company; and be it further

RESOLVED, that the form, terms and conditions of the Merger Agreement, copies of which have been provided to the Board of Directors, be, and the same hereby are, in all respects, approved, authorized and adopted by the Board of Directors, and the Merger, the other transactions contemplated by the Merger Agreement, and all other actions or matters necessary or appropriate to give effect to the foregoing be, and the same hereby are, in all respects approved, authorized and adopted by the Board of Directors; and be it further

RESOLVED, that the Chief Executive Officer, the Chief Financial Officer and/or such other officers of the Company as they may designate (together with the Chief Executive Officer and the Chief Financial Officer, the "Authorized Officers") be, and each of them with full power to act without the others hereby is, authorized to execute and deliver, in the name and on behalf of the Company, the Merger Agreement, including any amendments thereto, in such form and with, to the extent permitted by law, such changes as the Authorized Officer executing the same may approve, such approval to be conclusively evidenced by such Authorized Officer's execution and delivery of such agreement; and be it further

RESOLVED, that the issuance of shares of common stock, par value \$0.25 per share, of the Company contemplated by the Merger Agreement be, and hereby is, in all respects approved and authorized by the Board of Directors.

Financing

RESOLVED, that the Board of Directors adopts, and deems it advisable and in the best interests of the Company to enter into, the commitment letter, term sheets, fee letter and engagement letter (as such documents may be amended or modified as contemplated hereby, the "Debt Documents") received by the Company from Citigroup Global Markets, Inc. ("CGMI") in connection with the Merger, pursuant to which, among other things, CGMI will commit to provide certain debt financing to the Company in connection with the Merger; and be it further

RESOLVED, that the terms and conditions of the Debt Documents, as previously discussed with the Board of Directors, be, and the same hereby are, in all respects approved, authorized and adopted by the Board of Directors, and the incurrence of indebtedness and consummation of the transactions contemplated by the Debt Documents, and all other matters necessary or appropriate to give effect to the foregoing be, and the same hereby are, in all respects approved, authorized and adopted by the Board of Directors; and be it further

RESOLVED, that the Authorized Officers be, and each of them with full power to act without the others hereby is, authorized to execute and deliver, in the name and on behalf of the Company, the Debt Documents, including any amendments thereto, in such form and with, to the extent permitted by law, such changes as the Authorized Officer executing the same may approve, such approval to be conclusively evidenced by such Authorized Officer's execution and delivery of such agreements, and such other documents, agreements, instruments and certificates with respect to any financing required or advisable in connection with the Merger, whether pursuant to the Debt Documents or otherwise (the "Financing"), including, but not limited to, documentation relating to an amendment or amendment and restatement of the Company's existing credit facilities.

General Authorization and Ratification

RESOLVED that the Authorized Officers be, and each of them with full power to act without the others hereby is, authorized and empowered to:

- (i) prepare or cause to be prepared with the assistance of counsel, execute and file or cause to be filed, in the name and on behalf of the Company or any of its subsidiaries, all registrations, reports, statements, documents and information necessary or appropriate to be filed, printed or mailed under all applicable laws (including the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, the Federal securities laws, the Federal Communications Commission and the Pennsylvania Public Utility Commission) or applicable requirements and regulations of Federal, state, local and foreign administrative or governmental agencies or associations (including all applicable foreign merger control, antitrust or similar authorities and the New York Stock Exchange) in connection with the

Merger or the Financing, including the filing of a Registration Statement on Form S-4;

- (ii) cause the Company to consummate the Merger and to effect the other transactions contemplated by the Merger Agreement in accordance with the terms of the Merger Agreement and to do all actions and things necessary or appropriate to give effect to the foregoing;
- (iii) cause the Company to consummate the Financing and to do all actions and things necessary or appropriate to give effect to the foregoing;
- (iv) do any and all acts and things and prepare, sign, seal, execute, acknowledge, file, deliver and record all papers, instruments, documents, agreements and certificates and to pay all charges, fees, taxes and other expenses from time to time necessary or appropriate to be done, prepared, signed, sealed, executed, acknowledged, filed, delivered, recorded or paid, under any applicable law, under the Merger Agreement, the Debt Documents or otherwise, in the name and on behalf of the Company or any of its subsidiaries;
- (v) certify as having been adopted by the Board of Directors any form of resolution required by any law, regulation or agency necessary or appropriate to effectuate the purpose and intent of these resolutions or any of them and the agreements referred to above and the transactions contemplated thereby and any actions necessary or appropriate to give effect to the foregoing and such other agreements and documents as may be executed by any Authorized Officer pursuant to authorization granted in these resolutions or to carry out the transactions contemplated thereby; and
- (vi) retain, in the name and on behalf of the Company, such financial advisors, legal counsel and such other advisors, consultants or experts necessary or appropriate to carry out the actions contemplated in these resolutions, and to secure any appropriate advice and opinions from such advisors, consultants and experts, and to pay all fees and expenses incurred by the Company in connection with the transactions contemplated by the agreements referred to above and any actions or matters necessary or appropriate to give effect to the foregoing, including, but not limited to, all fees and expenses necessary or appropriate to effectuate the purpose and intent of the foregoing resolutions or any of them and the agreements referred to above and the transactions contemplated thereby and such other agreements and documents as may be executed by any Authorized Officer pursuant to authorization granted in these resolutions or to carry out the transactions contemplated thereby; and be it further

RESOLVED, that each Authorized Officer may authorize any other officer, employee or agent of, or counsel to, the Company or any of its subsidiaries to take any

and all actions and to execute and deliver any and all certificates, documents, agreements and instruments referred to in these resolutions in place of or on behalf of such Authorized Officer, with full power as if such Authorized Officer were taking such action himself or herself; and be it further

RESOLVED, that any or all actions heretofore taken by any officer or officers of the Company or any of its subsidiaries with respect to any matter referred to or contemplated by any of the foregoing resolutions be, and hereby are, ratified and confirmed as the act and deed of the Company or such subsidiary.