

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

Form 10-K/A  
Amendment No. 1

(Mark One)

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

For the Fiscal Year Ended December 31, 2011

OR

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

For the Transition Period from to

Commission File Number: 1-32362

OTELCO INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware

(State or Other Jurisdiction of  
Incorporation or Organization)

52-2126395

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

505 Third Avenue East, Oneonta,  
Alabama

(Address of Principal Executive Offices)

35121

(Zip Code)

205-625-3574

(Registrant's Telephone Number, Including Area Code)

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

**Title of Each Class**

**Name of Each Exchange on Which Registered**

Income Deposit Securities, each representing shares of  
Common Stock and Senior Subordinated  
Notes due 2019

The NASDAQ Stock Market LLC

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

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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

Smaller reporting company ☐

(Do not check if a smaller reporting

company)

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

As of June 30, 2011, the aggregate market value of the registrant's Income Deposit Securities (IDSs) held by non-affiliates of the registrant was \$247.1 million based on the closing sale price as reported on NASDAQ. Each IDS represents one share of Common Stock, par value \$0.01 per share, and \$7.50 principal amount of senior subordinated notes due 2019. In determining the market value of the registrant's IDSs held by non-affiliates, IDSs beneficially owned by directors, officers and holders of more than 10% of the registrant's IDSs have been excluded. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of March 5, 2012, the registrant had 13,221,404 shares of Common Stock, par value \$0.01 per share, outstanding.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Certain information required in Part III of this report is incorporated by reference from the registrant's proxy statement to be filed pursuant to Regulation 14A with respect to the registrant's 2012 annual meeting of stockholders.

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*Unless the context otherwise requires, the words “we,” “us,” “our,” the “Company” and “Otelco” refer to Otelco Inc., a Delaware corporation, and its consolidated subsidiaries as of December 31, 2011.*

## **EXPLANATORY NOTE**

The purpose of this Amendment No. 1 on Form 10-K/A (this “Amendment”) to our Annual Report on Form 10-K for the fiscal year ended December 31, 2011 (the “Form 10-K”) is to correct a typographical error in the long-term debt maturities table contained in Note 9 of Item 8 of the Form 10-K.

In accordance with applicable Securities and Exchange Commission rules, this Amendment also includes updated certifications from our Chief Executive Officer and Chief Financial Officer.

Other than as set forth above, we have not modified or updated disclosures presented in the Form 10-K. Accordingly, this Amendment does not reflect events occurring after the original filing of the Form 10-K or modify or update those disclosures affected by subsequent events, except as specifically referenced herein. Information not affected by this Amendment is unchanged and reflects the disclosures made at the time of the original filing of the Form 10-K. This Amendment should be read in conjunction with our periodic filings made with the Securities and Exchange Commission subsequent to the original filing of the Form 10-K, including any amendments to those filings, as well as any Current Reports filed on Form 8-K subsequent to the original filing of the Form 10-K.

## **PART II**

### **Item 8. Financial Statements and Supplementary Data**

#### **OTELCO INC.**

#### **CONSOLIDATED FINANCIAL STATEMENTS**

|                                                                           | <b>Page</b> |
|---------------------------------------------------------------------------|-------------|
| <a href="#">Reports of Independent Registered Public Accounting Firm</a>  | 2           |
| <a href="#">Consolidated Balance Sheets</a>                               | 4           |
| <a href="#">Consolidated Statements of Operations</a>                     | 5           |
| <a href="#">Consolidated Statements of Stockholders' Equity (Deficit)</a> | 6           |
| <a href="#">Consolidated Statements of Cash Flows</a>                     | 7           |
| <a href="#">Notes to Consolidated Financial Statements</a>                | 8           |

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## Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders  
Otelco Inc.  
Oneonta, Alabama

We have audited the accompanying consolidated balance sheets of Otelco Inc. as of December 31, 2011 and 2010 and the related consolidated statements of operations, stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 2011. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 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, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Otelco Inc. at December 31, 2011 and 2010, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Otelco Inc.'s internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 5, 2012 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP

Atlanta, Georgia  
March 5, 2012

## Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders  
Otelco Inc.  
Oneonta, Alabama

We have audited Otelco Inc.'s internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Otelco Inc.'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, included in the accompanying "Item 9A, Management's Report on Internal Control Over Financial Reporting". Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit 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. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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 (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) 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 (3) 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.

As indicated in the accompanying "Item 9A, Management's Report on Internal Control over Financial Reporting", management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of Shoreham Telephone LLC, which was acquired on October 14, 2011, and which is included in the consolidated balance sheets of Otelco Inc. as of December 31, 2011, and the related consolidated statements of operations, stockholders' deficit and cash flows for the year then ended. Shoreham Telephone LLC constituted 2.4% of total assets as of December 31, 2011, and 0.7% and 4.7% of revenues and net income, respectively, for the year then ended. Management did not assess the effectiveness of internal control over financial reporting of Shoreham Telephone LLC because of the timing of the acquisition which was completed on October 14, 2011. Our audit of internal control over financial reporting of Otelco Inc. also did not include an evaluation of the internal control over financial reporting of Shoreham Telephone LLC.

In our opinion, Otelco Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Otelco Inc. as of December 31, 2011 and 2010, and the related consolidated statements of operations, stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 2011 and our report dated March 5, 2012 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP

Atlanta, Georgia  
March 5, 2012

**OTELCO INC.  
CONSOLIDATED BALANCE SHEETS**

|                                                                                                              | <b>As of December 31,</b> |                       |
|--------------------------------------------------------------------------------------------------------------|---------------------------|-----------------------|
|                                                                                                              | <b>2010</b>               | <b>2011</b>           |
| <b>Assets</b>                                                                                                |                           |                       |
| Current assets                                                                                               |                           |                       |
| Cash and cash equivalents                                                                                    | \$ 18,226,374             | \$ 12,393,792         |
| Accounts receivable:                                                                                         |                           |                       |
| Due from subscribers, net of allowance for doubtful accounts of \$230,752 and \$260,568, respectively        | 4,406,257                 | 4,355,632             |
| Unbilled receivables                                                                                         | 2,161,277                 | 2,183,465             |
| Other                                                                                                        | 4,299,088                 | 5,449,074             |
| Materials and supplies                                                                                       | 1,817,311                 | 1,780,820             |
| Prepaid expenses                                                                                             | 1,305,028                 | 1,328,475             |
| Deferred income taxes                                                                                        | 626,267                   | 726,310               |
| Total current assets                                                                                         | <u>32,841,602</u>         | <u>28,217,568</u>     |
| Property and equipment, net                                                                                  | 63,887,213                | 65,881,975            |
| Goodwill                                                                                                     | 188,190,078               | 188,954,840           |
| Intangible assets, net                                                                                       | 25,934,042                | 20,545,691            |
| Investments                                                                                                  | 1,967,095                 | 1,943,805             |
| Deferred financing costs                                                                                     | 5,757,825                 | 4,485,324             |
| Deferred income taxes                                                                                        | 4,415,097                 | 7,454,443             |
| Prepaid expenses                                                                                             | 106,685                   | 238,386               |
| Other assets                                                                                                 | 77,261                    | 2,281                 |
| Total assets                                                                                                 | <u>\$ 323,176,898</u>     | <u>\$ 317,724,313</u> |
| <b>Liabilities and Stockholders' Deficit</b>                                                                 |                           |                       |
| Current liabilities                                                                                          |                           |                       |
| Accounts payable                                                                                             | \$ 768,055                | \$ 1,490,717          |
| Accrued expenses                                                                                             | 7,926,954                 | 6,034,104             |
| Advance billings and payments                                                                                | 1,595,133                 | 1,590,689             |
| Deferred income taxes                                                                                        | 353,285                   | 353,285               |
| Customer deposits                                                                                            | 172,479                   | 143,657               |
| Total current liabilities                                                                                    | <u>10,815,906</u>         | <u>9,612,452</u>      |
| Deferred income taxes                                                                                        | 42,512,576                | 48,112,384            |
| Interest rate swaps                                                                                          | 2,471,331                 | 241,438               |
| Advance billings and payments                                                                                | 656,968                   | 615,584               |
| Other liabilities                                                                                            | 368,349                   | 403,823               |
| Long-term notes payable                                                                                      | 271,595,855               | 271,106,387           |
| Total liabilities                                                                                            | <u>328,420,985</u>        | <u>330,092,068</u>    |
| Stockholders' deficit                                                                                        |                           |                       |
| Class A Common Stock, \$.01 par value-authorized 20,000,000 shares; issued and outstanding 13,221,404 shares | 132,214                   | 132,214               |
| Additional paid in capital                                                                                   | 921,718                   | —                     |
| Retained deficit                                                                                             | (6,298,019)               | (12,499,969)          |
| Total stockholders' deficit                                                                                  | <u>(5,244,087)</u>        | <u>(12,367,755)</u>   |
| Total liabilities and stockholders' deficit                                                                  | <u>\$ 323,176,898</u>     | <u>\$ 317,724,313</u> |

The accompanying notes are an integral part of these consolidated financial statements.

**OTELCO INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

|                                                    | <b>Years Ended December 31,</b> |                     |                     |
|----------------------------------------------------|---------------------------------|---------------------|---------------------|
|                                                    | <b>2009</b>                     | <b>2010</b>         | <b>2011</b>         |
| Revenues                                           | \$ 103,755,454                  | \$ 104,400,219      | \$ 101,843,567      |
| Operating expenses                                 |                                 |                     |                     |
| Cost of services                                   | 41,178,502                      | 41,286,418          | 43,995,953          |
| Selling, general and administrative expenses       | 14,164,465                      | 13,074,794          | 12,984,686          |
| Depreciation and amortization                      | 26,485,628                      | 23,670,243          | 20,232,833          |
| Total operating expenses                           | <u>81,828,595</u>               | <u>78,031,455</u>   | <u>77,213,472</u>   |
| Income from operations                             | <u>21,926,859</u>               | <u>26,368,764</u>   | <u>24,630,095</u>   |
| Other income (expense)                             |                                 |                     |                     |
| Interest expense                                   | (25,416,024)                    | (24,746,542)        | (24,776,123)        |
| Change in fair value of derivatives                | (1,354,759)                     | (878,518)           | 2,229,893           |
| Other income                                       | 359,484                         | 556,820             | 363,482             |
| Total other expenses                               | <u>(26,411,299)</u>             | <u>(25,068,240)</u> | <u>(22,182,748)</u> |
| Income (loss) before income tax                    | (4,484,440)                     | 1,300,524           | 2,447,347           |
| Income tax (expense) benefit                       | <u>1,366,629</u>                | <u>(609,809)</u>    | <u>(249,929)</u>    |
| Net income (loss) available to common stockholders | <u>\$ (3,117,811)</u>           | <u>\$ 690,715</u>   | <u>\$ 2,197,418</u> |
| Weighted average common shares outstanding:        |                                 |                     |                     |
| Basic                                              | 12,676,733                      | 12,985,629          | 13,221,404          |
| Diluted                                            | 13,221,404                      | 13,221,404          | 13,221,404          |
| Basic net income (loss) per common share           | \$ (0.25)                       | \$ 0.05             | \$ 0.17             |
| Diluted net income (loss) per common share         | \$ (0.25)                       | \$ 0.05             | \$ 0.17             |
| Dividends declared per common share                | \$ 0.71                         | \$ 0.71             | \$ 0.71             |

The accompanying notes are an integral part of these consolidated financial statements.

**OTELCO INC.**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)**

|                                              | Class A<br>Common Stock |                  | Class B<br>Common Stock |                 | Additional Paid-<br>In<br>Capital | Retained<br>Deficit   | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Total<br>Stockholders'<br>Equity (Deficit) |
|----------------------------------------------|-------------------------|------------------|-------------------------|-----------------|-----------------------------------|-----------------------|--------------------------------------------------------|--------------------------------------------|
|                                              | Shares                  | Amount           | Shares                  | Amount          |                                   |                       |                                                        |                                            |
| Balance, December 31, 2008                   | <u>12,676,733</u>       | <u>\$126,767</u> | <u>544,671</u>          | <u>\$ 5,447</u> | <u>\$ 19,277,959</u>              | <u>\$ (3,870,923)</u> | <u>\$ (1,160,759)</u>                                  | <u>\$ 14,378,491</u>                       |
| Comprehensive Loss                           |                         |                  |                         |                 |                                   |                       |                                                        |                                            |
| Net loss                                     |                         |                  |                         |                 |                                   | (3,117,811)           |                                                        | (3,117,811)                                |
| Change in fair value of<br>interest rate cap |                         |                  |                         |                 |                                   |                       | 1,160,759                                              | 1,160,759                                  |
| Total comprehensive loss                     |                         |                  |                         |                 |                                   |                       |                                                        | (1,957,052)                                |
| Dividends declared                           |                         |                  |                         |                 | (8,937,097)                       |                       |                                                        | (8,937,097)                                |
| Balance, December 31, 2009                   | <u>12,676,733</u>       | <u>\$126,767</u> | <u>544,671</u>          | <u>\$ 5,447</u> | <u>\$ 10,340,862</u>              | <u>\$ (6,988,734)</u> | <u>\$ –</u>                                            | <u>\$ 3,484,342</u>                        |
| Comprehensive Income                         |                         |                  |                         |                 |                                   |                       |                                                        |                                            |
| Net income                                   |                         |                  |                         |                 |                                   | 690,715               |                                                        | 690,715                                    |
| Total comprehensive<br>income                |                         |                  |                         |                 |                                   |                       |                                                        | 690,715                                    |
| Class B conversion to Class A                | 544,671                 | 5,447            | (544,671)               | (5,447)         |                                   |                       |                                                        | 0                                          |
| Direct cost of Class B<br>conversion         |                         |                  |                         |                 | (194,053)                         |                       |                                                        | (194,053)                                  |
| Dividends declared                           |                         |                  |                         |                 | (9,225,091)                       |                       |                                                        | (9,225,091)                                |
| Balance, December 31, 2010                   | <u>13,221,404</u>       | <u>\$132,214</u> | <u>–</u>                | <u>\$ –</u>     | <u>\$ 921,718</u>                 | <u>\$ (6,298,019)</u> | <u>\$ –</u>                                            | <u>\$ (5,244,087)</u>                      |
| Comprehensive Income                         |                         |                  |                         |                 |                                   |                       |                                                        |                                            |
| Net income                                   |                         |                  |                         |                 |                                   | 2,197,418             |                                                        | 2,197,418                                  |
| Total comprehensive<br>income                |                         |                  |                         |                 |                                   |                       |                                                        | 2,197,418                                  |
| Dividends declared                           |                         |                  |                         |                 | (921,718)                         | (8,399,368)           |                                                        | (9,321,086)                                |
| Balance, December 31, 2011                   | <u>13,221,404</u>       | <u>\$132,214</u> | <u>–</u>                | <u>\$ –</u>     | <u>\$ –</u>                       | <u>\$(12,499,969)</u> | <u>\$ –</u>                                            | <u>\$ (12,367,755)</u>                     |

The accompanying notes are an integral part of these consolidated financial statements.

**OTELCO INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

|                                                                                                | <b>Years Ended December 31,</b> |                      |                      |
|------------------------------------------------------------------------------------------------|---------------------------------|----------------------|----------------------|
|                                                                                                | <b>2009</b>                     | <b>2010</b>          | <b>2011</b>          |
| Cash flows from operating activities:                                                          |                                 |                      |                      |
| Net income (loss)                                                                              | \$ (3,117,811)                  | \$ 690,715           | \$ 2,197,418         |
| Adjustments to reconcile net income (loss) to cash flows from operating activities:            |                                 |                      |                      |
| Depreciation                                                                                   | 14,444,714                      | 13,837,560           | 11,891,474           |
| Amortization                                                                                   | 12,040,914                      | 9,832,683            | 8,341,359            |
| Interest rate caplet                                                                           | 1,168,522                       | —                    | —                    |
| Amortization of debt premium                                                                   | (82,212)                        | (92,307)             | (103,640)            |
| Amortization of loan costs                                                                     | 1,351,906                       | 1,361,351            | 1,368,095            |
| Change in fair value of derivatives                                                            | 1,354,759                       | 878,518              | (2,229,893)          |
| Provision (benefit) for deferred income taxes                                                  | (1,507,798)                     | 428,098              | 226,962              |
| Provision for uncollectible revenue                                                            | 920,945                         | 141,474              | 914,555              |
| Changes in operating assets and liabilities; net of operating assets and liabilities acquired: |                                 |                      |                      |
| Accounts receivables                                                                           | 739,921                         | 427,432              | (1,590,110)          |
| Material and supplies                                                                          | 339,909                         | 152,655              | 173,350              |
| Prepaid expenses and other assets                                                              | (200,341)                       | (69,464)             | (117,356)            |
| Income tax receivable                                                                          | (207,842)                       | 389,486              | —                    |
| Accounts payable and accrued liabilities                                                       | 1,094,474                       | (1,657,758)          | (1,423,589)          |
| Advance billings and payments                                                                  | (400,085)                       | (111,673)            | (116,732)            |
| Other liabilities                                                                              | (30,850)                        | 202,751              | (1,756)              |
| Net cash from operating activities                                                             | <u>27,909,125</u>               | <u>26,411,521</u>    | <u>19,530,137</u>    |
| Cash flows from investing activities:                                                          |                                 |                      |                      |
| Acquisition and construction of property and equipment                                         | (9,596,049)                     | (10,225,229)         | (10,547,705)         |
| Purchase of investment                                                                         | —                               | (1,708)              | (2,220)              |
| Proceeds (loss) from retirement of investment                                                  | (1,085)                         | 1,067                | —                    |
| Wholesale customer acquisition                                                                 | (179,554)                       | —                    | —                    |
| Payments for the purchase of Shoreham Telephone, net of cash acquired                          | —                               | —                    | (5,010,284)          |
| Deferred charges/acquisition                                                                   | (6,551)                         | (1,845)              | —                    |
| Net cash used in investing activities                                                          | <u>(9,783,239)</u>              | <u>(10,227,715)</u>  | <u>(15,560,209)</u>  |
| Cash flows used in financing activities:                                                       |                                 |                      |                      |
| Cash dividends paid                                                                            | (8,937,097)                     | (9,225,091)          | (9,321,086)          |
| Direct cost of exchange of Class B shares for Class A shares                                   | —                               | (194,053)            | —                    |
| Loan origination costs                                                                         | —                               | (155,160)            | (95,596)             |
| Repayment of long-term notes payable                                                           | (5,000,000)                     | (6,114,172)          | (385,828)            |
| Net cash used in financing activities                                                          | <u>(13,937,097)</u>             | <u>(15,688,476)</u>  | <u>(9,802,510)</u>   |
| Net increase (decrease) in cash and cash equivalents                                           | 4,188,789                       | 495,330              | (5,832,582)          |
| Cash and cash equivalents, beginning of period                                                 | 13,542,255                      | 17,731,044           | 18,226,374           |
| Cash and cash equivalents, end of period                                                       | <u>\$ 17,731,044</u>            | <u>\$ 18,226,374</u> | <u>\$ 12,393,792</u> |
| Supplemental disclosures of cash flow information:                                             |                                 |                      |                      |
| Interest paid                                                                                  | <u>\$ 23,378,798</u>            | <u>\$ 23,484,474</u> | <u>\$ 24,130,675</u> |
| Income taxes paid (received)                                                                   | <u>\$ 67,658</u>                | <u>\$ (265,275)</u>  | <u>\$ 90,517</u>     |

The accompanying notes are an integral part of these consolidated financial statements.

## OTELCO INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011

#### 1. Summary of Significant Accounting Policies

##### *Nature of Business*

Otelco Inc. (the “Company”) provides a broad range of telecommunications services on a retail and wholesale basis. These services include local and long distance calling; network access to and from our customers; data transport; digital high-speed and dial-up internet access; cable, satellite and internet protocol television; wireless; and other telephone related services. The principal markets for these services are residential and business customers residing in and adjacent to the exchanges the Company serves in Alabama, Massachusetts, Maine, Missouri, Vermont, and West Virginia. In addition, the Company serves business customers throughout Maine and New Hampshire and provides dial-up internet service throughout the states of Maine and Missouri. The Company offers various communications services that are sold to economically similar customers in a comparable manner of distribution. The majority of our customers buy multiple services, often bundled together at a single price. The Company views, manages and evaluates the results of its operations from the various communications services as one company and therefore has identified one reporting segment as it relates to providing segment information.

##### *Basis of Presentation and Principles of Consolidation*

The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are either directly or indirectly wholly owned. These include: Otelco Telecommunications LLC (“OTC”); Otelco Telephone LLC (“OTP”); Hopper Telecommunications Company, Inc. (“HTC”); Brindle Mountain Telephone Company, Inc. (“BMTC”); Blountsville Telephone Company, Inc. (“BTC”); Mid-Missouri Holding Corporation (“MMH”) and its wholly owned subsidiary Mid-Missouri Telephone Company (“MMT”) and its wholly owned subsidiary Imagination, Inc.; Mid-Maine Telecom, Inc. (“MMTI”); Mid-Maine TelPlus (“MMTP”); The Granby Telephone & Telegraph Co. of Massachusetts (“GTT”); War Acquisition Corporation (“WT”); The Pine Tree Telephone and Telegraph Company (“PTT”); Saco River Telegraph and Telephone Company (“SRT”); Shoreham Telephone LLC (“ST”); CRC Communications of Maine, Inc. (“PTN”); and Communications Design Acquisition Corporation (“CDAC”).

The accompanying consolidated financial statements include the accounts of the Company and all of the aforesaid subsidiaries after elimination of all material intercompany balances and transactions.

##### *Use of Estimates*

The Company prepares its consolidated financial statements in accordance with accounting principles generally accepted in the United States, which require management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities. The estimates and assumptions used in the accompanying consolidated financial statements are based upon management’s evaluation of the relevant facts and circumstances as of the date of the financial statements. Actual results may differ from the estimates and assumptions used in preparing the accompanying consolidated financial statements.

Significant accounting estimates include the recoverability of goodwill, identified intangibles, long-term assets, deferred tax valuation allowances and provision for bad debt.

##### *Regulatory Accounting*

The Company follows the accounting for regulated enterprises, which is now part of Accounting Standards Codification (“ASC”) 980, *Regulated Operations* (“ASC 980”), as issued by the Financial Accounting Standards Board (the “FASB”). This accounting practice recognizes the economic effects of rate regulation by recording costs and a return on investment as such amounts are recovered through rates authorized by regulatory authorities. Accordingly, ASC 980 requires the Company to depreciate telecommunications property and equipment over the estimated useful lives approved by regulators, which could be different than the estimated useful lives that would otherwise be determined by management. ASC 980 also requires deferral of certain costs and obligations based upon approvals received from regulators to permit recovery of such amounts in future years. Criteria that would give rise to the discontinuance of accounting in accordance with ASC 980 include (1) increasing competition restricting the ability of the Company to establish prices that allow it to recover specific costs and (2) significant changes in the manner in which rates are set by regulators from cost-based regulation to another form of regulation. The Company periodically reviews the criteria to determine whether the continuing application of ASC 980 is appropriate for its rural local exchange carriers.

## OTELCO INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011

The Company is subject to reviews and audits by regulatory agencies. The effect of these reviews and audits, if any, will be recorded in the period in which they first become known and determinable.

#### ***Intangible Assets and Goodwill***

Intangible assets consist primarily of the fair value of customer related intangibles, non-compete agreements and long-term customer contracts. Goodwill represents the excess of total acquisition cost over the assigned value of net identifiable tangible and intangible assets acquired through various business combinations. Due to the regulatory accounting required by ASC 980, the Company did not record acquired regulated telecommunications property and equipment at fair value as required by ASC 805, *Business Combinations* ("ASC 805"), through 2004. In accordance with 47 CFR 32.2000, the federal regulation governing acquired telecommunications property and equipment, such property and equipment is accounted for at original cost, and depreciation and amortization of property and equipment acquired is credited to accumulated depreciation.

The Company's annual budgeting, forecasting and tax planning cycle begins in September. The Company's strategy for growth includes acquisitions, a process that actively involves its board of directors in financial and strategy decisions, utilizing the budgeting, forecasting and tax planning information and changes in the telecommunications marketplace. Based on these factors and to allow the audit committee of the Company's board of directors sufficient time to review management's assessment of goodwill for impairment, management changed its annual goodwill impairment testing date from December 31 to October 1. The Company believes this change in testing date is preferable under the circumstances as the change more closely aligns the analysis with the Company's budgeting and forecasting process. The Company does not believe that this change in annual goodwill impairment testing date will accelerate, delay or avoid any impairment charge.

For the acquisition of ST, property has been recorded at fair value in accordance with ASC 805, resulting in a plant acquisition adjustment in 2011. The Company has acquired identifiable intangible assets associated with the territories it serves, including a non-compete agreement with one of the former owners of ST, and the customer lists of ST. Any excess of the total purchase price over the amounts assigned to tangible and identifiable assets is recorded as goodwill.

The Company performs a quarterly review of its identified intangible assets to determine if facts and circumstances exist which indicate that the useful life is shorter than originally estimated or that the carrying amount of assets may not be recoverable. If such facts and circumstances do exist, the Company assesses the recoverability of identified intangible assets by comparing the projected undiscounted net cash flows associated with the related asset or group of assets over their remaining lives against their respective carrying amounts. Impairment, if any, is based on the excess of the carrying amount over the fair value of those assets.

#### ***Revenue Recognition***

*Local services revenues* . Local services revenue for monthly recurring local services is billed in advance to a portion of the Company's customers and in arrears to the balance of the customers. The Company records revenue for charges that have not yet been invoiced to its customers as unbilled revenue when services are rendered. The Company records revenue billed in advance as advance billings and defers recognition until such revenue is earned. Long distance service is billed to customers in arrears based on actual usage except when it is included in service bundles. The Company records unbilled long distance revenue as unbilled revenue when services are rendered. In bundles, unlimited usage is billed in arrears at a flat rate.

*Network access* . Network access revenue is derived from several sources. Revenue for interstate access services is received through tariffed access charges filed by the National Exchange Carrier Association ("NECA") with the Federal Communications Commission ("FCC") on behalf of the NECA member companies for our regulated subsidiaries. These access charges are billed by the Company to interstate interexchange carriers and pooled with like-revenues from all NECA member companies. A portion of the pooled access charge revenue received by the Company is based upon its actual cost of providing interstate access service, plus a return on the investment dedicated to providing that service. The balance of the pooled access charge revenue received by the Company is based upon the nationwide average schedule costs of providing interstate access services. Rates for our competitive subsidiaries are set by FCC rule to be no more than the interconnecting interstate rate of the predominant local carrier. Revenue for intrastate access service is received through tariffed access charges billed by the Company to the originating intrastate carrier using access rates filed with the Alabama Public Service Commission ("APSC"), the Maine Public Utilities Commission ("MPUC"), the Massachusetts Department of Telecommunications and Cable ("MDTC"), the Missouri Public Service Commission ("MPSC"), the New Hampshire Public Utilities Commission ("NHPUC"), the Vermont Public Service Board ("VPSB") and the West Virginia Public Service Commission ("WVPSC") and are retained by the Company. Revenue for the intrastate/interLATA access service is received through tariffed access charges as filed with the APSC, MDTC, MPSC, MPUC, NHPUC, VPSB and WVPSC. These access charges are billed to the intrastate carriers and are retained by the Company. Revenue for terminating and originating long distance service is received through charges for providing usage of the local exchange network. Toll revenues are recognized when services are rendered.

## OTELCO INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011

*Cable television, internet and transport services* . Cable television, internet and transport service revenues are recognized when services are rendered. Operating revenues from the lease of dark fiber covered by indefeasible rights-of-use agreements are recorded as earned. In some cases, the entire lease payment is received at inception of the lease and recognized ratably over the lease term after recognition of expenses associated with lease inception. The Company has deferred revenue in the consolidated balance sheet as of December 31, 2010 and 2011 of \$656,968 and \$615,584, respectively, related to transport services.

#### ***Cash and Cash Equivalents***

Cash equivalents are stated at cost plus accrued interest, which approximates fair value. Cash equivalents are high-quality, short-term money market instruments and highly liquid debt instruments with an original maturity of three months or less when purchased. The cash equivalents are readily convertible to known amounts of cash and are so near maturity that they present insignificant risk of changes in value because of changes in interest rates.

#### ***Accounts Receivable***

The Company extends credit to its commercial and residential customers based upon a written credit policy. Service interruption is the primary vehicle for controlling losses. Accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Company's best estimate for the amount of probable credit losses in the Company's existing accounts receivable. The Company establishes an allowance for doubtful accounts based upon factors surrounding the credit risk of specific customers, historical trends, and other information. Receivable balances are reviewed on an aged basis and account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

#### ***Materials and Supplies***

Materials and supplies are stated at the lower of cost or market value. Cost is determined using an average cost basis.

#### ***Property and Equipment***

Regulated property and equipment is stated at original cost. Unregulated property and equipment purchased through acquisitions is stated at its fair value at the date of acquisition. Expenditures for improvements that significantly add to productive capacity or extend the useful life of an asset are capitalized. Expenditures for maintenance and repairs are expensed when incurred. Depreciation of regulated property and equipment is computed principally using the straight-line method over useful lives determined by the APSC, MDTC, MPSC, MPUC, NHPUC, VPSB and WVPSC as discussed above. Depreciation of unregulated property and equipment primarily employs the straight-line method over industry standard estimated useful lives.

#### ***Long-Lived Assets***

The Company reviews its long-lived assets for impairment at each balance sheet date and whenever events or changes in circumstances indicate that the carrying amount of an asset should be assessed. To determine if an impairment exists, the Company estimates the future undiscounted cash flows expected to result from the use of the asset being reviewed for impairment. If the sum of these expected future cash flows is less than the carrying amount of the asset, the Company recognizes an impairment loss in accordance with guidance included in ASC 360, *Property, Plant, and Equipment* . The amount of the impairment recognized is determined by estimating the fair value of the assets and recording a loss for the excess of the carrying value over the fair value.

#### ***Deferred Financing Costs***

Deferred financing and loan costs consist of debt issuance costs incurred in obtaining long-term financing, which are amortized over the life of the related debt. Amortization of deferred financing and loan costs is classified as "Interest expense". When amendments to debt agreements are considered to extinguish existing debt per guidance included in ASC 470, *Debt* , the remaining deferred financing costs are amortized at the time of amendment.

## OTELCO INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011

#### ***Derivative Financial Instruments***

Derivative financial instruments are accounted for under guidance included in ASC 815, *Derivatives and Hedging* ("ASC 815"). Under ASC 815, all derivatives are recorded on the balance sheet as assets or liabilities and measured at fair value. The embedded exchange feature of the Class B common stock was accounted for as a derivative liability. This liability was adjusted to estimated fair value on each balance sheet date with the offset to other non-operating income or expense. No liability existed and the Class B shares were exchanged for Income Deposit Securities ("IDS") units on a one-for-one basis on June 8, 2010. Each of the IDSs issued in the exchange includes a share of Class A common stock ("common stock").

The Company is exposed to the market risk of adverse changes in interest rates. An interest rate cap was purchased on December 21, 2004, coincident with the closing of our initial public offering and the recapitalization of our senior notes payable. The interest rate cap was purchased to mitigate the risk of rising interest rates to limit, or cap, the rate at 3% for the three month LIBOR index plus the applicable margin on \$80 million in senior debt for five years. On July 5, 2007, the Company repaid \$55,353,032 in debt, reducing its senior debt below the level of the rate cap. The cap was considered an effective hedge for the remaining senior debt as all critical terms of the interest rate cap were identical to the underlying debt it hedged. The balance of the cap at that time was considered as an investment and adjustments were made to accumulated other comprehensive income to reflect this change. On October 31, 2008, the Company implemented its second amended and restated credit agreement, increasing senior debt to \$173.5 million in conjunction with the acquisition of three entities from Country Road Communications LLC. The full \$80 million rate cap was accounted for as an effective hedge from that date through the end of the rate cap on December 20, 2009. The cost of the effective portion of the interest rate cap was expensed as interest over the effective life of the hedge in accordance with the quarterly value of the caplets as determined at the date of inception.

The Company acquired two interest rate swaps with approved counterparties. The first swap had a notional amount of \$90 million with the Company paying a fixed rate of 1.85% and the counterparty paying a variable rate based upon the three month LIBOR interest rate. It was effective from February 9, 2009 through February 8, 2012. The second swap had a notional amount of \$60 million with the Company paying a fixed rate of 2.0475% and the counterparty paying a variable rate based upon the three month LIBOR interest rate. It was effective from February 9, 2010 through February 8, 2012. From an accounting perspective, the documentation for both swaps did not meet the technical requirements of ASC 815 to allow the swaps to be considered highly effective hedging instruments and therefore the swaps did not qualify for hedge accounting. The change in fair value of the swaps was charged or credited to income as a change in fair value of derivatives. Over the life of the swaps, the cumulative change in fair value was zero.

#### ***Income Taxes***

The Company accounts for income taxes using the asset and liability approach in accordance with guidance included in ASC 740, *Income Taxes* ("ASC 740"). The asset and liability approach requires the recognition of deferred tax liabilities and assets for the expected future tax consequences of temporary differences between the carrying amounts and the tax basis of assets and liabilities. A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The provision for income taxes consists of an amount for the taxes currently payable and a provision for the tax consequences deferred to future periods.

Interest and penalties related to income tax matters would be recognized in income tax expense. As of December 31, 2011, we did not have an amount recorded for interest and penalties.

The Company conducts business in multiple jurisdictions and, as a result, one or more subsidiaries file income tax returns in the U.S. federal, various state and local jurisdictions. All tax years since 2004 are open for examination by various tax authorities.

#### ***Fair Value of Financial Instruments***

The carrying value of the Company's financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, derivative liabilities and long-term notes payable approximate their fair value as of December 31, 2010 and 2011.

**OTELCO INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2011**

***Comprehensive Income (Loss)***

Comprehensive income (loss) equals net income (loss) plus other comprehensive income. Other comprehensive income refers to revenue, expenses, gains and losses, which are reflected in retained earnings but excluded from net income.

***Income (Loss) per Common Share***

The Company computes net income (loss) per common share in accordance with the provision included in ASC 260, *Earnings per Share* ("ASC 260"). Under ASC 260, basic and diluted income per share is computed by dividing net income (loss) available to stockholders by the weighted average number of common shares and common share equivalents outstanding during the period. Basic income (loss) per common share excludes the effect of potentially dilutive securities, while diluted income (loss) per common share reflects the potential dilution that would occur if securities or other contracts to issue common shares were exercised for, converted into or otherwise resulted in the issuance of common shares. Net income (loss) is adjusted for the Class B derivative liability in calculating diluted earnings. On June 8, 2010, all of the Company's Class B shares were exchanged for IDSs, which include a common share, on a one-for-one basis.

***Recently Adopted Accounting Pronouncements***

In October 2009, the FASB issued Accounting Standards Update ("ASU") 2009-13, *Multiple-Deliverable Revenue Arrangements – a consensus of the FASB Emerging Issues Task Force* ("ASU 2009-13"), an update to ASC 605, *Revenue Recognition*. ASU 2009-13 provides application guidance on whether multiple deliverables exist, how the deliverables should be separated, and how the consideration should be allocated to one or more units of accounting. ASU 2009-13 establishes a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on vendor-specific objective evidence, if available, third-party evidence if vendor-specific evidence is not available, or estimated selling price if neither vendor-specific nor third-party evidence is available. The Company was required to apply this guidance prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010; however, earlier application was permitted and the Company began applying the guidance in July 2010. The early adoption of this update did not have a material impact on our consolidated financial statements.

In January 2010, the FASB issued ASU 2010-06, *Improving Disclosures about Fair Value Measurements* ("ASU 2010-06"), an update to ASC 820, *Fair Value Measurements and Disclosures* ("ASC 820"). ASU 2010-06 provides more robust disclosures about (1) the different classes of assets and liabilities measured at fair value, (2) the valuation techniques and inputs used, (3) the activity in Level 3 fair value measurements, and (4) the transfers between Levels 1, 2, and 3. The new disclosures and clarifications of existing disclosures were effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures were effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this update did not have a material impact on our consolidated financial statements.

In February 2010, the FASB issued ASU 2010-09, *Amendments to Certain Recognition and Disclosure Requirements* ("ASU 2010-09"), an update to ASC 855, *Subsequent Events*. ASU 2010-09 eliminates the requirement for a Securities and Exchange Commission ("SEC") filer to disclose a date through which subsequent events have been evaluated in both issued and revised financial statements. Revised financial statements include financial statements revised as a result of either correction of an error or retrospective application of accounting principles generally accepted in the United States. The FASB believes these amendments remove potential conflicts with the SEC's literature. ASU 2010-09 was effective upon issuance except for the use of the issued date for conduit debt obligors, which was effective for interim or annual periods ending after June 15, 2010. The adoption of this update did not have a material impact on our consolidated financial statements.

In July 2010, the FASB issued ASU 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* ("ASU 2010-20"), an update to ASC 310, *Receivables*. ASU 2010-20 provides additional information to assist financial statement users in assessing an entity's credit risk exposures and evaluating the adequacy of its allowance for credit losses. ASU 2010-20 applies to all entities with financing receivables, excluding short-term trade accounts receivable or receivables measured at fair value or the lower of cost or fair value. For public entities, this update was effective for interim and annual reporting periods ending on or after December 15, 2010. The adoption of this update did not have a material impact on our consolidated financial statements.

## OTELCO INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011

In December 2010, the FASB issued ASU 2010-29, *Disclosure of Supplementary Pro Forma Information for Business Combinations* (“ASU 2010-29”), an update to ASC 805. ASU 2010-29 applies to any public entity that enters into business combinations that are material on an individual or aggregate basis. If comparative financial statements are presented, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. This update also expands the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. ASU 2010-29 was effective prospectively for business combinations for which the acquisition date was on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. Early adoption was permitted and the Company began applying the guidance in December 2010. The adoption of this update did not have a material impact on our consolidated financial statements.

#### **Recent Accounting Pronouncements**

During 2011, the FASB issued ASU 2011-01 through ASU 2011-12. Except for ASU 2011-04, ASU 2011-05, ASU 2011-08, and ASU 2011-09, which are discussed below, these ASUs provide technical corrections to existing guidance related to specialized industries or entities and therefore, have minimal, if any, impact on the Company.

In May 2011, the FASB issued ASU 2011-04, *Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs* (“ASU 2011-04”), an update to ASC 820. ASU 2011-04 provides guidance to change the wording used to describe many of the requirements in U.S. generally accepted accounting principles for measuring fair value and for disclosing information about fair value measurements. For public entities, ASU 2011-04 is effective for interim and annual periods beginning after December 15, 2011 and is to be applied prospectively. As ASU 2011-04 impacts presentation only, the adoption of this update will not impact our consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, *Presentation of Comprehensive Income* (“ASU 2011-05”) an update to ASC 220, *Comprehensive Income*. This ASU requires the components of net income and the components of other comprehensive income to be presented either in a single continuous statement of comprehensive income or in two separate but continuous statements. ASU 2011-05 eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders’ equity. This guidance does not change the items that must be reported in other comprehensive income, when an item of other comprehensive income must be reclassified to net income or how earnings per share is calculated or presented. ASU 2011-05 is effective for public entities for interim and annual periods beginning after December 15, 2011. As ASU 2011-05 impacts presentation only, the adoption of this update will not impact our consolidated financial statements.

In September 2011, the FASB issued ASU 2011-08, *Testing Goodwill for Impairment* (“ASU 2011-08”), an update to ASC 350, *Intangibles – Goodwill and Other* (“ASC 350”). This ASU will provide an entity with the option to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of the reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test in accordance with ASC 350. ASU 2011-08 is effective for annual and interim goodwill impairment tests for fiscal years beginning after December 15, 2011. As ASU 2011-08 impacts testing procedures only, the adoption of this update will not impact our consolidated financial statements.

In September 2011, the FASB issued ASU 2011-09, *Disclosures about an Employer’s Participation in a Multiemployer Plan* (“ASU 2011-09”), an update to ASC 715, *Compensation – Retirement Benefits*, subtopic 80, *Multiemployer Plans*. ASU 2011-09 requires additional disclosures for multiemployer pension plans and multiemployer other postretirement benefit plans. ASU 2011-09 is intended to create greater transparency in financial reporting by disclosing the commitments an employer has made to a multiemployer pension plan and the potential future cash flow implications of an employer’s participation in the plan. ASU 2011-09 is effective for public entities for annual periods with fiscal years ending after December 15, 2011. ASU 2011-09 impacts disclosure only, the adoption of this update did not impact our consolidated financial statements.

#### **2. Income Deposit Securities Issued**

On June 8, 2010, the Company issued 544,671 IDSs, representing an aggregate of 544,671 shares of common stock and \$4,085,033 aggregate principal amount of our 13% senior subordinated notes due 2019, in exchange for all 544,671 shares of our issued and outstanding Class B common stock. There were no proceeds to the Company from this exchange. The \$4.1 million of senior subordinated notes was reclassified from the mezzanine section of the balance sheet to long-term notes payable. Interest on the \$4.1 million of senior subordinated notes was reflected in interest expense beginning June 8, 2010.

**OTELCO INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2011**

**3. Acquisitions**

On October 14, 2011, ST acquired 100% of the issued and outstanding common stock of Shoreham Telephone Company, Inc. ("STC") and, immediately thereafter, STC merged with and into ST. ST provides telecommunications solutions, including voice, data and internet services, to residential and business customers in western Vermont.

The stock purchase agreement relating to the acquisition of STC provided for cash consideration of \$5,248,134, including the extinguishment of notes payable of \$410,904 and accrued interest of \$3,081, which were paid at closing. The excess of the purchase price over the fair value of identifiable assets and liabilities is reflected as goodwill of \$764,761. The goodwill related to the acquisition is not deductible for tax purposes.

The allocation of the net purchase price for the STC acquisition was as follows:

|                                 | <b><u>October 14, 2011</u></b> |
|---------------------------------|--------------------------------|
| Cash                            | \$ 237,850                     |
| Other current assets            | 552,331                        |
| Property and equipment          | 4,529,760                      |
| Intangible assets               | 1,729,600                      |
| Goodwill                        | 764,761                        |
| Current liabilities             | (332,710)                      |
| Deferred income tax liabilities | (2,233,458)                    |
| Purchase price                  | <b><u>\$ 5,248,134</u></b>     |

The acquisition has been recorded at fair value in accordance with ASC 805 resulting in a plant acquisition adjustment in 2011. Property and equipment have depreciation lives consistent with those shown in the Property and Equipment Note. The intangible assets at time of acquisition included regulated customer based assets at fair value of \$1,672,200 which had remaining lives of 10 years; trade name fair valued at \$16,200 which had a remaining life of 5 years; and a non-competition agreement fair valued at \$41,200 which had a remaining life of 2 years. The acquisition was accounted for using the acquisition method of accounting and, accordingly, the accompanying consolidated financial statements include the financial position and results of operations from the date of acquisition.

The following unaudited pro forma information presents the combined results of operations of the Company as though the acquisition of STC had occurred at the beginning of 2010. The results include certain adjustments, including increased amortization expense related to intangible assets. The pro forma financial information does not necessarily reflect the results of operations had the acquisition been completed at the beginning of 2010 or those which may be obtained in the future.

|                                     | <b><u>Unaudited<br/>2010</u></b> | <b><u>Unaudited<br/>2011</u></b> |
|-------------------------------------|----------------------------------|----------------------------------|
| Revenues                            | \$ 106,812,024                   | \$ 103,707,313                   |
| Income from operations              | \$ 26,422,934                    | \$ 24,705,377                    |
| Net income                          | \$ 722,165                       | \$ 1,935,327                     |
| Basic net income per common share   | \$ 0.05                          | \$ 0.15                          |
| Diluted net income per common share | \$ 0.05                          | \$ 0.15                          |

**OTELCO INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2011**

**4. Goodwill and Intangible Assets**

ASC 350 requires that goodwill be tested for impairment. The Company performs an annual impairment test to determine whether the carrying value of goodwill exceeds its fair market value. We conducted our annual impairment test of goodwill as of October 1, 2011 and determined that no adjustment to the carrying value of goodwill for any reportable units was necessary. Although the Company has only one reporting segment, it considers its three territories (Alabama, Missouri and New England) to be reporting units for purposes of testing for impairment of goodwill. The fair value exceeds the carrying value of the net assets for Alabama, Missouri and New England by 8.7%, 11.0% and 41.3%, respectively. Goodwill for Alabama, Missouri and New England represents 53.8%, 9.4% and 36.8%, respectively, of total goodwill for the Company. As of December 31, 2011, we determined that no events or circumstances from October 1, 2011 through December 31, 2011 indicated that a further assessment was necessary. Based on the results of its impairment test, the Company does not believe that there is an impairment of the goodwill balance at December 31, 2010 or 2011, respectively.

Intangible assets are summarized as follows:

|                         | <b>December 31, 2010</b>  |                                     |                       | <b>December 31, 2011</b>  |                                     |                       |
|-------------------------|---------------------------|-------------------------------------|-----------------------|---------------------------|-------------------------------------|-----------------------|
|                         | <b>Carrying<br/>Value</b> | <b>Accumulated<br/>Amortization</b> | <b>Net<br/>Value</b>  | <b>Carrying<br/>Value</b> | <b>Accumulated<br/>Amortization</b> | <b>Net<br/>Value</b>  |
| Goodwill                |                           |                                     | <u>\$ 188,190,078</u> |                           |                                     | <u>\$ 188,954,840</u> |
| Other intangible assets |                           |                                     |                       |                           |                                     |                       |
| Customer relationships  | \$ 27,757,682             | \$ (11,773,248)                     | \$ 15,984,434         | \$ 29,429,882             | \$ (15,483,937)                     | \$ 13,945,945         |
| Contract relationships  | 19,600,000                | (9,683,333)                         | 9,916,667             | 19,600,000                | (13,066,667)                        | 6,533,333             |
| Non-competition         | 53,903                    | (20,962)                            | 32,941                | 95,103                    | (44,080)                            | 51,023                |
| Trade name              | -                         | -                                   | -                     | 16,200                    | (810)                               | 15,390                |
| Total                   | <u>\$ 47,411,585</u>      | <u>\$ (21,477,543)</u>              | <u>\$ 25,934,042</u>  | <u>\$ 49,141,185</u>      | <u>\$ (28,595,494)</u>              | <u>\$ 20,545,691</u>  |

These intangible assets have a range of 1 to 15 years of useful lives and utilize both the sum-of-the-years' digits and straight-line methods of amortization, as appropriate. The following table presents current and expected amortization expense of the existing intangible assets as of December 31, 2011 for each of the following periods:

Aggregate amortization expense:

|                                      |               |
|--------------------------------------|---------------|
| For the year ended December 31, 2009 | \$ 10,443,409 |
| For the year ended December 31, 2010 | \$ 8,271,338  |
| For the year ended December 31, 2011 | \$ 7,117,951  |

Expected amortization expense for the years ending December 31,

|            |                      |
|------------|----------------------|
| 2012       | \$ 6,038,437         |
| 2013       | 4,756,206            |
| 2014       | 3,475,031            |
| 2015       | 2,106,063            |
| 2016       | 1,054,458            |
| Thereafter | 3,115,496            |
| Total      | <u>\$ 20,545,691</u> |

**OTELCO INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2011**

**5. Property and Equipment**

A summary of property and equipment is shown as follows:

|                                           | <b>Estimated<br/>Life</b> | <b>December 31,<br/>2010</b> | <b>2011</b>          |
|-------------------------------------------|---------------------------|------------------------------|----------------------|
| Land                                      |                           | \$ 1,113,797                 | \$ 1,156,843         |
| Building and improvements                 | 20-40                     | 11,530,062                   | 12,246,942           |
| Telephone equipment                       | 6-20                      | 211,279,443                  | 227,825,838          |
| Cable television equipment                | 7                         | 10,368,161                   | 10,918,212           |
| Furniture and equipment                   | 8-14                      | 2,766,793                    | 2,967,337            |
| Vehicles                                  | 7-9                       | 5,768,620                    | 6,089,630            |
| Computer software equipment               | 5-7                       | 13,986,754                   | 15,590,697           |
| Internet equipment                        | 5                         | 3,707,226                    | 3,923,314            |
| Total property, plant and equipment       |                           | 260,520,856                  | 280,718,813          |
| Accumulated depreciation and amortization |                           | (196,633,643)                | (214,836,838)        |
| Net property, plant and equipment         |                           | <u>\$ 63,887,213</u>         | <u>\$ 65,881,975</u> |

The Company's composite depreciation rate for property and equipment was 20.9%, 21.7% and 19.2% in 2009, 2010 and 2011, respectively. Depreciation expense for the years ended December 31, 2009, 2010 and 2011 was \$14,444,714, \$13,837,560 and \$11,891,474, respectively. Amortization expense for telephone plant adjustment was \$1,554,932, \$1,554,932 and \$1,216,739 for the years ended December 31, 2009, 2010 and 2011, respectfully.

**6. Other Accounts Receivable**

Other accounts receivable consist of the following:

|                                       | <b>December 31,<br/>2010</b> | <b>2011</b>         |
|---------------------------------------|------------------------------|---------------------|
| Carrier access bills receivable       | \$ 1,815,060                 | \$ 1,561,174        |
| NECA receivable                       | 1,041,206                    | 682,016             |
| Receivables from Alabama Service Fund | 443,169                      | 423,356             |
| Wholesale contracts receivable        | 809,035                      | 1,880,608           |
| Other miscellaneous                   | 190,618                      | 901,920             |
|                                       | <u>\$ 4,299,088</u>          | <u>\$ 5,449,074</u> |

**7. Investments**

Investments consist of the following:

|                            | <b>December 31,<br/>2010</b> | <b>2011</b>         |
|----------------------------|------------------------------|---------------------|
| Investment in CoBank stock | \$ 1,474,920                 | \$ 1,474,920        |
| Rental property            | 423,154                      | 397,644             |
| Other miscellaneous        | 69,021                       | 71,241              |
|                            | <u>\$ 1,967,095</u>          | <u>\$ 1,943,805</u> |

The investment in CoBank stock is carried at historical cost due to no readily determinable fair value for those instruments being available. Management believes there has been no other than temporary impairment in such investment. This investment consists of patronage certificates that represent ownership in the financial institution where the Company has, and in the past, had, debt. These certificates yield dividends on an annual basis, and the investment is redeemed ratably subsequent to the repayment of the debt.

**OTELCO INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2011**

**8. Leases**

Minimum future rental commitments under non-cancellable operating leases, primarily for real property and office facilities at December 31, 2011, consist of the following:

|            |                     |
|------------|---------------------|
| 2012       | \$ 594,758          |
| 2013       | 561,866             |
| 2014       | 242,734             |
| 2015       | 114,486             |
| 2016       | 93,093              |
| Thereafter | 388,470             |
| Total      | <u>\$ 1,995,407</u> |

Rent expense for the years ended December 31, 2009, 2010 and 2011 was \$481,099, \$499,928 and \$599,569, respectively.

**9. Long-Term Debt**

The Company's credit agreement with General Electric Capital Corporation, originally dated December 21, 2004, has been amended and restated on several occasions to reflect requirements for funds to complete two acquisitions and the use of proceeds from the Company's successful offering of 3,000,000 IDS units on July 5, 2007. On October 20, 2008, the Company completed its second amendment and restatement of its credit agreement, increasing the principal balance from \$64.6 million to \$173.5 million on October 31, 2008 for the acquisition of Pine Tree Holdings, Inc., Granby Holdings, Inc. and War Holdings, Inc. (collectively, the "CR Companies") from Country Road Communications LLC, changing the variable margin, and extending the maturity from July 3, 2011 to October 31, 2013. The variable margin based on leverage is 4% over LIBOR. On May 9, 2011, November 9, 2010, and August 8, 2009, the Company made voluntary prepayments of \$385,828, \$6.1 million, and \$5.0 million, respectively, reducing the credit facility notes payable balance to \$162.0 million at December 31, 2011.

**OTELCO INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2011**

Long-term notes payable consists of the following:

|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | <b>December 31,</b>   |                       |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------|-----------------------|
|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | <b>2010</b>           | <b>2011</b>           |
| Term credit facility, General Electric Capital Corporation; variable interest rate of 4.29% at December 31, 2011. There are no scheduled principal payments. Interest payments are due on the last day of each LIBOR period or at one month intervals, whichever date comes first. Interest rate is the index rate plus the applicable term loan index margin or the applicable LIBOR rate plus the applicable term loan LIBOR margin. The Company made voluntary prepayments of \$5.0 million, \$6.1 million, and \$385,828 on August 8, 2009, November 9, 2010, and May 9, 2011, respectively. The unpaid balance will be due October 31, 2013. | \$ 162,385,828        | \$ 162,000,000        |
| 13% Senior subordinated notes, due 2019; interest payments are due quarterly. On June 8, 2010, IDS units that included \$4,085,033 in senior subordinated debt were issued in the conversion of Class B shares. Premium amortization for the years ended December 31, 2010 and 2011 was \$92,307 and \$103,640, respectively.                                                                                                                                                                                                                                                                                                                     | 100,710,027           | 100,606,387           |
| 13% Senior subordinated notes, held separately, due 2019; interest payments are due quarterly.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | 8,500,000             | 8,500,000             |
| Total long-term notes payable                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | 271,595,855           | 271,106,387           |
| Less: current portion                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             | —                     | —                     |
| Long-term notes payable                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | <u>\$ 271,595,855</u> | <u>\$ 271,106,387</u> |

Associated with these long-term notes payable, the Company capitalized \$8.1 million in deferred financing costs associated with the credit facility and the 13% senior subordinated notes put in place on December 21, 2004. On July 3, 2006, an additional \$1,545,743 in deferred financing costs was capitalized. On July 5, 2007, \$1,064,526 in deferred financing costs were written-off associated with the reduction in long-term notes payable from the proceeds of the Company's offering of 3,000,000 IDS units. On October 31, 2008, an additional \$5,311,138 in deferred financing costs was capitalized associated with the acquisition of the CR Companies. \$1,406,088 in deferred financing costs were written-off associated with the effective extinguishment of the existing indebtedness at time of closing. The credit facility is secured by the total assets of the subsidiary guarantors.

The Company has a revolving credit facility of \$15,000,000. There was no balance as of December 31, 2010 and 2011. The interest rate is the index rate plus a variable margin or LIBOR rate plus a variable margin, whichever is applicable. The margin at December 31, 2010 and 2011 was 4.0%. The range of margins can vary from 3.5% to 4.25%, depending on our total debt leverage. The Company pays a commitment fee of 0.50% per annum, payable quarterly in arrears, on the unused portion of the revolver loan. The commitment fee expense was \$76,042 for both years ended December 31, 2010 and 2011.

The deferred financing costs related to the issuance of debt is capitalized and amortized over the life of the debt obligation. Amortization of deferred financing costs is reflected in interest expense. The amortization of deferred financing costs also includes unamortized loan cost that is expensed due to the related debt being extinguished. The unamortized loan cost that was expensed and included in amortization expense for the years ended December 31, 2009, 2010 and 2011 was \$1,351,906, \$1,361,351 and \$1,368,095, respectively.

**OTELCO INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2011**

Maturities of long-term debt for the next five years are as follows:

|                     |                              |
|---------------------|------------------------------|
| 2012                | \$ —                         |
| 2013                | 162,000,000                  |
| 2014                | —                            |
| 2015                | —                            |
| 2016                | —                            |
| Thereafter          | <u>107,660,531</u>           |
| Total principal     | 269,660,531                  |
| Unamortized premium | <u>1,445,856</u>             |
| Total               | <u><u>\$ 271,106,387</u></u> |

The above schedule of maturities of long-term debt includes the premium paid for the debt associated with the 3,000,000 IDS units issued July 5, 2007.

The Company's long-term notes payable agreement is subject to certain financial covenants and restrictions on indebtedness, financial guarantees, business combinations and other related items. As of December 31, 2011, the Company is in compliance with all covenants.

**10. Derivative and Hedge Activities**

An interest rate cap was purchased on December 21, 2004, coincident with the closing of our initial public offering. The interest rate cap was purchased to mitigate the risk of rising interest rates by capping the rate at 3% for the three month LIBOR index plus the applicable margin on \$80 million in senior debt for five years. On July 5, 2007, the Company repaid \$55,353,032 in debt, reducing its senior debt below the level of the rate cap. The balance of the cap at that time was considered as an investment and adjustments were made to accumulated other comprehensive income to reflect this change. On October 31, 2008, the Company implemented its second amended and restated credit agreement, increasing senior debt to \$173.5 million in conjunction with the acquisition of the CR Companies. The full \$80 million rate cap again became effective as a hedge from that date forward through the end of the rate cap on December 20, 2009.

The Company had two interest rate swaps with approved counterparties. The first swap had a notional amount of \$90 million with the Company paying a fixed rate of 1.85% and the counterparty paying a variable rate based upon the three month LIBOR interest rate. It was effective from February 9, 2009 through February 8, 2012. The second swap had a notional amount of \$60 million with the Company paying a fixed rate of 2.0475% and the counterparty paying a variable rate based upon the three month LIBOR interest rate. It was effective from February 9, 2010 through February 8, 2012. From an accounting perspective, the documentation for both swaps did not meet the technical requirements of ASC 815 to allow the swaps to be considered highly effective as hedging instruments and therefore did not qualify for hedge accounting. The change in fair value of the swaps was charged or credited to income as a change in fair value of derivatives. Over the life of the swaps, the cumulative change in value was zero.

Changes in the fair value of the effective portion of the interest rate hedges are not included in earnings but are reported as a component of accumulated other comprehensive income. Changes in the fair value of interest rate hedges which do not technically qualify for hedge accounting are reported in the change in fair value of derivatives on the statement of operations and reflected in earnings.

The cost of the effective portion of the interest rate cap was expensed as interest over the effective life of the hedge in accordance with the quarterly value of the caplets as determined at the date of inception. For the year ended December 31, 2009, the cost of the effective portion of the interest rate cap was \$1,168,522. The rate cap ended December 20, 2009.

**OTELCO INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2011**

**11. Income Taxes**

Income tax expense (benefit) for the years ended December 31, 2009, 2010 and 2011 is summarized below:

|                                     | <b>For the Years Ended December 31,</b> |                   |                   |
|-------------------------------------|-----------------------------------------|-------------------|-------------------|
|                                     | <b>2009</b>                             | <b>2010</b>       | <b>2011</b>       |
| Federal income taxes                |                                         |                   |                   |
| Current                             | \$ 114,947                              | \$ (3,015)        | \$ (2,033)        |
| Deferred                            | (1,474,119)                             | 278,383           | (75,765)          |
| Total federal tax expense (benefit) | (1,359,172)                             | 275,368           | (77,798)          |
| State income taxes                  |                                         |                   |                   |
| Current                             | 26,222                                  | 184,726           | 25,000            |
| Deferred                            | (33,679)                                | 149,715           | 302,727           |
| Total state tax expense (benefit)   | (7,457)                                 | 334,441           | 327,727           |
| Total income tax expense (benefit)  | <u>\$ (1,366,629)</u>                   | <u>\$ 609,809</u> | <u>\$ 249,929</u> |

Total income tax expense (benefit) was different than that computed by applying U.S. federal income tax rates to income from continuing operations before income taxes for the years ended December 31, 2009, 2010 and 2011. The reasons for the differences are presented below:

|                                                                 | <b>For the Years Ended December 31,</b> |                   |                   |
|-----------------------------------------------------------------|-----------------------------------------|-------------------|-------------------|
|                                                                 | <b>2009</b>                             | <b>2010</b>       | <b>2011</b>       |
| Federal income tax at statutory rate                            | 35%                                     | 35%               | 35%               |
| Federal income tax provision (benefit) at statutory rate        | \$ (1,569,554)                          | \$ 455,183        | \$ 856,571        |
| Change in fair value of derivatives                             | 474,166                                 | 307,482           | (781,466)         |
| State income tax (provision), net of federal income tax effects | (4,847)                                 | 217,387           | 213,022           |
| Other                                                           | (266,394)                               | (370,243)         | (38,198)          |
| Provision (benefit) for income taxes                            | <u>\$ (1,366,629)</u>                   | <u>\$ 609,809</u> | <u>\$ 249,929</u> |
| Effective income tax rate                                       | 30.5%                                   | 46.9%             | 10.2%             |

As of December 31, 2011 the Company has U.S. federal and state net operating loss carryforwards of \$17.3 million and \$22.8 million, respectively. These net operating loss carryforwards expire at various times beginning in 2021 through 2031. These acquired losses are subject to annual limitations imposed by rules under the Internal Revenue Code. These net operating loss carryforwards are more likely than not to be used prior to their expiration.

During 2009, the Company took advantage of the 5-year net operating loss carryback provisions of the Worker, Homeownership, and Business Act of 2009. Approximately, \$1.7 million of the 2008 net operating loss was carried back to 2004 for a refund of \$0.4 million.

**OTELCO INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2011**

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities as of December 31, 2010 and 2011 are presented below:

|                                           | <b>December 31,</b>          |                              |
|-------------------------------------------|------------------------------|------------------------------|
|                                           | <b>2010</b>                  | <b>2011 <sup>(1)</sup></b>   |
| Deferred tax liabilities:                 |                              |                              |
| Amortization                              | \$(25,604,600)               | \$(28,374,977)               |
| Depreciation                              | (9,448,329)                  | (13,924,912)                 |
| Amortized intangibles                     | (7,443,579)                  | (5,796,972)                  |
| Prepaid expense                           | (353,285)                    | (353,285)                    |
| Other                                     | (16,068)                     | (15,523)                     |
| Total deferred tax liabilities            | <u><u>\$(42,865,861)</u></u> | <u><u>\$(48,465,669)</u></u> |
| Deferred tax assets:                      |                              |                              |
| Deferred compensation                     | \$ 308,479                   | \$ 297,468                   |
| Federal net operating loss carryforwards  | 3,163,018                    | 6,058,180                    |
| Alternative minimum credits carryforwards | 504,130                      | 504,130                      |
| State net operating loss carryforwards    | 278,462                      | 438,786                      |
| Advance payments                          | 272,357                      | 256,218                      |
| Bad debt                                  | 226,305                      | 298,683                      |
| Other                                     | 288,613                      | 327,288                      |
| Total deferred tax assets                 | <u><u>\$ 5,041,364</u></u>   | <u><u>\$ 8,180,753</u></u>   |

<sup>(1)</sup> The 2011 balances include net deferred tax liabilities in the amount of \$2,233,458 related to the STC stock acquisition that occurred on October 14, 2011.

Effective January 1, 2007, the Company adopted the provision included in ASC 740. ASC 740 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements. ASC 740 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This pronouncement also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The adoption of ASC 740 did not result in the identification of material uncertain tax positions through December 31, 2011. Tax years from 2007 forward remain open for audit.

## **12. Employee Benefit Program**

Employees of all subsidiaries except BTC participate in a defined contribution savings plan under Section 401(k) of the Internal Revenue Code, which is sponsored by the Company. The terms of the plan provide for an elective contribution from employees not to exceed \$16,500 for each of 2009, 2010 and 2011. The Company matches the employee's contribution up to 6% of the employee's annual compensation. For the years ended December 31, 2009, 2010 and 2011, the total expense associated with this plan was \$713,364, \$742,288 and \$733,161, respectively.

The employees of BTC participate in a multiemployer Retirement and Security Program ("RSP") as a defined benefit plan and a Savings Plan ("SP") provided through the National Telecommunications Cooperative Association ("NTCA"). Participation in the RSP requires a minimum employee contribution of 1% of their annual compensation. The Company contributes 9.4%, 6.0%, and 6.0% for 2009, 2010 and 2011, respectively, of their annual compensation for every participating employee. On October 1, 2009, the Company reduced its contribution from 10.5% to 6%. SP is a defined contribution savings plan under Section 401(k) of the Internal Revenue Code to which the Company made no contribution for 2009, 2010 or 2011. The employee can make voluntary contributions to the SP as desired. For the years ended December 31, 2009, 2010 and 2011, the total expense associated with these plans was \$70,271, \$60,030, and \$50,220, respectively.

## **13. Income (Loss) per Common Share and Potential Common Share**

Basic income (loss) per common share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding for the period. Diluted income (loss) per common share reflects the potential dilution that would occur had all of the issued and outstanding shares of Class B common stock been exchanged for IDSs at the beginning of the period. On June 8, 2010, all of the Company's issued and outstanding shares of Class B common stock were exchanged for IDSs on a one-for-one basis. Each of the IDSs issued in the exchange includes a common share. Diluted amounts are not included in the computation of diluted loss per common share when the inclusion of such amounts would be anti-dilutive.



**OTELCO INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2011**

A reconciliation of the common shares for the Company's basic and diluted income (loss) per common share calculation is as follows:

|                                                                    | <b>For the Years Ended December 31,</b> |             |              |
|--------------------------------------------------------------------|-----------------------------------------|-------------|--------------|
|                                                                    | <b>2009</b>                             | <b>2010</b> | <b>2011</b>  |
| Weighted average of common shares-basic                            | 12,676,733                              | 12,985,629  | 13,221,404   |
| Effect of dilutive securities                                      | 544,671                                 | 235,775     | —            |
| Weighted average common shares and potential common shares-diluted | 13,221,404                              | 13,221,404  | 13,221,404   |
| Net income (loss) available to common shareholders                 | \$ (3,117,811)                          | \$ 690,715  | \$ 2,197,418 |
| Net income (loss) per basic common share                           | \$ (0.25)                               | \$ 0.05     | \$ 0.17      |
| Net income (loss) available to common stockholders                 | \$ (3,117,811)                          | \$ 690,715  | \$ 2,197,418 |
| Change in fair value of Class B derivative                         | (238,054)                               | —           | —            |
| Net income (loss) available for diluted common shares              | \$ (3,355,865)                          | \$ 690,715  | \$ 2,197,418 |
| Net income (loss) per diluted common share                         | \$ (0.25)                               | \$ 0.05     | \$ 0.17      |

**14. Selected Quarterly Financial Data (unaudited)**

|                                             | <b>First<br/>Quarter</b> | <b>Second<br/>Quarter</b> | <b>Third<br/>Quarter</b> | <b>Fourth<br/>Quarter</b> |
|---------------------------------------------|--------------------------|---------------------------|--------------------------|---------------------------|
| Fiscal 2010:                                |                          |                           |                          |                           |
| Revenue                                     | \$ 25,794,209            | \$ 26,510,944             | \$ 26,145,227            | \$ 25,949,839             |
| Operating income                            | 5,868,729                | 7,011,337                 | 6,727,966                | 6,760,732                 |
| Net income (loss)                           | (385,656)                | 417,276                   | 63,075                   | 596,020                   |
| Net income (loss) per common share, basic   | \$ (0.03)                | \$ 0.03                   | \$ —                     | \$ 0.04                   |
| Net income (loss) per common share, diluted | \$ (0.03)                | \$ 0.03                   | \$ —                     | \$ 0.04                   |
| Fiscal 2011:                                |                          |                           |                          |                           |
| Revenue                                     | \$ 25,392,000            | \$ 25,501,062             | \$ 25,302,747            | \$ 25,647,758             |
| Operating income                            | 5,320,713                | 7,326,611                 | 6,124,154                | 5,858,617                 |
| Net income                                  | 4,654                    | 1,283,277                 | 885,462                  | 24,025                    |
| Net income per common share, basic          | \$ —                     | \$ 0.10                   | \$ 0.07                  | \$ —                      |
| Net income per common share, diluted        | \$ —                     | \$ 0.10                   | \$ 0.07                  | \$ —                      |

**15. Fair Value Measurement**

The Company adopted ASC 820, which defines fair value, establishes a framework for measuring fair value and requires disclosures about fair value measurements. The framework that is set forth in this standard is applicable to the fair value measurements where it is permitted or required under other accounting pronouncements.

ASC 820 defines fair value as the exit price, which is the price that would be received to sell an asset or paid to transfer a liability in a transaction between market participants at the measurement date. ASC 820 establishes a three-tier value hierarchy that prioritizes inputs to valuation techniques used for fair value measurement.

- Level 1 consists of observable market data in an active market for identical assets or liabilities.

**OTELCO INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2011**

- Level 2 consists of observable market data, other than that included in Level 1, that is either directly or indirectly observable.
- Level 3 consists of unobservable market data. The input may reflect the assumptions of the Company, not a market participant, if there is little available market data and the Company's own assumptions are considered by management to be the best available information.

In accordance with ASC 820, the following table represents the Company's fair value hierarchy for its financial assets and liabilities as of December 31, 2010 and 2011:

| <b>December 31, 2010</b> |                     |                               |                               |                               |
|--------------------------|---------------------|-------------------------------|-------------------------------|-------------------------------|
|                          | <b>Fair Value</b>   | <b>Level 1 <sup>(1)</sup></b> | <b>Level 2 <sup>(2)</sup></b> | <b>Level 3 <sup>(3)</sup></b> |
| <b>Liabilities</b>       |                     |                               |                               |                               |
| Interest rate swaps      | \$ 2,471,331        | \$ —                          | \$ 2,471,331                  | \$ —                          |
| Total liabilities        | <u>\$ 2,471,331</u> | <u>\$ —</u>                   | <u>\$ 2,471,331</u>           | <u>\$ —</u>                   |
| <b>December 31, 2011</b> |                     |                               |                               |                               |
|                          | <b>Fair Value</b>   | <b>Level 1 <sup>(1)</sup></b> | <b>Level 2 <sup>(2)</sup></b> | <b>Level 3 <sup>(3)</sup></b> |
| <b>Liabilities</b>       |                     |                               |                               |                               |
| Interest rate swaps      | \$ 241,438          | \$ —                          | \$ 241,438                    | \$ —                          |
| Total liabilities        | <u>\$ 241,438</u>   | <u>\$ —</u>                   | <u>\$ 241,438</u>             | <u>\$ —</u>                   |

<sup>(1)</sup> Quoted prices in active markets for identical assets.

<sup>(2)</sup> Significant other observable inputs.

<sup>(3)</sup> Significant unobservable inputs.

The interest rate swaps are valued at the end of the quarter based on available market information.

## **16. Subsidiary Guarantees**

On October 1, 2011, MMT became a guarantor of the Company's senior subordinated notes and on October 14, 2011, ST became a guarantor of the Company's senior subordinated notes.

The Company has no independent assets or operations separate from its operating subsidiaries. The guarantees of its senior subordinated notes by 14 of its 15 operating subsidiaries are full and unconditional, joint and several. The operating subsidiaries have no independent long-term notes payable. There are no significant restrictions on the ability of the Company to obtain funds from its operating subsidiaries by dividend or loan. The condensed consolidated financial information is provided for the guarantor entities.

The following tables present condensed consolidating balance sheets as of December 31, 2010 and 2011; condensed consolidating statements of operations for the years ended December 31, 2009, 2010 and 2011; and condensed consolidating statements of cash flows for the years ended December 31, 2009, 2010 and 2011.

**OTELCO INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2011**

**Otelco Inc.  
Condensed Consolidating Balance Sheet  
December 31, 2010**

|                                                       | <b>Parent</b>         | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-<br/>Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b>   | <b>Consolidated</b>   |
|-------------------------------------------------------|-----------------------|-----------------------------------|--------------------------------------------|-----------------------|-----------------------|
| <b>ASSETS</b>                                         |                       |                                   |                                            |                       |                       |
| Current assets                                        |                       |                                   |                                            |                       |                       |
| Cash and cash equivalents                             | \$ —                  | \$ 18,064,970                     | \$ 161,404                                 | \$ —                  | \$ 18,226,374         |
| Accounts receivable, net                              | —                     | 10,072,847                        | 793,775                                    | —                     | 10,866,622            |
| Materials and supplies                                | —                     | 893,186                           | 924,125                                    | —                     | 1,817,311             |
| Prepaid expenses                                      | 184,055               | 1,022,697                         | 98,276                                     | —                     | 1,305,028             |
| Deferred income taxes                                 | 626,267               | —                                 | —                                          | —                     | 626,267               |
| Investment in subsidiaries                            | 131,010,180           | —                                 | —                                          | (131,010,180)         | —                     |
| Intercompany receivable                               | (129,599,481)         | —                                 | —                                          | 129,599,481           | —                     |
| Total current assets                                  | 2,221,021             | 30,053,700                        | 1,977,580                                  | (1,410,699)           | 32,841,602            |
| Property and equipment, net                           | 218,301               | 54,043,819                        | 9,625,093                                  | —                     | 63,887,213            |
| Goodwill                                              | 239,970,317           | (49,843,599)                      | (1,936,640)                                | —                     | 188,190,078           |
| Intangibles assets, net                               | —                     | 23,326,214                        | 2,607,828                                  | —                     | 25,934,042            |
| Investments                                           | 1,203,605             | 433,059                           | 330,431                                    | —                     | 1,967,095             |
| Deferred income taxes                                 | 4,415,097             | —                                 | —                                          | —                     | 4,415,097             |
| Other long-term assets                                | 5,757,825             | 183,946                           | —                                          | —                     | 5,941,771             |
| Total assets                                          | <u>\$ 253,786,166</u> | <u>\$ 58,197,139</u>              | <u>\$ 12,604,292</u>                       | <u>\$ (1,410,699)</u> | <u>\$ 323,176,898</u> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b> |                       |                                   |                                            |                       |                       |
| Current liabilities                                   |                       |                                   |                                            |                       |                       |
| Accounts payable and accrued expenses                 | \$ 2,280,661          | \$ 4,991,249                      | \$ 1,423,099                               | \$ —                  | \$ 8,695,009          |
| Intercompany payables                                 | —                     | (131,769,870)                     | 2,170,389                                  | 129,599,481           | —                     |
| Other current liabilities                             | 353,285               | 1,678,145                         | 89,467                                     | —                     | 2,120,897             |
| Total current liabilities                             | 2,633,946             | (125,100,476)                     | 3,682,955                                  | 129,599,481           | 10,815,906            |
| Deferred income taxes                                 | 22,592,597            | 16,666,501                        | 3,253,478                                  | —                     | 42,512,576            |
| Other liabilities                                     | 2,471,331             | 1,025,317                         | —                                          | —                     | 3,496,648             |
| Long-term notes payable                               | 231,332,379           | 40,263,476                        | —                                          | —                     | 271,595,855           |
| Stockholders' equity (deficit)                        | (5,244,087)           | 125,342,321                       | 5,667,859                                  | (131,010,180)         | (5,244,087)           |
| Total liabilities and stockholders' equity (deficit)  | <u>\$ 253,786,166</u> | <u>\$ 58,197,139</u>              | <u>\$ 12,604,292</u>                       | <u>\$ (1,410,699)</u> | <u>\$ 323,176,898</u> |

**OTELCO INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2011**

**Otelco Inc.  
Condensed Consolidating Balance Sheet  
December 31, 2011**

|                                                       | <b>Parent</b>         | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-<br/>Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b>   |
|-------------------------------------------------------|-----------------------|-----------------------------------|--------------------------------------------|---------------------|-----------------------|
| <b>ASSETS</b>                                         |                       |                                   |                                            |                     |                       |
| Current assets                                        |                       |                                   |                                            |                     |                       |
| Cash and cash equivalents                             | \$ —                  | \$ 12,393,441                     | \$ 351                                     | \$ —                | \$ 12,393,792         |
| Accounts receivable, net                              | —                     | 11,445,049                        | 543,122                                    | —                   | 11,988,171            |
| Materials and supplies                                | —                     | 827,194                           | 953,626                                    | —                   | 1,780,820             |
| Prepaid expenses                                      | 194,244               | 1,115,339                         | 18,892                                     | —                   | 1,328,475             |
| Deferred income taxes                                 | 726,310               | —                                 | —                                          | —                   | 726,310               |
| Investment in subsidiaries                            | 147,614,140           | —                                 | —                                          | (147,614,140)       | —                     |
| Intercompany receivable                               | (154,849,721)         | (688,391)                         | 688,391                                    | 154,849,721         | —                     |
| Total current assets                                  | (6,315,027)           | 25,092,632                        | 2,204,382                                  | 7,235,581           | 28,217,568            |
| Property and equipment, net                           | —                     | 64,524,981                        | 1,356,994                                  | —                   | 65,881,975            |
| Goodwill                                              | 239,970,317           | (47,435,761)                      | (3,579,716)                                | —                   | 188,954,840           |
| Intangibles assets, net                               | —                     | 18,186,227                        | 2,359,464                                  | —                   | 20,545,691            |
| Investments                                           | 1,203,605             | 432,186                           | 308,014                                    | —                   | 1,943,805             |
| Deferred income taxes                                 | 7,454,443             | —                                 | —                                          | —                   | 7,454,443             |
| Other long-term assets                                | 4,485,324             | 240,667                           | —                                          | —                   | 4,725,991             |
| Total assets                                          | <u>\$ 246,798,662</u> | <u>\$ 61,040,932</u>              | <u>\$ 2,649,138</u>                        | <u>\$ 7,235,581</u> | <u>\$ 317,724,313</u> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b> |                       |                                   |                                            |                     |                       |
| Current liabilities                                   |                       |                                   |                                            |                     |                       |
| Accounts payable and accrued expenses                 | \$ 1,306,872          | \$ 4,793,854                      | \$ 1,424,095                               | \$ —                | \$ 7,524,821          |
| Intercompany payables                                 | —                     | (154,849,721)                     | —                                          | 154,849,721         | —                     |
| Other current liabilities                             | 353,285               | 1,668,933                         | 65,413                                     | —                   | 2,087,631             |
| Total current liabilities                             | 1,660,157             | (148,386,934)                     | 1,489,508                                  | 154,849,721         | 9,612,452             |
| Deferred income taxes                                 | 26,421,911            | 20,354,646                        | 1,335,827                                  | —                   | 48,112,384            |
| Other liabilities                                     | 241,438               | 1,019,407                         | —                                          | —                   | 1,260,845             |
| Long-term notes payable                               | 230,842,911           | 40,263,476                        | —                                          | —                   | 271,106,387           |
| Stockholders' equity (deficit)                        | (12,367,755)          | 147,790,337                       | (176,197)                                  | (147,614,140)       | (12,367,755)          |
| Total liabilities and stockholders' equity (deficit)  | <u>\$ 246,798,662</u> | <u>\$ 61,040,932</u>              | <u>\$ 2,649,138</u>                        | <u>\$ 7,235,581</u> | <u>\$ 317,724,313</u> |

**OTELCO INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2011**

**Otelco Inc.  
Condensed Consolidating Statement of Operations  
For the Twelve Months Ended December 31, 2009**

|                                          | <u>Parent</u>         | <u>Guarantor<br/>Subsidiaries</u> | <u>Non-<br/>Guarantor<br/>Subsidiaries</u> | <u>Eliminations</u>    | <u>Consolidated</u>   |
|------------------------------------------|-----------------------|-----------------------------------|--------------------------------------------|------------------------|-----------------------|
| Revenue                                  | \$ 3,318,678          | \$ 100,173,351                    | \$ 11,701,213                              | \$ (11,437,788)        | \$ 103,755,454        |
| Operating expenses                       | (3,318,678)           | (80,815,648)                      | (9,132,057)                                | 11,437,788             | (81,828,595)          |
| Income from operations                   | –                     | 19,357,703                        | 2,569,156                                  | –                      | 21,926,859            |
| Other income (expense)                   | (26,098,959)          | (390,828)                         | 78,488                                     | –                      | (26,411,299)          |
| Earnings from subsidiaries               | 14,247,278            | –                                 | –                                          | (14,247,278)           | –                     |
| Income (loss) before income tax          | (11,851,681)          | 18,966,875                        | 2,647,644                                  | (14,247,278)           | (4,484,440)           |
| Income tax (expense) benefit             | 8,733,870             | (6,330,343)                       | (1,036,898)                                | –                      | 1,366,629             |
| Net income (loss) to common stockholders | <u>\$ (3,117,811)</u> | <u>\$ 12,636,532</u>              | <u>\$ 1,610,746</u>                        | <u>\$ (14,247,278)</u> | <u>\$ (3,117,811)</u> |

**Otelco Inc.  
Condensed Consolidating Statement of Operations  
For the Twelve Months Ended December 31, 2010**

|                                   | <u>Parent</u>     | <u>Guarantor<br/>Subsidiaries</u> | <u>Non-<br/>Guarantor<br/>Subsidiaries</u> | <u>Eliminations</u>    | <u>Consolidated</u> |
|-----------------------------------|-------------------|-----------------------------------|--------------------------------------------|------------------------|---------------------|
| Revenues                          | \$ 3,493,053      | \$ 101,600,140                    | \$ 10,855,909                              | \$ (11,548,883)        | \$ 104,400,219      |
| Operating expenses                | (3,493,053)       | (77,083,003)                      | (9,004,282)                                | 11,548,883             | (78,031,455)        |
| Income from operations            | –                 | 24,517,137                        | 1,851,627                                  | –                      | 26,368,764          |
| Other income (expense)            | (24,856,925)      | (311,219)                         | 99,904                                     | –                      | (25,068,240)        |
| Earnings from subsidiaries        | 26,157,449        | –                                 | –                                          | (26,157,449)           | –                   |
| Income before income tax          | 1,300,524         | 24,205,918                        | 1,951,531                                  | (26,157,449)           | 1,300,524           |
| Income tax expense                | (609,809)         | (7,944,116)                       | (761,943)                                  | 8,706,059              | (609,809)           |
| Net income to common stockholders | <u>\$ 690,715</u> | <u>\$ 16,261,802</u>              | <u>\$ 1,189,588</u>                        | <u>\$ (17,451,390)</u> | <u>\$ 690,715</u>   |

**Otelco Inc.  
Condensed Consolidating Statement of Operations  
For the Twelve Months Ended December 31, 2011**

|                                   | <u>Parent</u>       | <u>Guarantor<br/>Subsidiaries</u> | <u>Non-<br/>Guarantor<br/>Subsidiaries</u> | <u>Eliminations</u>    | <u>Consolidated</u> |
|-----------------------------------|---------------------|-----------------------------------|--------------------------------------------|------------------------|---------------------|
| Revenues                          | \$ 3,289,457        | \$ 99,770,739                     | \$ 4,234,814                               | \$ (5,451,443)         | \$ 101,843,567      |
| Operating expenses                | (3,289,457)         | (75,146,885)                      | (4,228,573)                                | 5,451,443              | (77,213,472)        |
| Income from operations            | –                   | 24,623,854                        | 6,241                                      | –                      | 24,630,095          |
| Other income (expense)            | (21,825,630)        | (356,881)                         | (237)                                      | –                      | (22,182,748)        |
| Earnings from subsidiaries        | 24,272,977          | –                                 | –                                          | (24,272,977)           | –                   |
| Income before income tax          | 2,447,347           | 24,266,973                        | 6,004                                      | (24,272,977)           | 2,447,347           |
| Income tax expense                | (249,929)           | (7,666,626)                       | (2,395)                                    | 7,669,021              | (249,929)           |
| Net income to common stockholders | <u>\$ 2,197,418</u> | <u>\$ 16,600,347</u>              | <u>\$ 3,609</u>                            | <u>\$ (16,603,956)</u> | <u>\$ 2,197,418</u> |



**OTELCO INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2011**

**Otelco Inc.  
Condensed Consolidating Statement of Cash Flows  
For the Twelve Months Ended December 31, 2009**

|                                                                                               | <b>Parent</b>  | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-<br/>Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|-----------------------------------------------------------------------------------------------|----------------|-----------------------------------|--------------------------------------------|---------------------|---------------------|
| Cash flows from operating activities:                                                         |                |                                   |                                            |                     |                     |
| Net income (loss)                                                                             | \$ (3,117,811) | \$ 12,636,532                     | \$ 1,610,746                               | \$ (14,247,278)     | \$ (3,117,811)      |
| Adjustment to reconcile net income (loss) to cash flows from operating activities             | 5,379,288      | 21,551,341                        | 2,761,121                                  | –                   | 29,691,750          |
| Changes in operating assets and liabilities, net of operating assets and liabilities acquired | 25,922,898     | (21,716,059)                      | (2,871,653)                                | –                   | 1,335,186           |
| Net cash provided by operating activities                                                     | 28,184,375     | 12,471,814                        | 1,500,214                                  | (14,247,278)        | 27,909,125          |
| Cash flows used in investing activities                                                       | –              | (8,375,686)                       | (1,407,553)                                | –                   | (9,783,239)         |
| Cash flows used in financing activities                                                       | (28,184,375)   | –                                 | –                                          | 14,247,278          | (13,937,097)        |
| Net increase in cash and cash equivalents                                                     | –              | 4,096,128                         | 92,661                                     | –                   | 4,188,789           |
| Cash and cash equivalents, beginning of period                                                | –              | 13,521,138                        | 21,117                                     | –                   | 13,542,255          |
| Cash and cash equivalents, end of period                                                      | \$ –           | \$ 17,617,266                     | \$ 113,778                                 | \$ –                | \$ 17,731,044       |

**Otelco Inc.  
Condensed Consolidating Statement of Cash Flows  
For the Twelve Months Ended December 31, 2010**

|                                                                                               | <b>Parent</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-<br/>Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|-----------------------------------------------------------------------------------------------|---------------|-----------------------------------|--------------------------------------------|---------------------|---------------------|
| Cash flows from operating activities:                                                         |               |                                   |                                            |                     |                     |
| Net income                                                                                    | \$ 690,715    | \$ 16,261,802                     | \$ 1,189,588                               | \$ (17,451,390)     | \$ 690,715          |
| Adjustment to reconcile net income to cash flows from operating activities                    | 5,075,290     | 18,105,293                        | 3,206,795                                  | –                   | 26,387,378          |
| Changes in operating assets and liabilities, net of operating assets and liabilities acquired | 27,592,163    | (25,289,272)                      | (2,969,463)                                | –                   | (666,572)           |
| Net cash provided by operating activities                                                     | 33,358,168    | 9,077,823                         | 1,426,920                                  | (17,451,390)        | 26,411,521          |
| Cash flows used in investing activities                                                       | (218,301)     | (8,630,120)                       | (1,379,294)                                | –                   | (10,227,715)        |
| Cash flows used in financing activities                                                       | (33,139,867)  | 1                                 | –                                          | 17,451,390          | (15,688,476)        |
| Net increase in cash and cash equivalents                                                     | –             | 447,704                           | 47,626                                     | –                   | 495,330             |
| Cash and cash equivalents, beginning of period                                                | –             | 17,617,266                        | 113,778                                    | –                   | 17,731,044          |
| Cash and cash equivalents, end of period                                                      | \$ –          | \$ 18,064,970                     | \$ 161,404                                 | \$ –                | \$ 18,226,374       |

**OTELCO INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2011**

**Otelco Inc.  
Condensed Consolidating Statement of Cash Flows  
For the Twelve Months Ended December 31, 2011**

|                                                                                               | <u>Parent</u> | <u>Guarantor<br/>Subsidiaries</u> | <u>Non-<br/>Guarantor<br/>Subsidiaries</u> | <u>Eliminations</u> | <u>Consolidated</u>  |
|-----------------------------------------------------------------------------------------------|---------------|-----------------------------------|--------------------------------------------|---------------------|----------------------|
| Cash flows from operating activities:                                                         |               |                                   |                                            |                     |                      |
| Net income                                                                                    | \$ 2,197,418  | \$ 33,204,304                     | \$ 3,608                                   | \$ (33,207,912)     | \$ 2,197,418         |
| Adjustment to reconcile net income to cash flows from operating activities                    | (275,513)     | 19,762,543                        | 921,882                                    | –                   | 20,408,912           |
| Changes in operating assets and liabilities, net of operating assets and liabilities acquired | 24,266,264    | (27,119,787)                      | (222,670)                                  | –                   | (3,076,193)          |
| Net cash provided by operating activities                                                     | 26,188,169    | 25,847,060                        | 702,820                                    | (33,207,912)        | 19,530,137           |
| Cash flows used in investing activities                                                       | 218,301       | (15,075,741)                      | (702,769)                                  | –                   | (15,560,209)         |
| Cash flows used in financing activities                                                       | (26,406,470)  | (16,603,952)                      | –                                          | 33,207,912          | (9,802,510)          |
| Net increase (decrease) in cash and cash equivalents                                          | –             | (5,832,633)                       | 51                                         | –                   | (5,832,582)          |
| Cash and cash equivalents, beginning of period                                                | –             | 18,226,074                        | 300                                        | –                   | 18,226,374           |
| Cash and cash equivalents, end of period                                                      | <u>\$ –</u>   | <u>\$ 12,393,441</u>              | <u>\$ 351</u>                              | <u>\$ –</u>         | <u>\$ 12,393,792</u> |

**17. Revenue Concentrations**

Revenues for interstate access services are based on reimbursement of costs and an allowed rate of return. Revenues of this nature are received from the NECA in the form of monthly settlements. Such revenues amounted to 10.8%, 9.9%, and 10.1% of the Company's total revenues for the years ended December 31, 2009, 2010 and 2011, respectively.

In connection with the acquisition of the CR Companies, the Company has a contract through 2012 with Time Warner Cable ("TW") for the provision of wholesale network connections to TW's customers in Maine and New Hampshire. TW represented approximately 10.7% and 11.7% of the consolidated revenue for the years ended December 31, 2010 and 2011, respectively. Other unrelated telecommunications providers also pay the Company access revenue for terminating calls through us to TW's customers.

**18. Commitments and Contingencies**

From time to time, we may be involved in various claims, legal actions and regulatory proceedings incidental to and in the ordinary course of business, including administrative hearings of the APSC, MDTC, MPSC, MPUC, NHPUC, VPSB and WVPSC relating primarily to rate making. Currently, none of the legal proceedings are expected to have a material adverse effect on our business.

**19. Subsequent Events**

Effective as of January 1, 2012, each of the Company's subsidiaries that was a corporation converted into a limited liability company pursuant to applicable state law, except that MMH was merged with and into the Company effective as of January 1, 2012. As a result of the conversions and the merger, the Company currently expects to lower its income tax obligation in Missouri, as well as lower its cash income tax obligation in Alabama by utilizing net operating loss carryforwards and deferred tax assets.

## PART III

### Item 9. Exhibits and Financial Statement Schedules

#### (a)(1) Financial Statements

|                                                           | Page |
|-----------------------------------------------------------|------|
| Reports of Independent Registered Public Accounting Firm  | 2    |
| Consolidated Balance Sheets                               | 4    |
| Consolidated Statements of Operations                     | 5    |
| Consolidated Statements of Stockholders' Equity (Deficit) | 6    |
| Consolidated Statements of Cash Flows                     | 7    |
| Notes to Consolidated Financial Statements                | 8    |

#### (a)(2) Financial Statement Schedules

None

#### (a)(3) Exhibits

| Exhibit No. | Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
|-------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1         | Certificate of Incorporation of Otelco Inc. (filed as Exhibit 3.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2004 and incorporated herein by reference)                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
| 3.2         | Third Amended and Restated By-laws of Otelco Inc. (filed as Exhibit 3.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 2004 and incorporated herein by reference)                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
| 4.1         | Indenture, dated as of December 21, 2004, among Otelco Inc., each subsidiary listed on the signature pages thereto and Wells Fargo Bank, National Association, as trustee, relating to the 13% Senior Subordinated Notes due 2019 (filed as Exhibit 4.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2004 and incorporated herein by reference)                                                                                                                                                                                                                                                                                   |
| 4.2         | Supplemental Indenture, dated as of July 3, 2006, by and among Mid-Maine Communications, Inc., Mid-Maine TelPlus, the Existing Guarantors listed on the signature pages thereto, and Wells Fargo Bank, NA, as trustee (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed on July 5, 2006 and incorporated herein by reference)                                                                                                                                                                                                                                                                                                             |
| 4.3         | Second Supplemental Indenture, dated as of July 5, 2007, by and among Otelco Inc., certain of its subsidiaries and Wells Fargo Bank, National Association, as trustee (filed as Exhibit 4.1 to the Company's Current Report on Form 8-K filed on July 5, 2007 and incorporated herein by reference)                                                                                                                                                                                                                                                                                                                                                              |
| 4.4         | Third Supplemental Indenture, dated as of October 31, 2008, by and among War Holdings, Inc., Pine Tree Holdings, Inc., The Pine Tree Telegraph and Telephone Company, CRC Communications of Maine, Inc., Saco River Telegraph and Telephone Company, Communications Design Acquisition Corporation, Granby Holdings, Inc., The Granby Telegraph and Telephone Co. of Mass., Inc., the Existing Guarantors listed on the signature pages thereto, Otelco Inc. and Wells Fargo Bank, National Association, as trustee (filed as Exhibit 4.4 to the Company's Annual Report on Form 10-K for the year ended December 31, 2008 and incorporated herein by reference) |
| 4.5         | Fourth Supplemental Indenture, dated as of June 8, 2010, among Otelco Inc., certain of its subsidiaries and Wells Fargo Bank, National Association, as trustee (filed as Exhibit 4.1 to the Company's Current Report on Form 8-K filed on June 8, 2010 and incorporated herein by reference)                                                                                                                                                                                                                                                                                                                                                                     |
| 4.6         | Fifth Supplemental Indenture, dated as of October 1, 2011, among Otelco Inc., Mid-Missouri Telephone Company, the Existing Guarantors listed on the signature pages thereto and Wells Fargo Bank, National Association, as trustee (filed as Exhibit 4.1 to the Company's Current Report on Form 8-K filed on October 3, 2011 and incorporated herein by reference)                                                                                                                                                                                                                                                                                              |

| <b>Exhibit<br/>No.</b> | <b>Description</b>                                                                                                                                                                                                                                                                                                                                                                                                                  |
|------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 4.7                    | Sixth Supplemental Indenture, dated as of October 14, 2011, among Otelco Inc., Shoreham Telephone LLC, the Existing Guarantors listed on the signature pages thereto and Wells Fargo Bank, National Association, as trustee (filed as Exhibit 4.1 to the Company's Current Report on Form 8-K filed on October 14, 2011 and incorporated herein by reference)                                                                       |
| 4.8                    | Form of 13% Senior Subordinated Note due 2019 (included in Exhibit 4.1)                                                                                                                                                                                                                                                                                                                                                             |
| 4.9                    | Form of stock certificate for common stock (filed as Exhibit 4.4 to Amendment No. 4 to Registration Statement on Form S-1 (file no. 333-115341) and incorporated herein by reference)                                                                                                                                                                                                                                               |
| 4.10                   | Form of global Income Deposit Security (filed as Exhibit 4.5 to Amendment No. 4 to Registration Statement on Form S-1 (file no. 333-115341) and incorporated herein by reference)                                                                                                                                                                                                                                                   |
| 10.1                   | Amended and Restated Employment Agreement, dated as of March 11, 2009, between Otelco Inc. and Michael D. Weaver (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on March 12, 2009 and incorporated herein by reference)*                                                                                                                                                                                  |
| 10.2                   | Amended and Restated Employment Agreement, dated as of March 11, 2009, between Otelco Inc. and Curtis L. Garner, Jr. (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed on March 11, 2009 and incorporated herein by reference)*                                                                                                                                                                              |
| 10.4                   | Employment Agreement, dated as of August 24, 2006, between Otelco Inc. and Dennis Andrews (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on August 29, 2006 and incorporated herein by reference)*                                                                                                                                                                                                        |
| 10.5                   | Employment Agreement, dated as of November 15, 2006, between Otelco Inc. and Jerry C. Boles (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed on November 15, 2006 and incorporated herein by reference)*                                                                                                                                                                                                    |
| 10.6                   | Second Amended and Restated Credit Agreement, dated as of October 20, 2008, by and among Otelco Inc. and the other credit party signatories thereto and General Electric Capital Corporation, as a lender and as an agent for the lenders, and the other lenders from time to time party thereto (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on October 21, 2008 and incorporated herein by reference) |
| 10.7                   | Amendment, dated as of December 17, 2008, to the Employment Agreement, dated as of August 24, 2006, between Otelco Inc. and Dennis Andrews (filed as Exhibit 10.10 to the Company's Annual Report on Form 10-K filed on March 11, 2009 and incorporated herein by reference)*                                                                                                                                                       |
| 10.8                   | Amendment, dated as of December 17, 2008, to the Employment Agreement, dated as of November 15, 2006, between Otelco Inc. and Jerry C. Boles (filed as Exhibit 10.11 to the Company's Annual Report on Form 10-K for the year ended December 31, 2008 and incorporated herein by reference)*                                                                                                                                        |
| 10.9                   | Amended and Restated Employment Agreement, dated as of April 27, 2009, between Otelco Inc. and Robert Souza (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on April 28, 2009 and incorporated herein by reference)*                                                                                                                                                                                       |
| 10.10                  | Executive Long Term Incentive Plan approved May 12, 2009, effective January 1, 2009 (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on May 14, 2009 and incorporated herein by reference)*                                                                                                                                                                                                                 |
| 10.11                  | Amendment, dated as of March 5, 2010, to the Amended and Restated Employment Agreement, dated as of March 11, 2009, between Otelco Inc. and Michael D. Weaver (filed as Exhibit 10.13 to the Company's Annual Report on Form 10-K for the year ended December 31, 2009 and incorporated herein by reference)*                                                                                                                       |
| 10.12                  | Amendment, dated as of March 5, 2010, to the Amended and Restated Employment Agreement, dated as of March 11, 2009, between Otelco Inc. and Curtis L. Garner, Jr. (filed as Exhibit 10.14 to the Company's Annual Report on Form 10-K for the year ended December 31, 2009 and incorporated herein by reference)*                                                                                                                   |
| 10.13                  | Second Amendment, dated as of March 4, 2011, to the Employment Agreement, dated as of August 24, 2006, between Otelco Inc. and Dennis Andrews, as previously amended on December 17, 2008 (filed as Exhibit 10.14 to the Company's Annual Report on Form 10-K for the year ended December 31, 2010 and incorporated herein by reference)*                                                                                           |

| <b>Exhibit<br/>No.</b> | <b>Description</b>                                                                                                                                                                                                                                                                                                                                                                                                                              |
|------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.14                  | Second Amendment, dated as of March 4, 2011, to the Employment Agreement, dated as of November 15, 2006, between Otelco Inc. and Jerry C. Boles, as previously amended on December 17, 2008 (filed as Exhibit 10.15 to the Company's Annual Report on Form 10-K for the year ended December 31, 2010 and incorporated herein by reference)*                                                                                                     |
| 10.15                  | Amendment, dated as of March 4, 2011, to the Amended and Restated Employment Agreement, dated as of April 27, 2009, between Otelco Inc. and Robert Souza (filed as Exhibit 10.16 to the Company's Annual Report on Form 10-K for the year ended December 31, 2010 and incorporated herein by reference)*                                                                                                                                        |
| 10.16                  | Amended and Restated Employment Agreement, dated as of April 10, 2009, between Otelco Inc and Edwin D. Tisdale (filed as Exhibit 10.18 to the Company's Annual Report on Form 10-K for the year ended December 31, 2010 and incorporated herein by reference)*                                                                                                                                                                                  |
| 10.17                  | Amendment, dated as of March 4, 2011, to the Amended and Restated Employment Agreement, dated as of April 10, 2009, between Otelco Inc and Edwin D. Tisdale (filed as Exhibit 10.19 to the Company's Annual Report on Form 10-K for the year ended December 31, 2010 and incorporated herein by reference)*                                                                                                                                     |
| 10.18                  | Employment Agreement, dated as of August 14, 2011, between Otelco Inc. and Jon C. P. Henderson (filed as Exhibit 10.18 to the Company's Annual Report on Form 10-K for the year ended December 31, 2011 and incorporated herein by reference)                                                                                                                                                                                                   |
| 12.1                   | Computation of Ratio of Earnings to Fixed Charges (filed as Exhibit 12.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2011 and incorporated herein by reference)                                                                                                                                                                                                                                                 |
| 18.1                   | BDO USA, LLP Preferability Letter (filed as Exhibit 18.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2011 and incorporated herein by reference)                                                                                                                                                                                                                                                                 |
| 23.1                   | Consent of BDO USA, LLP, Independent Registered Public Accounting Firm (filed as Exhibit 23.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2011 and incorporated herein by reference)                                                                                                                                                                                                                            |
| 31.1                   | Certificate pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 of the Chief Executive Officer                                                                                                                                                                                                                                                                                                                  |
| 31.2                   | Certificate pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 of the Chief Financial Officer                                                                                                                                                                                                                                                                                                                  |
| 32.1                   | Certificate pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of the Chief Executive Officer                                                                                                                                                                                                                                                                                            |
| 32.2                   | Certificate pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of the Chief Financial Officer                                                                                                                                                                                                                                                                                            |
| 101                    | The following information from the Company's annual report on Form 10-K for the year ended December 31, 2011 formatted in Extensible Business Reporting Language (XBRL): (i) Consolidated Balance Sheets; (ii) Consolidated Statements of Operations; (iii) Consolidated Statements of Stockholders' Equity (Deficit); (iv) Consolidated Statements of Cash Flows; and (v) Notes to Consolidated Financial Statements, tagged as blocks of text |

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\* Management contract or compensatory plan or arrangement

## **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.

### **OTELCO INC.**

By: /s/ Curtis L. Garner, Jr.

Curtis L. Garner, Jr.

Chief Financial Officer

Date: November 26, 2012

**CERTIFICATION BY CHIEF EXECUTIVE OFFICER**

I, Michael D. Weaver, certify that:

1. I have reviewed this annual report on Form 10-K of Otelco 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(s) 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 control 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(s) 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: November 26, 2012

/s/ Michael D. Weaver

Michael D. Weaver

*President & Chief Executive Officer*

**CERTIFICATION BY CHIEF FINANCIAL OFFICER**

I, Curtis L. Garner, Jr., certify that:

1. I have reviewed this annual report on Form 10-K of Otelco 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(s) 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 control 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(s) 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: November 26, 2012

/s/ Curtis L. Garner, Jr.

Curtis L. Garner, Jr.

Chief Financial Officer

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the annual report of Otelco Inc. (the "Company") on Form 10-K for the period ended December 31, 2011, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Michael D. Weaver, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) 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 the Company.

/s/ Michael D. Weaver

Michael D. Weaver  
President & Chief Executive Officer  
November 26, 2012

*A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.*

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the annual report of Otelco Inc. (the "Company") on Form 10-K for the period ended December 31, 2011, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Curtis L. Garner, Jr., Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) 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 the Company.

/s/ Curtis L. Garner, Jr.

Curtis L. Garner, Jr.  
Chief Financial Officer  
November 26, 2012

*A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.*