#### STATEMENT OF FINANCIAL CAPABILITY

Advanced TelCom Group, Inc. ("ATG") was incorporated in July 1998. As such its financial statements are not available for the requested past three years. Attached to this application are the audited financial statements for ATG for the seven months ended December 31, 1998 and unaudited financial statements for the period ended November 30, 1999. ATG Group, Inc., ATG's holding company parent, dependent of the period ended November 30, 1999.

Service in the geographic area proposed to be served, to maintain the requested services and to meet ownership and lease obligations. The financial information is being filed under separate cover requesting confidential treatment.

DOCUMENT NUMBER-DATE 03149 MAR 108 FPSC-RECORDS/REPORTING



# CONFIDENTIAL

# ADVANCED TELCOM GROUP, INC. (A Development Stage Enterprise)

Financial Statements

December 31, 1998

(With Independent Auditors' Report Thereon)

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#### **Table of Contents**

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1

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	Page
Independent Auditors' Report	1
Balance Sheet	2
Statement of Operations	3
Statement of Stockholders' Equity	4
Statement of Cash Flows	5
Notes to Financial Statements	6

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500 E. Middlefield Road Mountain View, CA 94043

#### Independent Auditors' Report

The Board of Directors Advanced TelCom Group, Inc.:

We have audited the accompanying balance sheet of Advanced TelCom Group, Inc. (the Company), a development stage enterprise, as of December 31, 1998, and the related statements of operations, stockholders' equity, and cash flows for the period from July 22, 1998 (inception) to December 31, 1998. 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 audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Advanced TelCom Group, Inc., a development stage enterprise, as of December 31, 1998, and the results of its operations and its cash flows for the period from July 22, 1998 (inception) to December 31, 1998, in conformity with generally accepted accounting principles.

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February 11, 1999

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#### ADVANCED TELCOM GROUP, INC. (A Development Stage Enterprise)

#### **Balance** Sheet

December 31, 1998

#### Assets

Current assets: Cash and cash equivalents Prepaid expenses and other assets

Total current assets

Networks and equipment, net

#### Liabilities and Stockholders' Equity

Current liabilities: Accounts payable Accrued expenses

Total liabilities

#### Commitments

Stockholders' equity:

Redeemable convertible preferred stock:

Series A, \$0.0001 par value; 27,000 shares authorized, issued, and outstanding; liquidation preference of \$2,000,000

Series B, \$0.0001 par value; 1,350,000 shares authorized;

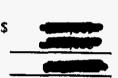
336,775 shares issued and outstanding; liquidation preference of \$24,946,305 Redeemable preferred stock, no par value; 27,000 shares authorized and unissued Common stock, \$0.0001 par value; 2,346,000 shares authorized; 73,000 shares issued and outstanding Additional paid-in capital (par value in excess of contribution)

Deficit accumulated during the development stage

Total stockholders' equity

Total liabilities and stockholders' equity

See accompanying notes to financial statements.





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#### ADVANCED TELCOM GROUP, INC. (A Development Stage Enterprise)

Statement of Operations

Period from July 22, 1998 (inception) to December 31, 1998

Costs and expenses: Technical expenses Sales and marketing General and administrative

Loss from operations

Interest income

Net loss



See accompanying notes to financial statements.

#### ADVANCED TELCOM GROUP, INC. (A Development Stage Enterprise) Statement of Stockholders' Equity Period from July 22, 1998 (inception) to December 31, 1998

Deficit accumulated Redeemable convertible preferred stock Additional during the Total Series A Serles B Redeemable preferred stock Common stock paid-in development stockholders' Shares Shares Amount Amount Shares Amount Shares Amount capital stage equity sance of common stock to founders 5 - \$ 5 ance of Series A redeemable convertible preferred stock 4 4. sance of Series B redeemable onvertible preferred stock, set of issuance costs of \$164,288 loss ances as of December 31, 1998

accompanying notes to financial statements.

4

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Statement of Cash Flows

Period from July 22, 1998 (inception) to December 31, 1998

Cash flows from operating activities: Net loss \$ Adjustments to reconcile net loss to net cash used in operating activities: Depreciation Changes in operating assets and liabilities: - Prepaid expenses and other assets Accounts payable and other current liabilities Net cash used in operating activities Cash flows used in investing activities - acquisitions of networks and equipment Cash flow from financing activities: Proceeds from sale of preferred stock, net Proceeds from sale of common stock, net Net cash provided by financing activities Net increase in cash and cash equivalents Cash and cash equivalents, beginning of period Cash and cash equivalents, end of period

See accompanying notes to financial statements.

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#### ADVANCED TELCOM GROUP, INC. (A Development Stage Enterprise)

Notes to Financial Statements

December 31, 1998

#### (1) Description of Business and Summary of Significant Accounting Policies

#### (a) Description of Business

Advanced TelCom Group, Inc. (the Company) was incorporated in the state of Delaware on July 22, 1998, and raised initial equity funding of **Company** from founders and other investors. In addition, the Company secured subscriptions to Series B redeemable convertible preferred stock in the amount of **Company** (see Note 3). The Company is a facilities-based competitive local exchange carrier that focuses on the under served markets in midsized cities across the United States. The Company is in the development and pre-revenue phase of its existence. Primary activities to date have included identifying markets, raising capital, developing strategic alliances, and designing an operating support system.

#### (b) Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported results of operations during the reporting period. Actual results could differ from those estimates.

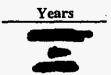
#### (c) Cash and Cash Equivalents

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents.

#### (d) Networks and Equipment.

Networks and equipment are stated at cost. Depreciation is provided using the straight-line method over the estimated useful lives of the assets as follows:

Telecommunication networks Electronics and related equipment Furniture and office equipment



CONFIDENTIAL

## ADVANCED TELCOM GROUP, INC.

(A Development Stage Enterprise)

Notes to Financial Statements

December 31, 1998

#### (e) Income Taxes

The Company uses the asset and liability method of accounting for income taxes. Under this method, 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 and operating loss and tax credit carryforwards. 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. A valuation allowance is recorded to reduce deferred tax assets to an amount whose realization is more likely than not. The effect on deferred tax assets and liabilities of a change in tax rates is recognized as income in the period that includes the enactment.

#### (f) Accounting for Impairment of Long-Lived Assets

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value less cost to sell.

#### (g) Comprehensive Loss

The Company has no significant components of other comprehensive loss and, accordingly, the comprehensive loss is the same as net loss for the period presented.

#### (h) Internal Use Software

The Company accounts for the costs of internal use software pursuant to the American Institute of Certified Public Accountants issued Statement of Position (SOP) 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use. In accordance with SOP 98-1, the Company has expensed the costs incurred during the year related to the evaluation of its financial and operating support system requirements.

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Notes to Financial Statements

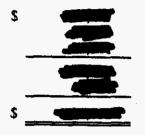
December 31, 1998

#### (2) Networks and Equipment

Networks and equipment as of December 31, 1998, consisted of the following:

Telecommunications networks Electronics and related equipment Furniture and office equipment

Less accumulated depreciation



As of December 31, 1998, networks and equipment represent networks in progress that are not in service and, accordingly, have not been depreciated.

Included in fixed assets are payments for an Indefeasible Right of Use (IRU) of optical fibers in the second secon

#### (3) Stockholders' Equity

#### (a) Series A Redeemable Convertible Preferred Stock

The Company has **preferred** authorized and issued shares of Series A redeemable convertible preferred stock (Series A preferred stock) as of December 31, 1998. The Series A preferred stock is convertible, at the option of the holder, into fully paid and nonassessable shares of common stock and redeemable preferred stock. The conversion rate is one share of common stock and one share of redeemable preferred stock for each share of Series A preferred stock, subject to adjustments for stock dividends, stock splits, and capital reorganizations and dilution. The Series A preferred stock automatically converts upon the closing of an underwritten public offering of shares of the Company's common stock prior to November 30, 2003, resulting in total proceeds of at least **company** and with a minimum share price of at least **company**. The holders of the Series A preferred stock are entitled to vote on an "as if converted" basis.

The Series A preferred stock accumulates dividends at a rate of 15% per annum compounded annually. In the event of a liquidation, dissolution, or winding up of the Company, the holders of Series A preferred stock will be paid an amount equal to the original purchase price plus accumulated but unpaid dividends. In the event that the Company is prohibited under applicable law from redeeming the shares of Series A preferred stock at the liquidation date, then beginning 30 days after such date, interest will accrue on the outstanding redemption amount at a rate of 15% per annum compounded annually, increasing to a maximum of 20% per annum compounded annually until such time of redemption.

CONFIDENTIAL

Notes to Financial Statements

December 31, 1998

Shares of Series A preferred stock are redeemable after November 30, 2005, upon written request of the holder of such shares. The redemption price is equal to the amount determined pursuant to a liquidation as described above.

During 1998, the Company issued **Company** shares of Series A preferred stock for cash of t

#### (b) Series B Redeemable Convertible Preferred Stock

The Company has **preferred** suthorized shares of Series B redeemable convertible preferred stock (Series B preferred stock), **preferred** of which were issued and outstanding as of December 31, 1998. The Series B preferred stock is convertible, at the option of the holder, into fully paid and nonassessable shares of common stock. The conversion rate is one-for-one, subject to adjustments for stock dividends, stock splits, and capital reorganizations and dilution. The Series B preferred stock automatically converts upon the closing of an underwritten public offering of shares of the Company's common stock prior to November 30, 2003, resulting in total proceeds of at least **preferred** and with

a minimum share price of at least **(and the preferred stock are entitled to vote on an** "as if converted" basis.

The Series B preferred stock accumulates dividends at a rate of 10% per annum compounded annually. In the event of a liquidation, dissolution, or winding up of the Company, the holders of Series B preferred stock will be paid an amount equal to the original purchase price plus accumulated but unpaid dividends. In the event that the Company is prohibited under applicable law from redeeming the shares of Series B preferred stock at the liquidation date, then beginning 30 days after such date, interest will accrue on the outstanding redemption amount at a rate of 15% per annum compounded annually, increasing to a maximum of 20% per annum compounded annually until such time of redemption.

Shares of Series B preferred stock are redeemable after November 30, 2005, upon written request of the holders of such shares. The redemption price is equal to the amount determined pursuant to a liquidation as described above.

During 1998, **Control** shares of Series B preferred stock were subscribed for at an aggregate committed purchase price of **Control**. The Company issued **Control** shares for cash of **Control** net of issuance costs of **Control**. The **Company** issued **Control** shares of Series B redeemable convertible preferred stock represent subscriptions receivable of **Control** which will be funded at such time and in such amounts as determined by a majority of the Board of Directors and not less than 75% of the Board of Director members representing the holders of Series A and B redeemable convertible preferred stock. Additionally each investor may fund at any time the remaining portion of their investment amount.

CONFIDENTIAL

Notes to Financial Statements

December 31, 1998

#### (c) Redeemable Preferred Stock

The Company has **provide** authorized redeemable preferred stock, none of which have been issued as of December 31, 1998. The redeemable preferred stock are nonvoting and only issuable upon conversion of shares of Series A preferred stock. The redeemable preferred stock accumulate dividends at an annual rate of 15% compounded annually.

In the event of a liquidation, dissolution, or winding up of the Company, the holders of redeemable preferred stock will be paid an amount equal to the original purchase price that was paid for the Series A redeemable convertible preferred stock converted into redeemable preferred stock plus accumulated but unpaid dividends, including accumulated and unpaid dividends on the Series A preferred stock converted into redeemable preferred stock. In the event that the Company is prohibited under applicable law from redeeming the shares of redeemable preferred stock at the liquidation date, then beginning 30 days after such date, interest will accrue on the outstanding redemption amount at a rate of 15% per annum compounded annually, increasing to a maximum of 20% per annum compounded annually until such time of redemption.

The redeemable preferred stock are redeemable (1) at the option of the Company, at any time, (2) upon written notice to the holders of the redeemable preferred stock, and (3) at the option of the holders upon the earlier of the closing of an underwritten public offering or upon written request of the majority of the holders of such shares subsequent to November 30, 2003. The redemption price is equal to the amount determined pursuant to a liquidation as described above.

#### (d) Common Stock

There are **providents** authorized shares of common stock with a par value of **the set of the set of** 

During 1998, the Company issued the shares of common stock for cash of

#### (e) Stock Option Plan

During 1998, the Company adopted its 1998 Stock Option Plan (the Plan) under which the Board of Directors may issue either nonqualified or incentive stock options to employees, officers, directors, advisers or contractors of the Company. The Company reserved **Contractors** shares of common stock for issuance under the Plan. The Plan expires 10 years from the date of adoption. Options are granted at fair market value at date of grant for incentive stock options or no less than 85% of fair market value for nonqualified options. Options will vest under the terms of the option agreements. There were no options issued as of December 31, 1998.

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#### Notes to Financial Statements

December 31, 1998

#### (4) Income Taxes

The Company accounts for income taxes in accordance with the provisions of Statement of Financial Accounting Standards No. 109. No provision for income taxes was recorded for 1998. As of December 31 1998, the deferred income tax asset totaled **totaled totaled** comprised primarily of deferred start-up and organizational costs. A valuation allowance is provided when it is more likely than not that some portion of the deferred tax asset will not be realized. The Company has established a valuation allowance for the entire portion of the net deferred income tax asset.

#### (5) Commitments

The Company leases office space at various locations under noncancelable operating leases, which expire at various dates through 2003. Future minimum lease payments as of December 31, 1998, are as follows:

Year ending December 31.	
1 <del>999</del>	
2000	
2001	*
2002	×.
2003	
Thereafter	· ·
Total mini	imum lease payments

\$ \$

Rent expense for the period from July 22, 1998 (inception) to December 31, 1998, was

In relation to an IRU, the Company has a purchase commitment of **set and a set of the se** 

#### (6) Subsequent Event

Effective February 11, 1999, the Company amended its Certificate of Incorporation, whereby each outstanding share of common stock was split and converted into 10 shares of common stock. The stock split results in **Company** authorized shares of common stock with a par value of **Company**. The qualifying minimum share price of the Company's common stock has been adjusted to a minimum share price of at least **Company** and the conversion price of the Series A and B redeemable convertible preferred stock have been adjusted to **Company** to reflect this split (see Note 3).

#### ATG GROUP, INC. AND SUBSIDIARY CONSOLIDATED TRENDED STATEMENT OF OPERATIONS For the Eleven Months Ended November 30, 1999 (Unaudited and Confidential)

Year to Date	November	October	Quarterly Trended Results			
Eleven Months Ended	One Month Ended	One Month Ended	Three Months Ended	Three Months Ended	Three Months Ended	
November 30, 1999	November 30, 1999	October 31, 1999	September 30, 1999	June 30, 1999	March 31, 1999	

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#### Revenue

Cost of sales

#### Gross margin

#### Costs and expenses

Selling, general and administrative expenses Depreciation and amortization

#### Total costs and expenses

Loss from operations

#### Interest expense

Interest and other income

#### Net loss

EBITDA

#### ATG GROUP, INC. AND SUBSIDIARY CONSOLIDATED STATEMENT OF CASH FLOWS For the Eleven Months Ended November 30, 1999 (Unaudited and Confidential)

YTD	Nov Oct		Qu	arterly Trended Results		
Eleven Months Ended November 30, 1999	One Month Ended November 30, 1999	One Month Ended October 31, 1999	Three Month Ended September 30, 1999	Three Months Ended June 30, 1999	Three Months Ended March 31, 1999	

Cash flows from operating activities:

Net Loss

Adjustments to reconcile net loss to net cash used in operating activities: Depreciation and amortization Changes in operating assets and liabilities: Accounts receivable Unbilled revenue Prepaid expenses and other assets Accounts payable and other current liabilities related to operating activities Net cash used for operating activities

Cash flows used in investing activities

Purchase of property, plant and equipment Change in accounts payable and other current liabilities related to purchases of property, plant and equipment Acquisition and related costs of Shared Communications Services, Inc. Acquisition and related costs of NewComm Net, Inc. Net cash used by investing activities

Cash flows from financing activities:

Proceeds from sale of preferred stock Increase in long term payable for non-compete contract Payments for loan origination costs Proceeds from long term debt Principal payments for Capital Leases Net cash provided by financing activities

Net increase (decrease) in cash and cash equivalents

Cash and cash equivalents, beginning of period

Cash and cash equivalents, end of period

loncash investing activities Common Stock Issued for Purchase of NewComm Net, Inc.

oncash financing activities

Preferred stock dividends accrued

### ATG GROUP, INC. AND SUBSIDIARY CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY For the Eleven Months Ended November 30, 1999 (Unaudited and Confidential)

			•	Deficit	
				accumulated	
				during the	Total
Common Stock		Additional	development	stockholders'	
_	Shares	Amount	paid-in capital	stage	deficit

Balances at December 31, 1998

Shares Issued for Acquisition of Newcomm Net, Inc.

Dividends on preferred stock

Net loss

Balances as of October 31, 1999

### ATG GROUP, INC. AND SUBSIDIARY CONSOLIDATED STATEMENT OF OPERATIONS For the Eleven Months Ended November 30, 1999 (Unaudited and Confidential)

	· · · · · · · · · · · · · · · · · · ·	Year to Date Results			Month of November Results		
	•			Actual Results			
				for Month	Budget for		
			Variance:	Ended	Month Ended	Variance:	
			Favorable /	November 30,	November 30,	Favorable /	
	YTD Actual	YTD Budget	(Unfavorable)	1999	1999	(Unfavorable)	
D		· · · · · · · · · · · · · · · · · · ·	· · · · · · · · · · · · · · · · · · ·				

Revenue Cost of services

Gross margin

Costs and expenses

Selling, general and administrative expenses Depreciation and amortization

Total costs and expenses

Loss from operations

Interest expense Interest and other income

> Net loss Dividends on preferred stock

Net loss attributable to common shareholders

EBITDA

#### ATG GROUP, INC. AND SUBSIDIARY CONSOLIDATED BALANCE SHEET November 30, 1999 (Unaudited and Confidential)

Quarterly Trended Balance Sheets

1

Current assets: Cash and cash equivalents Accounts receivable Unbilled revenue Income taxes receivable Prepaid expenses and other

Total current assets

Property, plant and equipment, net Loan origination costs, net Intangible assets Other assets

Total assets

Current liabilities: Accounts payable Accrued liabilities and other Current portion of capital leases

Total current liabilities

Long term debt Capital leases Other long term liabilities

Redeemable convertible preferred stock:
Series A, \$0.0001 par value; 1,350,000 shares authorized, issued and outstanding; stated at liquidation preference
Series B, \$0.0001 par value; 40,500,042 shares issued and outstanding; stated at liquidation preference
Series C, \$0.0001 par value; 751,940 shares issued and outstanding; stated at liquidation preference
Series B; 26,999,958 ahares subscribed but unissued
Series B; subscription receivable
Redeemable preferred stock, \$0.0001 par value; 1,350,000 shares authorized and unissued

Stockholders' deficit: Common stock, \$0.001 par value; 4,900,458 shares issued and outstanding Additional paid-in capital Deficit accumulated during the development stage

Total stockholders' deficit

Total liabilities and stockholders' deficit