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

**FORM 10-Q**

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

For the quarterly period ended September 30, 2011

OR

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

Commission File Number: 333-169979

**Zayo Group, LLC**

(Exact Name of Registrant as Specified in Its Charter)

**DELAWARE**  
(State or other jurisdiction of  
incorporation or organization)

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

**400 Centennial Parkway, Suite 200,  
Louisville, CO 80027**  
(Address of Principal Executive Offices)

**(303) 381-4683**  
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No  The registrant is no longer subject to the filing requirements of the Exchange Act, but has filed all Exchange Act reports as if it were required to do so.

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a small reporting company)

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

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

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**ZAYO GROUP, LLC AND SUBSIDIARIES**

**PART I. FINANCIAL INFORMATION**

**ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)**

(in thousands)

	<u>September 30, 2011</u>	<u>June 30, 2011</u>
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 20,846	\$ 25,394
Trade receivables, net of allowance of \$900 and \$799 as of September 30, 2011 and June 30, 2011, respectively	20,976	13,983
Due from related-parties	15	187
Prepaid expenses	6,886	6,388
Deferred income taxes	3,374	3,343
Other assets, current	<u>1,053</u>	<u>645</u>
<b>Total current assets</b>	<b>53,150</b>	<b>49,940</b>
Property and equipment, net of accumulated depreciation of \$112,520 and \$101,941 as of September 30, 2011 and June 30, 2011, respectively	534,513	518,513
Intangible assets, net of accumulated amortization of \$31,968 and \$37,980 as of September 30, 2011 and June 30, 2011, respectively	101,349	104,672
Goodwill	83,805	83,820
Debt issuance costs, net	10,867	11,446
Investment in US Carrier	15,075	15,075
Other assets, non-current	<u>5,949</u>	<u>5,795</u>
<b>Total assets</b>	<b><u>\$ 804,708</u></b>	<b><u>\$ 789,261</u></b>
<b>Liabilities and member's equity</b>		
Current liabilities		
Accounts payable	\$ 13,833	\$ 12,988
Accrued liabilities	26,270	22,453
Accrued interest	1,621	10,627
Capital lease obligations, current	967	950
Due to related-parties	4,590	4,590
Deferred revenue, current	<u>15,911</u>	<u>15,664</u>
<b>Total current liabilities</b>	<b>63,192</b>	<b>67,272</b>
Capital lease obligations, non-current	9,978	10,224
Long-term debt	354,450	354,414
Deferred revenue, non-current	71,996	63,893
Stock-based compensation liability	48,561	45,067
Deferred tax liability	12,289	8,322
Other long term liabilities	<u>2,744</u>	<u>2,724</u>
<b>Total liabilities</b>	<b>563,210</b>	<b>551,916</b>
Commitments and contingencies (Note 14)		
<b>Member's equity</b>		
Member's interest	246,438	245,433
Accumulated deficit	<u>(4,940)</u>	<u>(8,088)</u>
<b>Total member's equity</b>	<b>241,498</b>	<b>237,345</b>
<b>Total liabilities and member's equity</b>	<b><u>\$ 804,708</u></b>	<b><u>\$ 789,261</u></b>

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

**ZAYO GROUP, LLC AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)**  
(in thousands)

	<b>Three months ended</b>	
	<b>September 30,</b>	
	<b>2011</b>	<b>2010</b>
Revenue	\$ 78,443	\$ 62,926
Operating costs and expenses		
Operating costs, excluding depreciation and amortization	18,150	17,038
Selling, general and administrative expenses	22,596	20,284
Stock-based compensation	3,704	5,131
Depreciation and amortization	17,062	11,808
Total operating costs and expenses	61,512	54,261
Operating income	16,931	8,665
Other expenses		
Interest expense	(9,168)	(6,257)
Other expense, net	(11)	(161)
Total other expense, net	(9,179)	(6,418)
Earnings from continuing operations before provision for income taxes	7,752	2,247
Provision for income taxes	4,604	2,799
Earnings/(loss) from continuing operations	3,148	(552)
Earnings from discontinued operations, net of income taxes	—	280
Net earnings/(loss)	\$ 3,148	\$ (272)

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

**ZAYO GROUP, LLC AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENT OF MEMBER'S EQUITY**  
**THREE MONTHS ENDED SEPTEMBER 30, 2011**  
**(UNAUDITED)**  
**(in thousands)**

	<b>Member's interest</b>	<b>Accumulated Deficit</b>	<b>Total Member's equity</b>
Balance at July 1, 2011	\$ 245,433	\$ (8,088)	\$ 237,345
Capital contributed (cash)	100	—	100
Capital contributed (non-cash)	695	—	695
Accretion of preferred stock-based compensation	210	—	210
Net earnings	—	3,148	3,148
Balance at September 30, 2011	<u>\$ 246,438</u>	<u>\$ (4,940)</u>	<u>\$ 241,498</u>

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

**ZAYO GROUP, LLC AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**  
(in thousands)

	Three months ended September 30,	
	2011	2010
<b>Cash flows from operating activities</b>		
Net earnings/(loss)	\$ 3,148	\$ (272)
Earnings from discontinued operations	—	280
<b>Earnings/(loss) from continuing operations</b>	<b>3,148</b>	<b>(552)</b>
<i>Adjustments to reconcile net earnings/(loss) to net cash provided by operating activities</i>		
Depreciation and amortization	17,062	11,808
Provision for bad debt expense	148	179
Non-cash interest expense	616	535
Stock-based compensation	3,704	5,131
Amortization of deferred revenues	(2,580)	(1,737)
Deferred income taxes	4,462	2,307
<b>Changes in operating assets and liabilities, net of acquisitions</b>		
Trade receivables	(7,141)	(2,155)
Prepaid expenses	(498)	(802)
Other assets	201	1,383
Accounts payable and accrued liabilities	(5,268)	(5,984)
Due to/from related parties	169	94
Customer prepayments	10,182	1,602
Other liabilities	20	(1,327)
<b>Net cash provided by continuing operating activities</b>	<b>24,225</b>	<b>10,482</b>
<b>Cash flows from investing activities</b>		
Purchases of property and equipment	(31,442)	(21,396)
Broadband stimulus grants received	2,798	250
Acquisition of AGL Networks, LLC, net of cash acquired	—	(73,666)
<b>Net cash used in investing activities</b>	<b>(28,644)</b>	<b>(94,812)</b>
<b>Cash flows from financing activities</b>		
Equity contributions	100	35,500
Principal repayments on capital lease obligations	(229)	(610)
Advance from Communications Infrastructure Investments, LLC	—	13,026
Proceeds from long-term debt	—	103,000
Changes in restricted cash	—	790
Deferred financing costs	—	(3,319)
<b>Net cash (used in)/provided by financing activities</b>	<b>(129)</b>	<b>148,387</b>
<b>Cash flows from discontinued operations</b>		
Operating activities	—	1,229
Investing activities	—	(225)
<b>Net cash provided by discontinued operations</b>	<b>—</b>	<b>1,004</b>
Net (decrease)/increase in cash and cash equivalents	(4,548)	65,061
Cash and cash equivalents, beginning of period	25,394	87,864
Increase in cash and cash equivalents of discontinued operations	—	(494)
<b>Cash and cash equivalents, end of period</b>	<b>\$ 20,846</b>	<b>\$ 152,431</b>

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

(Continued)

ZAYO GROUP, LLC AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)  
(in thousands)

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

	Three months ended	
	September 30,	
	2011	2010
Cash paid for interest	\$ 18,344	\$ 13,457
Cash paid for income taxes	323	1,455
Non-cash purchases of equipment through capital leasing	—	125
Increase in accrued expenses for purchases of property and equipment	1,096	3,182

Refer to Note 3 — *Acquisitions*, to the Company's condensed consolidated financial statements for details of the Company's recent acquisitions and Note 4 — *Spin-off of Business Unit* for details of the Company's discontinued operations.

Refer to Note 11 — *Equity*, to the Company's condensed consolidated financial statements for details of the non-cash capital settlements.

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

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONDENSED CONSOLIDATED STATEMENTS (UNAUDITED) (in thousands)

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

Zayo Group, LLC, a Delaware Limited Liability Company, formerly CII Holdco, 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 and Internet infrastructure 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:

- Dark and lit bandwidth infrastructure services on metro and regional fiber networks.
- Colocation and interconnection 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”).

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

##### a. Basis of Presentation

The accompanying condensed 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. The accompanying condensed consolidated financial statements and related notes are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) for interim financial reporting and pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”) for quarterly reports on Form 10-Q, and do not include all of the information and note disclosures required by GAAP for complete financial statements. These condensed consolidated financial statements should therefore be read in conjunction with the consolidated financial statements and notes thereto for the year ended June 30, 2011 included in the Company’s Annual Report on Form 10-K filed with the SEC on September 9, 2011. In the opinion of management, all adjustments considered necessary for fair presentation of financial position, results of operations and cash flows of the Company have been included. The results of operations for the three month period ended September 30, 2011 are not necessarily indicative of the operating results for any interim period or the full year.

Unless otherwise noted, dollar amounts and disclosures throughout the Notes to the condensed consolidated financial statements relate to the Company’s continuing operations and are presented in thousands of dollars.

##### b. Spin-off of Business Units

On April 1, 2011, the Company completed a spin-off of its Zayo Enterprise Networks (“ZEN”) business unit. The Company distributed all of the assets and liabilities of ZEN to Holdings on the spin-off date.

Management determined that it had discontinued all significant cash flows and continuing involvement with respect to ZEN’s operations and therefore considers ZEN to be a discontinued operation. During the three months ended September 30, 2010, the results of the operations of ZEN have been aggregated and are presented in a single caption entitled, “Earnings from discontinued operations, net of income taxes” on the accompanying condensed consolidated statements of operations. Management has not allocated any general corporate overhead to amounts presented in discontinued operations, nor has it elected to allocate interest costs.

##### c. Use of Estimates

The preparation of the Company’s condensed consolidated financial statements in conformity with GAAP requires 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

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONDENSED CONSOLIDATED STATEMENTS (UNAUDITED) (in thousands)

line cost billings, determining useful lives for depreciation and amortization, assessing the need for impairment charges (including those related to intangible assets and goodwill), allocating purchase price among the fair values of assets acquired and liabilities assumed, accounting for income taxes and related valuation allowance against deferred tax assets, estimating the stock-based compensation liability, and various other items. Management evaluates these estimates and judgments on an ongoing basis and makes estimates based 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. Restricted cash balances which are not expected to become unrestricted during the next twelve months are recorded as other assets, non-current.

#### **e. Investments**

Investments in which the Company does not have significant influence over the investee, or investments that do not have a readily determinable fair value are recorded using the cost method of accounting. Under this method, the investment is recorded in the balance sheet at historical cost. Subsequently, the Company recognizes as income any dividends received that are distributed from earnings since the date of initial investment. Dividends received that are distributed from earnings prior to the date of acquisition are recorded as a reduction of the cost of the investment. Cost method investments are reviewed for impairment if factors indicate that a decrease in value of the investment has occurred.

#### **f. Trade Receivables**

Trade receivables are recorded at the invoiced amount and do not bear interest. 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.

#### **g. 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 date fair value. 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. Management estimates the useful life of property and equipment by reviewing historical usage, with consideration given to technological changes, trends in the industry, and other economic factors that could impact the network architecture and asset utilization.

Equipment acquired under capital leases is 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. Depreciation 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.

Management reviews property and equipment for impairment whenever events or changes in circumstances indicate that the carrying value of its property and equipment 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.

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONDENSED CONSOLIDATED STATEMENTS (UNAUDITED) (in thousands)

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 property and equipment and the resulting amount of the impairment. No impairment charges were recorded for property and equipment during the three months ended September 30, 2011 or 2010.

The Company capitalizes interest for all assets that require a period of time to get them ready for their intended use.

#### **h. 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 May and when a triggering event occurs between impairment test dates. The goodwill impairment test is a two-step test. Under the first step, the estimated fair value of the reporting unit is compared with its carrying value (including goodwill). If the estimated 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. 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 finite 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 charges were recorded for goodwill or intangibles during the three months ended September 30, 2011 or 2010.

#### **i. 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 a 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 term.

The Company typically records revenues from leases of dark fiber, including indefeasible rights-of-use ("IRU") agreements, as services are provided. Dark fiber IRU agreements generally require the customer to make a down payment upon execution of the agreement; however in some cases the Company receives up to the entire lease payment at the inception of the lease and recognizes the revenue ratably over the lease term. IRU contract terms are reviewed to determine if the terms would require sales-type accounting treatment, which would result in revenue recognition upon the execution of the contract. Sales-type accounting treatment is required for dark fiber leases when the agreements provide for the transfer of legal title to the dark fiber to the customer at the end of the agreement's term and the following criteria have been met:

- the sale has been consummated;
- the customer's initial and continuing investments are adequate to demonstrate a commitment to pay for the property;
- the Company's receivable is not subject to future subordination; and
- the Company has transferred to the buyer the usual risks and rewards of ownership in a transaction that is in substance a sale and does not have a substantial continuing involvement with the property.

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONDENSED CONSOLIDATED STATEMENTS (UNAUDITED) (in thousands)

#### **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 charges 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 condensed consolidated financial statements, management 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 common units granted by 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 three or four years and may fully vest subsequent to a liquidation event.

The preferred units granted by the Company's ultimate parent company, CII, are considered stock-based compensation with terms that require the awards to be classified as equity. As such, the Company accounts for these awards as equity, which requires the cost to be measured at the grant date based on the fair value of the award and which is recognized as expense over the requisite service period.

Determining the fair value of share-based awards at the grant date and subsequent reporting dates requires judgment. If actual results differ significantly from these estimates, stock-based compensation expense and the Company's results of operations could be materially impacted.

#### **l. Government Grants**

The Company receives grant moneys from the National Telecommunications and Information Administration ("NTIA") Broadband Technology Opportunity Program. The Company recognizes government grants when it is probable that the Company will comply with the conditions attached to the grant arrangement and the grant will be received. The Company accounts for grant moneys received for reimbursement of capital expenditures as a reduction 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 recognizes income taxes under the asset and liability 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. 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.

There are various factors that may cause tax assumptions to change in the near term, and the Company may have to record a

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONDENSED CONSOLIDATED STATEMENTS (UNAUDITED) (in thousands)

future valuation allowance against its deferred tax assets. The Company recognizes the benefit of an uncertain tax position taken or expected to be taken on its income tax returns if it is “more likely than not” that such tax position will be sustained based on its technical merits.

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

#### **n. Fair Value of Financial Instruments**

The Company applies ASC 820-10 *Fair Value Measurements*, for its financial assets and liabilities. 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; and
- 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.

The Company views 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, management 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.

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

Financial instruments that potentially subject the Company to concentration of credit risk consist principally of cash investments and accounts receivable. The Company does not enter into financial instruments for trading or speculative

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONDENSED CONSOLIDATED STATEMENTS (UNAUDITED) (in thousands)

purposes. The Company's cash and cash equivalents are primarily 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. As of September 30, 2011, the Company had three customers with a trade receivable balance in excess of 10 percent of the Company's consolidated net trade receivable balance. These three customers accounted for 18 percent, 12 percent and 11 percent of the consolidated net trade receivable balance as of September 30, 2011. As of June 30, 2011 the Company had one customer with a trade receivable balance of 12 percent of total receivables. As of September 30, 2011, the Company had two customers that accounted for over 10 percent of the Company's monthly recurring revenue – the Company's largest customer accounted for 13 percent and a second customer accounted for 10 percent of the Company's monthly recurring revenue. As of September 30, 2010, the Company had one customer that accounted for 10 percent of the Company's monthly recurring revenue.

#### p. Recently Issued Accounting Standards

From time to time, the FASB or other standards-setting bodies issue new accounting pronouncements. Updates to ASC's are communicated through issuance of an Accounting Standards Update ("ASU"). Management has reviewed all new accounting pronouncements and believes they will not have a material impact on the Company's consolidated results of operations, financial condition, or financial disclosure.

### (3) ACQUISITIONS

Since the formation of Zayo Group, LLC in May 2007, the Company has consummated 12 business combinations. The consummation of the acquisitions was executed as part of the Company's business strategy of expanding through acquisitions. The acquisition of these businesses have allowed 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 condensed consolidated financial statements include the operations of the acquired entities from their respective acquisition dates.

#### Acquisitions during the year ended June 30, 2011

##### *American Fiber Systems Holding Corporation ("AFS")*

On October 1, 2010, the Company completed a merger with American Fiber Systems Holding Corporation, the parent company of American Fiber Systems, Inc. ("AFS Inc."). The AFS merger was consummated with the exchange of \$110,000 in cash and a \$4,500 non-interest bearing promissory note due in 2012 for all of the interest in AFS. The Company calculated the fair market value of the promissory note to be \$4,141 resulting in an aggregate purchase price of \$114,141. The purchase price was based upon the valuation of both the business and assets directly owned by AFS and its ownership interest in US Carrier Telecom Holdings, LLC ("US Carrier"). There was no contingent consideration associated with the purchase. The acquisition was financed with cash on hand and proceeds from the issuance of the Company's \$100,000 note issuance – See Note 9— *Long-Term Debt*.

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 owns and operates approximately 1,251 routes miles and over 172,415 fiber miles of fiber networks.

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(in thousands)

The following table presents the Company's allocation of the purchase price to the assets acquired and liabilities assumed, based on their estimated fair values on the acquisition date.

<b>Acquisition date</b>	<b>AFS October 1, 2010</b>
Current assets	\$ 3,808
Property and equipment	56,481
Intangibles – customer relationships	57,082
Goodwill	15,731
Investment in US Carrier	15,075
Other assets	350
<b>Total assets acquired</b>	<b>148,527</b>
Current liabilities	3,396
Deferred revenue	23,905
Deferred tax liability	3,958
Other liabilities	3,127
<b>Total liabilities assumed</b>	<b>34,386</b>
<b>Net assets acquired</b>	<b>114,141</b>
Seller Note payable to former AFS Holdings owners	(4,141)
<b>Net cash paid</b>	<b>\$ 110,000</b>

The goodwill of \$15,731 arising from the AFS merger consists of the synergies and economies-of-scale expected from the AFS merger. The goodwill associated with the AFS merger is not deductible for tax purposes. The Company has allocated the goodwill to the business units that are expected to benefit from the acquired goodwill. The allocation was determined based on the excess of the fair value of the acquired business over the fair value of the individual assets acquired and liabilities assumed that are assigned to the business units. Goodwill of \$8,061 and \$7,670 was allocated to the Zayo Bandwidth and Zayo Fiber Solutions business units, respectively.

In connection with the AFS merger, the Company acquired significant customer relationships. These relationships represent a valuable intangible asset as the Company anticipates continued business from the AFS customer base. The Company valued the AFS customer relationships utilizing the multi-period excess earnings valuation technique which resulted in a fair market value of \$57,082.

In connection with the AFS merger, the previous owners had entered into various agreements, including IRU agreements with other telecommunication service providers to lease them fiber and other bandwidth infrastructure. The Company recorded the acquired deferred revenue balance at the acquisition date at fair market value, which was determined based upon management's assessment of the future costs to be incurred in connection with the Company's continued legal obligation associated with the acquired deferred revenue plus a reasonable profit margin. A fair value of \$23,905 was assigned to the acquired deferred revenue balance of AFS. The balance of the deferred revenue with no remaining obligations was not recorded. The acquired deferred revenue is expected to be recognized over the next five to twenty years.

*AGL Networks, LLC ("AGL Networks")*

On July 1, 2010 the Company acquired all of the equity interest in AGL Networks. AGL Networks is a communication service provider focused on providing dark fiber services to its customers who are primarily located in the Atlanta, Georgia; Phoenix, Arizona; and Charlotte, North Carolina markets. AGL Networks operated a network of approximately 786 route miles and over 190,000 fiber miles. The purchase price of this acquisition, after post-close adjustments, was \$73,666. The acquisition was financed with cash on hand. There was no contingent consideration associated with the purchase.

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

<b>Acquisition date</b>	<b>AGL Networks July 1, 2010</b>
Current assets	\$ 3,714
Property and equipment	93,136
Intangibles – customer relationships	3,433
Goodwill	220
Other assets	680
Total assets acquired	<u>101,183</u>
Current liabilities	1,006
Deferred revenue	26,511
Total liabilities assumed	<u>27,517</u>
Net assets acquired	<u>\$ 73,666</u>
Purchase consideration/Net cash paid	<u>\$ 73,666</u>

The goodwill of \$220 arising from the AGL Networks acquisition consists of the synergies and economies-of-scale expected from combining the operations of AGL Networks and the Company. The goodwill associated with the AGL Networks acquisitions is deductible for tax purposes. The full amount of the goodwill recognized in the AGL Networks acquisition has been assigned to the Zayo Fiber Solutions business unit.

In connection with the AGL Networks acquisition, the Company acquired certain customer relationships. These relationships represent a valuable intangible asset as the Company anticipates continued business from the AGL Networks customer base. The Company valued the AGL Networks customer relationships utilizing the multi-period excess earnings valuation technique which resulted in a fair market value of \$3,433.

In connection with the AGL Networks acquisition, the previous owners had entered into various agreements, including infeasible rights-of-use agreements with other telecommunication service providers to lease them fiber and other bandwidth infrastructure. The Company recorded the acquired deferred revenue balance at the acquisition date at fair market value which was determined based upon management's assessment of the future costs to be incurred in connection with the Company's continued legal obligation associated with the acquired deferred revenue plus a reasonable profit margin. A fair value of \$26,511 was assigned to the acquired deferred revenue balance of AGL Networks. The balance of the deferred revenue with no remaining obligations was not recorded. The acquired deferred revenue is expected to be recognized over the next five to twenty years.

*Acquisition costs*

Acquisition costs include expenses incurred which are directly related to potential and closed acquisitions. The Company incurred acquisition-related costs of \$330 and \$159 which have been charged to selling, general and administrative expenses during the three months ended September 30, 2011 and 2010, respectively.

**(4) SPIN-OFF OF BUSINESS UNIT**

Effective January 1, 2011, the Company finalized a restructuring of its business units which resulted in the segments more closely aligning with their product offerings rather than a combination of product offerings and customer demographics. See Note 16 – *Segment Reporting*, for discussion of the restructuring. Prior to the restructuring, the ZEN unit held a mix of bandwidth infrastructure, colocation, interconnection, competitive local exchange carrier ("CLEC") and enterprise product offerings. Subsequent to the restructuring, the remaining ZEN unit consisted of only CLEC and enterprise product offerings. As the product offerings provided by the restructured ZEN unit fall outside of the Company's business model of providing bandwidth infrastructure, colocation and interconnection services, the unit was spun-off to Holdings, the parent of the Company, on April 1, 2011.

Consistent with discontinued operations reporting provisions, management determined that it has discontinued all significant cash flows and continuing involvement with respect to the ZEN operations effective April 1, 2011. Therefore, for the three months

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### NOTES TO THE CONDENSED CONSOLIDATED STATEMENTS (UNAUDITED) (in thousands)

ended September 30, 2010, the results of the operations of ZEN have been aggregated in a single caption entitled, "Earnings from discontinued operations, net of income taxes" on the accompanying condensed 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.

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

	<u>Three months ended</u> <u>September 30, 2010</u>
Revenue	\$ 5,653
Earnings before income taxes	\$ 480
Income tax expense	(200)
Earnings from discontinued operations, net of income taxes	\$ 280

The Company continues to have ongoing contractual relationships with ZEN, which are based on agreements which were entered into at estimated market rates. The Company has contractual relationships to provide ZEN with certain data and colocation services and ZEN has contractual relationships to provide the Company with certain enterprise services. Prior to April 1, 2011, transactions with ZEN were eliminated upon consolidation. Since the spin-off date, transactions with ZEN have been included in the Company's results of operations. See Note 15 — *Related-Party Transactions*, for a discussion of transactions with ZEN during the three months ended September 30, 2011.

#### (5) INVESTMENT

In connection with the AFS merger, the Company acquired an ownership interest in US Carrier. US Carrier is a regional provider of certain telecommunication services to and from cities and rural communities throughout Georgia and other states in the Southeast United States. AFS Inc.'s continued ownership in US Carrier is comprised of 55% of the outstanding Class A membership units and 34% of the outstanding Class B membership units. Subsequent to the AFS merger, the board of managers of US Carrier has recognized AFS Inc.'s economic interest in US Carrier; however, the board of managers has claimed that the AFS merger at the American Fiber Systems Holdings Corporation level resulted in an unauthorized transfer of AFS Inc.'s ownership interest under the US Carrier operating agreement which would result in a loss of AFS Inc.'s voting interest. The Company has requested the financial information which would be necessary to account for the US Carrier investment utilizing the equity method of accounting but has been denied this information by the board of managers of US Carrier. The Company has also requested that US Carrier recognize AFS Inc.'s continued and uninterrupted representation on the board of managers but such requests have been denied. AFS Inc. has filed an arbitration proceeding against US Carrier to protect its ownership position in US Carrier, including all of its rights under the US Carrier operating agreement. Although the Company has a significant ownership position in US Carrier, at this time and in light of US Carrier's wrongful actions, AFS Inc. is unable to exercise significant influence over US Carrier's operating and financial policies and as such the Company has accounted for this investment utilizing the cost method of accounting.

At the time of the AFS merger, management estimated the fair market value of its interest in US Carrier to be \$15,075. In valuing the Company's interest in US Carrier, management used both an income- and market- based approach to estimate the acquisition date fair market value. Since the acquisition, the Company has not received any dividend payments from US Carrier nor has the Company invested any additional capital in US Carrier.

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(in thousands)

**(6) PROPERTY AND EQUIPMENT**

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

	Estimated useful lives (in years)	As of	
		September 30, 2011	June 30, 2011
Land	N/A	228	\$ 228
Building improvements and site improvements	8 to 15	11,976	11,692
Furniture, fixtures and office equipment	3 to 7	1,269	1,295
Computer hardware	2 to 5	2,759	3,461
Software	2 to 3	3,005	4,243
Machinery and equipment	3 to 7	7,012	6,469
Fiber optic equipment	4 to 8	339,053	326,163
Circuit switch equipment	10	7,955	7,378
Packet switch equipment	3 to 5	21,299	20,727
Fiber optic network	8 to 20	198,343	192,926
Construction in progress	N/A	54,134	45,872
Total		647,033	620,454
Less accumulated depreciation		(112,520)	(101,941)
Property and equipment, net		<u>\$ 534,513</u>	<u>\$ 518,513</u>

Total depreciation expense, including depreciation of assets held under capital leases, for the three months ended September 30, 2011 and 2010 was \$13,739 and \$9,107, respectively. During the three months ended September 30, 2011, the Company wrote-off \$3,160 of fully depreciated property and equipment.

Included within the Company's property and equipment balance are capital leases with a cost basis of \$11,929 (net of accumulated depreciation of \$3,897) and \$12,215 (net of accumulated depreciation of \$3,611) as of September 30, 2011 and June 30, 2011, respectively. The Company recognized depreciation expense associated with assets under capital leases of \$286 and \$347 for the three months ended September 30, 2011 and 2010, respectively.

During the three months ended September 30, 2011 and 2010, the Company received a total of \$2,798 and \$250, respectively, in grant money from the NTIA's Broadband Technology Opportunities Program ("the 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 additional \$31,894 in grant money related to grant agreements entered into as a direct recipient under the Broadband Technology Opportunities Program as of September 30, 2011 which will offset capital expenditures in future periods. As of September 30, 2011, the Company has incurred \$3,245 of capital expenditures which are pending reimbursement from the program. The Company's property and equipment balance will be reduced by this amount upon receipt of these reimbursements. See Note 14 — *Commitments and Contingencies- Other Commitments*.

During the three months ended September 30, 2011 and 2010, the Company capitalized interest in the amount of \$831 and \$925, respectively. The Company also capitalized \$1,853 and \$1,244 of labor to property and equipment accounts during the three months ended September 30, 2011 and 2010, respectively.

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(in thousands)

**(7) GOODWILL**

The Company's goodwill balance was \$83,805 and \$83,820 as of September 30, 2011 and June 30, 2011, respectively, and was allocated as follows to the Company's business units:

	As of June 30, 2011	Adjustments	As of September 30, 2011
Zayo Bandwidth	\$ 71,714	\$ (15)	\$ 71,699
Zayo Fiber Solutions	12,082	—	12,082
zColo	24	—	24
<b>Total</b>	<b><u>\$ 83,820</u></b>	<b><u>\$ (15)</u></b>	<b><u>\$ 83,805</u></b>

**(8) INTANGIBLE ASSETS**

Identifiable acquisition-related intangible assets as of September 30, 2011 and June 30, 2011 were as follows:

	Gross Carrying Amount	Accumulated Amortization	Net
<b>September 30, 2011</b>			
Customer relationships	<u>\$133,317</u>	<u>\$ (31,968)</u>	<u>\$101,349</u>
<b>June 30, 2011</b>			
Customer relationships	\$ 133,317	\$ (28,645)	\$ 104,672
Non-compete agreements	8,835	(8,835)	—
Tradenames	500	(500)	—
<b>Total</b>	<b><u>\$ 142,652</u></b>	<b><u>\$ (37,980)</u></b>	<b><u>\$ 104,672</u></b>

The weighted average amortization period for the customer relationship intangible assets is 11.1 years. The amortization of intangible assets for the three months ended September 30, 2011 and 2010 was \$3,323 and \$2,701, respectively. During the three months ended September 30, 2011, the Company wrote off \$9,335 in fully amortized intangible assets. Estimated future amortization of intangible assets is as follows:

Year ending June 30,	
2012 (remaining nine months)	\$ 9,966
2013	13,289
2014	11,073
2015	8,693
2016	8,598
Thereafter	49,730
<b>Total</b>	<b><u>\$101,349</u></b>

**(9) LONG-TERM DEBT**

In March 2010, the Company co-issued, with its 100 percent owned finance subsidiary — Zayo Capital Inc. (at an issue price of 98.779%), \$250,000 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 \$239,050 after deducting the discount on the Notes of \$3,052 and debt issuance costs of approximately \$7,898. 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 Notes issued in March is 10.87%. The Company used a portion of the proceeds from this issuance of the Notes to repay its term loans in March of 2010.

In September 2010, the Company completed an offering of an additional \$100,000 in Notes (at an issue price of 103%). These Notes are part of the same series as the \$250,000 Senior Secured Notes and also accrue interest at a rate of 10.25% and mature on

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March 15, 2017. The net proceeds from this debt issuance were approximately \$98,954 after adding the premium on the Notes of \$3,000 and deducting debt issuance costs of approximately \$4,046. The effective interest rate on the Notes issued in September is 10.41%. The Company used a portion of the proceeds from this issuance of the Notes to fund the merger with AFS (See Note 3 — *Acquisitions*).

The balance of the Notes was \$350,141 and \$350,147 at September 30, 2011 and June 30, 2011, net of unamortized premiums and discounts of \$141 and \$147, respectively.

In October 2010, in connection with the AFS merger, the former owners of AFS provided the Company with a promissory note in the amount of \$4,500. The note is a non-interest bearing note and is due in full on October 1, 2012. The Company recorded this note at its fair market value on the acquisition date, which was determined to be \$4,141. Management estimated the imputed interest associated with this note on the acquisition date to be \$359, which is being recognized over the term of the promissory note. During the three months ended September 30, 2011, the Company recognized interest expense and a corresponding increase to the promissory note obligation of \$43. The balance of the promissory note was \$4,309 and \$4,266 as of September 30, 2011 and June 30, 2011, respectively.

In March 2010, the Company also entered into a revolving line-of-credit (the “Revolver”). Concurrent with offering the \$100,000 Notes in September 2010, the Company amended the terms of its Revolver to increase the borrowing capacity from \$75,000 to \$100,000 (adjusted for letter of credit usage). The Company has capitalized \$2,248 in debt issuance costs associated with the Revolver.

The Revolver expires on March 1, 2014 and bears interest at the option of the Company at either a base rate or a Eurodollar rate plus the applicable margin which is based on the following table:

Level	Leverage Ratio	Applicable Margin for LIBOR Advances	Applicable Margin for Base Rate Advances
I	Greater than or equal to 3.25 to 1.00	4.50%	3.50%
II	Greater than or equal to 2.50 to 1.00 but less than 3.25 to 1.00	4.00%	3.00%
III	Greater than or equal to 1.75 to 1.00 but less than 2.50 to 1.00	3.75%	2.75%
IV	Less than 1.75 to 1.00	3.50%	2.50%

The leverage ratio as defined in the credit agreement is determined based on the Company’s total outstanding debt (including capital leases) divided by the previous quarter’s annualized earnings before interest expense, income taxes, depreciation and amortization. In addition to the interest rate on outstanding borrowings, the Company is required to pay an unused line fee of 0.5% on any undrawn portion of the Revolver.

As of September 30, 2011 and June 30, 2011, no amounts were outstanding under the Revolver. Standby letters of credit were outstanding in the amount of \$6,420 resulting in \$93,580 being available on the Revolver as of September 30, 2011 and June 30, 2011. Outstanding letters of credit backed by the Revolver accrue interest at a rate ranging from 3.5 to 4.5 percent per annum based upon the Company’s leverage ratio. As of September 30, 2011, the interest rate was 4.0 percent.

#### *Guarantees*

The Notes are fully and unconditionally guaranteed, jointly and severally, on a senior secured basis by all of the Company’s current and future domestic restricted subsidiaries. The Notes were co-issued with Zayo Group Capital, Inc., which is a 100 percent owned finance subsidiary of the parent and does not have independent assets or operations.

#### *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 balance of debt issuance costs as of September 30, 2011 and June 30, 2011 was \$10,867 (net of accumulated amortization of \$3,326) and \$11,446 (net of accumulated amortization of \$2,746), respectively. Interest expense associated with the amortization of debt issuance costs was \$580 and \$449 during the three months ended September 30, 2011 and 2010, respectively. The amortization of debt issuance costs is included on the condensed consolidated statements of cash flows within

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the caption “non-cash interest expense” along with the amortization or accretion of the premium and discount on the Company’s outstanding Notes.

#### *Debt covenants*

The Company’s credit agreement associated with the \$100,000 Revolver 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, which is defined as funded debt to annualized earnings before interest, taxes, depreciation and amortization, non-cash charges or reserves and certain extraordinary or non-recurring gains or losses (“modified EBITDA”) of 4.25x the last quarter’s annualized modified EBITDA.

*Fixed-charge coverage ratio:* The Company must maintain a consolidated fixed-charge coverage ratio, as determined under the credit agreement, of at least 1.1x for the periods ended 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 restricts certain dividend payments to the Company’s parent. Under the terms of the agreement, if the Company’s Revolver availability is in excess of \$32,500 the Company may pay an annual dividend to its parent of up to \$45,000, which is limited based upon the following leverage ratios:

<u>Leverage Ratio</u>	<u>Maximum Annual Dividend Payment</u>
Greater than or equal to 3.5x	\$ —
Less than 3.5x but greater than or equal to 2.5x	\$ 25,000
Less than 2.5x but greater than or equal to 1.5x	\$ 35,000
Less than 1.5x	\$ 45,000

The Company does not have any restrictions on its subsidiaries’ ability to pay dividends to Zayo Group.

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 \$10,000, insolvency or inability to pay debts, bankruptcy, or a change of control.

The Company was in compliance with all covenants associated with its Notes and credit agreement as of September 30, 2011 and June 30, 2011.

#### *Redemption rights*

At any time prior to March 15, 2013, the Company may redeem all or part of the Notes at a redemption price equal to the sum of (i) 100 percent of the principal amount thereof, plus (ii) the applicable premium as of the date of redemption, plus (iii) accrued and unpaid interest and additional interest, if any, to the date of redemption, subject to the rights of the holders of the Notes on the relevant record date to receive interest due on the relevant interest payment date. The applicable premium is the greater of (i) 1.0% of the principal amount of the redeemed Notes and (ii) the excess of (A) the present value at the date of redemption of (1) the redemption price of the Notes at March 15, 2013, plus (2) all remaining required interest payments due on such Notes through March 15, 2013 (excluding accrued but unpaid interest to the date of redemption), discounted to present value using a discount rate equal to the Treasury Rate plus 50 basis points, over (B) the principal amount of such Notes.

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On or after March 15, 2013, the Company may redeem all or part of the Notes, at the redemption prices (expressed as percentages of principal amount and set forth below), plus accrued and unpaid interest and additional interest, if any, thereon, to the applicable redemption date, subject to the rights of the holders of the Notes on the relevant record date to receive interest due on the relevant interest payment date, if redeemed during the 12-month period beginning on March 15 of the years indicated below:

Year	Redemption Price
2013	105.125%
2014	102.563%
2015 and thereafter	100.000%

In the event of an equity offering, at any time prior to March 15, 2013, the Company may redeem up to 35% of the aggregate principal amount of the Notes issued under the Company's indenture at a redemption price of 110.25% of the principal amount thereof, plus accrued and unpaid interest and additional interest, if any, thereon to the redemption date, subject to the rights of the holders of the Notes on the relevant record date to receive interest due on the relevant interest payment date, with the net cash proceeds of one or more equity offerings, provided that at least (i) 65% of the aggregate principal amount of the Notes issued under the indenture remains outstanding immediately after the occurrence of such redemption and (ii) the redemption must occur within 90 days of the date of the closing of such equity offering.

The Company may purchase the Notes in open-market transactions, tender offers, or otherwise. The Company is not required to make any mandatory redemption or sinking fund payments with respect to the Notes.

#### (10) INCOME TAXES

The Company, a limited liability company, is taxed at its parent level, Holdings. All income tax balances resulting from the operations of Zayo Group are pushed down to the Company.

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

	For the three months ended September 30,	
	2011	2010
Federal income taxes — current	\$ —	\$ 148
Federal income taxes — deferred	3,717	1,984
Provision for federal income taxes	<u>3,717</u>	<u>2,132</u>
State income taxes — current	143	344
State income taxes — deferred	744	323
Provision for state income taxes	<u>887</u>	<u>667</u>
Provision for income taxes	<u>\$4,604</u>	<u>\$2,799</u>

The Company's effective income tax rate differs from what would be expected if the federal statutory rate were applied to earnings before income taxes primarily because of certain expenses that represent permanent differences between book and tax expenses/deduction, such as stock-based compensation expenses that are deductible for financial reporting purposes but not deductible for tax purposes.

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONDENSED CONSOLIDATED STATEMENTS (UNAUDITED) (in thousands)

A reconciliation of the actual income tax provision and the tax computed by applying the U.S. federal rate (34%) to the earnings before income taxes during the three month periods ended September 30, 2011 and 2010 follows:

	For the three months ended September 30,	
	2011	2010
Expected provision at statutory rate of 34%	\$ 2,636	\$ 763
Increase due to:		
Non-deductible stock-based compensation	1,259	1,745
State income taxes, net of federal benefit	587	227
Transactions costs not deductible	112	54
Other, net	10	10
Provision for income taxes	\$ 4,604	\$ 2,799

Deferred income taxes reflect the 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.

Each interim period, management estimates the annual effective tax rate and applies that rate to its reported year-to-date earnings. The tax expense or benefit related to significant, unusual, or extraordinary items that will be separately reported, or reported net of their related tax effect, are individually computed and are recognized in the interim period in which those items occur. In addition, the effect of changes in enacted tax laws or rates or tax status is recognized in the interim period in which the change occurs.

The computation of the annual estimated effective tax rate at each interim period requires certain estimates and significant judgment including, but not limited to, the expected operating income for the year, projections of the proportion of income earned and taxed in various jurisdictions, permanent and temporary differences, and the likelihood of realizing deferred tax assets generated in the current year. The accounting estimates used to compute the provision for income taxes may change as new events occur, more experience is acquired, additional information is obtained, or the tax environment changes.

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 owing additional income taxes. The statute of limitations is open with respect to tax years 2007 to 2010 however, to the extent that the Company has a net operating loss (“NOL”) balance which was generated in a tax year outside of this statute of limitations period, such tax years will remain open until such NOLs are utilized by the Company. The Company establishes reserves, when the management believes there is uncertainty with respect to certain positions and the Company may not succeed in realizing the tax benefits. 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. 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 September 30, 2011 and June 30, 2011, there were no unrecognized tax benefits. As of September 30, 2011 and June 30, 2011, there was no accrued interest or penalties related to uncertain tax positions.

Management believes it is more likely than not that it will utilize its net deferred tax assets to reduce or eliminate tax payments in future periods. The Company’s evaluation encompassed (i) a review of its recent history of profitability for the past three years (excluding permanent book versus tax differences) and (ii) a review of internal financial forecasts demonstrating its expected capacity to utilize its deferred tax assets.

#### (11) EQUITY

Zayo Group, LLC was initially formed on May 4, 2007, and is a wholly-owned subsidiary of Holdings, which in turn is wholly owned by CII. CII was organized on November 6, 2006, and subsequently capitalized on May 7, 2007, with capital contributions from various institutional and founder investors. Cash, property, and service proceeds from the capitalization of CII were contributed to the Company and the contributions are reflected in the Company’s member’s equity.

During the three months ended September 30, 2010, CII contributed \$35,500 in capital to the Company through Holdings. CII

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONDENSED CONSOLIDATED STATEMENTS (UNAUDITED) (in thousands)

funded this amount from equity contributions from its investors. During the three months ended September 30, 2011, the Company received an additional \$100 in capital from Holdings. As of September 30, 2011, the equity commitments from CII's investors have been fulfilled.

CII has issued preferred units to certain executives as compensation. The terms of these preferred unit awards require equity accounting treatment. As such, the Company estimates the fair value of these equity awards on the grant date and recognizes the related expense over the vesting period of the awards.

During fiscal year 2008, CII issued 6,400,000 Class A preferred units in CII to the two founders of the Company. The vesting for these units was completed in September 2010. Management estimated the fair value of the equity awards on the grant date to be \$6,400. Stock-based compensation expense recognized in connection with these Class A units was \$240 during the three months ended September 30, 2010. These Class A Preferred Units were in lieu of any significant cash compensation to the founders during the period beginning on May 1, 2007 and ending October 31, 2010.

In June 2010, CII issued 136,985 Class B preferred units to two of the Company's Board members. The Class B preferred units issued vest over a period of three years. Management estimated the fair value of the equity awards on the grant date to be \$312. In March of 2011, one of these Board members resigned from his position resulting in a forfeiture of the 63,926 Class B preferred units issued to the Board member and a reversal of the stock compensation expense recognized related to the grant. The grant date fair value of the 73,059 class B preferred units issued to the remaining Board member was determined to be \$167. Stock-based compensation expense recognized for these grants during the three months ended September 30, 2011 and 2010 was \$10 and \$26, respectively.

In December 2010, CII issued 390,000 Class B preferred units to a founder of the Company. Management estimated the fair value of the equity awards on the grant date to be \$967 based on a weighted average of various market and income based valuation approaches. The Company recognizes the related expense over the vesting period of three years which began October 31, 2010. In January of 2011, CII issued an additional 580,000 Class B preferred units to the same founder. The Company estimated the fair value of these equity awards on the grant date to be \$1,438 and the Company recognizes the related expense over a vesting period of three years which began October 31, 2010. The preferred units issued to the Company founder are in lieu of any significant cash compensation for the founder during the three year vesting period that started on October 31, 2010. Stock-based compensation expense recognized for these Class B preferred units during the three months ended September 30, 2011 was \$200.

As these awards have been issued by CII to employees and Directors of the Company as compensation, the related expense has been recorded by the Company in the accompanying condensed consolidated statements of operations.

Holdings is the taxable parent of the Company and Onvoy Voice Services, Inc. ("Onvoy"). Subsequent to spinning the ZEN segment to Holdings, Holdings contributed the assets and liabilities of the historical ZEN segment to Onvoy. Holdings allows for the sharing of Holding's NOL carryforwards between the Company and OVS. To the extent that any entity utilizes NOLs or other tax assets that were generated or acquired by the other entity, the entities will settle the related-party transfer of deferred tax asset associated with such NOLs and other deferred-tax transfers between the companies via an increase or decrease to the respective entities' member's equity. During the three months ended September 30, 2011, the Company member's equity balance increased by \$695 as a result of utilizing tax assets of Onvoy.

#### **(12) STOCK COMPENSATION**

The Company has been given authorization by CII to issue 125,000,000 of CII's common units as profits interest awards to employees and directors. As of September 30, 2011, CII had five classes of common units with different liquidation preferences — Class A, B, C, D and E 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 September 30, 2011, 108,462,120 common units were issued and outstanding to employees and directors of the Company and 11,264,440 common units were available to be issued.

The common units are considered to be 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 until the date of settlement.

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONDENSED CONSOLIDATED STATEMENTS (UNAUDITED) (in thousands)

As of September 30, 2011 and June 30, 2011, the estimated fair value of the common units was as follows:

Common Unit Class	As of	
	September 30, 2011	June 30, 2011
	(estimated per share value)	
Class A	\$0.83	\$0.81
Class B	\$0.59	\$0.58
Class C	\$0.36	\$0.33
Class D	\$0.34	\$0.31
Class E	\$0.25	\$0.23

The liability associated with the common units was \$48,561 and \$45,067 as of September 30, 2011 and June 30, 2011, respectively. The stock-based compensation expenses associated with the common units was \$3,494 and \$4,865 during the three months ended September 30, 2011 and 2010, respectively.

The holders of common units are not entitled to transfer their units or 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 capital contributions of the CII preferred unit holders plus their priority return of 6% per annum has been reimbursed. The remaining proceeds from a liquidation event are distributed between the preferred and common unit holders on a scale ranging from 85% to the preferred unit holders and 15% to the common unit holders to 80% to the preferred unit holders and 20% to the common unit holders. The percentage allocated to the common unit holders is dependent upon the return multiple realized by the Class A preferred unit holders. The maximum incremental allocation of proceeds from a liquidation event to common unit holders, of 20 percent, occurs if the return multiple realized by the Class A preferred unit holders reaches 3.5 times the Class A preferred holder's combined capital contributions. As discussed above, the Class A common unit holders receive proceeds from a liquidation event once the preferred shareholders capital contributions and accrued dividends are returned. The Class B common unit holders begin sharing in the proceeds of a liquidation event once the Class A common unit holders have been distributed a total of \$15,000 of the liquidation proceeds. The Class C common unit holders begin sharing in the proceeds of a liquidation event once the earlier common unit classes have been distributed a combined \$40,000 in proceeds. The Class D common unit holders begin sharing in the proceeds of a liquidation event once the earlier common unit classes have been distributed a combined \$45,000 in proceeds. Lastly, the Class E common unit holders begin sharing in the proceeds of a liquidation event once the earlier common unit classes have been distributed a combined \$75,000 in proceeds.

### (13) FAIR VALUE MEASUREMENTS

The Company's financial instruments consist of cash and cash equivalents, restricted cash, trade receivable, accounts payable, 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 September 30, 2011 and June 30, 2011 due to the short maturity of these instruments. The carrying value of the Company's Notes reflects the original amounts borrowed, net of unamortized discounts or accretion of premiums and was \$350,141 and \$350,147 as of September 30, 2011 and June 30, 2011, respectively. Based on current market interest rates for debt of similar terms and average maturities and based on recent transactions, the fair value of the Notes balance as of September 30, 2011 and June 30, 2011, is estimated to be \$364,000 and \$385,875, respectively. The Company recorded its promissory note with the previous owners of AFS at its fair value on the acquisition date, which was determined to be \$4,141. Management estimated the imputed interest associated with this note to be \$359, which is being recognized through March 2017. The fair value of this note is not re-measured each reporting period; however, based on current interest rates for debt instruments with similar maturity dates, the September 30, 2011 book value of the AFS promissory note approximates fair value. The Company records its stock-based compensation liability at its estimated fair value.

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONDENSED CONSOLIDATED STATEMENTS (UNAUDITED) (in thousands)

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

	Level	September 30, 2011	June 30, 2011
<i>Liabilities Recorded at Fair Value in the Financial Statements:</i>			
Stock-based compensation liability	Level 3	\$ 48,561	\$ 45,067

We use a third party valuation firm to assist in the valuation of our common units each reporting period and preferred units when granted. In developing a value for these units, we utilize a two-step valuation approach. In the first step we estimate the value of our equity instruments through an analysis of valuations associated with various future potential liquidity scenarios for our shareholders. A composite valuation is developed based upon the probability-weighted present values of each of the scenarios. The second step involves allocating this value across our capital structure. The valuation is conducted in consideration of the guidance provided in the American Institute of Certified Public Accountant (“AICPA”) Practice Aid “Valuation of Privately-Held Company Equity Securities Issued as Compensation” and with adherence to the Uniform Standards of Professional Appraisal Practice (“USPAP”) set forth by the Appraisal Foundation.

In estimating the fair value of the common units, the Company has historically evaluated both market and income based valuation techniques. The income approach was based on managements’ projected free cash flows. The market based approach, estimates the fair value based on the prices paid by investors and acquirers of interests of comparable companies in the public and private markets. The valuation was based on a weighted average of the market and income valuation techniques. As a result of the Company’s expansion since inception and due to the fact that the committed capital from the Company’s ultimate investors has been fully funded, the potential of a liquidation event for the Company’s shareholders in the future has increased. As such, management revised the market based approach utilized in the valuation of the common units to account for potential liquidation events beginning with the quarter ended March 31, 2011.

Effective on March 31, 2011, the Company employed a probability-weighted estimated return method to value the common units. The method estimates the value of the units based on an analysis of values of the enterprise assuming various future outcomes. The estimated fair value of the common units is based on a probability-weighted present value of expected future proceeds to the Company’s shareholders, considering each potential liquidity scenario available to the Company’s investors as well as preferential rights of each security. This approach utilizes a variety of assumptions regarding the likelihood of a certain scenario occurring, if the event involves a transaction, the potential timing of such an event, and the potential valuation that each scenario might yield. The potential future outcomes that were considered by management were remaining a private company with the same ownership, a sale or merger, an initial public offering (“IPO”), and a partial recapitalization.

#### (14) COMMITMENTS AND CONTINGENCIES

##### *Purchase commitments*

At September 30, 2011, the Company was contractually committed for \$19,027 of capital expenditures for construction materials and purchases of property and equipment. These purchase commitments exclude commitments related to stimulus projects – see – *Other Commitments*. A majority of these purchase commitments are expected to be satisfied in the next twelve months. These purchase commitments are primarily success-based; that is, the Company has executed customer contracts that support the future capital expenditures. These purchase commitments include commitments associated with the stimulus grants.

##### *Outstanding letters of credit*

As of September 30, 2011, the Company had \$6,420 in outstanding letters of credit, primarily to collateralize surety bonds securing the Company’s performance under various contracts.

##### *Other commitments*

In February 2010, the Company was awarded an NTIA Broadband Technology Opportunities Program grant for a fiber network project in Indiana (the “Indiana Stimulus Project”). The Indiana Stimulus Project involves approximately \$31,425 of capital

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONDENSED CONSOLIDATED STATEMENTS (UNAUDITED) (in thousands)

expenditures, of which \$25,140 is to be funded by a government grant and approximately \$6,285 is to be funded by the Company. In connection with this project, 626 route miles of fiber are to be constructed and lit. The Company began capitalizing certain preconstruction costs associated with this project in April of 2010 and began receiving grant funds in May 2010. As of September 30, 2011, the Company has been reimbursed for \$96 of expenses and \$5,945 of capital expenditures related to the Indiana Stimulus Project. The Company also contributed \$4,400 of pre-existing network assets to the project. The Company anticipates this project will be completed within the next two years.

In July 2010, the Company was awarded from the NTIA Broadband Technology Opportunities Program a \$13,383 grant to construct 286 miles of fiber network in Anoka County, Minnesota, outside of Minneapolis (the "Anoka Stimulus Project"). The Anoka Stimulus Project involves approximately \$19,117 of capital expenditures, of which \$13,383 is to be funded by a government grant and approximately \$5,735 is to be funded by the Company. As of September 30, 2011, the Company has been reimbursed for \$121 of expenses and \$467 of capital expenditures related to the Anoka Stimulus Project. The Company anticipates this project will be completed within the next two years.

In September 2011, the company signed a sub-recipient agreement on an award granted to Com Net, Inc ("Com Net") from the NTIA Broadband Technology Opportunities Program. The award of approximately \$30,032 to Com Net will expand broadband services to rural and underserved communities in Western Ohio. In order to effectively implement the project, Com Net established the GigE Plus Availability Coalition consisting of Zayo, OARnet and an initial group of 33 Broadband Service Providers to deploy broadband to 28 western Ohio counties. Upon completion, the project will add nearly 366 new miles of fiber to Zayo's existing Ohio network. As a sub recipient, the Company is required to contribute to the federal match. The Company's maximum contribution is \$3,111 which represents a 30 percent match on the assets of which the Company will take ownership. The company anticipates the project will be completed by July 2013.

#### *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 material adverse effect on the Company's financial condition, results of operations, or cash flows.

#### **(15) RELATED-PARTY TRANSACTIONS**

As of September 30, 2011 and June 30, 2011, the Company had a due to related-party balance with CII of \$4,590 which is payable on demand. The liability with CII relates to an interest payment made by CII on the Company's Notes. During the three months ended September 30, 2010, CII made an advance payment of \$13,026 to the Company which was returned to CII during the three months ended December 31, 2010. The advance was used to make an interest payment on the Company's Notes.

The Company has contractual relationships with Onvoy, which are based on agreements which were entered into at estimated market rates. 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 and enterprise services. As of September 30, 2011 and June 30, 2011, the Company had a net receivable balance due from Onvoy in the amount of \$15 and \$187, respectively, related to services the Company provided to Onvoy and services Onvoy provided to the Company. The following table represents the revenue and expense transactions recognized with Onvoy which are included in the Company's condensed consolidated statement of operations during the three months ended September 30, 2011 and 2010.

	For the Three Months Ended September 30,	
	2011	2010
Revenue	\$ 1,593	1,195
Operating costs	125	—
Selling, general and administrative expenses	143	568
Net	\$ 1,325	\$ 627

On September 14, 2010, Dan Caruso, the Company's President, Chief Executive Officer and Director of Zayo Group, LLC,

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONDENSED CONSOLIDATED STATEMENTS (UNAUDITED) (in thousands)

purchased \$500 of the Company's Notes in connection with the Company's \$100,000 Notes offering in September 2010. The purchase price of the notes acquired by Mr. Caruso was \$516 after considering the premium on the notes and accrued interest.

#### (16) SEGMENT REPORTING

A business unit is 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 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's business units have historically been identified by both the products they offer and the customers they serve. Effective January 1, 2011, management approved a restructuring of the ZEN unit, which resulted in all of the Company's business units more closely aligning with their product offerings rather than a combination of product offerings and customer demographics. The restructuring of the ZEN unit resulted in the ZEN unit transferring its bandwidth infrastructure products to the ZB unit and its colocation products to the zColo unit. The restructured ZEN unit, which contained only the Company's legacy managed services and CLEC product offerings, was spun-off to Holdings on April 1, 2011.

Subsequent to the restructuring, the ZB unit offers primarily lit bandwidth infrastructure services and the zColo unit provides colocation and inter-connection transport services. The Company has restated the comparative historical segment financial information below to account for the restructuring of the business units.

In connection with the AGL Networks acquisition (See Note 3 — *Acquisitions*), Zayo established the ZFS unit. ZFS is dedicated to marketing and supporting dark fiber related services. Prior to the formation of the ZFS unit, the Company's dark fiber assets and the related revenues and expenses associated with dark fiber customers were allocated between ZB and ZEN based upon the nature and size of the customers receiving the dark fiber services. Upon the formation of the ZFS business units, effective July 1, 2011, dark fiber assets of the Company and the related revenues and expense associated with dark fiber customers were allocated to the ZFS business unit.

Prior to the formation of the ZFS unit, the Company generated income from dark fiber products. The historical operating results from this product offering were primarily reflected in the results of the ZB business unit. The Company has not restated the historical ZB unit information to carve-out the operating results related to dark fiber services prior to the July 1, 2010 formation of the ZFS unit as management has determined it is impractical to do so.

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

**ZAYO GROUP, LLC AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED STATEMENTS (UNAUDITED)**  
(in thousands)

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

**As of and for the three months ended September 30, 2011**

	<b>ZB</b>	<b>zColo</b>	<b>ZFS</b>	<b>Corporate/ eliminations</b>	<b>Total</b>
Revenue	\$ 56,544	\$ 9,668	\$ 13,231	—	\$ 79,443
Intersegment revenue	—	(1,000)	—	—	(1,000)
Revenue from external customers	56,544	8,668	13,231	—	78,443
Gross profit (revenue less operating costs excluding depreciation and amortization)	43,136	4,935	12,758	(536)	60,293
Depreciation and amortization	11,744	1,373	3,945	—	17,062
Operating income/(loss)	13,060	1,817	4,120	(2,066)	16,931
Interest expense	(212)	(54)	(7)	(8,895)	(9,168)
Other (expense)/income, net	(19)	—	1	7	(11)
Earnings from continuing operations before provision for income taxes	12,829	1,763	4,114	(10,954)	7,752
Total assets	504,762	52,757	218,863	28,326	804,708
Capital expenditures, net of stimulus grant reimbursements	24,117	900	3,627	—	28,644

**As of and for the three months ended September 30, 2010**

	<b>ZB</b>	<b>zColo</b>	<b>ZFS</b>	<b>Corporate/ eliminations</b>	<b>Total</b>
Revenue	\$48,943	\$ 7,564	\$ 7,821	\$ —	\$ 64,328
Intersegment revenue	(794)	(608)	—	—	(1,402)
Revenue from external customers	48,149	6,956	7,821	—	62,926
Gross profit (revenue less operating costs excluding depreciation and amortization)	35,260	3,977	7,665	(1,014)	45,888
Depreciation and amortization	8,558	1,352	1,898	—	11,808
Operating income/(loss)	8,255	1,334	2,181	(3,105)	8,665
Interest expense	(262)	(59)	(2)	(5,934)	(6,257)
Other income/(expense), net	—	—	2	(163)	(161)
Earnings from continuing operations before provision for income taxes	7,993	1,275	2,181	(9,202)	2,247
Total assets	374,140	58,143	138,132	175,008	745,423
Capital expenditures, net of stimulus grant reimbursements	19,103	438	1,605	—	21,146

**(17) CONDENSED CONSOLIDATING FINANCIAL INFORMATION**

On June 30, 2011, the Company completed a rollup of certain legal subsidiaries into Zayo Group, LLC. The rollup included the merger of the following legal subsidiaries up and into Zayo Group, LLC: (i) Zayo Bandwidth, LLC; (ii) Zayo Fiber Solutions, LLC; (iii) Zayo Bandwidth Tennessee, LLC; and (iv) Adesta Communications, Inc. In connection with the rollup, the assets, liabilities and operating results of these legacy subsidiaries were consolidated with and into the Zayo Group, LLC entity. Prior to the rollup, Zayo Group, LLC did not have significant independent assets or operations. Subsequent to the rollup, Zayo Colocation, Inc. (and its subsidiaries), American Fiber Systems Holding Corp (and its subsidiary American Fiber Systems, Inc.), and Zayo Capital, Inc. remain the only wholly owned legal subsidiaries of the Company.

In March 2010, the Company co-issued, with its 100 percent owned finance subsidiary — Zayo Capital, Inc. (at an issue price of 98.779%) \$250,000 of Senior Secured Notes. The notes bear interest at 10.25% annually and are due on March 15, 2017.

In September 2010, the Company completed an offering of an additional \$100,000 in notes (at an issue price of 103%). These notes are part of the same series as the \$250,000 Senior Secured Notes and also accrue interest at a rate of 10.25% and mature on March 15, 2017.

## **ZAYO GROUP, LLC AND SUBSIDIARIES**

### **NOTES TO THE CONDENSED CONSOLIDATED STATEMENTS (UNAUDITED) (in thousands)**

Both note issuances are fully and unconditionally guaranteed, jointly and severally, on a senior secured basis by all of the Company's current and future domestic restricted subsidiaries. Zayo Capital, Inc., the co-issuer of both Note issuances, does not have independent assets or operations.

The accompanying condensed consolidating financial information has been prepared and presented pursuant to SEC Regulation S-X Rule 3-10 "Financial statements of guarantors and affiliates whose securities collateralize an issue registered or being registered."

The operating activities of the separate legal entities included in the Company's condensed consolidated financial statements are interdependent. The accompanying condensed consolidating financial information presents the results of operations, financial position and cash flows of each legal entity. Zayo Group, LLC and Zayo Colocation, Inc. provide services to each other during the normal course of business. These transactions are eliminated in the consolidated results of the Company.

**ZAYO GROUP, LLC AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED STATEMENTS (UNAUDITED)**  
(in thousands)

**Condensed Consolidating Balance Sheets**  
**September 30, 2011**

	<b>Zayo Group, LLC</b>	<b>Zayo Colocation, Inc.</b>	<b>Eliminations</b>	<b>Total</b>
<b>Assets</b>	<b>(Issuer)</b>	<b>(Guarantor)</b>		
<b>Current assets:</b>				
Cash and cash equivalents	\$ 19,475	\$ 1,371	\$ -	\$ 20,846
Trade receivables, net	17,753	3,223	-	20,976
Due from related-parties	15	-	-	15
Prepaid expenses	5,857	1,029	-	6,886
Deferred income taxes	3,374	-	-	3,374
Other assets, current	1,049	4	-	1,053
<b>Total current assets</b>	<b>47,523</b>	<b>5,627</b>	<b>-</b>	<b>53,150</b>
Property and equipment, net	503,202	31,311	-	534,513
Intangible assets, net	86,270	15,079	-	101,349
Goodwill	83,781	24	-	83,805
Debt issuance costs, net	10,867	-	-	10,867
Investment in US Carrier	15,075	-	-	15,075
Other assets, non-current	5,233	716	-	5,949
Investment in subsidiary	46,029	-	(46,029)	-
<b>Total assets</b>	<b>\$ 797,980</b>	<b>\$ 52,757</b>	<b>\$ (46,029)</b>	<b>\$ 804,708</b>
<b>Liabilities and member's equity:</b>				
<b>Current liabilities</b>				
Accounts payable	\$ 13,440	\$ 393	\$ -	\$ 13,833
Accrued liabilities	22,437	3,833	-	26,270
Accrued interest	1,621	-	-	1,621
Capital lease obligation, current	967	-	-	967
Due to related-parties	4,569	21	-	4,590
Deferred revenue, current	15,533	378	-	15,911
<b>Total current liabilities</b>	<b>58,567</b>	<b>4,625</b>	<b>-</b>	<b>63,192</b>
Capital lease obligations, non-current	9,978	-	-	9,978
Long-term debt	354,450	-	-	354,450
Deferred revenue, non-current	70,856	1,140	-	71,996
Stock-based compensation liability	47,598	963	-	48,561
Deferred tax liability	12,289	-	-	12,289
Other long term liabilities	2,744	-	-	2,744
<b>Total liabilities</b>	<b>556,482</b>	<b>6,728</b>	<b>-</b>	<b>563,210</b>
<b>Member's equity:</b>				
Member's interest	258,340	34,127	(46,029)	246,438
(Accumulated deficit)/retained earnings	(16,842)	11,902	-	(4,940)
<b>Total member's equity</b>	<b>241,498</b>	<b>46,029</b>	<b>(46,029)</b>	<b>241,498</b>
<b>Total liabilities and member's equity</b>	<b>\$ 797,980</b>	<b>\$ 52,757</b>	<b>\$ (46,029)</b>	<b>\$ 804,708</b>

**ZAYO GROUP, LLC AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED STATEMENTS (UNAUDITED)**  
(in thousands)

**Condensed Consolidating Balance Sheets**  
**June 30, 2011**

	Zayo Group, LLC	Zayo Colocation, Inc.	Eliminations	Total
	(Issuer)	(Guarantor)		
<b>Assets</b>				
Current assets:				
Cash and cash equivalents	\$ 24,213	\$ 1,181	\$ -	\$ 25,394
Trade receivables, net	11,856	2,127	-	13,983
Due from related-parties	2,182	-	(1,995)	187
Prepaid expenses	5,517	871	-	6,388
Deferred income taxes	3,343	-	-	3,343
Other assets, current	640	5	-	645
<b>Total current assets</b>	<b>47,751</b>	<b>4,184</b>	<b>(1,995)</b>	<b>49,940</b>
Property and equipment, net	486,847	31,666	-	518,513
Intangible assets, net	89,117	15,555	-	104,672
Goodwill	83,796	24	-	83,820
Debt issuance costs, net	11,446	-	-	11,446
Investment in US Carrier	15,075	-	-	15,075
Other assets, non-current	5,060	735	-	5,795
Investment in subsidiary	45,594	-	(45,594)	-
<b>Total assets</b>	<b>\$ 784,686</b>	<b>\$ 52,164</b>	<b>\$ (47,589)</b>	<b>\$ 789,261</b>
<b>Liabilities and member's equity:</b>				
Current liabilities				
Accounts payable	\$ 12,287	\$ 701	\$ -	\$ 12,988
Accrued liabilities	19,122	3,331	-	22,453
Accrued interest	10,627	-	-	10,627
Capital lease obligation, current	950	-	-	950
Due to related-parties	6,364	221	(1,995)	4,590
Deferred revenue, current	15,341	323	-	15,664
<b>Total current liabilities</b>	<b>64,691</b>	<b>4,576</b>	<b>(1,995)</b>	<b>67,272</b>
Capital lease obligations, non-current	10,224	-	-	10,224
Long-term debt	354,414	-	-	354,414
Deferred revenue, non-current	62,704	1,189	-	63,893
Stock-based compensation liability	44,263	804	-	45,067
Deferred tax liability	8,322	-	-	8,322
Other long term liabilities	2,724	-	-	2,724
<b>Total liabilities</b>	<b>547,342</b>	<b>6,569</b>	<b>(1,995)</b>	<b>551,916</b>
<b>Member's equity:</b>				
Member's interest	255,572	35,455	(45,594)	245,433
(Accumulated deficit)/retained earnings	(18,228)	10,140	-	(8,088)
<b>Total member's equity</b>	<b>237,344</b>	<b>45,595</b>	<b>(45,594)</b>	<b>237,345</b>
<b>Total liabilities and member's equity</b>	<b>\$ 784,686</b>	<b>\$ 52,164</b>	<b>\$ (47,589)</b>	<b>\$ 789,261</b>

**ZAYO GROUP, LLC AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED STATEMENTS (UNAUDITED)**  
(in thousands)

**Condensed Consolidating Statements of Operations**  
**Three months ended September 30, 2011**

	<b>Zayo Group, LLC (Issuer)</b>	<b>Zayo Colocation, Inc. (Guarantor)</b>	<b>Eliminations</b>	<b>Total</b>
Revenue	\$ 69,775	\$ 9,668	\$ (1,000)	\$ 78,443
<b>Operating costs and expenses</b>				
Operating costs, excluding depreciation and amortization	13,880	4,734	(464)	18,150
Selling, general and administrative expenses	21,545	1,587	(536)	22,596
Stock-based compensation	3,546	158	-	3,704
Depreciation and amortization	15,689	1,373	-	17,062
Total operating costs and expenses	<u>54,660</u>	<u>7,852</u>	<u>(1,000)</u>	<u>61,512</u>
Operating income	<u>15,115</u>	<u>1,816</u>	<u>-</u>	<u>16,931</u>
<b>Other expense</b>				
Interest expense	(9,114)	(54)	-	(9,168)
Other expense, net	(11)	-	-	(11)
Total other expense, net	<u>(9,125)</u>	<u>(54)</u>	<u>-</u>	<u>(9,179)</u>
Earnings from continuing operations before income taxes	5,990	1,762	-	7,752
Provision for income taxes	<u>4,604</u>	<u>-</u>	<u>-</u>	<u>4,604</u>
Earnings from continuing operations	<u>1,386</u>	<u>1,762</u>	<u>-</u>	<u>3,148</u>
Earnings from discontinued operations, net of income taxes	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Net earnings</b>	<u><b>\$ 1,386</b></u>	<u><b>\$ 1,762</b></u>	<u><b>\$ -</b></u>	<u><b>\$ 3,148</b></u>

**ZAYO GROUP, LLC AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED STATEMENTS (UNAUDITED)**  
(in thousands)

**Condensed Consolidating Statements of Operations**  
**Three months ended September 30, 2010**

	<b>Zayo Group, LLC (Issuer)</b>	<b>Zayo Colocation, Inc. (Guarantor)</b>	<b>Eliminations</b>	<b>Total</b>
Revenue	\$ 56,764	\$ 7,564	\$ (1,402)	\$ 62,926
<b>Operating costs and expenses</b>				
Operating costs, excluding depreciation and amortization	13,838	3,587	(387)	17,038
Selling, general and administrative expenses	19,665	1,247	(628)	20,284
Stock-based compensation	5,087	44	-	5,131
Depreciation and amortization	10,456	1,352	-	11,808
Total operating costs and expenses	<u>49,046</u>	<u>6,230</u>	<u>(1,015)</u>	<u>54,261</u>
Operating income	<u>7,718</u>	<u>1,334</u>	<u>(387)</u>	<u>8,665</u>
<b>Other expense</b>				
Interest expense	(6,198)	(59)	-	(6,257)
Other expense	(161)	-	-	(161)
Total other expense, net	<u>(6,359)</u>	<u>(59)</u>	<u>-</u>	<u>(6,418)</u>
Earnings from continuing operations before income taxes	1,359	1,275	(387)	2,247
Provision for income taxes	<u>2,799</u>	<u>-</u>	<u>-</u>	<u>2,799</u>
(Loss)/earnings from continuing operations	<u>(1,440)</u>	<u>1,275</u>	<u>(387)</u>	<u>(552)</u>
Earnings from discontinued operations, net of income taxes	<u>280</u>	<u>-</u>	<u>-</u>	<u>280</u>
<b>Net (loss)/earnings</b>	<u><b>\$ (1,160)</b></u>	<u><b>\$ 1,275</b></u>	<u><b>\$ (387)</b></u>	<u><b>\$ (272)</b></u>

**ZAYO GROUP, LLC AND SUBSIDIARIES**

**NOTES TO THE CONDENSED CONSOLIDATED STATEMENTS (UNAUDITED)**  
(in thousands)

**Condensed Consolidating Statements of Cash Flows**  
**Three months ended September 30, 2011**

	<b>Zayo Group, LLC</b>	<b>Zayo Colocation, Inc.</b>	<b>Total</b>
	<b>(Issuer)</b>	<b>(Guarantor)</b>	
<b>Net cash provided by continuing operating activities</b>	<b>\$ 21,735</b>	<b>\$ 2,490</b>	<b>\$ 24,225</b>
<b>Cash flows from investing activities:</b>			
Purchases of property and equipment, net of stimulus grants	(27,744)	(900)	(28,644)
<b>Net cash used in investing activities</b>	<b>(27,744)</b>	<b>(900)</b>	<b>(28,644)</b>
<b>Cash flows from financing activities:</b>			
Equity contributions	100	-	100
Dividend received/(paid)	1,400	(1,400)	-
Principal repayments on capital lease obligations	(229)	-	(229)
<b>Net cash provided/(used) by financing activities</b>	<b>1,271</b>	<b>(1,400)</b>	<b>(129)</b>
Net (decrease)/increase in cash and cash equivalents	(4,738)	190	(4,548)
Cash and cash equivalents, beginning of period	24,213	1,181	25,394
<b>Cash and cash equivalents, end of period</b>	<b>\$ 19,475</b>	<b>\$ 1,371</b>	<b>\$ 20,846</b>

**Condensed Consolidating Statements of Cash Flows**  
**Three months ended September 30, 2010**

	<b>Zayo Group, LLC</b>	<b>Zayo Colocation, Inc.</b>	<b>Total</b>
	<b>(Issuer)</b>	<b>(Guarantor)</b>	
<b>Net cash provided by continuing operating activities</b>	<b>\$ 8,373</b>	<b>\$ 2,109</b>	<b>\$ 10,482</b>
<b>Cash flows from investing activities:</b>			
Purchases of property and equipment, net of stimulus grants	(20,708)	(438)	(21,146)
Acquisitions, net of cash acquired	(73,666)	-	(73,666)
<b>Net cash used in investing activities</b>	<b>(94,374)</b>	<b>(438)</b>	<b>(94,812)</b>
<b>Cash flows from financing activities:</b>			
Equity contributions	35,500	-	35,500
Advance from CII	13,026	-	13,026
Proceeds from borrowings	103,000	-	103,000
Change in restricted cash	790	-	790
Principal repayments on capital lease obligations	(610)	-	(610)
Deferred financing costs	(3,319)	-	(3,319)
<b>Net cash provided by financing activities</b>	<b>148,387</b>	<b>-</b>	<b>148,387</b>
<b>Cash flows from discontinued operations:</b>			
Operating activities	1,229	-	1,229
Investing activities	(225)	-	(225)
<b>Net cash provided by discontinued operations</b>	<b>1,004</b>	<b>-</b>	<b>1,004</b>
Net increase in cash and cash equivalents	63,390	1,671	65,061
Cash and cash equivalents, beginning of period	84,967	2,897	87,864
Increase in cash and cash equivalents of discontinued operations	(494)	-	(494)
<b>Cash and cash equivalents, end of period</b>	<b>\$ 147,863</b>	<b>\$ 4,568</b>	<b>\$ 152,431</b>

## ZAYO GROUP, LLC AND SUBSIDIARIES

### NOTES TO THE CONDENSED CONSOLIDATED STATEMENTS (UNAUDITED) (in thousands)

#### (18) SUBSEQUENT EVENTS

##### **Pending Acquisitions**

On October 6, 2011, the Company entered into a Stock Purchase Agreement (the “Agreement”) with 360 Networks Corporation, 360 Networks (fiber holdco) Ltd., and 360 Networks (fiber subco) Ltd. (collectively, the “Sellers”).

Upon the close of the transaction contemplated by the Agreement, Zayo will acquire 100 percent of the outstanding capital stock of 360networks Holdings (USA) Inc., (“360networks”) a wholly owned subsidiary of the Sellers (the “Acquisition”). The purchase price, subject to certain adjustments at closing and post-closing, is \$345,000 to be paid in cash. The Agreement is subject to customary closing conditions (including regulatory approval) and provides for customary representations, warranties, covenants and agreements, including, among others, that each party will use commercially reasonable efforts to complete the acquisition.

In connection with the Agreement, Zayo has obtained a debt commitment letter that, subject to customary closing conditions, commits certain lenders to provide financing to the Company in an amount sufficient to permit Zayo, together with cash on hand, to make all payments required to be made to the Sellers in connection with the closing of the Acquisition.

360networks operates over 18,000 route miles of intercity and metro fiber network across 22 states and British Columbia. 360networks’ intercity network interconnects over 70 markets across the central and western United States, including 23 Zayo fiber markets and a number of new markets such as Albuquerque, Bismarck, Des Moines, San Francisco, San Diego and Tucson. In addition to its intercity network, 360networks operates over 800 route miles of metropolitan fiber networks across 26 markets, including Seattle, Denver, Colorado Springs, Omaha, Sacramento, and Salt Lake City.

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### **Certain Factors That May Affect Future Results**

Information contained or incorporated by reference in this Quarterly Report on Form 10-Q (this "Report") and in other filings by Zayo Group, LLC ("we" or "us"), with the Securities and Exchange Commission (the "SEC") that are not historical by nature constitute "forward-looking statements," and can be identified by the use of forward-looking terminology such as "believes," "expects," "plans," "intends," "estimates," "projects," "could," "may," "will," "should," or "anticipates," or the negatives thereof, other variations thereon or comparable terminology, or by discussions of strategy. No assurance can be given that future results expressed or implied by the forward-looking statements will be achieved and actual results may differ materially from those contemplated by the forward-looking statements. Such statements are based on our current expectations and beliefs and are subject to a number of risks and uncertainties that could cause actual results to differ materially from those expressed or implied by the forward-looking statements. These risks and uncertainties include, but are not limited to, those relating to our financial and operating prospects, current economic trends, future opportunities, ability to retain existing customers and attract new ones, our acquisition strategy and ability to integrate acquired companies and assets, outlook of customers, reception of new products and technologies, and strength of competition and pricing. Other factors and risks that may affect our business and future financial results are detailed in our SEC filings, including, but not limited to, those described under "Risk Factors" in our Annual Report on Form 10-K filed with the SEC on September 9, 2011 and in this "Management's Discussion and Analysis of Financial Condition and Results of Operations." We caution you not to place undue reliance on these forward-looking statements, which speak only as of their respective dates. We undertake no obligation to publicly update or revise forward-looking statements to reflect events or circumstances after the date of this Report or to reflect the occurrence of unanticipated events, except as may be required by law.

The following discussion and analysis should be read together with our unaudited condensed consolidated financial statements and the related notes appearing in this Report and in our audited annual consolidated financial statements as of and for the year ended June 30, 2011, included in our Annual Report on Form 10-K filed with the SEC on September 9, 2011.

Amounts presented in this Item 2 are rounded. As such, rounding differences could occur in period over period changes and percentages reported throughout this Item 2.

### **Overview**

#### ***Introduction***

We are a provider of bandwidth infrastructure and network-neutral colocation and interconnection services, which are key components of telecommunications and Internet infrastructure services. These services enable our customers to manage, operate, and scale their telecommunications and data networks and data center related operations. We provide our bandwidth infrastructure services over our dense regional and metropolitan fiber networks, enabling our customers to transport data, voice, video, and Internet traffic, as well as to interconnect their networks. Our bandwidth infrastructure services are primarily used by wireless service providers, carriers and other communications service providers, media and content companies, and other bandwidth-intensive enterprises. We typically provide our lit bandwidth infrastructure services for a fixed-rate monthly recurring fee under long-term contracts, which are usually three to five years in length (and typically seven to ten years for fiber-to-the-tower services). Our dark-fiber contracts are generally longer term in nature, up to 20 years and in a few cases longer. Our network-neutral colocation and interconnection services facilitate the exchange of voice, video, data, and Internet traffic between multiple third-party networks.

Our fiber networks span nearly 25,000 route miles, serve 153 geographic markets in the United States, and connect to over 4,500 buildings, including approximately 2,100 cellular towers, allowing us to provide our bandwidth infrastructure services to our customers over redundant fiber facilities between key customer locations. The majority of the markets that we serve and buildings to which we connect have few other networks capable of providing similar bandwidth infrastructure services, which we believe provides us with a sustainable competitive advantage in these markets. As a result, we believe that the services we provide our customers would be difficult to replicate in a cost- and time-efficient manner. We provide our network-neutral colocation and interconnection services

utilizing our own data centers located within three major carrier hotels in the important gateway markets of New York and New Jersey and in facilities located in Los Angeles, California; Nashville, Tennessee; Plymouth, Minnesota; Cincinnati, Ohio; Cleveland, Ohio; Columbus, Ohio; Pittsburgh, Pennsylvania; and Memphis, Tennessee.

We are a wholly-owned subsidiary of Zayo Group Holdings, Inc., a Delaware corporation (“Holdings”), which is in turn wholly owned by Communications Infrastructure Investments, LLC, a Delaware limited liability company (“CII”).

Our fiscal year ends June 30 each year and we refer to the fiscal year ended June 30, 2011 as “Fiscal 2011” and the year ending June 30, 2012 as “Fiscal 2012.”

### ***Our Business Units***

We are organized into three business units: Zayo Bandwidth (“ZB”), zColo and Zayo Fiber Solutions (“ZFS”). Each business unit is structured to provide sales, delivery, and customer support for its specific telecom and Internet infrastructure services. A fourth business unit, Zayo Enterprise Networks (“ZEN”), was spun-off during Fiscal 2011 to Holdings, our direct shareholder. The ZEN business unit was spun-off as it was determined that the services it provided did not fit within our business model of providing bandwidth infrastructure, colocation and interconnection services.

Our business units have historically been identified by both the products they offer and the customers they serve. Effective January 1, 2011, prior to the spin-off of the ZEN unit, the ZEN unit was restructured in order for our business units to more closely align with their product offerings rather than a combination of product offerings and customer demographics. The restructuring resulted in the ZEN unit transferring its bandwidth infrastructure products to the ZB unit, its dark fiber products to the ZFS unit and its colocation products to the zColo unit. The remaining ZEN unit that was spun-off to Holdings on April 1, 2011, comprised our legacy managed services product offerings.

*Zayo Bandwidth.* Through our ZB unit, we provide bandwidth infrastructure services over our regional and metropolitan fiber networks. These services are typically lit bandwidth, meaning that we use optronics to “light” the fiber, and consist of private line, wavelength, and Ethernet services. Our target customers within this unit are primarily wireless service providers, carriers and other communications service providers (including Incumbent Local Exchange Carriers (“ILECs”), Inter Exchange Carrier (“IXCs”), Rural Local Exchange Carrier (“RLECs”), Competitive Local Exchange Carriers (“CLECs”), and foreign carriers), media and content companies (including cable and satellite video providers), and other Internet-centric businesses that require an aggregate minimum of 10 Gbps of bandwidth across their networks.

*zColo.* Through our zColo unit, we provide network-neutral colocation and interconnection services in three major carrier hotels in the New York metropolitan area and in facilities located in Los Angeles, California and Nashville, Tennessee. As a result of the restructuring of our business units, in January 2011, zColo was transferred five facilities from ZEN and ZB located in Plymouth, Minnesota; Cincinnati, Ohio; Cleveland, Ohio; Columbus, Ohio; and Memphis, Tennessee. In July 2011, zColo was transferred an additional colocation facility from ZB which is located in Pittsburgh, Pennsylvania. In addition, we are the exclusive operator of the Meet-Me Room at 60 Hudson Street, which is one of the most important carrier hotels in the United States with approximately 200 global networks interconnecting within this facility. Our zColo data centers house and power Internet and private-network equipment in secure, environmentally-controlled locations that our customers use to aggregate and distribute data, voice, Internet, and video traffic. Throughout two of the three facilities in the New York City metropolitan area, we operate intra-building interconnect networks that, along with the Meet-Me Room at 60 Hudson Street, are utilized by our customers to efficiently and cost-effectively interconnect with other Internet, data, video, voice, and wireless networks. As of September 30, 2011 and June 30, 2011 the zColo unit managed 77,175 and 72,927 square feet of billable colocation space, respectively.

*Zayo Fiber Solutions.* The ZFS unit was formally launched on July 1, 2010, after our acquisition of AGL Networks, a company whose business was comprised solely of dark-fiber-related services.

Through our ZFS unit, we provide dark-fiber and related services primarily on our existing fiber footprint. We lease dark-fiber pairs to our customers and, as part of our service offering, we manage and maintain the underlying fiber network for the

customer. Our customers light the fiber using their own optronics, and as such, we do not manage the bandwidth that the customer receives. This allows the customer to manage bandwidth on their own metro and long haul networks according to their specific business needs. ZFS's customers include carriers and other communication service providers, Internet service providers, wireless service providers, major media and content companies, large enterprises, and other companies that have the expertise to run their own fiber optic networks. We market and sell dark-fiber-related services under long-term contracts (up to 20 years and in a few cases longer); our customers generally pay us on a monthly basis for these services.

### ***Recent Developments***

#### ***Entry into a Material Definitive Agreement***

On October 6, 2011, we entered into a Stock Purchase Agreement (the "Agreement") with 360 Networks Corporation, 360 Networks (fiber holdco) Ltd., and 360 Networks (fiber subco) Ltd. (collectively, the "Sellers").

Upon the close of the transaction contemplated by the Agreement, we will acquire 100 percent of the outstanding capital stock of 360networks Holdings (USA) Inc., ("360networks") a wholly owned subsidiary of the Sellers (the "Acquisition"). The purchase price, subject to certain adjustments at closing and post-closing, is \$345.0 million. The Agreement is subject to customary closing conditions (including regulatory approval) and provides for customary representations, warranties, covenants and agreements, including, among others, that each party will use commercially reasonable efforts to complete the acquisition.

In connection with the Agreement, we obtained a debt commitment letter that, subject to customary closing conditions, commits certain lenders to provide financing to us in an amount sufficient to permit us, together with cash on hand, to make all payments required to be made to the Sellers in connection with the closing of the Acquisition.

360networks operates over 18,000 route miles of intercity and metro fiber network across 22 states and British Columbia. 360networks' intercity network interconnects over 70 markets across the central and western United States, including 23 of our fiber markets and a number of new markets such as Albuquerque, Bismarck, Des Moines, San Francisco, San Diego and Tucson. In addition to its intercity network, 360networks operates over 800 route miles of metropolitan fiber networks across 26 markets, including Seattle, Denver, Colorado Springs, Omaha, Sacramento, and Salt Lake City.

#### ***Broadband Stimulus Awards***

We are an active participant in federal broadband stimulus projects created through the American Recovery and Reinvestment Act. To date, we have been awarded, as a direct recipient, federal stimulus funds for two projects and as a sub-recipient federal stimulus funds for one project by the National Telecommunication and Information Administration. The projects involve the construction, ownership, and operation of fiber networks for the purpose of providing broadband services to governmental and educational institutions, as well as underserved, and usually rural, communities. As part of the award, the federal government funds a large portion of the construction and development costs. On the three projects awarded to us to date, as either a direct or sub-recipient, the stimulus funding will cover, on average, approximately 75% of the total expected cost of the projects. All of these projects allow for our ownership or use of the network for other commercial purposes, including the sale of our bandwidth infrastructure services to new and existing customers. The details of the three awards are as follows:

- In February 2010, we, as the direct recipient, were awarded \$25.1 million in funding to construct 626 miles of fiber network connecting 21 community colleges in Indiana. The total project involves approximately \$31.4 million of capital expenditures of which \$6.3 million is anticipated to be funded by us.
- In July 2010, we, as the direct recipient, were awarded a \$13.4 million grant to construct 286 miles of fiber network in Anoka County, Minnesota, outside of Minneapolis. The total project involves approximately \$19.2 million of capital expenditures of which \$5.7 million is anticipated to be funded by us.
- In September 2011, we signed, as a sub-recipient, an agreement on an award granted to Com Net, Inc ("Com Net") from

the NTIA Broadband Technology Opportunities Program. Our portion of the project involves the construction of nearly 366 fiber miles in the Western Ohio region. Per the terms of our sub-recipient agreement, we will match up to 30 percent of total costs of constructing the 366 fiber miles up to a maximum contribution of \$3.1 million. We estimate the total costs (before reimbursements) of constructing these 366 fiber miles to be approximately \$10.4 million.

## **Factors Affecting Our Results of Operations**

### ***Business Acquisitions***

We were founded in 2007 in order to take advantage of the favorable Internet, data and wireless growth trends driving the demand for bandwidth infrastructure services. These trends have continued in the years since our founding, despite volatile economic conditions, and we believe that we are well-positioned to continue to capitalize on those trends. We have built our network and services through 16 acquisitions and asset purchases for an aggregate purchase consideration (including assumed debt) of \$546.5 million (after deducting our acquisition cost for OVS and ZEN, two business units operated by our subsidiary Onvoy, which we spun-off on March 11, 2010 and April 1, 2011, respectively).

#### *Acquisition of AGL Networks, LLC (“AGL Networks”)*

On July 1, 2010, we acquired 100% of the equity of AGL Networks from its parent, AGL Resources Inc., and changed AGL Networks’ name to Zayo Fiber Solutions, LLC. We paid the purchase price of approximately \$73.7 million with cash on hand. AGL Networks’ assets were comprised of dense, high-fiber-count networks totaling 786 (761 of which are incremental to our existing footprint) route miles and over 190,000 fiber miles, and included 289 (281 incremental) on-net buildings across the metropolitan markets of Atlanta, Georgia, Charlotte, North Carolina, and Phoenix, Arizona. AGL Networks generated all of its revenue from providing dark-fiber related services to both wholesale and enterprise customers.

In connection with the AGL Networks acquisition, we established the ZFS unit on July 1, 2010. The assets of AGL Networks complement our existing dark-fiber services, which had previously been provided by ZEN and ZB. Subsequent to the acquisition, we transferred those existing dark-fiber customer contracts to our ZFS unit and began leveraging a portion our pre-existing fiber network to provide dark-fiber solution offerings.

#### *Merger with American Fiber Systems Holding Corporation*

On October 1, 2010, we completed a merger with AFS, the parent company of American Fiber Systems, Inc. (“AFS Inc.”). The AFS merger was consummated with the exchange of \$110.0 million in cash and a \$4.5 million non-interest bearing promissory note due in October 2012 for all of the interest in AFS. The Company calculated the fair market value of the promissory note to be \$4.1 million resulting in an aggregate purchase price of \$114.1 million. The AFS merger was effected through a merger between AFS and a special purpose vehicle created for the AFS merger. The purchase price was based upon the valuation of both the business and assets directly owned by AFS and the ownership interest in US Carrier Telecom Holdings, LLC, held by AFS Inc. for which we estimated the fair value to be \$15.1 million. AFS is a provider of 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 owns and operates approximately 1,251 route miles (about 1,000 of which are incremental to our existing footprint) and approximately 172,415 fiber miles of fiber networks and has over 600 incremental on-net buildings in these markets.

The results of the legacy AFS business are only included in the operating results of the ZB and ZFS business units for the three months ended September 30, 2011.

#### *Acquisition of Dolphini Assets*

On September 20, 2010, our zColo business unit acquired certain colocation assets in Nashville, Tennessee from Dolphini Corporation for a cash purchase price of \$0.2 million.

### ***Spin-Off of Business Units***

As discussed in the Overview – Our Business Units section, above, effective April 1, 2011, we spun-off our ZEN business unit to Holdings. During the three months ended September 30, 2010, the results of the operations of ZEN have been aggregated and are presented in a single caption entitled, “Earnings from discontinued operations, net of income taxes” on our consolidated statements of operations. Prior to the spin-off, transactions with the ZEN business unit were eliminated in consolidation. Subsequent to the spin-off transactions with ZEN are reflected within our results of operations.

All discussions contained in this “Management’s Discussion and Analysis of Financial Condition and Results of Operations” relate only to our results of operations from our continuing operations.

### ***Substantial Capital Expenditures***

During the three months ended September 30, 2011 and 2010, we invested \$28.6 million (net of stimulus grant reimbursements) and \$21.1 million (net of stimulus grant reimbursements), respectively, in capital expenditures related to property and equipment primarily to expand our fiber network and largely in connection with new customer contracts. We expect to continue to make significant capital expenditures in future periods.

As a result of the growth of our business from the acquisitions described above, as well as from such capital expenditures, our results of operations for the respective periods presented and discussed herein are not comparable.

### ***Substantial Indebtedness***

We had total indebtedness (excluding capital leases) of \$354.5 million and \$354.4 million as of September 30, 2011 and June 30, 2011, respectively, which principally includes our \$350 million of Senior Secured Notes (“Notes”), the net proceeds from which were used to fund our acquisitions and for other working capital purposes. The nominal interest rate on our Notes as of September 30, 2011 and June 30, 2011 was 10.25 percent.

### ***Critical Accounting Policies and Estimates***

For a description of our critical accounting policies and estimates, see Item 7 in our Annual Report on Form 10-K for the year ended June 30, 2011, “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

### **Background for Review of Our Results of Operations**

#### ***Operating Costs***

Our operating costs consist primarily of third-party network service costs, colocation facility costs and colocation facility utilities costs. Third-party network service costs result from our leasing of certain network facilities, primarily leases of circuits and dark fiber, from other local exchange carriers to augment our owned infrastructure for which we are generally billed a fixed monthly fee. Our colocation facility costs comprise rent and license fees paid to the landlords of the buildings in which our zColo business operates along with the utility costs to power those facilities.

Recurring transport costs are the largest component of our operating costs and primarily include monthly service charges from telecommunication carriers related to the circuits and dark fiber utilized by us to interconnect our customers. While increases in demand will drive additional operating costs in our business, we expect to primarily utilize our existing network infrastructure and augment, when necessary, with additional circuits or services from third-party providers. Non-recurring transport costs primarily include the cost of the initial installation of such circuits.

#### ***Selling, General and Administrative Expenses***

Our selling, general and administrative (“SG&A”) expenses include personnel costs, costs associated with the operation of our network (network operations), and other related expenses, including sales commissions, marketing programs, office rent, professional

fees, travel, software maintenance costs, costs incurred related to potential and closed acquisitions (i.e. transaction costs) and other expenses.

After compensation and benefits, network operations expenses are the largest component of our SG&A expenses. Network operations expenses include all of the non-personnel related expenses of maintaining our network infrastructure, including contracted maintenance fees, right-of-way costs, rent for locations where fiber is located (including cellular towers), pole attachment fees, and relocation expenses.

### ***Stock-Based Compensation***

We compensate certain members of our management and independent directors through grants of common units of CII, which vest over varying periods of time, depending on the terms of employment of each such member of management or directors. In addition, certain of our senior executives and independent directors have been granted preferred units of CII.

For the common units granted to members of management and directors, we recognize an expense equal to the fair value of all of those common units vested during the period, and record a liability in respect of that amount. Subsequently, we recognize changes in the fair value of those common units through increases or decreases in stock-based compensation expense and related adjustments to the related stock-based compensation liability.

When the preferred units are initially granted, we recognize no expense. We use the straight line method, over the vesting period, to amortize the fair value of those units, as determined on the date of grant. Subsequent changes in the fair value of the preferred units granted to those executive officers and directors are not taken into consideration as we amortize that expense.

## Results of Operations

Statement of Operations Data	Three months ended September 30,			
	2011		2010	
Revenue:	(amounts in thousands)			
Zayo Bandwidth	\$ 56,544	72%	\$ 48,943	78%
Zayo Fiber Solutions	13,231	17	7,821	12
zColo	9,668	12	7,564	12
Intercompany eliminations	(1,000)	(1)	(1,402)	(2)
Total Revenue	<u>78,443</u>	<u>100%</u>	<u>62,926</u>	<u>100%</u>
Costs and expenses				
Operating costs, excluding depreciation and amortization	18,150	23%	17,038	27%
Selling, general and administrative expenses	22,596	29	20,284	32
Stock based compensation	3,704	5	5,131	8
Depreciation and amortization	17,062	22	11,808	19
Total operating costs and expenses	<u>61,512</u>	<u>78%</u>	<u>54,261</u>	<u>86%</u>
Operating income	16,931	22	8,665	14
Interest expense	(9,168)	(12)	(6,257)	(10)
Other income/(expense)	(11)	(0)	(161)	(0)
Earnings from continuing operations before income taxes	7,752	10	2,247	4
Provision for income taxes	4,604	6	2,799	4
Earnings/(loss) from continuing operations	<u>3,148</u>	<u>4%</u>	<u>(552)</u>	<u>(1%)</u>
EBITDA (add backs)				
Interest expense	9,168		6,257	
Provision for income taxes	4,604		2,799	
Depreciation and amortization	17,062		11,808	
EBITDA	<u>33,982</u>	<u>43%</u>	<u>20,312</u>	<u>32%</u>
Adjusted EBITDA (add backs)				
Stock-based compensation	3,704		5,131	
Transaction costs	330		159	
Adjusted EBITDA	<u>\$ 38,016</u>	<u>48%</u>	<u>\$ 25,602</u>	<u>41%</u>

### *Three Months Ended September 30, 2011 Compared to the Three Months Ended September 30, 2010*

#### Revenue

Our total revenue for the three months ended September 30, 2011 increased by \$15.5 million, or 25%, from \$62.9 million to \$78.4 million during the three months ended September 30, 2010 and 2011, respectively. The increase is principally a result of the AFS merger, which occurred on October 1, 2010 and organic growth. As a result of internal sales efforts since September 30, 2010, we have entered into \$443.0 million of gross new sales contracts, which will represent an additional \$6.7 million in monthly revenue once installation on those contracts is accepted. Since September 30, 2010, we have received acceptance on gross installations that have resulted in additional monthly revenue of \$6.1 million as of September 30, 2011, as compared to September 30, 2010. This increase in revenue related to our organic growth is partially offset by total customer churn of \$3.9 million in monthly revenue since

September 30, 2010.

The stratification of our revenue during the three months ended September 30, 2011 and 2010 was consistent with a majority of the revenue recognized during the periods presented resulting from monthly recurring revenue streams. The following table reflects the stratification of our revenues during these periods:

	Three months ended			
	September 30,			
	2011			2010
	(in thousands)			
Monthly Recurring Revenue	\$74,410	95%	\$60,409	96%
Amortization of deferred revenues	2,580	3	1,737	3
Other Revenue	1,453	2	780	1
Total	<u>\$78,443</u>	<u>100%</u>	<u>\$62,926</u>	<u>100%</u>

*Zayo Bandwidth.* Our revenues from our Zayo Bandwidth operating segment increased by \$7.6 million, or 16%, from \$48.9 million to \$56.5 million during the three months ended September 30, 2010 and 2011, respectively. This increase is primarily a result of additional revenue associated with the AFS merger on October 1, 2010 and organic growth related to our sales efforts and expansion of our network. Partially offsetting this increase is a decrease resulting from Zayo Bandwidth transferring certain intra-building and colocation assets and the related customer revenues to the zColo segment on January 1, 2011 and July 1, 2011.

*Zayo Fiber Solutions.* Our revenues from our Zayo Fiber Solutions segment increased by \$5.4 million, or 69% from \$7.8 million to \$13.2 million during the three months ended September 30, 2010 and 2011, respectively. The increase in revenue is primarily a result of additional revenue associated with the AFS merger on October 1, 2010 and organic growth related to our sales efforts.

*zColo.* Our revenues from our zColo operating segment increased by \$2.1 million or 28% from \$7.6 million to \$9.7 million during the three months ended September 30, 2010 and 2011, respectively. The increase is primarily a result of revenues from intra-building and colocation services which were migrated from the ZB to the zColo segment effective January 1, 2011 and organic growth. On January 1, 2011, the ZB unit transferred contracts amounting to approximately \$0.3 million in monthly recurring revenue to the zColo business unit. Effective July 1, 2011, ZB transferred a colocation facility in Pittsburgh, Pennsylvania and the associated revenues to the zColo segment. This transfer resulted in an increase to the revenue recognized by zColo during the three months ended September 30, 2011 of \$0.1 million as compared to the three months ended September 30, 2010.

#### **Operating Costs, Excluding Depreciation and Amortization**

Our operating costs, excluding depreciation and amortization, increased by \$1.1 million, or 7%, from \$17.0 million to \$18.2 million during the three months ended September 30, 2010 and 2011, respectively. The increase in operating costs, excluding depreciation and amortization, primarily relates to the increased costs associated with our merger with AFS on October 1, 2010. The 7% increase in operating costs, excluding depreciation and amortization, occurred during the same period in which our revenues increased by 25%. The lower ratio of operating costs as compared to revenues is primarily a result of gross installed revenues having a lower component of associated operating costs than the prior period's revenue base and churned revenue due to a higher percentage of our newly installed revenue being supported by our owned infrastructure assets (i.e. on-net). The ratio also benefited from synergies realized related to our previous acquisitions.

## Selling, General and Administrative Expenses:

The table below sets forth the components of our SG&A expenses during the three months ended September 30, 2011 and 2010.

	Three months ended	
	September 30,	
	2011	2010
	(In thousands)	
Compensation and benefits expenses	\$ 10,442	\$ 9,149
Network operating expenses	7,077	5,828
Other SG&A expenses	4,747	5,148
Transaction costs	330	159
<b>Total SG&amp;A expenses</b>	<b>\$ 22,596</b>	<b>\$ 20,284</b>

*Compensation and Benefits Expenses.* Compensation and benefits expenses increased by \$1.3 million, or 14%, from \$9.1 million to \$10.4 million during the three months ended September 30, 2010 and 2011, respectively. The increase reflects the increased number of employees as our business grew during this period, principally as a result of our merger with AFS on October 1, 2010 and organic growth. At September 30, 2011 we had 399 full time employees compared to 352 at September 30, 2010, representing a 13% increase period-over-period.

*Network Operations Expenses.* Network operations expenses increased by \$1.2 million, or 21%, from \$5.8 million to \$7.1 million during the three months ended September 30, 2010 and 2011, respectively. The increase in such expenses principally reflects the growth of our network assets and the related expenses of operating that expanded network following the AFS merger on October 1, 2010. The ratio of network operating expenses as compared to revenues was consistent during the three months ended September 30, 2011 and 2010 at 9%.

*Other SG&A.* Other SG&A expenses, which includes expenses such as property tax, franchise fees, travel, office expense, and maintenance expense on colocation facilities, decreased by \$0.4 million, or 8%, from \$5.1 million to \$4.7 million during the three months ended September 30, 2010 and 2011, respectively. The decrease is principally a result of reduced franchise fees resulting from favorable renegotiations on existing franchise agreements. These savings were partially offset by increased other SG&A expenses associated with our merger with AFS on October 1, 2010.

## Stock-Based Compensation

Stock-based compensation expenses decreased by \$1.4 million, or 28%, from \$5.1 million to \$3.7 million during the three months ended September 30, 2010 and 2011, respectively. The \$5.1 million stock-based compensation expense during the three months ended September 30, 2010 is primarily a result of an increase in the estimated fair value of the common units during the period and additional vesting. The \$3.7 million of stock-based compensation expense recorded during the three months ended September 30, 2011 is primarily a result of an additional 23,052,433 common units vested as of September 30, 2011 as compared to September 30, 2010. Also contributing to the stock-based compensation expense was a slight increase to the estimated value of the common units due to the Company's organic growth. The increase in the value of the common units during the three months ended September 30, 2010 was primarily a result of an increase during that period in the valuation of the Company based on expected synergies associated with the July 1, 2010 acquisition of AGL Networks and organic growth. The following table reflects the estimated fair value of the Company's common units during the relevant periods impacting the stock compensation expense for the three months ended September 30, 2011 and 2010.

	Estimated fair value as of			
	2011		2010	
	June 30	September 30	June 30	September 30
Class A	\$0.81	\$0.83	\$0.49	\$0.56
Class B	\$0.58	\$0.59	\$0.28	\$0.32
Class C	\$0.33	\$0.36	\$0.03	\$0.03
Class D	\$0.31	\$0.34	n/a	n/a
Class E	\$0.23	\$0.25	n/a	n/a

## Depreciation and Amortization

Depreciation and amortization expense increased by \$5.3 million, or 44%, from \$11.8 million to \$17.1 million during the three months ended September 30, 2010 and 2011, respectively. The increase is a result of the substantial increase to our property and equipment and intangible asset balance since September 30, 2010, principally from \$120.0 million in capital expenditures since September 30, 2010 and the increase to our property and equipment and intangible balance due to the merger with AFS on October 1, 2010.

## Interest Expense

Interest expense increased by \$2.9 million, or 47%, from \$6.3 million to \$9.2 million during the three months ended September 30, 2010 and 2011, respectively. The increase is primarily a result of our increased indebtedness associated with our Notes. As of September 30, 2011 we had Notes with a principal amount of \$350.0 million, which accrue interest at 10.25%. From the period June 30, 2010 through September 11, 2010, our indebtedness associated with our Notes was \$250.0 million. On September 11, 2010, we issued an additional \$100 million in Notes. The increased average outstanding debt balance during the three months ended September 30, 2011 as compared to the three months ended September 30, 2010 was the primary cause of the increase in interest expense during the period.

## Provision for Income Taxes

Income tax expense increased during the period by \$1.8 million from \$2.8 million to \$4.6 million during the three month periods ended September 30, 2010 and 2011, respectively. Our provision for income taxes includes both the current provision and a provision for deferred income tax expense resulting from timing differences between tax and financial reporting accounting bases. We are unable to combine our net operating losses (“NOLs”) for application to the income of our subsidiaries in some states and thus our state income tax expense is higher than the expected blended rate. In addition, as noted above, we are subject to limits on the amount of carry forward NOLs that we may use each year for federal and state purposes. The following table reconciles an expected tax provision based on a statutory federal tax rate of 34 percent applied to our book net income.

	For the three months ended	
	September 30,	
	2011	2010
Expected provision at statutory rate of 34%	\$ 2,636	\$ 763
Increase due to:		
Non-deductible stock-based compensation	1,259	1,745
State income taxes, net of federal benefit	587	227
Transactions costs not deductible	112	54
Other, net	10	10
Provision for income taxes	<u>\$ 4,604</u>	<u>\$ 2,799</u>

## Adjusted EBITDA

We define Adjusted EBITDA as earnings from continuing operations before interest, income taxes, depreciation and amortization (“EBITDA”) adjusted to exclude transaction costs, stock-based compensation, and certain non-cash items. We use EBITDA and Adjusted EBITDA to evaluate operating performance and liquidity, and these financial measures are among the primary measures used by management for planning and forecasting of future periods. We believe Adjusted EBITDA is especially important in a capital-intensive industry such as telecommunications. We further believe that the presentation of EBITDA and Adjusted EBITDA is relevant and useful for investors because it allows investors to view results in a manner similar to the method used by management and makes it easier to compare our results with the results of other companies that have different financing and capital structures.

We also monitor EBITDA as we have debt covenants that restrict our borrowing capacity that are based on a leverage ratio which utilizes EBITDA. We must not exceed a consolidated leverage ratio (funded debt to annualized EBITDA), as determined under the credit agreement, of 4.25x the last quarter’s annualized EBITDA. Adjusted EBITDA results, along with other quantitative and qualitative information, are also utilized by management and our compensation committee for purposes of determining bonus payouts to employees.

EBITDA and Adjusted EBITDA have limitations as analytical tools, and should not be considered in isolation from, or as substitutes for, analysis of our results as reported under accounting principles generally accepted in the United States. For example, Adjusted EBITDA:

- does not reflect capital expenditures, or future requirements for capital and major maintenance expenditures or contractual commitments;
- does not reflect changes in, or cash requirements for, our working capital needs;
- does not reflect the significant interest expense, or the cash requirements necessary to service the interest payments on our debt; and
- does not reflect cash required to pay income taxes.

Our computation of Adjusted EBITDA may not be comparable to other similarly titled measures computed by other companies, because all companies do not calculate Adjusted EBITDA in the same fashion. A reconciliation from earnings/(loss) from continuing operations to Adjusted EBITDA is as follows:

**Three months ended September 30, 2011**

(\$ in millions)	Zayo Bandwidth	zColo	ZFS	Corporate	Zayo Group
Earnings/(loss) from continuing operations	\$ 12.8	\$ 1.8	\$ 4.1	\$ (15.6)	\$ 3.1
Interest expense	0.2	0.1	—	8.9	9.2
Income tax expense	—	—	—	4.6	4.6
Depreciation and amortization expense	11.8	1.4	3.9	—	17.1
<b>EBITDA</b>	<b>24.8</b>	<b>3.3</b>	<b>8.0</b>	<b>(2.1)</b>	<b>34.0</b>
Transaction costs	0.2	—	0.1	—	0.3
Stock-based compensation	1.2	0.1	0.3	2.1	3.7
<b>Adjusted EBITDA</b>	<b>\$ 26.2</b>	<b>\$ 3.4</b>	<b>\$ 8.4</b>	<b>\$ —</b>	<b>\$ 38.0</b>

**Three months ended September 30, 2010**

(\$ in millions)	Zayo Bandwidth	zColo	ZFS	Corporate	Zayo Group
Earnings/(loss) from continuing operations	\$ 8.0	\$ 1.3	\$ 2.2	\$ (12.0)	\$ (0.5)
Interest expense	0.3	—	—	6.0	6.3
Income tax expense	—	—	—	2.8	2.8
Depreciation and amortization expense	8.5	1.4	1.9	—	11.8
<b>EBITDA</b>	<b>16.8</b>	<b>2.7</b>	<b>4.1</b>	<b>(3.2)</b>	<b>20.3</b>
Transaction costs	0.1	—	0.1	—	0.2
Stock-based compensation	2.1	—	0.3	2.6	5.1
<b>Adjusted EBITDA</b>	<b>\$ 19.0</b>	<b>\$ 2.7</b>	<b>\$ 4.5</b>	<b>\$ (0.6)</b>	<b>\$ 25.6</b>

### **Liquidity and Capital Resources**

Our primary sources of liquidity have been cash provided by operations, equity contributions, and borrowings. Our principal uses of cash have been for acquisitions, capital expenditures, and debt-service requirements. See “— Cash flows,” above. We anticipate that our principal uses of cash in the future will be for acquisitions, capital expenditures, working capital and debt service.

We have debt covenants under both the indenture governing our Notes and our credit facility that, under certain circumstances, restrict our ability to incur additional indebtedness. The credit facility covenants prohibit us from increasing our total indebtedness above 4.25 times of our previous quarter’s annualized EBITDA. Under the indenture governing our Notes, any increase in secured indebtedness would be subject to a pro-forma permitted liens test not to exceed 3.5 times our previous quarter’s annualized EBITDA, and the incurrence of total indebtedness is restricted not to exceed 4.25 times our previous quarter’s annualized EBITDA.

As of September 30, 2011, we had \$20.8 million in cash and cash equivalents. Cash and cash equivalents consist of amounts held in bank accounts and highly-liquid U.S. treasury money market funds. Working capital (current assets less current liabilities) at September 30, 2011 was a deficit of \$10.1 million. Although we have a working capital deficit as of September 30, 2011, a majority of the deficit is a result of the current portion of our deferred revenue balance of \$15.9 million that we will be recognizing as revenue over the next twelve months. The actual cash outflows associated with fulfilling this deferred revenue obligation during the next twelve months will be significantly less than the September 30, 2011 current deferred revenue balance. Additionally, as of September 30, 2011, we had \$93.6 million available on our line of credit, which can be used to satisfy any short term obligations.

Our net capital expenditures increased by \$7.5 million, or 34%, during the three months ended September 30, 2011 as compared to the three months ended September 30, 2010, from \$21.1 million to \$28.6 million (net of stimulus grants), respectively. Our capital expenditures primarily relate to success-based contracts. The increase in capital expenditures is a result of meeting the needs of our increased customer base resulting from our acquisition of AGL Networks and merger with AFS and organic growth. We expect to continue to invest in our network (in part driven by fiber-to-the-tower activities) for the foreseeable future. Over the next fiscal year, we expect that the level of our investment will be closely correlated to the amount of Adjusted EBITDA we generate. Adjusted EBITDA is a performance, rather than cash flow measure. Correlating our capital expenditures to our Adjusted EBITDA does not imply that we will be able to fund such capital expenditures solely with cash from operations. We expect to fund such capital expenditures with cash from operations, available borrowings under our credit agreement, and available cash on hand. These capital expenditures, however, are expected to primarily be success-based; that is, in most situations, we will not invest the capital until we have an executed customer contract that supports the investment. As a result, the amount we invest in such capital expenditures will generally be based on contracts that are executed and may at times be above or below our actual adjusted EBITDA generation.

As part of our corporate strategy, we continue to be regularly involved in discussions regarding potential acquisitions of companies and assets, some of which may be quite large. We expect to fund such acquisitions with cash from operations, debt (including available borrowings under our revolving credit facility), equity contributions, and available cash on hand.

On October 6, 2011, we entered into a Stock Purchase Agreement to acquire 100 percent of the outstanding capital stock of 360networks. We expect to close on the acquisition during the second or third quarter of Fiscal 2012. The purchase price, subject to certain adjustments at closing and post-closing, is \$345.0 million. In connection with the Stock Purchase Agreement, we have obtained a debt commitment letter that, subject to customary closing conditions, commits certain lenders to provide financing to us in an amount sufficient to permit us, together with cash on hand, to make all payments required to be made to the Sellers in connection with the closing of the acquisition.

### **Cash Flows**

We believe that our cash flow from operating activities, in addition to cash and cash equivalents currently on-hand, will be sufficient to fund our operating activities for the foreseeable future, and in any event for at least the next 12 to 18 months. Given the generally volatile global economic climate no assurance can be given that this will be the case.

The following table sets forth components of our cash flow for the three months ended September 30, 2011 and 2010.

	<b>Three months ended September 30,</b>	
	<b>2011</b>	<b>2010</b>
	<b>(in thousands)</b>	
Net cash provided by operating activities	\$ 24,225	\$ 10,482
Net cash used in investing activities	(28,644)	(94,812)
Net cash (used)/provided by financing activities	(129)	148,387

### **Net Cash Flows from Operating Activities**

Net cash flows from operating activities increased by \$13.7 million, or 131%, from \$10.5 million to \$24.2 million during the three months ended September 30, 2010 and 2011, respectively. Net cash flows from operating activities during the three months ended September 30, 2011 represents our earnings from continuing operations of \$3.1 million, plus the add back to our net earnings of non-cash items deducted in the determination of net earnings, principally depreciation and amortization of \$17.1 million, the deferred

tax provision of \$4.5 million and non-cash stock-based compensation expense of \$3.7 million, plus the change in working capital components.

Net cash flows from operating activities during the three months ended September 30, 2010 represents our loss from continuing operations of \$0.5 million, plus the add back to our net earnings of non-cash items deducted in the determination of net income, principally depreciation and amortization of \$11.8 million, the deferred tax provision of \$2.3 million and non-cash stock-based compensation expense of \$5.1 million plus the change in working capital components.

The increase in net cash flows from operating activities during the three months ended September 30, 2011 as compared to September 30, 2010 is primarily a result of the increase in our earnings associated with our merger with AFS on October 1, 2010, synergies realized from our acquisition of AGL on July 1, 2010 and organic growth.

#### *Cash Flows Used for Investing Activities*

We used cash in investing activities of \$28.6 million and \$94.8 million during the three months ended September 30, 2011 and 2010, respectively. During the three months ended September 30, 2011, our principal use of cash for investing activities was \$28.6 million in additions to property and equipment, net of stimulus grant reimbursements.

During the three months ended September 30, 2010, our principal uses of cash for investing activities were our \$73.7 million purchase of AGL Networks and \$21.1 million for additions to property and equipment, net of stimulus grant reimbursements.

#### *Cash Flows from Financing Activities*

Our net cash provided (used)/provided by financing activities was (\$0.1) million and \$148.4 million during the three months ended September 30, 2011 and 2010, respectively. Our cash flows from financing activities during the three months ended September 30, 2011 comprise \$0.1 million in equity contributions from Holdings. This cash inflow was partially offset by \$0.2 million in principal payments on capital leases during the period.

Our cash flows from financing activities during the three months ended September 30, 2010 primarily comprise \$103.0 million in cash proceeds from our September 2010 Notes offering, \$35.5 million in equity contributions from CII, \$13.0 million in advances from CII and \$0.8 million in transfers of cash from restricted cash accounts. These cash inflows were partially offset by \$3.3 million in deferred financing costs and \$0.6 million in principal payments on capital leases during the period.

#### **Off-Balance Sheet Arrangements**

We do not have any off-balance sheet arrangements other than our operating leases. We do not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements.

#### **New Accounting Pronouncements**

We have reviewed all new accounting pronouncements and have concluded that none of the recently issued pronouncements will have a material impact on our consolidated results of operations, financial condition, or financial disclosure.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our exposure to market risk consists of changes in interest rates from time to time.

As of September 30, 2011, we had outstanding approximately \$350.1 million of fixed-rate Notes, approximately \$10.9 million of capital lease obligations, and \$93.6 million available for borrowing under our \$100.0 million revolving credit facility, at floating rates, subject to certain conditions. Based on current market interest rates for debt of similar terms and average maturities and based on recent transactions, the estimated fair value of our Notes as of September 30, 2011 was \$364.0 million compared to the carrying value of \$350.1 million.

We are exposed to the risk of changes in interest rates if it is necessary to acquire additional funding to support the expansion of our business and to support acquisitions. The interest rate that we may be able to obtain on future debt financings will be dependent on market conditions.

We do not have any material foreign currency or commodity price risk.

#### **ITEM 4. CONTROLS AND PROCEDURES**

As of the end of the period covered by this Quarterly Report on Form 10-Q, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 15d-15. Based upon this evaluation, the Chief Executive Officer and Chief Financial Officer each concluded that our disclosure controls and procedures are effective as of September 30, 2011 and are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in reports filed or submitted under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

There have been no changes in internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

In the ordinary course of business, we are from time to time party to various litigation matters that we believe are incidental to the operation of our business. We record an appropriate provision when the occurrence of loss is probable and can be reasonably estimated. We cannot estimate with certainty our ultimate legal and financial liability with respect to any such pending litigation matters and it is possible one or more of them could have a material adverse effect on us. However, we believe that the outcome of such pending litigation matters will not have a material adverse effect upon our results of operations or our consolidated financial condition.

### **ITEM 1A. RISK FACTORS**

There have been no material changes in our risk factors from those disclosed in our Annual Report on Form 10-K for the fiscal year ended June 30, 2011.

## ITEM 6. EXHIBITS –

<u>Exhibit No.</u>	<u>Description of Exhibit</u>
3.1	Certificate of Formation of Zayo Group, LLC (incorporated by reference to Exhibit 3.1 of our Registration Statement on Form S-4 filed with the SEC on October 18, 2010).
3.2	Operating Agreement of Zayo Group, LLC (incorporated by reference to Exhibit 3.2 of our Registration Statement on Form S-4 filed with the SEC on October 18, 2010).
31.1	Certification of Chief Executive Officer of the Registrant, pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.
31.2	Certification of Chief Financial Officer of the Registrant, pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.
32.1	Certification of Chief Executive Officer of the Registrant, pursuant to 18 U.S.C. Section 1350, as adopted, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer of the Registrant, pursuant to 18 U.S.C. Section 1350, as adopted, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	Financial Statements from the Company’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2011, formatted in XBRL: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statement of Member’s Equity, (iv) Consolidated Statements of Cash Flows, and (v) Notes to Consolidated Financial Statements. <sup>(1)</sup>

<sup>(1)</sup> The XBRL related information in Exhibit 101 shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability of that section and shall not be incorporated by reference into any filing or other document pursuant to the Securities Act of 1933, as amended, except as shall be expressly set forth by specific reference in such filing or document.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**ZAYO GROUP, LLC**

Date: November 10, 2011

By: /s/ Dan Caruso  
Dan Caruso  
Chief Executive Officer

Date: November 10, 2011

By: /s/ Ken desGarenes  
Ken desGarenes  
Chief Financial Officer