



Grant Thornton

## Consolidated Financial Statements

*As of June 30, 2010 and 2009 and for the three years ended June 30, 2010*

### Zayo Group, LLC

Delaware  
(State of Incorporation)

26-2012549  
(I.R.S. Employer  
Identification No.)

400 Centennial Parkway, Suite 200, Louisville, CO  
(Address of principal executive offices)

80027  
(Zip Code)

(303) 381-4683  
(Company's telephone number, including area code)

---

---

**ZAYO GROUP, LLC AND SUBSIDIARIES**  
**CONSOLIDATED FINANCIAL STATEMENTS**

	<u>Page</u>
Report of Independent Certified Public Accountants	1
Consolidated Balance Sheets as of June 30, 2010 and 2009	2
Consolidated Statements of Operations for the years ended June 30, 2010, 2009 and 2008	3
Consolidated Statements of Member's Equity for the years ended June 30, 2010, 2009 and 2008	4
Consolidated Statements of Cash Flows for the years ended June 30, 2010, 2009 and 2008	5
Notes to the Consolidated Financial Statements	7

---



Grant Thornton

## Report of Independent Certified Public Accountants

Audit • Tax • Advisory

Grant Thornton LLP  
707 17th Street, Suite 3200  
Denver, CO 80202-3336

T 303.813.4000  
F 303.839.5711  
[www.GrantThornton.com](http://www.GrantThornton.com)

To the Members of  
Zayo Group, LLC and Subsidiaries

We have audited the accompanying consolidated balance sheets of Zayo Group, LLC (a Delaware corporation) and subsidiaries (collectively, the "Company") as of June 30, 2010 and 2009, and the related consolidated statements of operations, member's equity, and cash flows for each of the three years in the period ended June 30, 2010. 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 auditing standards generally accepted in the United States of America established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also 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 Zayo Group, LLC and subsidiaries as of June 30, 2010 and 2009, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2010 in conformity with accounting principles generally accepted in the United States of America.

*Grant Thornton LLP*

Denver, Colorado  
September 10, 2010

**ZAYO GROUP, LLC AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**  
(in thousands)

	June 30,	
	2010	2009
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 89,161	\$ 38,781
Restricted cash, current	809	-
Trade receivables, net of allowance of \$1,093 and \$1,151 as of June 30, 2010 and 2009, respectively	12,721	4,755
Due from related parties	871	30
Other receivables	348	158
Prepaid expenses	5,144	2,626
Deferred income taxes	4,060	-
Debt issuance costs, net	-	1,176
Assets of discontinued operations, current	-	5,810
<b>Total current assets</b>	<b>113,114</b>	<b>53,336</b>
Property and equipment, net of accumulated depreciation of \$57,425 and \$28,379 as of June 30, 2010 and 2009, respectively	301,911	216,583
Intangible assets, net of accumulated amortization of \$28,222 and \$16,159 as of June 30, 2010 and 2009, respectively	59,851	30,242
Goodwill	68,751	68,751
Deferred income taxes	7,050	-
Restricted cash, non-current	-	245
Debt issuance costs, net	9,560	3,536
Other assets	4,144	3,072
Assets of discontinued operations, non-current	-	46,397
<b>Total assets</b>	<b>\$ 564,381</b>	<b>\$ 422,162</b>
<b>Liabilities and member's equity</b>		
<b>Current liabilities</b>		
Accounts payable	\$ 10,502	\$ 6,279
Accrued liabilities	18,349	10,060
Accrued interest	7,794	1,579
Current portion of capital lease obligations	1,673	1,959
Current portion long-term debt	-	1,350
Deferred revenue, current portion	8,146	2,602
Liabilities of discontinued operations, current	-	2,602
<b>Total current liabilities</b>	<b>46,464</b>	<b>26,431</b>
Capital lease obligations, net of current portion	11,033	13,204
Long-term debt, net of current portion	247,080	134,975
Deferred revenue, net of current portion	22,648	18,724
Stock-based compensation liability	21,623	4,590
Deferred income taxes	-	6,470
Other long term liabilities	2,397	2,382
Liabilities of discontinued operations, non-current	-	2,367
<b>Total liabilities</b>	<b>351,245</b>	<b>209,143</b>
<b>Member's equity</b>		
Member's interest	217,129	217,473
Accumulated deficit	(3,993)	(4,454)
<b>Total member's equity</b>	<b>213,136</b>	<b>213,019</b>
<b>Total liabilities and member's equity</b>	<b>\$ 564,381</b>	<b>\$ 422,162</b>

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

**ZAYO GROUP, LLC AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in thousands)

	Years ended June 30,		
	2010	2009	2008
Revenue	\$ 224,045	\$ 150,804	\$ 77,569
Operating costs and expenses			
Operating costs, excluding depreciation and amortization	73,537	48,797	24,328
Selling, general and administrative expenses	73,771	62,419	37,404
Stock-based compensation	18,228	6,418	3,381
Depreciation and amortization	41,184	29,567	11,922
Total operating costs and expenses	<u>206,720</u>	<u>147,201</u>	<u>77,035</u>
Operating income	<u>17,325</u>	<u>3,603</u>	<u>534</u>
Other income (expense)			
Interest expense	(18,692)	(15,248)	(6,287)
Other income	10,607	249	351
Loss on extinguishment of debt	(5,881)	-	-
Total other expense, net	<u>(13,966)</u>	<u>(14,999)</u>	<u>(5,936)</u>
Earnings/(loss) from continuing operations before income taxes	<u>3,359</u>	<u>(11,396)</u>	<u>(5,402)</u>
Provision/(benefit) for income taxes	<u>6,293</u>	<u>(2,106)</u>	<u>(699)</u>
Loss from continuing operations	<u>(2,934)</u>	<u>(9,290)</u>	<u>(4,703)</u>
Earnings from discontinued operations, net of income taxes	<u>3,395</u>	<u>7,043</u>	<u>2,750</u>
Net earnings/(loss)	<u>\$ 461</u>	<u>\$ (2,247)</u>	<u>\$ (1,953)</u>

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

**ZAYO GROUP, LLC AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF MEMBER'S EQUITY**  
(in thousands)

	Member's interest	Accumulated deficit	Total Member's equity
<b>Balance at July 1, 2007</b>	<b>\$ 6,797</b>	<b>\$ (254)</b>	<b>\$ 6,543</b>
Capital contributed (cash)	166,450	-	166,450
Property contributed	3,250	-	3,250
Stock-based compensation	3,381	-	3,381
Net loss	-	(1,953)	(1,953)
<b>Balance at June 30, 2008</b>	<b>179,878</b>	<b>(2,207)</b>	<b>177,671</b>
Capital contributed (cash)	35,546	-	35,546
Stock-based compensation	2,049	-	2,049
Net loss	-	(2,247)	(2,247)
<b>Balance at June 30, 2009</b>	<b>217,473</b>	<b>(4,454)</b>	<b>213,019</b>
Capital contributed (cash)	39,800	-	39,800
Capital contributions (non-cash)	1,200	-	1,200
Stock-based compensation	1,195	-	1,195
Spin-off of Onvoy Voice Services	(42,539)	-	(42,539)
Net earnings	-	461	461
<b>Balance at June 30, 2010</b>	<b>\$ 217,129</b>	<b>\$ (3,993)</b>	<b>\$ 213,136</b>

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

**ZAYO GROUP, LLC AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)

	June 30,		
	2010	2009	2008
<b>Cash flows from operating activities:</b>			
Net earnings/(loss)	\$ 461	\$ (2,247)	\$ (1,953)
Earnings from discontinued operations	3,395	7,043	2,750
Loss from continuing operations	(2,934)	(9,290)	(4,703)
<i>Adjustments to reconcile net earnings/(loss) from continuing operations to net cash provided by operating activities</i>			
Depreciation and amortization	41,184	29,567	11,922
Loss on extinguishment of debt	5,881	-	-
Loss on disposal of assets	-	66	-
Bad debt expense	278	756	112
Amortization of deferred financing costs	1,624	1,114	500
Stock-based compensation	18,228	6,418	3,381
Gain on bargain purchase	(9,081)	-	-
Amortization of deferred revenue	(7,858)	(3,843)	(4,914)
Unrealized loss on interest rate swaps	744	3,143	-
Deferred income taxes	5,421	(1,906)	(600)
<b>Changes in operating assets and liabilities, net of acquisitions</b>			
Customer prepayments	7,988	7,462	1,317
Interest rate swap	(2,463)	(859)	-
Receivables	727	2,126	6,740
Prepaid expenses	(288)	(775)	(189)
Restricted cash	(564)	-	-
Other assets	(995)	(1,973)	(179)
Accounts payable and accrued liabilities	5,538	(3,283)	(1,617)
Payables to related parties	(2,030)	7	(37)
Other liabilities	15	(322)	781
<b>Net cash provided by operating activities</b>	<b>61,415</b>	<b>28,408</b>	<b>12,484</b>
<b>Cash flows from investing activities:</b>			
Purchases of property and equipment	(59,779)	(62,107)	(22,729)
Proceeds from disposition of property and equipment	-	-	1,189
Acquisition of FiberNet Telecom Group, Inc., net of cash acquired	(96,571)	-	-
Acquisition of Columbia Fiber Solutions LLC, net of cash acquired	-	(12,091)	-
Acquisition of Onvoy, Inc. net of cash acquired	-	-	(34,327)
Acquisition of Memphis Network, LLC, net of cash acquired	-	-	(9,173)
Acquisition of PPL Telcom, LLC, net of cash acquired	-	-	(41,318)
Acquisition of Indiana Fiber Works, LLC, net of cash acquired	-	-	(22,601)
Acquisition of Vopicepipe Communications, Inc., net of cash acquired	-	(15)	465
Acquisition of Citynet Fiber Network, LLC, net of cash acquired	-	(35)	(99,168)
Acquisition of Northwest Telephone, Inc., net of cash acquired	-	618	(5,799)
Acquisition of NTI CA LLC, net of cash acquired	-	(15)	-
<b>Net cash used in investing activities</b>	<b>(156,350)</b>	<b>(73,645)</b>	<b>(233,461)</b>

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

Continued

**ZAYO GROUP, LLC AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)

	June 30,		
	2010	2009	2008
<b>Cash flows from financing activities:</b>			
Equity contributions	39,800	35,546	166,450
Proceeds from borrowings	276,948	47,000	100,002
Principal repayments on debt obligations	(166,193)	(10,677)	-
Principal repayments on capital lease obligations	(2,192)	(2,267)	(877)
Restricted cash	-	-	(230)
Deferred financing costs	(12,353)	(1,681)	(4,645)
<b>Net cash provided by financing activities</b>	<b>136,010</b>	<b>67,921</b>	<b>260,700</b>
<b>Cash flows from discontinued operations:</b>			
Operating activities	10,144	11,932	1,149
Investing activities	(781)	(1,033)	(36,782)
Financing activities	-	-	-
<b>Net cash provided/(used) by discontinued operations</b>	<b>9,363</b>	<b>(10,899)</b>	<b>(35,633)</b>
Net increase in cash and cash equivalents	50,438	33,583	4,090
Cash and cash equivalents, beginning of year	38,781	4,554	1,552
(Increase)/decrease in cash and cash equivalents of discontinued operations	(58)	644	(1,088)
<b>Cash and cash equivalents, end of year</b>	<b>\$ 89,161</b>	<b>\$ 38,781</b>	<b>\$ 4,554</b>
<b>Supplemental disclosure of cash flows information:</b>			
Cash paid for interest	\$ 6,215	\$ 10,845	\$ 5,346
Cash paid for income taxes	257	326	5

**Supplemental disclosure of non-cash, investing and financing activities:**

The Company had approximately \$7,032, \$3,665 and \$5,012 of accrued construction liabilities relating to its various development projects as of June 30, 2010, 2009 and 2008, respectively. The Company has adjusted the total purchases of property and equipment by these amounts to reflect the cash amounts paid in the respective periods. In addition, the Company entered into capital leases of approximately \$324, \$1,650 and \$1,180 during the year ended June 30, 2010, 2009 and 2008, respectively. The Company has offset the total purchases of property and equipment by these amounts.

Subsequent to the spin-off of Onvoy Voice Services ("Onvoy") (See Note 4 – *Spin-off of Onvoy Voice Services Segment*) the Company utilized \$3,001 of net operating losses ("NOL") of Onvoy which is now a subsidiary of the Company's parent – Communications Infrastructure Investments, LLC ("CII"). The Company has accounted for the benefit realized from the usage of the NOLs of \$1,200 as a non-cash equity contribution from its Parent.

During fiscal year 2008 CII contributed to the Company through Holdings property from Voicepipe Communications, Inc. valued at \$3,250.

Refer to Note 3 – *Acquisitions*, of the Company's consolidated financial statements for details of the Company's recent acquisitions and Note 4 – *Spin-off of Onvoy Voice Services Segment*, for details of the Company's discontinued operations.

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



**ZAYO GROUP, LLC AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**(1) ORGANIZATION AND DESCRIPTION OF BUSINESS**

Zayo Group, LLC, a Delaware Limited Liability Company ("LLC"), formerly CII Holdeo, Inc., and, prior to that, Zayo Bandwidth, Inc., was formed on May 4, 2007, and is the operating parent company of a number of subsidiaries engaged in telecommunication services. Zayo Group, LLC and its subsidiaries are collectively referred to as "Zayo Group" or the "Company". Headquartered in Louisville, Colorado, the Company operates an integrated metropolitan and nationwide fiber optic infrastructure to offer:

- Converged and data services.
- Private line services consisting of local and intercity dedicated facilities.
- Colocation services and intra building transport services.

Zayo Group, LLC is wholly owned by Zayo Group Holdings, Inc., ("Holdings") which in turn is wholly owned by Communications Infrastructure Investments, LLC ("CII"). Zayo Group Holdings, Inc. has no operations and was formed to pledge its equity interest in Zayo Group, LLC, to the Company's lenders.

**(2) BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES**

**a. Basis of Presentation**

The accompanying consolidated financial statements include all the accounts of the Company and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. Certain prior year amounts have been reclassified to conform to the current year presentation. The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP").

**b. Spin-off of operating segment**

On March 12, 2010, the Company completed a spin-off of one of its operating segments, Onvoy Voice Services ("Onvoy"). The Company distributed all assets and liabilities of Onvoy to Holdings. Consistent with the discontinued operations reporting provisions of the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 280-20, *Discontinued Operations*, the Company determined that it had discontinued all significant cash flows and continuing involvement with respect to Onvoy's operations and therefore consider these to be discontinued operations. Therefore, for the periods presented the results of the operations of Onvoy have been aggregated and are presented in a single caption entitled "Earnings from discontinued operations, net of income taxes" on the accompanying consolidated statements of operations. The Company has not allocated any general corporate overhead to amounts presented in discontinued operations, nor has it elected to allocate interest costs. Assets and liabilities associated with Onvoy have been segregated from continuing operations and presented as assets and liabilities of discontinued operations on the accompanying June 30, 2009 consolidated balance sheet. Also see Note 4 – *Spin-off of Onvoy Voice Service Segment* for further information.

Unless otherwise noted, dollar amounts and disclosures throughout the Company's Notes to the Consolidated Financial Statements relate to the Company's continuing operations and are presented in thousands of dollars.

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

#### c. Use of Estimates

The preparation of the Company's consolidated financial statements in conformity with accounting principles generally accepted in the United States requires the Company's management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting period. Significant estimates are used when establishing allowances for doubtful accounts, reserves for disputed line cost billings, determining useful lives for depreciation and amortization, assessing the need for impairment charges, allocating purchase price among the fair values of assets acquired and liabilities assumed, accounting for income taxes, stock-based compensation liability and various other items. The Company evaluates these estimates and judgments on an ongoing basis and bases its estimates on historical experience, current conditions and various other assumptions that are believed to be reasonable under the circumstances. The results of these estimates form the basis for making judgments about the carrying values of assets and liabilities as well as identifying and assessing the accounting treatment with respect to commitments and contingencies. Actual results may differ from these estimates under different assumptions or conditions.

#### d. Cash and Cash Equivalents and Restricted Cash

The Company considers all highly liquid investments with original maturities of three months or less to be cash and cash equivalents. Cash equivalents are stated at cost, which approximates fair value. Restricted cash consists of cash balances held by various financial institutions as collateral for letters of credit and surety bonds. These balances are reclassified to cash and cash equivalents when the underlying obligation is satisfied, or in accordance with the governing agreement. Restricted cash balances expected to become unrestricted during the next twelve months are recorded as current assets.

#### e. Trade Receivables

Trade receivables are recorded at the invoiced amount and do not bear interest. Amounts collected on trade receivables are included in net cash provided by operating activities in the consolidated statements of cash flows. The Company maintains an allowance for doubtful accounts for estimated losses inherent in its trade receivable portfolio. In establishing the required allowance, management considers historical losses adjusted to take into account current market conditions and the customer's financial condition, the amount of receivables in dispute, and the age of receivables and current payment patterns. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

#### f. Property and Equipment

The Company's property and equipment includes assets in service and under construction or development.

Property and equipment is recorded at historical cost or acquisition fair value (net of reductions for the allocation of gain on bargain purchase for acquisitions recorded prior to July 1, 2009). Costs associated directly with network construction, service installations and development of business support systems including employee related costs, are capitalized. Depreciation is calculated on a straight-line basis over the assets' estimated useful lives from the date placed into service, which are determined based on historical usage with consideration given to technological changes, trends in the industry and other economic factors

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

that could impact the network architecture and asset utilization. Assets held for sale are stated at the lower of the carrying value or fair market value less costs to sell and are not depreciated.

Equipment acquired under capital leases are recorded at the lower of the fair value of the asset or the net present value of the minimum lease payments at the inception of the lease (net of reductions for the allocation of gain on bargain purchase for acquisitions recorded prior to July 1, 2009). Amortization of equipment held under capital leases is included in depreciation and amortization expense, and is calculated on a straight-line basis over the estimated useful lives of the assets, or the related lease term, whichever is shorter.

In accordance with ASC 360-10-35 (formerly FASB Statement No 144), the Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of its assets may not be recoverable. An impairment loss is recognized when the assets' carrying value exceeds both the assets' estimated undiscounted future cash flows and the assets' estimated fair value. Measurement of the impairment loss is then based on the estimated fair value of the assets. Considerable judgment is required to project such future cash flows and, if required, to estimate the fair value of the long-lived assets and the amount of the impairment.

#### g. Goodwill and Purchased Intangibles

Goodwill represents the excess of the purchase price over the fair value of the net identifiable assets acquired in a business combination. Goodwill is reviewed for impairment at least annually in April and when a triggering event occurs between impairment test dates, in accordance with the provisions of ASC 350 (formerly FASB Statement No. 142), *Goodwill and Other Intangible Assets*. The goodwill impairment test is a two-step test. Under the first step, the fair value of the reporting unit is compared with its carrying value (including goodwill). If the fair value of the reporting unit is less than its carrying value, an indication of goodwill impairment exists for the reporting unit and the enterprise must perform step two of the impairment test (measurement). Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation, in accordance with ASC 805-10 (Formerly FASB Statement No. 141), *Business Combinations*. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is determined using a discounted cash flow analysis. If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed.

Intangible assets with estimable useful lives are amortized over their respective estimated useful lives and reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. No impairment charge was recorded during the years ended June 30, 2010, 2009 or 2008.

#### h. Derivative Financial Instruments

The Company utilizes interest rate swaps to mitigate its exposure to interest rate risk. Derivative instruments are recorded in the balance sheet as either assets or liabilities, measured at fair value. Changes in fair value are recognized in earnings. The Company entered into interest rate swaps to convert a portion of its floating rate debt to fixed rate debt and did not elect to apply hedge accounting. The interest rate differentials to be paid or received under such derivatives and the changes in the fair value of the instruments are recognized and recorded as adjustments to interest expense. The principle objectives of the

# ZAYO GROUP, LLC AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

derivative instruments are to minimize the interest rate risks associated with financing activities. The Company does not use financial instruments for trading purposes. The Company has open interest rate swap contracts which were entered into in connection with obtaining the Company's term loans. The term loans were paid in full from the proceeds of the Company's high yield bond offering in March 2010. The interest rate swaps associated with the term loans were not cancelled however the contracts terminate in September 2010. See Note 8 – *Long-term Debt*, for further discussion of the Company's debt obligations and Note 12 – *Fair Market Measurements*, for a discussion of the fair market value of the interest rate swaps.

### i. Revenue Recognition

The Company's revenue was generated from the following products and services:

	Year ended June 30,					
	2010		2009		2008	
	Amounts	Percentage (1)	Amounts	Percentage (1)	Amounts	Percentage (1)
Converged and data services	\$33,245	14.8%	\$26,043	17.3%	\$12,946	16.7%
Private line services	169,736	75.8	124,761	82.7	64,623	83.3
Colocation services (2)	21,064	9.4	N/A (2)	N/A (2)	N/A (2)	N/A (2)
	<u>\$224,045</u>	<u>100%</u>	<u>\$150,804</u>	<u>100%</u>	<u>\$77,569</u>	<u>100%</u>

(1) Represents percentage of revenue

(2) Colocation services business was acquired in September 2009.

In accordance with ASC 605-10 *Revenue Recognition*, the Company recognizes revenues derived from leasing fiber optic telecommunications infrastructure and the provision of telecommunications and colocation services when the service has been provided and when there is persuasive evidence of an arrangement, the fee is fixed or determinable and collection of the receivable is reasonably assured. Taxes collected from customers and remitted to governmental authority are reported on a net basis and are excluded from revenue.

Most revenue is billed in advance on a fixed rate basis. The remainder of revenue is billed in arrears on a transactional basis determined by customer usage. Fees billed in connection with customer installations and other up-front charges are deferred and recognized as revenue ratably over the contract life.

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

#### j. Operating Costs and Accrued Liabilities

The Company leases certain network facilities, primarily circuits, from other local exchange carriers to augment its owned infrastructure for which it is generally billed a fixed monthly fee. The Company also uses the facilities of other carriers for which it is billed on a usage basis.

The Company recognizes the cost of these facilities or services when it is incurred in accordance with contractual requirements. The Company disputes incorrect billings. The most prevalent types of disputes include disputes for circuits that are not disconnected on a timely basis and usage bills with incorrect or inadequate call detail records. Depending on the type and complexity of the issues involved, it may take several quarters to resolve disputes.

In determining the amount of such operating expenses and related accrued liabilities to reflect in its consolidated financial statements, the Company considers the adequacy of documentation of disconnect notices, compliance with prevailing contractual requirements for submitting such disconnect notices and disputes to the provider of the facilities, and compliance with its interconnection agreements with these carriers. Significant judgment is required in estimating the ultimate outcome of the dispute resolution process, as well as any other amounts that may be incurred to conclude the negotiations or settle any litigation.

#### k. Stock-based Compensation

The Company accounts for stock-based compensation in accordance ASC 718 (formerly FASB Statement No. 123R), *Compensation – Stock Compensation*. The common units granted in the Company's ultimate Parent company, CII, are considered stock-based compensation with terms that require the awards to be classified as liabilities. As such, the Company accounts for these awards as a liability and re-measures the liability at each reporting date. These awards vest over a period of four years or fully vest subsequent to a liquidation event.

#### l. Government Grants

The Company receives grant moneys from the Federal Recovery Act Broadband Opportunity Program. The Company accounts for grant moneys received as a deduction from the cost of the asset in arriving at its book value. The grant is thus recognized in earnings over the useful life of a depreciable asset by way of a reduced depreciation charge.

#### m. Income Taxes

The Company accounts for income taxes in accordance with ASC 740 (formerly SFAS No. 109 *Accounting for Income Taxes*). Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in earnings in the period that includes the enactment date.

The Company records interest related to unrecognized tax benefits and penalties in income tax expense.

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

#### n. Fair Value of Financial Instruments

The Company adopted ASC 820-10 (formerly FASB No. 157, *Fair Value Measurements*), for its financial assets and liabilities effective June 30, 2009. This pronouncement defines fair value, establishes a framework for measuring fair value, and requires expanded disclosures about fair value measurements. ASC 820-10 emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and defines fair value as the price that would be received to sell an asset or transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820-10 discusses valuation techniques, such as the market approach (comparable market prices), the income approach (present value of future income or cash flow) and the cost approach (cost to replace the service capacity of an asset or replacement cost), which are each based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions.

##### *Fair Value Hierarchy*

ASC 820-10 establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. GAAP establishes three levels of inputs that may be used to measure fair value:

##### *Level 1*

Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Company has the ability to access.

##### *Level 2*

Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability;
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

##### *Level 3*

Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

ASC 820-10 defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required to be recorded at fair value, the Company

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

considers the principal or most advantageous market in which it would transact and considers assumptions that market participants would use when pricing the asset or liability, such as inherent risk, transfer restrictions, and risk of nonperformance.

The Company's financial instruments consist of cash and cash equivalents, restricted cash, accounts receivable, accounts payable, interest rate swaps and long-term debt. The Company records its stock-based compensation liability at fair value

#### **o. Concentration of Credit Risk**

Financial instruments which potentially subject the Company to concentration of credit risk consist principally of temporary cash investments and accounts receivable. The Company does not enter into financial instruments for trading or speculative purposes. The Company's cash and cash equivalents are held in commercial bank accounts in the United States of America. Account balances generally exceed federally insured limits, however the Company limits its cash investments to high quality financial institutions in order to minimize its credit risk. The Company's trade receivables, which are unsecured, are geographically dispersed. During fiscal year 2010 the Company had one customer which represented 12 percent of the Company's total revenue. No customers represented greater than 10 percent of total revenue during 2009 and 2008. As of June 30, 2010 and 2009 the Company did not have a single customer with a trade receivable balance exceeding 10 percent of the Company's consolidated net trade receivable balance.

#### **p. Recently Issued Accounting Standards**

In June 2009, the FASB issued ASC 105 (formerly FASB Statement No. 168), *Generally Accepted Accounting Principles*, establishing the *FASB Accounting Standards Codification* (ASC) as the source of authoritative generally accepted accounting principles (GAAP) to be applied by nongovernmental entities. ASC 105 is effective for annual and interim periods ending after September 15, 2009, and the Company has updated its references to GAAP in this report in accordance with the provisions of this pronouncement. The implementation of ASC 105 did not have an effect on the Company's financial position or results of operations.

In February 2010, the FASB issued Accounting Standards Update ("ASU") 2010-09, *Subsequent Events*, which updated ASC 855, *Subsequent Events* ("ASC 855"). FASB ASU 2010-09 clarifies the date through which the Company is required to evaluate subsequent events. Companies are required to evaluate subsequent events through the date that the financial statements are available to be issued. The Company has adopted this standard effective June 30, 2010.

In January 2010, the FASB issued ASU 2010-06, *Improving Disclosures about Fair Value Measurements*. ASU 2010-06 requires a reporting entity to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 and describe the reasons for the transfers. A reporting entity should separately disclose information about purchases, sales, issuances and settlements for Level 3 reconciliation disclosures. The new disclosures and clarifications of existing disclosures are effective for financial statements issued interim or annual financial periods ending after December 15, 2009, with the exception for the reconciliation disclosures for Level 3, which are effective for financial statements issued with interim or annual financial periods ending after December 15, 2010. The adoption of the new accounting standards update did not have an impact on the Company's consolidated results of operations, financial condition or financial disclosures.

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

In June 2009, the FASB issued ASU 2009-17, *Consolidations* (ASC Topic 860), a new accounting standard that changes the consolidation rules as they relate to variable interest entities. The new standard makes significant changes to the model for determining who should consolidate a variable interest entity, and also addresses how often this assessment should be performed. The standard becomes effective for Zayo on July 1, 2010. The adoption of the new accounting standards update is not expected to have a material impact on the Company's consolidated results of operations, financial condition or financial disclosures.

In October 2009, the FASB issued Accounting Standards Update Number 2009-13, *Revenue Recognition (ASC 605) Multiple-Deliverable Revenue Arrangements a consensus of the FASB Emerging Issues Task Force*. This ASU establishes a new selling price hierarchy to use when allocating the sales price of a multiple element arrangement between delivered and undelivered elements. This ASU is generally expected to result in revenue recognition for more delivered elements than under current rules. The Company is required to adopt this ASU prospectively for new or materially modified agreements beginning January 1, 2011. The Company is evaluating the effect of this ASU, but does not expect its adoption to have a material effect on its consolidated financial statements.

#### (3) ACQUISITIONS

The Company adopted the revised guidance for accounting for business combinations in accordance with ASC 805-10. These revisions apply to business combinations for acquisitions consummated on or after July 1, 2009. These revisions had several significant changes to existing accounting practices for business combinations. Most notably, (i) acquisition-related transaction costs, such as legal and professional fees, are expensed rather than accounted for as part of the acquisition cost; (ii) acquired in-process research and development is capitalized rather than expensed at the acquisition date; (iii) contingent consideration is recorded at fair value at the acquisition date rather than the points in time that payment becomes probable; and (iv) bargain purchases are recognized by the acquirer in earnings rather than as a reduction to certain assets acquired. The standard defines a bargain purchase as a business combination in which the total acquisition-date fair value of the identifiable net assets acquired exceeds the fair value of the consideration transferred plus any non-controlling interest in the acquiree.

The adoption of this guidance has and will continue to impact the results of operations and financial position of the Company to the extent that the Company makes acquisitions.

During the three year period ended June 30, 2010, the Company has consummated the acquisition of ten entities. The consummation of the acquisitions was executed as part of the Company's business strategy of expanding through acquisitions. The acquisition of these companies will allow the Company to increase the scale at which it operates, which in turn affords the Company the ability to increase its operating leverage, extend its network reach, and broaden its customer base.

The accompanying consolidated financial statements include the operations and financial position of the acquired entities from their respective acquisition dates.



# ZAYO GROUP, LLC AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Acquisition during fiscal year 2010

#### *Fibernet Networks Telecom Group, Inc. ("Fibernet")*

On September 9, 2009 the Company acquired all of the outstanding equity interest in Fibernet. Fibernet is a communications service provider focused on providing complex interconnection services enabling the exchange of voice, video and data traffic between global networks. Fibernet owns and operates integrated colocation facilities and diverse transport routes in the two gateway markets of New York/New Jersey, Los Angeles, Chicago, Miami and San Francisco. FiberNet's network infrastructure and facilities are designed to provide comprehensive broadband interconnectivity for the world's largest network operators, including leading domestic and international telecommunications carriers, service providers and enterprises.

The following table presents the allocation of the purchase price to the assets acquired and liabilities assumed, and based on their estimated fair values. Acquisition-related costs associated with the Fibernet acquisition of \$698 have been charged to selling, general and administrative expenses during the year ended June 30, 2010.

	Fibernet
Acquisition date	September 9, 2009
Current assets	\$ 16,824
Property and equipment	50,734
Intangibles	43,900
Deferred income taxes	19,659
Other assets	838
Total assets acquired	131,955
Current liabilities	11,534
Deferred revenue	7,257
Total liabilities assumed	18,791
Net assets	113,164
Excess of net assets over purchase consideration (bargain purchase)	9,081
Purchase consideration	104,083
Cash acquired	7,512
Net cash paid	\$ 96,571

During the year ended June 30, 2010, the Company recognized a gain on bargain purchase associated with the Fibernet acquisition. The gain of \$9,081 is included in the other income caption on the consolidated statements of operations. The bargain purchase is primarily the result of recording of deferred income tax assets for the Net Operating Loss carryforwards ("NOLs") of Fibernet, in view of the Company's evaluation that these deferred income tax assets will more likely than not be realized. Upon the determination that the Company was going to recognize a gain related to the bargain purchase, the Company reassessed its valuation assumptions utilized as part of the acquisition accounting. No adjustments to the acquisition accounting valuations were identified as a result of management's reassessment.

# ZAYO GROUP, LLC AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Acquisition during fiscal year 2009

#### *Columbia Fiber Solutions ("CFS") and Northwest Telephone, Inc. CA, LLC ("NTI CA")*

On September 30, 2008 the Company acquired all of the outstanding equity interests in CFS. CFS is a provider of leased dark fiber services and fiber-based Ethernet services over a transparent LAN (TLS) infrastructure in the Inland Northwest. On May 26, 2009, the Company acquired all of the outstanding equity interest in NTI CA. NTI CA is a local exchange carrier and inter exchange carrier which provides carrier access services in rural and underserved markets in California.

The following table presents the allocation, of the purchase price to the assets acquired and liabilities assumed, based on their estimated fair values:

	CFS	NTI CA
Acquisition date	September 30, 2008	May 26, 2009
Current assets	\$ 461	\$ 1
Property and equipment	4,772	92
Intangibles	3,412	-
Goodwill	4,170	-
Other assets	-	101
Total assets acquired	12,815	194
Current liabilities	500	179
Deferred revenue	154	-
Total liabilities assumed	654	179
Purchase consideration	12,161	15
Less cash acquired	70	-
Net cash paid	\$ 12,091	\$ 15

The full amount of the goodwill associated with the CFS acquisition was allocated to the Zayo Bandwidth business segment.

# ZAYO GROUP, LLC AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Acquisitions during fiscal year 2008

	Memphis	PPL	Indiana	Onvoy	Voicepipe	Citynet	Northwest
Acquisition date	July 31, 2007	August 24, 2007	September 28, 2007	November 7, 2007	November 7, 2007	February 15, 2008	May 30, 2008
Current assets	\$ 754	\$ 2,810	\$ 1,659	\$ 16,175	\$ 810	\$ 4,365	\$ 1,224
Property and equipment	10,771	54,631	25,646	41,910	180	32,185	4,353
Intangibles	1,581	6,307	-	26,912	1,085	16,947	786
Goodwill	-	-	5,606	3,032	2,184	52,967	2,957
Deferred income taxes	-	56	4,534	22,448	27	-	28
Other assets	506	100	13	68	-	301	113
Total assets acquired	13,612	63,913	37,468	110,565	4,286	106,765	9,481
Current liabilities	3,823	4,220	3,485	13,261	364	1,889	1,023
Capital lease obligations	616	10,433	-	1,407	-	1,688	1,594
Long-term debt	-	-	-	303	-	-	-
Deferred revenue	-	2,909	10,849	3,051	227	2,520	689
Deferred income taxes	-	-	-	13,255	445	-	852
Other liabilities	-	50	-	3,831	-	73	-
Total liabilities assumed	4,439	17,612	14,334	35,108	1,036	6,270	4,158
Purchase consideration	9,173	46,301	23,134	75,457	3,250	100,495	5,303
Less cash acquired	-	-	533	5,495	450	1,292	122
Less units issued	-	-	-	-	3,250	-	-
Net cash paid (received)	\$ 9,173	\$ 46,301	\$ 22,601	\$ 69,962	\$ (450)	\$ 99,203	\$ 5,181

From the acquisitions consummated in fiscal year 2008, the Zayo Bandwidth and Zayo Enterprise Networks business segments were allocated goodwill of \$63,861 and \$2,541, respectively. \$344 of the acquired goodwill was allocated to the OVS business segment.

During the year ended June 30, 2009, additional purchase price in the amount of \$8, \$15 and \$35 was recorded in connection with the Onvoy, Voicepipe and Citynet acquisitions, respectively, due to additional acquisition related expenses incurred. The purchase price of the Northwest acquisition was reduced by \$618 due to the seller not being able to fulfill some of the closing conditions resulting in the Company receiving purchase consideration held in escrow.

A portion of the consideration in the Memphis, Onvoy, Citynet and Northwest acquisitions was paid into escrow accounts, to be disbursed upon the settlement of various purchase agreement terms including net working capital adjustments, severance payments and claims for indemnification. As of June 30, 2010, 2009 and 2008, \$100, \$7,335 and \$10,067 was in escrow, respectively.

In connection with the various acquisitions, the previous owners entered into various agreements, including indefeasible rights-of-use agreements with other telecommunication service providers to lease them fiber and other infrastructure. In accordance ASC 805-10 *Business Combinations* the estimated value of deferred revenue was calculated based on its estimated fair value at the acquisition date. The Company determined that approximately \$7,257, \$154 and \$20,245 of deferred revenue acquired during the years ended June 30, 2010, 2009 and 2008, respectively, met the standards of ASC 805-10 as representing assumed legal obligations, the balance of the deferred revenue, mostly customer prepayments with no remaining obligations was not recorded. This deferred revenue is expected to be recognized over the next five to twenty years.

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

#### *Goodwill*

The goodwill arising from these acquisitions consists largely of the synergies and economies of scale expected from combining the operations of the acquired entities and the Company. Goodwill of \$4,170, \$5,606 and \$52,967 million from the CFS, Indiana and Citynet acquisitions, respectively, are deductible for tax purposes. The goodwill associated with all other acquisitions is not deductible for tax purposes.

#### *Pro Forma Results (Unaudited)*

The unaudited pro forma results presented below include the effects of the Company's 2009 acquisition of FiberNet as if it had been consummated as of July 1, 2008. The pro-forma loss for fiscal years 2010 and 2009 include the additional depreciation and amortization resulting from the adjustments to the value of fixed assets and intangible assets resulting from purchase accounting, and interest expense associated with debt used to fund the acquisition. The pro-forma results for fiscal year 2010 also includes an adjustment to reduce the historical FiberNet's stock-based compensation related to the acceleration of stock-based compensation upon the change of control of FiberNet and a reduction to FiberNet's selling, general and administrative expenses related to transaction costs incurred by FiberNet related to the acquisition and severance paid to FiberNet's executives upon a change of control. However, the pro forma results do not include any anticipated synergies or other expected benefits of the acquisition. Accordingly, the unaudited pro forma financial information below is not necessarily indicative of either future results of operations or results that might have been achieved had the acquisition been consummated as of July 1, 2009.

(unaudited)	Year ended June 30,	
	2010	2009
Revenue	\$ 236,111	\$ 212,580
Loss from continuing operations	(3,913)	(13,265)

As a result of the numerous acquisitions which occurred during fiscal year 2008 and the time which has elapsed since those acquisitions, the Company does not have access to all of the required information necessary to prepare pro forma revenue and earnings/(loss) estimates for fiscal year 2008.

#### (4) SPIN-OFF OF ONVOY VOICE SERVICES SEGMENT

During the third quarter of fiscal year 2010, management determined that the services provided by one of the Company's operating segments - Onvoy Voice Services ("Onvoy"), did not fit within the Company's current business model of providing telecom and internet infrastructure services, and the Company therefore spun-off Onvoy to Holdings – the parent of the Company.

Consistent with the discontinued operations reporting provisions of ASC 205-20, *Discontinued Operations*, the Company determined that it has discontinued all significant cash flows and continuing involvement with respect to the Onvoy operations effective March 12, 2010. Therefore, for the periods presented the results of the Onvoy operations have been aggregated in a single caption entitled "Earnings from discontinued operations, net of income taxes" on the accompanying consolidated statements of operations. The Company has not allocated any general corporate overhead to amounts presented in discontinued operations, nor has it elected to allocate interest costs. Assets and liabilities associated with Onvoy have been segregated from continuing operations and presented as assets and liabilities of discontinued operations on the accompanying consolidated balance sheet of June 30, 2009.

# ZAYO GROUP, LLC AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Earnings from discontinued operations, net of income taxes in the accompanying consolidated statements of operations are comprised of the following:

	Years ended June 30,		
	2010	2009	2008
Revenue	\$ 28,489	\$ 38,721	\$ 24,780
Earnings before income taxes	\$ 6,037	\$ 11,687	\$ 4,181
Income tax expense	2,642	4,644	1,431
Earnings from discontinued operations, net of tax	\$ 3,395	\$ 7,043	\$ 2,750

The following is a detail of the assets and liabilities associated with Onvoy classified as assets and liabilities of discontinued operations on the accompanying consolidated balance sheet as of June 30, 2009:

Current assets	\$	5,810
Property and equipment, net		18,579
Intangible assets, net		6,494
Deferred tax asset and other		21,324
Total assets	\$	52,207
Current liabilities	\$	2,602
Other liabilities		2,367
Total liabilities	\$	4,969

The Company continues to have ongoing contractual relationships with Onvoy, which are based on agreements which were entered into at estimated market rates among the relevant Onvoy and Zayo parties. Subsequent to the spin-off the Company has contractual relationships to provide Onvoy with certain data and colocation services and Onvoy has contractual relationships to provide the Company with certain voice services. Prior to March 12, 2010 these transactions were eliminated upon consolidation. The following table represents the revenue and expense transactions the Company incurred with Onvoy during the years ended June 30, 2010, 2009 and 2008 which were eliminated upon consolidation.

	Year ended June 30,		
	2010	2009	2008
Zayo Group, LLC			
Revenue from Onvoy Voice Services	\$ 2,488	\$ 1,570	\$ 967
Operating costs from Onvoy Voice Services	473	<sup>(1)</sup> (3,720)	<sup>(1)</sup> (2,269)
Selling, general and administrative expenses from Onvoy Voice Services	82	25	-

<sup>(1)</sup> - Certain intercompany transactions between the Company and Onvoy have historically been internally accounted for as a reduction to expenses rather than revenues. Prior to the spin-off these transactions eliminated upon consolidation.

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Subsequent to the spin-off the revenue and expenses associated with transactions with Onvoy are recorded in the results from continuing operations. The Company recognized revenue and incurred expenses from Onvoy in the amount of \$1,436 and \$564 during the period March 12, 2010 through June 30, 2010. As of the spin-off date the Company had a receivable balance from Onvoy in the amount of \$841.

The Company has determined that the continuing cash flows to and from Onvoy are not direct cash flows of the disposed segment and as such the requirements of ASC 205-20-50 *Disclosures*, as it relates to discontinued operations presentation have been met.

#### (5) PROPERTY AND EQUIPMENT

Property and equipment, including assets held under capital leases, was comprised of the following:

	Estimated useful lives (in years)	June 30, 2010	2009
Land	N/A	\$209	\$209
Buildings improvements and site improvements	15	9,003	8,230
Furniture, fixtures and office equipment	7	1,219	623
Computer hardware	3 to 5	3,292	2,165
Software	3	4,066	2,658
Machinery and equipment	4 to 7	3,568	3,327
Fiber optic equipment	8	127,379	94,127
Circuit switch equipment	10	7,225	7,027
Packet switch equipment	5	21,761	19,527
Fiber optic network	20	141,171	89,877
Construction in progress	N/A	40,443	17,192
Total		<u>359,336</u>	<u>244,962</u>
Less accumulated depreciation		<u>(57,425)</u>	<u>(28,379)</u>
Property and equipment, net		<u>\$301,911</u>	<u>\$216,583</u>

Total depreciation expense, including depreciation of assets held under capital leases, for the years ended June 30, 2010, 2009 and 2008 was \$29,121, \$19,047 and \$7,307 respectively.

Included in property and equipment are assets under capital leases of \$17,092 and \$16,768 as of June 30, 2010 and 2009, respectively. Depreciation expense related to these assets during the year ended June 30, 2010, 2009 and 2008 was \$1,293, \$1,253 and \$593, respectively. Accumulated depreciation associated with assets under capital leases was \$3,037 and \$1,744 as of June 30, 2010 and 2009, respectively.

As of June 30, 2010 the Company has received \$70 in grant money from the Federal Recovery Act Broadband Opportunity Program for reimbursement of property and equipment expenditures. The Company has accounted for these funds as a reduction of the cost of its fiber optic network. The Company anticipates the receipt of an

# ZAYO GROUP, LLC AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

additional \$24,934 in grant money related to grant agreements entered into under the Federal Recovery Act Broadband Opportunity Program, as of June 30, 2010.

### (6) GOODWILL

The Company's goodwill balance at June 30, 2010 and June 30, 2009 was \$68,751 and was allocated as follows to the Company's business units:

Zayo Bandwidth	\$ 66,548
Zayo Enterprise Networks	2,203
Total	<u>\$ 68,751</u>

### (7) INTANGIBLE ASSETS

Identifiable acquisition-related intangible assets as of June 30, 2010 and June 30, 2009 were as follows:

	Gross Carrying Amount	Accumulated Amortization	Net
<b>June 30, 2010</b>			
Customer relationships	\$ 78,738	\$ (19,182)	\$ 59,556
Non-compete Agreements	8,835	(8,623)	212
Tradenames	500	(417)	83
<b>Total</b>	<u>\$ 88,073</u>	<u>\$ (28,222)</u>	<u>\$ 59,851</u>
<b>June 30, 2009</b>			
Customer relationships	37,556	(9,961)	27,595
Non-compete Agreements	8,845	(6,198)	2,647
<b>Total</b>	<u>\$ 46,401</u>	<u>\$ (16,159)</u>	<u>\$ 30,242</u>

The amortization of intangible assets for the years ended June 30, 2010, 2009 and 2008 was \$12,063, \$10,520 and \$4,615, respectively. Estimated future amortization of intangible assets is as follows:

Year ending June 30,	
2011	\$ 10,276
2012	9,981
2013	9,981
2014	7,096
2015	4,435
Thereafter	18,082
	<u>\$ 59,851</u>

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Non-compete agreements are being amortized on a straight-line basis over the expected term of the contracts ranging from two to three years. Customer relationships are being amortized on a straight-line basis over six to ten years. The trademark asset from the Fibernet acquisition has a limited life and is being amortized over one year.

#### (8) LONG-TERM DEBT

In March 2010, the Company co-issued, with one of its subsidiaries - Zayo Capital Inc., (at an issue price of 98.779%) \$250 million of Senior Secured Notes (the "Notes"). The Notes bear interest at 10.25 % annually and are due on March 15, 2017. The net proceeds from this debt issuance were approximately \$239,060 after deducting the discount on the Notes of \$3,052 and debt issuance costs of approximately \$7,888. The Notes are being accreted to their par value over the term of the Notes as additional interest expense. The effective interest rate of the Company's Notes is 10.7 percent.

The Notes are secured and backed by substantially all of the assets of the Company.

A portion of the proceeds from the Notes were used to pay off all of the Company's term loans. Long-term debt consisted of the following as of June 30, 2010 and June 30, 2009:

	Year ended June 30,	
	2010	2009
Senior Secured Notes due 2017 (10.25%)	\$ 247,080	\$ -
Tranche A term loan due 2013 (6.39%)	-	69,650
Tranche B term loan due 2013 (5.86%)	-	29,850
Tranche C term loan due 2013 (6.33%)	-	34,825
Revolver maturing in 2013 (6.36%) <sup>(1)</sup>	-	2,000
Less current portion	-	(1,350)
Total long-term debt	<u>\$ 247,080</u>	<u>\$ 134,975</u>

Each of the term loans and the Revolver were paid off in March 2010 with proceeds from the issuance of the Notes. The interest rates reflected for the term loans and the Revolver represents the interest rates for these loans at June 30, 2009.

In September 2009 the Company entered into a \$30 million term loan to finance the Fibernet acquisition. This loan was paid off in March 2010 with the proceeds from the Notes.

In March 2010 the Company also entered into a revolving line-of-credit with Sun Trust Bank ("the Revolver"). During the term of the Revolver, the Company can borrow, repay and re-borrow against the Revolver in an amount up to \$75,000 (adjusted for letter of credit usage). The Revolver matures on March 1, 2014. Loans under the Revolver bear interest at a rate equal to the higher of either (i) the rate which the administrative agent announces as its prime lending rate, (ii) the Federal Funds Rate plus one-half of one percent per annum or (iii) the Eurodollar Rate.

As of June 30, 2010, no amounts were outstanding under the Revolver. Standby letters of credit were outstanding in the amount of \$5,945 as of June 30, 2010, resulting in \$69,055 being available on the Revolver as of June 30, 2010. Outstanding letters of credit backed by the Revolver accrue interest at a rate ranging from 3.5 to 4.25 percent per annum based upon the Company's leverage ratio. As of June 30, 2010 the interest rate was 4 percent.



## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

#### *Debt issuance costs*

Debt issuance costs have been capitalized on the accompanying consolidated balance sheets and are being amortized using the effective interest rate method over the term of the borrowing agreements, unless terminated earlier, at which time the unamortized costs are immediately expensed. The unamortized debt issuance costs of \$5,881 associated with the term loans (Tranche A through D) and the Revolver maturing in 2013 were expensed in March 2010 upon the settlement of these credit agreements. Debt issuance costs associated with the Senior Secured Notes issued in March 2010 were \$7,888. Debt issuance costs associated with the Revolver entered into in March 2010 were \$2,148. The balance of debt issuance costs as of June 30, 2010 and 2009 was \$9,560 (net of accumulated amortization of \$526) and \$4,712 (net of accumulated amortization of \$1,614), respectively. Interest expense associated with the amortization of debt issuance costs was \$1,624, \$1,114 and \$500 for the years ended June 30, 2010, 2009 and 2008, respectively.

#### *Debt covenants*

The Company's credit agreement associated with the Notes contains two financial covenants: (1) a maximum leverage ratio and (2) a minimum fixed charge coverage ratio.

*Leverage ratio:* The Company must not exceed a consolidated leverage ratio (funded debt to EBITDA), as determined under the credit agreement, of 4.25x for any trailing four-quarter period ending on March 31, 2010 or later.

*Fixed charge coverage ratio:* The Company must maintain a consolidated fixed charge coverage ratio, as determined under the credit agreement, of at least 1.0x for the periods ending September 30 and December 31, 2010; 1.1x for the periods ending March 31 and June 30, 2011; 1.15x for the periods ending September 30 and December 31, 2011 and March 31 and June 30, 2012; and 1.25x for the periods ending September 30, 2012 and each fiscal quarter thereafter.

The Company's credit agreement contains customary representations and warranties, affirmative and negative covenants, and customary events of default, including among others, non-payment of principal, interest or other amounts when due, inaccuracy of representations and warranties, breach of covenants, cross default to indebtedness in excess of \$10.0 million, insolvency or inability to pay debts, bankruptcy, or a change of control.

The Company was in compliance with all covenants associated with its Notes as of June 30, 2010.

#### *Interest rate derivatives*

On June 30, 2008, the Company entered into an interest rate swap agreement on a notional value of \$60,000 with a maturity date of September 13, 2010. There was no up-front cost for this agreement. The contract states that the Company pays 3.69% fixed for the term of the agreement. The counterparty either pays to the Company or receives from the Company the difference between actual LIBOR and the fixed rate.

On March 23, 2009, the Company entered into another interest rate swap agreement on a notional value of \$40,000 with a maturity date of September 13, 2010. There was no up-front cost for this agreement. The contract states that the Company pays 1.42% fixed for the term of the agreement. The counterparty either pays to the Company or receives from the Company the difference between actual LIBOR and the fixed rate.

Any change in fair value of the interest rate swaps are recorded as an increase or decrease in interest expense in the consolidated statements of operations for the applicable period. During the years ended June 30, 2010 and 2009 \$744 and \$3,143, respectively, were recorded as an increase in interest expense for the change in the fair value of the interest rate swaps. The Company made payments on the swaps of \$2,463 and \$859 during the years ended June 30,

# ZAYO GROUP, LLC AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

2010 and 2009, respectively, which are also recorded as interest expense. The liability associated with the swaps was \$566 and \$2,284 as of June 30, 2010 and 2009, respectively.

### (9) INCOME TAXES

The Company, a Limited Liability Corporation, is taxed at its ultimate parent level - CII. The parent is a holding company with no operations and therefore all income tax balances are pushed down to the Company.

The Company's provision for income taxes is summarized as follows:

	Year ended June 30,		
	2010	2009	2008
Federal income taxes – current	\$ -	\$ -	\$ -
Federal income taxes – deferred	4,726	(1,662)	(703)
Provision for federal income taxes	4,726	(1,662)	(703)
State income taxes – current	872	(200)	107
State income taxes – deferred	695	(244)	(103)
Provision for state income taxes	1,567	(444)	4
Total provision for income taxes	\$ 6,293	\$ (2,106)	\$ (699)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

A reconciliation of the actual income tax provision and the tax computed by applying the U.S. federal rate (34%) to the earnings/(loss) before income taxes for each of the years in the three-year period ended June 30, 2010 follows:

	Year ended June 30,		
	2010	2009	2008
Expected provision/(benefit) at statutory rate of 34%	\$ 1,142	\$ (3,874)	\$ (1,837)
Increase/(decrease) due to:			
Deferred compensation	6,198	2,160	1,150
State taxes, net of federal benefit	985	(200)	(55)
Transaction costs not deductible	438	-	-
Gain on bargain purchase	(3,087)	-	-
Other, net	337	(192)	43
Adjustment of income taxes provided for in prior periods	280		
Provision/(benefit) for income taxes	\$ 6,293	\$ (2,106)	\$ (699)

# ZAYO GROUP, LLC AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

On a consolidated basis, \$217, \$326 and \$5 of income taxes was paid to federal and state jurisdictions during the years ended June 30, 2010, 2009 and 2008.

The tax effect of temporary differences that give rise to significant portions of the deferred taxes assets and deferred tax liabilities are as follows:

	Year ended June 30,	
	2010	2009
Deferred income tax assets		
Net operating loss carry forwards	\$ 38,262	\$ 2,209
Alternate minimum tax credit carryforwards	78	150
Deferred revenue	8,790	5,462
Unrealized loss on interest rate swaps	223	860
Accrued expenses	722	685
Other liabilities	354	53
Allowance for doubtful accounts	1,402	76
Other	1	1
Total deferred income tax assets	<u>\$ 49,832</u>	<u>\$ 9,496</u>
Deferred income tax liabilities		
Property and equipment	24,483	11,325
Intangible assets	13,884	4,641
Total deferred income tax liabilities	<u>38,367</u>	<u>15,966</u>
Less: Valuation allowance	<u>(355)</u>	<u>-</u>
Net deferred income tax assets	<u>\$ 11,110</u>	<u>\$ (6,470)</u>

As of June 30, 2010, the Company had \$102,036 of net operating loss ("NOLs") carry forwards. The Company acquired \$5,060 of NOLs in the Northwest Telephone acquisition and \$94,655 of NOLs in the FiberNet acquisition. Each of these acquisitions, however, was a "change in ownership" within the meaning of Section 382 of the Internal Revenue Code and, as a result, such NOL's are subject to an annual limitation, and thus the Company is limited in its ability to use such NOLs to reduce its income tax exposure. The current annual NOL usage limitation related to the Company's acquired NOLs is \$7,456. Additionally the Company generated \$2,321 of NOLs for the years ended June 30, 2009 and 2008 which are also available to offset future taxable income.

From the period of the respective acquisitions through June 30, 2010, the Company has not utilized any of its own or acquired NOLs; however the Company has used approximately \$10,290 of NOLs which were generated by Onvoy – See Note 11 *Equity*, for a discussion of the tax sharing agreement between the Company and Onvoy. The Company utilized \$3,001 of Onvoy's NOL's subsequent to the spin-off date of March 12, 2010. This amount has been reflected on the statement of member's interest.

As of June 30, 2010 management believes it is more-likely-than-not that the Company will not be able to utilize \$1.0 million of the NOLs acquired from the FiberNet acquisition; as such the Company has recorded a \$0.4 million valuation allowance against such NOLs to reflect the portion of NOLs that the Company would not be able to use.

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

The Company is subject to audit by various taxing authorities, and these audits may result in proposed assessments where the ultimate resolution results in the Company owning additional taxes. The Company is required to establish reserves under ASC 740-10 (formerly FASB Interpretation No. 48 *Accounting for Uncertainty in Income Taxes*), when the Company believes there is uncertainty with respect to certain positions and the Company may not succeed in realizing the tax benefits. The Company adopted ASC 740-10-25 during the current year. In accordance with ASC 740-10-25 the Company recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. Prior to the adoption, the Company recognized the effect of income tax positions only if such positions were probable of being sustained. The application of income tax law is inherently complex, as such; it requires many subjective assumptions and judgments regarding income tax exposures. Interpretations of and guidance surrounding income tax laws and regulations change over time; as such, changes in these subjective assumptions and judgments can materially affect amounts recognized in the balance sheets and statements of operations. At the adoption date of July 1, 2009, the Company had no unrecognized tax benefits which would affect the effective tax rate if recognized. At June 30, 2010, there were no unrecognized tax benefits. As of June 30, 2010, there was no accrued interest or penalties related to uncertain tax positions.

#### (10) ACCRUED LIABILITIES

Accrued liabilities included in current liabilities consisted of the following:

	Year ended June 30,	
	2010	2009
Accrued compensation and benefits	\$ 3,854	\$ 2,347
Accrued property and equipment purchases	2,441	697
Network expense accruals	4,445	2,636
Other accruals	7,609	4,380
Total	<u>\$ 18,349</u>	<u>\$ 10,060</u>

#### (11) EQUITY

Zayo Group, LLC was initially formed on May 4, 2007 and is a wholly owned subsidiary of Zayo Group Holdings, Inc., which in turn is wholly owned by Communications Infrastructure Investments, LLC ("CII"). CII was organized on November 6, 2006 and subsequently capitalized on May 7, 2007 with capital contributions from various institutional and founder investors. The cash proceeds from the capitalization of CII were contributed to the Company and are reflected in the Company's member's equity.

During the years ended June 30, 2010, 2009 and 2008, CII contributed \$39,800, \$35,546 and \$166,450, respectively in capital to the Company through Holdings. Additionally, during fiscal year 2008 CII contributed to the Company through Holdings property from Voicepipe Communications, Inc. valued at \$3,250.

During fiscal year 2008, CII issued 6,400,000 Class A preferred units in CII to the two founders of the Company. The Class A preferred units issued to the two Company founders vest according to the following schedule: 10% in the 24th month, 10% in the 30th month, 10% in the 36th month, 10% in the 42nd month and the remaining 60% in the 48th month. Stock-based compensation expense recognized in connection with these executive Class A issuances for the years ended June 30, 2010, 2009 and 2008 totaled \$1,150, \$1,628, and \$3,381, respectively. The

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

remaining stock-based compensation expense of \$241 will be recognized in fiscal 2011. CII has also issued 465,000 Class A preferred units to three of the Company's executives in fiscal 2009. The Class A preferred units issued to two of the executives vested during the year ended June 30, 2009 and the remaining units became fully vested in February 2010. Stock-based compensation expense recognized for these grants for the years ended June 30, 2010 and 2009 totaled \$45 and \$421, respectively.

As these awards have been issued by CII to employees of the Company as compensation, the expense has been recorded by the Company in the accompanying consolidated statements of operations in accordance with ASC 718 – *Compensation – Stock Compensation*.

Onvoy Voice Services ("OVS") was spun-off from Zayo Group, LLC on March 12, 2010 to its parent - Holdings (see Note 4). At the time of the spin-off, the book value of OVS was \$39,401. As a result of the spin-off the Company's member's interest account was initially reduced by \$39,401. Subsequent to the spin-off date, the Company entered into a tax sharing agreement with OVS and CII – the taxable entity. As part of the agreement management of the Company and OVS allocated the deferred tax assets and liabilities of CII to the Company and OVS based on the source of the asset or liability generating the benefit. NOLs generated by entities acquired by Zayo Group entities and which the assets and liabilities of such acquisition remain at one of Zayo Group's subsidiaries were allocated to Zayo Group. The agreement provided for the past and future settlement of due-to/due-from balances related to the allocation of deferred tax assets and liabilities between the two entities as an increase or decrease to the respective entities member's equity. As a result of the tax sharing agreement and non-cash settlement of the inter-company balances as of the spin-off date, the net book value of the OVS business segment was increased by \$3,138 resulting in a non-cash decrease to the member's account of the Company. Subsequent to the spin-off date the Company utilized \$3,001 of Onvoy's NOLs resulting in a non-cash capital contribution from CII, the taxable entity and parent of the Company, in the amount of \$1,200.

#### (12) STOCK COMPENSATION

The Company has been given authorization by CII to issue 125,000,000 of CII's common units as awards to employees and directors. CII has three classes of common units with different liquidation preferences -- Class A, B and C units. Common units are issued to employees and to independent directors and are allocated by the Chief Executive Officer and the Board of Managers on the terms and conditions specified in the employee equity agreement. At June 30, 2010, 70,975,130 of common units were issued and outstanding.

As these awards have been issued by CII to employees and directors of the Company the related compensation expense has been pushed down and recorded by the Company in the accompanying consolidated statements of operations in accordance with ASC 718 – *Compensation – Stock Compensation*.

The common units are considered to be stock-based compensation with terms which require the awards to be classified as liabilities. As such, the Company accounts for these awards as a liability and re-measures the liability at each reporting date until the date of settlement.

The Common units vest according to the following schedule: 1/4th in the 12th month and 1/48th in each of the next 36 months or immediately five months after the consummation of a sale of the Company. As of June 30, 2010 and June 30, 2009, the value of the Class A common units was determined to be \$0.49 and \$0.16 per unit, respectively. As of June 30, 2010 and June 30, 2009 the value of the Class B common units was determined to be \$0.28 and \$0 per unit, respectively. As of June 30, 2010 and June 30, 2009 the value of Class C common units was determined to be \$0.03 and \$0 per unit, respectively.

# ZAYO GROUP, LLC AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

The liability associated with the common units was \$21,623 and \$4,590 as of June 30, 2010 and 2009, respectively. The stock-based compensation expenses associated with the common units was \$17,033, \$4,590 and \$0 for the years ended June 30, 2010, 2009 and 2008, respectively.

The holders of common units are not entitled to receive dividends or distributions, except at the discretion of the Board of Directors. Upon a liquidation of CII, or upon a non-liquidating distribution, the holders of common units share in the proceeds after the CII preferred unit holders receive their unreturned capital contributions and their priority return (6% per annum). After the preferred unreturned capital contributions and the priority return are satisfied, the remaining proceeds are allocated on a scale ranging from 85% to the Class A preferred unit holders and 15% to the common unit holders and 80% to the Class A preferred unit holders and 20% to the common unit holders depending upon the return multiple to the Class A preferred unit holders up to the amount of the Class A gain percentage. Once the amount of proceeds related to the Class A percentage gain has been distributed, then the Class B gain percentages are distributed in a similar method as the Class A gains.

The following table represents the activity as it relates to common unit issuances and forfeitures during the years ended June 30, 2010, 2009 and 2008.

	A Common Units	B Common Units	C Common Units	Totals Units
Balance at June 30, 2007	-	-	-	-
Common units issued	45,954,072	-	-	45,954,072
Common units forfeited	(720,417)	-	-	(720,417)
Balance at June 30, 2008	45,233,655	-	-	45,233,655
Common units issued	6,199,665	-	-	6,199,665
Common units forfeited	(3,212,262)	-	-	(3,212,262)
Balance at June 20, 2009	48,221,058	-	-	48,221,058
Common units issued	-	19,879,500	3,630,218	23,509,718
Common units forfeited	(545,646)	(210,000)	-	(755,646)
Balance at June 30, 2010	47,675,412	19,669,500	3,630,218	70,975,130

# ZAYO GROUP, LLC AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

The following table represents the activity as it relates to common units vested during the years ended June 30, 2010, 2009 and 2008.

	Year ended June 30,			Totals
	2008	2009	2010	
Common A vested	15,846,600	11,837,579	12,604,516	40,288,695
Common B vested	-	2,604,479	4,092,625	6,697,104
Common C vested	-	54,792	258,859	313,651
Total Vested	15,846,600	14,496,850	16,956,000	47,299,450

### (13) FAIR VALUE MEASUREMENTS

The Company's financial instruments consist of cash and cash equivalents, restricted cash, accounts receivable, accounts payable, interest rate swaps, long-term debt and stock-based compensation. The carrying values of cash and cash equivalents, restricted cash, trade receivable and accounts payable approximated their fair values at June 30, 2010 and 2009 because of the short maturity of these instruments. The interest rate swaps are recorded in the consolidated balance sheets at fair value. The carrying value of the Company's long-term debt reflects the original amounts borrowed, net of unamortized discounts and was \$247,080 as of June 30, 2010. Based on current market interest rates for debt of similar terms and average maturities and based on recent transactions, the fair value of the long-term debt as of June 30, 2010, is estimated to be \$252,500 compared to its carrying value of \$247,080. The Company records its stock-based compensation liability at its estimated value.

GAAP defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact and considers assumptions that market participants would use when pricing the asset or liability, such as inherent risk, transfer restrictions, and risk of nonperformance.

Financial instruments measured at fair value on a recurring and non-recurring basis are summarized below:

		As of June 30,	
	Level	2010	2009
<i>Liabilities Recorded at Fair Value in the Financial Statements:</i>			
Interest rate swap liabilities	Level 2	\$ 566	\$ 2,284
Stock-based compensation liability	Level 3	21,623	4,590
Total liabilities recorded at fair value in the consolidated financial statements		<u>\$ 22,189</u>	<u>\$ 6,874</u>
<i>Liabilities not Recorded at Fair Value in the Financial Statements:</i>			
Long-term debt, including the current portion		<u>\$ 247,080</u>	<u>\$ 136,325</u>

The interest rate swaps are valued using discounted cash flow techniques that use observable market inputs, such as LIBOR-based yield curves, forward rates, and credit ratings.

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

The stock-based compensation liability is valued using both an income and market based approach. The income based approach is based on an analysis of discounted cash flows. The market based approach is primarily based on an analysis of prices paid by investors and acquirers of interests of comparable companies in the public and private markets.

Changes in the fair market value of the interest rate swaps resulted in an increase of \$744 and \$3,143 in interest expense during the years ended June 30, 2010 and 2009, respectively.

Changes in the estimated fair value of common units resulted in an increase of \$17,033, \$4,369 and \$0 in the stock-based compensation liability during the years ended June 30, 2010, 2009 and 2008, respectively.

#### (14) COMMITMENTS AND CONTINGENCIES

##### *Capital leases*

Future contractual payments under the terms of the Company's capital lease obligations were as follows:

	As of June 30, 2010
Year ending June 30,	
2011	\$ 2,572
2012	1,745
2013	1,709
2014	1,670
2015	1,627
Thereafter	8,792
Total minimum lease payments	<u>18,115</u>
Less amounts representing interest	(5,409)
Less current portion	<u>(1,673)</u>
Capital lease obligations, less current portion	<u>\$ 11,033</u>

The weighted average interest rate on capital lease obligations was 12.1% and 12.4% as of June 30, 2010 and 2009, respectively.

##### *Operating leases*

The Company leases office space, warehouse space, network assets, switching and transport sites, points of presence and equipment under non-cancelable operating leases. Lease expense was \$30,439, \$15,186 and \$6,983 for the years ended June 30, 2010, 2009 and 2008, respectively.



## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Minimum contractual lease payments due under the Company's long-term operating leases are as follows:

	As of June 30, 2010
Year ending June 30,	
2011	\$ 22,688
2012	19,257
2013	17,177
2014	15,460
2015	14,406
Thereafter	86,347
	<u>\$ 175,335</u>

At June 30, 2010, the Company had commitments of approximately \$26,847 for construction materials and purchases of property and equipment all of which are expected to be acquired in the next twelve months.

#### *Contingencies*

In the normal course of business, the Company is party to various outstanding legal proceedings, claims, commitments and contingent liabilities. In the opinion of management, the ultimate disposition of these matters will not have a materially adverse effect on the Company's financial condition, results of operations, or cash flows.

#### *Outstanding letters of credit*

As of June 30, 2010, the Company had \$5,945 in outstanding letters of credit primarily to collateralize surety bonds securing the Company's performance under various contracts.

#### *Acquisitions*

##### *AGL Networks*

On March 14, 2010, the Company entered into a definitive agreement to purchase AGL Networks, LLC ("AGL Networks"). The Company closed on this transaction on July 1, 2010 at which time the Company acquired 100% of the ownership interest of AGL Networks which operates a network of approximately 786 route miles and over 190,000 fiber miles. The purchase price of this acquisition, after post-close adjustments, was \$72,979. The acquisition was financed with cash on hand.

AGL Networks provides Bandwidth Infrastructure services to customers primarily in Georgia, Arizona, and North Carolina.

The unaudited pro forma results presented below include the effect of the AGL acquisition as if the acquisition was consummated as of July 1, 2008. The pro-forma loss for fiscal years 2010 and 2009 include the additional depreciation and amortization resulting from the adjustments to the value of fixed assets and intangible assets resulting from purchase accounting. The pro forma results do not include any anticipated synergies or other expected benefits of the acquisition. Accordingly, the unaudited pro forma financial information below is not necessarily indicative of either future results of operations or results that might have been achieved had the acquisition been consummated as of July 1, 2008.

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)	Year ended June 30,	
	2010	2009
Revenue	\$ 247,681	\$ 168,238
Loss, from continuing operations	1,950	(13,943)

#### American Fiber Systems

On June 24, 2010, the Company entered into a definitive agreement to acquire American Fiber Systems Holding Corporation ("AFS") for a purchase price of \$115,500, including \$110,000 in cash and a \$5,500 promissory note. The purchase price is based upon the valuation of both the business and assets directly owned by AFS and their ownership interest in US Carrier Telecom Holdings, LLC. The purchase price is subject to adjustments in the event certain AFS financial measures deviate from those detailed in the definitive agreement. AFS is a provider of lit and dark Bandwidth Infrastructure services in nine metropolitan markets: Atlanta, Georgia, Boise, Idaho, Cleveland, Ohio, Kansas City, Missouri, Las Vegas, Nevada, Minneapolis, Minnesota, Nashville, Tennessee, Reno, Nevada and Salt Lake City, Utah. AFS's services and customers are similar to those of Zayo Bandwidth, Zayo Enterprise Networks and Zayo Fiber Solutions and, as a result, its contracts and assets will be assigned to the appropriate business units in order to retain Zayo's current operating structure. American Fiber Systems owns and operates approximately 1,200 routes miles and over 160,000 fiber miles of fiber networks and has 620 on-net buildings in these markets.

#### Other Commitments

In February 2010, the Company was awarded a Federal stimulus project in Indiana. The Indiana Stimulus Project involves the expenditure of approximately \$31.4 million of capital expenditures, of which \$25.1 million is to be funded by a government grant and approximately \$6.3 million is to be funded by the Company. The Company expects to receive \$2.5 million in up-front customer payments. In connection with this project, 626 route miles of fiber are to be constructed and lit. The Company began construction on this project in April of 2010 and began receiving grant funds in May 2010. As of June 30, 2010, the Company has been reimbursed for \$96 of expenses and \$70 of capital expenditures related to the Indiana Stimulus Project.

#### (15) RELATED PARTY TRANSACTIONS

Subsequent to the spin-off of Onvoy Voice Services (See Note 4 -- *Spin-off of Onvoy Voice Services Segment*), the Company and Onvoy will continue to have certain contractual relationships. Prior to the spin-off, transactions between the Company and Onvoy have been eliminated upon consolidation. Subsequent to the spin-off these transactions are included in the operating results of the Company. As of June 30, 2010, the Company has a receivable from an affiliate in the amount of \$871. \$30 of this amount relates to receivables from CII for various legal costs that have been paid by the Company on CII's behalf. The remaining balance relates to amounts owed to the Company from Onvoy Voice Services related to the services provided to Onvoy, net of amounts payable to Onvoy for services it provided to the Company discussed in Note 4.

Subsequent to the spin-off, the revenue and expenses associated with transactions with Onvoy are recorded in the results from continuing operations. The Company recognized revenue from Onvoy in the amount of \$1,436 during the period March 12, 2010 through June 30, 2010. The Company purchased services from Onvoy during the same period in the amount of \$564.

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

#### (16) SEGMENT REPORTING

ASC 280-10-50 defines an operating segment as a component of an entity that has all of the following characteristics:

- It engages in business activities from which it may earn revenues and incur expenses.
- Its operating results are regularly reviewed by the public entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance.
- Its discrete financial information is available.

The Company operates its business as four business segments which are defined by the product sets they offer and customers they target. Zayo Bandwidth ("BW") offers bandwidth infrastructure services to the Company's 200 largest users, Zayo Enterprise Networks ("ZEN") provides bandwidth infrastructure to regional and enterprise customers and converged and data communications services and Zcolo provides colocation services and intra building transport services.

In anticipation of the close of the AGL Networks acquisition (See Note 13 - *Commitments and Contingencies*), Zayo has established a fourth business unit, Zayo Fiber Solutions ("ZFS"). Zayo Fiber Solutions is dedicated to marketing and supporting dark fiber related services to a broad set of customers. Although ZFS did not have operation or hold long term assets as of June 30, 2010, upon the acquisition of AGL on July 1, 2010 all of the Company's dark fiber assets were transferred to the ZFS business unit. In preparation of establishing this new business segment the Company incurred certain selling, general and administrative costs associated with the new segment.

Revenues for all of the Company's products are included in one of these four business segments. The results of operations for each business segment include an allocation of certain corporate overhead costs. The allocation is based on a percentage determined by management that represents management's estimate of the relative burden each segment bears on corporate overhead costs. Identifiable assets for each business segment are reconciled to total consolidated assets including unallocated corporate assets and intercompany eliminations. Unallocated corporate assets consist primarily of cash, deferred tax assets and deferred debt issuance costs.

# ZAYO GROUP, LLC AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

The following tables summarize significant financial information of each of the segments:

	For the year ended June 30, 2010					
	BW	ZEN	Zcolo	ZFS	Corporate	Total
Revenue	\$ 175,348	\$ 33,953	\$ 22,850	\$ -	\$ -	\$ 232,151
Intersegment revenue	(5,612)	(708)	(1,786)	-	-	(8,106)
Revenue from external customers	169,736	33,245	21,064	-	-	224,045
Depreciation and amortization	32,915	3,765	4,504	-	-	41,184
Operating income/(loss)	26,992	750	3,386	(393)	(13,410)	17,325
Interest expense	(1,130)	-	(164)	-	(17,398)	(18,692)
Loss on extinguishments of debt	-	-	-	-	(5,881)	(5,881)
Other income <sup>(1)</sup>	382	-	-	-	10,225	10,607
Total assets	373,391	35,666	56,431	98	98,795	564,381
Capital Expenditures	57,013	2,201	514	51	-	59,779

<sup>(1)</sup> Other income includes a gain of \$9,081 on the bargain purchase of Fibernet. See Note 3 – *Acquisitions*.

	For the year ended June 30, 2009					
	BW	ZEN	Zcolo	ZFS	Corporate	Total
Revenue	\$ 128,695	\$ 26,135	\$ -	\$ -	\$ -	\$ 154,830
Intersegment revenues	(3,934)	(92)	-	-	-	(4,026)
Revenues from external customers	124,761	26,043	-	-	-	150,804
Depreciation and amortization	26,287	3,280	-	-	-	29,567
Operating income/(loss)	17,153	(3,195)	-	-	(10,356)	3,602
Interest expense	(1,182)	(3)	-	-	(14,063)	(15,248)
Other income	52	15	-	-	182	249
Total assets <sup>(2)</sup>	302,577	26,685	-	-	92,900	422,162
Capital expenditures	60,829	1,278	-	-	-	62,107

<sup>(2)</sup> Total assets of corporate include \$52,207 of assets of discontinued operations.

# ZAYO GROUP, LLC AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

	For the year ended June 30, 2008					
	BW	ZEN	Zcolo	ZFS	Corporate	Total
Revenue	\$ 66,149	\$ 12,946	\$ -	\$ -	\$ -	\$ 79,095
Intersegment revenues	(1,526)	-	-	-	-	(1,526)
Revenues from external customers	64,623	12,946	-	-	-	77,569
Depreciation and amortization	10,374	1,548	-	-	-	11,922
Operating income/(loss)	6,034	(1,139)	-	-	(4,361)	534
Interest expense	(820)	-	-	-	(5,467)	(6,287)
Other income	220	44	-	-	87	351
Total assets <sup>(3)</sup>	275,761	12,684	-	-	50,994	339,439
Capital expenditures	22,729	-	-	-	-	22,729

<sup>(3)</sup> Total assets of corporate include \$69,936 of assets of discontinued operations.

### (17) SUBSEQUENT EVENTS

Management performed an evaluation of the Company's activity through September 10, 2010, the date the consolidated financial statements were available to be issued.

In July 2010, the Company was awarded from the federal Recovery Act Broadband Opportunity Program a \$13.4 million grant to construct 286 miles of fiber network in Anoka County, Minnesota, outside of Minneapolis.

On August 24, 2010 the Company made a capital call to its investors for the remainder of the investor's \$35 million capital commitment to the Company. The Company expects to receive the funds in September. The invested capital will be used to fund a portion of the AFS acquisition.

# ZAYO GROUP, LLC AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### (18) QUARTERLY FINANCIAL DATA (UNAUDITED)

The following table presents the unaudited quarterly results for the year-ended June 30, 2010:

	2010 Quarter Ended				
	September 30	December 31	March 31	June 30	Total
Revenue	\$ 45,503	\$ 58,227 <sup>(1)</sup>	\$ 58,912	\$ 61,403	\$ 224,045
Operating costs and expenses					
Operating costs, excluding depreciation and amortization	14,426	19,777 <sup>(1)</sup>	19,536	19,798	73,537
Selling, general and administrative expenses	16,850	18,920 <sup>(1)</sup>	18,726	19,275	73,771
Stock-based compensation	852	592	11,831 <sup>(2)</sup>	4,953 <sup>(2)</sup>	18,228
Depreciation and amortization	9,062	10,565	10,630	10,927	41,184
Total operating costs and expenses	41,190	49,854	60,723	54,953	206,720
Operating income/(loss)	4,313	8,373	(1,811)	6,450	17,325
Other income (expense)					
Interest expense	(3,570)	(3,241)	(4,449)	(7,432) <sup>(3)</sup>	(18,692)
Other income	5	-	1,001	9,601 <sup>(3)</sup>	10,607
Loss on extinguishment of debt	-	-	(5,881) <sup>(3)</sup>	-	(5,881)
Total other expense, net	(3,565)	(3,241)	(9,329)	2,169	(13,966)
Earnings/(loss) from continuing operations before income taxes	748	5,132	(11,139)	8,619	3,359
Provision/(benefit) for income taxes	1,112	2,513	525	2,143	6,293
Earnings/(loss) from continuing operations	\$ (364)	\$ 2,619	\$ (11,664)	\$ 6,476	\$ (2,934)
Earnings/(loss) from discontinued operations, net of income taxes	1,963	1,436	879	(883)	3,395
Net earnings/(loss)	\$ 1,599	\$ 4,055	\$ (10,785)	\$ 5,593	\$ 461

<sup>(1)</sup> The Company realized an increase in revenue beginning September 9, 2009 as a result of the acquisition of Fibernet. As a result of the acquisition the Company incurred additional operating and selling, general and administrative expenses attributed to the additional revenues associated with the acquisition.

<sup>(2)</sup> Stock-based compensation expense increased significantly during the quarters ended March 31, 2010 and June 30, 2010 as a result of an increase in the value of the common units granted to the Company's employees and additional units vesting during these quarters. See Note 12 - *Stock Compensation*.

<sup>(3)</sup> Interest expense increased during the quarter ended June 30, 2010 primarily as a result of the bond offering which closed on March 11, 2010. Interest expense increased as a result of the higher interest rates on the bonds as compared to the senior debt which was repaid on March 11, 2010 and as a result of the larger debt balance during the quarter. As a result of paying off the senior notes with the proceeds from the bond offering, the Company wrote

**ZAYO GROUP, LLC AND SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

off \$5,881 in unamortized debt issuance costs during the quarter ended March 31, 2010. See Note 8 *Long Term Debt*.

<sup>(4)</sup> During the year ended June 30, 2010 the Company recognized a gain on bargain purchase of \$9,081 associated with the Fibernet acquisition. See Note 3 – *Acquisitions*.

**ZAYO GROUP, LLC AND SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

The following table presents the unaudited quarterly results for the year-ended June 30, 2009:

	2009 Quarter Ended				
	September 30	December 31	March 31	June 30	Total
Revenue	\$ 34,515	\$ 37,446	\$ 38,399	\$ 40,444	\$ 150,804
Operating costs and expenses					
Operating costs, excluding depreciation and amortization	12,360	12,319	11,898	12,220	48,797
Selling, general and administrative expenses	13,921	14,996	15,565	17,937	62,419
Stock-based compensation	403	547	403	5,065	6,418
Depreciation and amortization	6,212	7,003	7,498	8,854	29,567
Total operating costs and expenses	32,896	34,865	35,364	44,076	147,201
Operating income/(loss)	1,619	2,581	3,035	(3,632)	3,603
Other income (expense)					
Interest expense	(3,242)	(5,661)	(3,455)	(2,890)	(15,248)
Other income	39	105	81	24	249
Total other expense, net	(3,203)	(5,556)	(3,374)	(2,866)	(14,999)
Earnings/(loss) from continuing operations before income taxes	(1,584)	(2,975)	(339)	(6,498)	(11,396)
Provision/(benefit) for income taxes	82	(368)	519	(2,339)	(2,106)
Earnings/(loss) from continuing operations	(1,666)	(2,607)	(858)	(4,159)	(9,290)
Earnings/(loss) from discontinued operations, net of income taxes	2,536	2,282	2,321	(96)	7,043
Net earnings/(loss)	\$ 870	\$ (325)	\$ 1,463	\$ (4,255)	\$ (2,247)