**PART II**

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Market Information

The Company's Class A common stock is quoted on the National Association of Securities Dealers Automated Quotations System National Market System (NASDAQ- NMS). Adelphia Business Solutions' NASDAQ-NMS symbol is "ABIZ". Prior to October 25, 1999, the Company's NASDAQ-NMS symbol was "HYPT".

The following table sets forth the range of high and low closing bid prices of the Class A common stock on NASDAQ/NMS. Such bid prices represent inter- dealer quotations, without retail mark-up, mark-down or commission, and may not necessarily represent actual transactions.

| | CLASS A COMMON STOCK | |
|---|---|---|
| QUARTER ENDED: | HIGH | LOW |
| June 30, 1998 | $18 1/6 | $14 1/4 |
| September 30, 1998 | $16 5/8 | $5 7/8 |
| December 31, 1998 | $15 1/8 | $4 1/2 |
| March 31, 1999 | $16 3/8 | $8 5/8 |
| June 30, 1999 | $18 7/8 | $11 |
| September 30, 1999 | $25 | $15 1/2 |
| December 31, 1999 | $51 1/4 | $24 11/16 |

As of March 24, 2000 there were 210 holders of record of the Company's Class A common stock, par value $0.01 per share and 22 holders of record of the Company's Class B common stock, par value $0.01 per share.

Dividends

The Company has never declared any cash dividends on any of its respective equity securities. Covenants in the indenture pursuant to which the Company's Senior Discount Notes, Senior Secured Notes and Senior Subordinated Notes were issued restrict the ability of the Company to pay cash dividends on its capital stock.

Sale of Unregistered Securities

On November 30, 1999, Adelphia Business Solutions issued and sold 8,750,000 shares of Class A common stock at a price to the public of $30.00 per share. Simultaneously, in a private placement in reliance on the exemption under Section 4(2) of the Securities Act, Adelphia purchased 5,181,350 shares of Class B common stock at a purchase price of $28.95 per share representing a price equal to the public offering price less the underwriting discount for the Class A common stock. The net proceeds of approximately $403 million will be used to continue to fund the expansion of Adelphia Business Solutions' existing markets and to build new markets.

## ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data as of and for each of the three years in the period ended March 31, 1998, the nine months ended December 31, 1998 and the year ended December 31, 1999 have been derived from the audited consolidated financial statements of the Company and the related notes thereto. These data should be read in conjunction with the consolidated financial statements and related notes thereto for the year ended March 31, 1998, the nine months ended December 31, 1998, the year ended December 31, 1999 and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this Form 10-K. The balance sheet data as of March 31, 1996, 1997 and 1998 and the statement of operations data and the other Company data with respect to the years ended March 31, 1996 and 1997 have been derived from audited consolidated financial statements of the Company not included herein.

| | Year Ended March 31, | | | Nine Months Ended December 31, | Year Ended December 31, |
|---|---|---|---|---|---|
| | 1996 | 1997 | 1998 | 1998 | 1999 |
| | (Dollars in thousands, except per share amounts) | | | | |
| Statement of Operations Data (a): | | | | | |
| Revenues | $3,322 | $5,088 | $13,510 | $34,776 | $154,575 |
| Operating expenses: | | | | | |
| Network operations | 2,690 | 3,432 | 7,804 | 18,709 | 58,525 |
| Selling, general and administrative | 3,084 | 6,780 | 14,314 | 35,341 | 142,615 |
| Depreciation and amortization | 1,184 | 3,945 | 11,477 | 26,671 | 65,244 |
| Operating loss | (3,636) | (9,069) | (20,085) | (45,945) | (111,809) |
| Gain on sale of investment | --- | 8,405 | --- | --- | --- |
| Interest income | 199 | 5,976 | 13,304 | 10,233 | 19,933 |
| Interest income - affiliate | --- | --- | --- | 8,395 | 8,483 |
| Interest expense and fees | (6,088) | (28,377) | (49,334) | (38,638) | (74,314) |
| Other income | --- | --- | --- | 1,113 | --- |
| Equity in net loss of joint ventures | (4,292) | (7,223) | (12,967) | (9,580) | (7,758) |
| Net loss | (13,620) | (30,547) | (69,082) | (74,185) | (165,466) |
| Dividend requirements applicable to preferred stock | --- | --- | (12,409) | (21,117) | (31,618) |
| Net loss applicable to common stockholders | (13,620) | (30,547) | (81,491) | (95,302) | (197,084) |
| Basic and diluted net loss per weighted average share of common stock | $(0.42) | $(0.89) | $(2.33) | $(1.80) | $(3.47) |
| Common stock dividends | --- | --- | --- | --- | --- |
| Other Company Data (a): | | | | | |
| EBITDA (b) | $(2,452) | $(5,124) | $(8,608) | $(19,274) | $(46,565) |
| Capital expenditures and company investments (c) | 18,899 | 79,396 | 132,889 | 215,770 | 477,755 |
| Cash (used in) provided by operating activities | (833) | (4,823) | (6,333) | (8,810) | 17,485 |
| Cash used in investing activities | (18,899) | (72,818) | (266,604) | (200,458) | (556,247) |
| Cash provided by financing activities | 19,732 | 137,455 | 443,873 | 221,088 | 298,325 |

| | As of March 31, | | | As of December 31, | |
|---|---|---|---|---|---|
| | 1996 | 1997 | 1998 | 1998 | 1999 |
| | (Dollars in thousands) | | | | |
| Balance Sheet Data (a): | | | | | |
| Cash and cash equivalents | $--- | $59,814 | $230,750 | $242,570 | $2,133 |
| Total assets | 35,269 | 174,601 | 639,992 | 836,342 | 1,563,703 |
| Long term debt and exchangeable redeemable preferred stock | 50,855 | 215,675 | 735,980 | 722,783 | 1,103,507 |
| Common stock and other stockholders' equity (deficiency) | (27,323) | (50,254) | (118,991) | 74,031 | 279,931 |

(a) The data presented represents financial information for the Company and its consolidated subsidiaries. As of December 31, 1999, four of the Company's networks were owned by joint ventures in which it owned an interest of 50%, and for which the Company reports its interest pursuant to the equity method of accounting consistent with generally accepted accounting principles.

(b) Earnings before interest expense, income taxes, depreciation and amortization, other non-cash charges, gain on sale of investment, interest income and equity in net loss of joint ventures ("EBITDA") and similar measurements of cash flow are commonly used in the telecommunications industry to analyze and compare telecommunications companies on the basis of operating performance, leverage, and liquidity. While EBITDA is not an alternative to operating income as an indicator of operating performance or an alternative to cash flows from operating activities as a measure of liquidity, all as defined by generally accepted accounting principles, and while EBITDA may not be comparable to other similarly titled measures of other companies, the Company's management believes EBITDA is a meaningful measure of performance.

(c) For the fiscal years ended March 31, 1996, 1997 and 1998, the nine months ended December 31, 1998, and the year ended December 31, 1999, the Company's capital expenditures (including capital expenditures relating to its wholly owned operating companies) were $6.1, $24.6, $68.6, $146.8 and $453.2 million, respectively, and the Company's investments in its less than wholly owned operating companies were $12.8, $34.8, $64.3, $69.0 and $24.5 million, respectively, for the same periods.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements. Certain information or statements included in this Form 10-K, including Management's Discussion and Analysis of Financial Condition and Results of Operations is forward-looking, such as information relating to future growth, expansion of operations or the effect of future regulation or competition. These "forward-looking statements" include statements regarding the intent, belief and current expectations of Adelphia Business Solutions and its directors and officers, and can be identified by the use of forward-looking terminology such as "believes," "expects," "may," "will," "should," "intends" or "anticipates" or the negative thereof or other variations thereon or comparable terminology or by discussions of strategy that involve risks and uncertainties. Any such forward-looking information involves important risks and uncertainties that could significantly affect expected results in the future from those expressed in any forward-looking statements made by, or on behalf of, the Company.

These risks and uncertainties include, but are not limited to, uncertainties relating to our ability to successfully market our services to current and new customers, access markets on a nondiscriminatory basis, identify, design and construct fiber optic networks, install cable and facilities (including switching electronics) and obtain rights of way, access rights to buildings and any required governmental authorizations, franchises and permits, all in a timely manner, at reasonable costs and on satisfactory terms and conditions, as well as risks and uncertainties relating to general economic conditions, the availability and cost of capital, acquisitions and divestitures, government and regulatory policies, the pricing and availability of equipment, materials, inventories and programming, technological developments, the costs and other effects of rapid growth and changes in the competitive environment in which the Company operates. Readers of this Form 10-K are cautioned that such statements are only predictions, that no assurance can be given that any particular future results will be achieved, and that actual events or results may differ materially. In evaluating such statements, readers should specifically consider the various factors which could cause actual events or results to differ materially from those indicated by such forward looking statements. Unless otherwise stated, the information contained in this Form 10-K is as of and for the twelve months ended December 31, 1999. Additional information regarding factors that may affect the business and financial results of Adelphia Business Solutions can be found in the Company's filings with the Securities and Exchange Commission, including the prospectus and most recent prospectus supplement under Registration Statement No. 333-11142 (formerly No. 333-88927), under the caption "Risk Factors."

The "Company" or "Adelphia Business Solutions" means Adelphia Business Solutions, Inc. together with its majority-owned subsidiaries, except where the context otherwise requires. Unless the context otherwise requires, references herein to the networks mean (i) the 22 telecommunications networks in operation or under construction as of May 8, 1998, the date of the Company's initial public offering (the "Original Markets"), which are owned by wholly and majority owned subsidiaries or by three joint venture partnerships or limited liability companies managed by the Company and in which the Company holds a 50% equity interest with one or more other partners, and (ii) the additional networks operational or under development subsequent to May 8, 1998 (the "New Markets").

Adelphia Business Solutions is a leading national provider of facilities-based integrated communications services to customers that include businesses, governmental and educational end users and other communications services providers throughout the United States. The Company currently offers a full range of communications services in 53 markets and expects by the end of the year 2000 to be offering services in approximately 115 markets nationwide, including substantially all of the top 40 metropolitan statistical areas in the United States. To serve the Company's customers' broad and expanding communications needs, the Company has assembled a diverse collection of high- bandwidth, local and national network assets. The Company intends to integrate these assets with advanced communications technologies and services in order to provide comprehensive end-to-end communications services over its national network. The Company provides customers with communications services such as local switch dial tone (also known as local phone service), long distance service, high-speed data transmission and Internet connectivity. The Company's customers have a choice of receiving these services separately or as bundled packages which are typically priced at a discount when compared to the price of the separate services.

In order to take advantage of the improved economic returns and better customer service from providing services "on-net," or over the Company's own network, the Company is in the process of further expanding the reach of its network system nationwide. The Company's Original Markets are principally located in the eastern half of the United States; however, due to the Company's success in operating and expanding these markets the Company is pursuing an aggressive nationwide growth plan. The Company intends to serve 200 total markets nationwide by the end of the year 2001, leveraging the Company's existing and planned switching platforms and inter-city fiber networks. The Company believes that this nationwide footprint will position it to address approximately 65% of the 60 million business access lines nationwide, which currently represent approximately $75 billion in annual revenues. This network system expansion includes the purchase, lease or construction of local fiber optic network facilities and the interconnection of all of the Company's existing and new markets with its own fiber optic facilities. The Company will also implement various technologies including dense wave division multiplexing, or DWDM, to provide greater bandwidth capacity on its local and long-haul network system. Once fully installed, the 33,000 route mile fiber optic backbone will connect each of the Company's local markets. This fully redundant network system will support the Company's full line of communication service offerings.

The Company has experienced success in the sale of business access lines--with approximately 360,205 access lines sold as of December 31, 1999, of which approximately 331,007 lines were installed at such date. This represents an addition of 87,570 access lines sold and 80,202 access lines installed during the quarter ended December 31, 1999 and an addition of 229,856 access lines sold and 224,339 access lines installed during the year ended December 31, 1999. As of December 31, 1999, approximately 55% of these access lines are provisioned on Company owned switches.

Financing Transactions

On March 2, 1999 Adelphia Business Solutions issued $300 million of 12% Senior Subordinated Notes due 2007 (the "Subordinated Notes"). An entity controlled by members of the Rigas family, controlling stockholders of Adelphia, purchased $100 million of the Subordinated Notes directly from Adelphia Business Solutions at a price equal to the aggregate principal amount less the discount to the initial purchasers. The net proceeds of approximately $295 million were used to fund Adelphia Business Solutions' acquisition of interests held by local partners in certain of its markets and were used to fund capital expenditures and investments in its networks and for general corporate and working capital purposes.

On October 13, 1999, the Company filed a shelf registration statement with the Securities and Exchange Commission to sell up to $1.5 billion in debt securities, preferred and common stock, depository shares, and other equity securities. This registration statement became effective on October 22, 1999. Proceeds of any sales under this registration statement are expected to be used for general corporate purposes, including capital spending, acquisitions, debt repayment, investments and other purposes, and to facilitate the national expansion.

On November 30, 1999, Adelphia Business Solutions issued and sold 8,750,000 shares of Class A Common Stock at a price to the public of $30.00 per share, prior to the exercise of any underwriters' over-allotment option. Simultaneously, Adelphia purchased 5,181,350 shares of Class B Common Stock at a price equal to the public offering price less the underwriting discount for the Class A Common Stock. The net proceeds of approximately $403 million will be used to fund the expansion of Adelphia Business Solutions' existing markets and to build new markets. At December 31, 1999, Adelphia owned approximately 60% of the Adelphia Business Solutions' outstanding common stock and approximately 90% of the total voting power.

Acquisitions of Partner Interests

During March 1999, Adelphia Business Solutions consummated purchase agreements with subsidiaries of Multimedia, Inc. and MediaOne of Colorado Inc. to acquire their respective interests in our jointly owned networks located in the Wichita, KS, Jacksonville, FL and Richmond, VA markets for an aggregate of approximately $89.8 million. The agreements increased the Company's ownership interest in each of these networks to 100%. The acquisitions were accounted for under the purchase method of accounting. Accordingly, the financial results of the acquired networks are included in the consolidated results of Adelphia Business Solutions effective from the date acquired.

During June 1999, the Company consummated a purchase agreement with Entergy Corporation ("Entergy"), the parent of its local partner in the Baton Rouge, LA, Little Rock, AR, and Jackson, MS markets, whereby Entergy received approximately $36.5 million for its ownership interests in these markets. The agreements increased the Company's ownership interest in each of these networks to 100%. The acquisitions were accounted for under the purchase method of accounting. Accordingly, the financial results of the acquired networks are included in the consolidated results of Adelphia Business Solutions effective from the date acquired.

On March 21, 2000, the Company entered into a purchase agreement with Allegheny Communications Connect, Inc. ("Allegheny") to acquire Allegheny's 50% interest in the jointly owned network in State College, Pennsylvania, and to make certain changes to the fiber lease agreement with Allegheny for this network. The consideration to be paid to Allegheny under the purchase agreement is 330,000 shares of the Company's Class A common stock. The consummation of this transaction is subject to certain regulatory approvals and customary closing conditions.

Results of Operations

Change of Year End. On March 30, 1999, the Board of Directors of Adelphia Business Solutions approved a change in the Company's fiscal year from March 31 to December 31. The decision was made to conform to general industry practice and for administrative purposes. The change became effective for the nine months ended December 31, 1998.

Twelve months ended December 31, 1999 in comparison with twelve months ended December 31, 1998

Revenues increased 290% to $154.6 million for the twelve months ended December 31, 1999, from $39.6 million in the prior twelve-month period.

| The increase is attributable to the following: | Amounts (in thousands) |
|---|---|
| Growth in Original Markets | $75,978 |
| Acquisition of local partner interests | 27,955 |
| New Markets | 9,798 |
| Management fees | 1,247 |

The primary sources of revenues, reflected as a percentage of total revenue were as follows:

| | Twelve Months Ended December 31, 1998 | 1999 |
|---|---|---|
| Local Service | 53.0% | 69.1% |
| Dedicated Access | 37.5% | 21.1% |
| Management Fees | 9.3% | 3.2% |
| Enhanced Services | --- | 3.1% |
| Long Distance | 0.1% | 1.1% |
| Other | 0.1% | 2.3% |

Network operations expense increased 175% to $58.5 million for the twelve months ended December 31, 1999, from $21.3 million in the prior twelve-month period.

| The increase is attributable to the following: | Amounts (in thousands) |
|---|---|
| Growth in Original Markets | $17,270 |
| Acquisition of local partner interests | 8,381 |
| New Markets | 10,888 |
| Network Control Center | 701 |

The increased number and size of the operations of the networks resulted in increased employee related costs, equipment maintenance costs and expansion costs.

Selling, general and administrative expense increased 251% to $142.6 million for the twelve months ended December 31, 1999, from $40.6 million in the prior twelve-month period.

| The increase is attributable to the following: | Amounts (in thousands) |
|---|---|
| Growth in Original Markets | $28,406 |
| Acquisition of local partner interests | 12,242 |
| New Markets | 42,609 |
| Sales and marketing activities | 6,865 |
| Corporate overhead charges | 11,830 |

Depreciation and amortization expense increased 110% to $65.2 million during the twelve months ended December 31, 1999, from $31.1 million in the prior twelve-month period primarily as a result of increased depreciation resulting from the higher depreciable asset base at the NOCC and the networks, amortization of deferred financing costs and the acquisition of local partner interests.

Interest income increased to $19.9 million from $15.6 million in the prior twelve-month period as a result of the payment of interest due to the Company from Telergy as discussed previously, offset by decreases in interest income resulting from lower amounts of cash and cash equivalents and U.S. Government securities.

Interest income - affiliate remained relatively unchanged at $8.5 million compared to $8.4 million in the prior twelve-month period.

Interest expense increased 43% to $74.3 million for the twelve months ended December 31, 1999, from $52.0 million in the prior twelve-month period as a result of the issuance of the 12% Senior Subordinated Notes due

2007 discussed previously, partially offset by an increase in the amount of interest capitalized on projects under construction in 1999.

Equity in net loss of joint ventures decreased by 41% to $7.8 million for the twelve months ended December 31, 1999, from $13.3 million in the prior twelve- month period as a result of the consolidation of several joint ventures resulting from the purchase of the local partners' interests, and the maturing of the remaining joint venture networks. The decreased net losses of the joint ventures were primarily the result of increased revenues only partially offsetting startup and other costs and expenses associated with design, construction, operation and management of the networks.

The number of non-consolidated joint venture networks paying management fees to the Company decreased from eight at December 31, 1998 to four at December 31, 1999. These networks paid management and monitoring fees to the Company, which are included in revenues, aggregating approximately $4.9 million for the twelve months ended December 31, 1999, an increase of approximately $1.2 million over the prior twelve-month period. The non-consolidated networks' net losses, including networks under construction, for the twelve months ended December 31, 1998 and 1999 aggregated approximately $28.4 million and $15.2 million respectively.

Preferred stock dividends increased 14% to $31.6 million during the twelve months ended December 31, 1999 from $27.7 million during the prior twelve-month period. The increase was due to a higher outstanding preferred stock base resulting from the payment of dividends in additional shares of preferred stock.

Nine months Ended December 31, 1998 in Comparison with Nine months Ended December 31, 1997

Revenues increased 300% to $34.8 million for the nine months ended December 31, 1998, from $8.7 million for the same period in the prior fiscal year. Growth in revenues of $26.1 million resulted from an increase in revenues from majority and wholly-owned networks of approximately $27.2 million as compared to the same period in the prior fiscal year due to the continued expansion of the Company's customer base, its success in the roll out of switched services and the consolidation of the Buffalo, Syracuse, New Jersey, Louisville, Lexington and Harrisburg networks. Management fees from non-consolidated subsidiaries decreased $1.1 million as compared to the same period in the prior fiscal year primarily due to the consolidation of the above mentioned networks.

Network operations expense increased 255% to $18.7 million for the nine months ended December 31, 1998 from $5.3 million for the same period in the prior fiscal year. The increase was attributable to the expansion of operations at the NOCC, and the increased number and size of the operations of the networks which resulted in increased employee related costs and equipment maintenance costs and the consolidation of the Buffalo, Syracuse, New Jersey, Louisville, Lexington and Harrisburg networks.

Selling, general and administrative expense increased 288% to $35.3 million for the nine months ended December 31, 1998 from $9.1 million for the same period in the prior fiscal year. The increase was due primarily to increased expense associated with the network expansion plan, an increase in the sales force in the Original Markets and an increase in corporate overhead costs to accommodate the growth in the number, size and operations of the networks managed and monitored by the Company, as well as the consolidation of the Buffalo, Syracuse, New Jersey, Louisville, Lexington and Harrisburg networks.

Depreciation and amortization expense increased 280% to $26.7 million during the nine months ended December 31, 1998 from $7.1 million for the same period in the prior fiscal year primarily as a result of increased amortization of deferred financing costs and increased depreciation resulting from the higher depreciable asset base at the NOCC and the majority and wholly owned networks and the consolidation of the Buffalo, Syracuse, New Jersey, Louisville, Lexington and Harrisburg networks.

Interest income for the nine months ended December 31, 1998 increased 33% to $10.2 million from $7.7 million for the same period in the prior fiscal year as a result of increased cash and cash equivalents and U.S.

Government securities due to the investment of the proceeds of the 12 1/4% Senior Secured Notes, the 12 7/8% Senior Exchangeable Redeemable Preferred Stock and the Company's initial public offering of Class A common stock, partially offset by demand advances made to Adelphia.

Interest income - affiliate for the nine months ended December 31, 1998 increased to $8.4 million from $0.3 million as a result of demand advances made to Adelphia during the current period.

Interest expense increased 8% to $38.6 million during the nine months ended December 31, 1998 from $35.9 million for the same period in the prior fiscal year. The increase was attributable to the interest on the 12 1/4% Senior Secured Notes partially offset by the reduction of interest expense associated with the reduced amounts payable to Adelphia and higher interest capitalized on networks under construction.

Equity in net loss of joint ventures increased to $9.6 million during the nine months ended December 31, 1998 from $9.3 million for the same period in the prior fiscal year. The net losses of the nonconsolidated networks for the nine months ended December 31, 1998 were primarily the result of increased revenues only partially offsetting startup and other costs and expenses associated with design, construction, operation and management of the networks, and the effect of the typical lag time between the incurrence of such costs and expenses and the subsequent generation of revenues by a network. The increase was partially offset by the consolidation of the Buffalo, Syracuse, New Jersey, Louisville, Lexington and Harrisburg networks for the current period.

The number of non-consolidated networks paying management fees to the Company was eight at December 31, 1998. These networks and networks under construction paid management and monitoring fees to the Company, which are included in revenues, aggregating approximately $2.7 million for the nine months ended December 31, 1998, as compared with $3.8 million for the same period in the prior fiscal year. The non-consolidated networks' net losses, including networks under construction, for the nine months ended December 31, 1997 and 1998 aggregated approximately $13.7 million and $22.3 million respectively.

Preferred stock dividends increased by 264% to $21.1 million for the nine months ended December 31, 1998 from $5.8 million for the same period in the prior fiscal year. The increase is due to the preferred stock which was issued in October 1997.

Supplementary Network Financial Analysis

The Company believes that historically, working with Local Partners to develop markets has enabled the Company to build larger networks in a rapid and more cost effective manner than it could have on its own. The Company currently has joint ventures covering four networks with Local Partners where the Company owns 50% of each joint venture. As a result of the Company's historic ownership position in these and other joint ventures, a substantial portion of the networks' historic results have been reported by the Company on the equity method of accounting for investments which only reflects the Company's pro rata share of net income or loss of the networks. Because of the recently completed partner roll-ups, management of the Company believes this historical presentation of the assets, liabilities and results of operations of the Company does not represent a complete measure of the financial position, growth or operations of the Company.

In order to provide an additional measure of the financial position, growth and performance of the Company and its networks, management of the Company analyzes financial information of the consolidated networks and the non- consolidated joint venture networks on a combined basis. This combined financial presentation in the table below reflects Adelphia Business Solutions' consolidated financial position and results of operations adjusted for the inclusion of certain networks (Richmond, Jacksonville and Wichita) which were purchased in March 1999 (the "Adjusted Operating Results") combined with the non-consolidated joint ventures' results of operations. All combined results of operations in the table below are presented as if Adelphia Business Solutions consolidated all networks which were involved in the partnership roll-ups during the entire period presented. This financial information, however, is not indicative of the Company's overall historical financial position or results of operations.

| | Year ended December 31, 1999 | | | Year ended December 31, 1998 | | |
|---|---|---|---|---|---|---|
| | (dollars in thousands) | | | (dollars in thousands) | | |
| | Adjusted Consolidated Operating Results | Adjusted Joint Venture Operating Results | Combined Operating Results | Adjusted Consolidated Operating Results | Adjusted Joint Venture Operating Results | Combined Operating Results |
| Revenues | $159,803 | $38,524 | $198,327 | $55,925 | $11,231 | $67,156 |
| Direct Operating Expenses | 60,346 | 11,764 | 72,110 | 26,664 | 6,634 | 33,298 |
| Gross Margin | 99,457 | 26,760 | 126,217 | 29,261 | 4,597 | 33,858 |
| Gross Margin Percentage | 62.2% | 69.5% | 63.6% | 52.3% | 40.9% | 50.4% |
| Selling, General and Administrative Expenses | 144,531 | 20,086 | 164,617 | 45,800 | 12,471 | 58,271 |
| EBITDA (a) | (45,074) | 6,674 | (38,400) | (16,539) | (7,874) | (24,413) |
| EBITDA Percentage of Revenues | (28.2%) | 17.3% | (19.4%) | (29.6%) | (70.1%) | (36.4%) |

| | December 1999 Year vs. December 1998 Year | | |
|---|---|---|---|
| % Change Comparison | Consolidated Operating Results | Joint Venture Operating Results | Combined Operating Results |
| Revenues | 185.7% | 243.0% | 195.3% |
| Direct Operating Expenses | 126.3% | 77.3% | 116.6% |
| Gross Margin | 239.9% | 482.1% | 272.8% |
| Selling, General and Administrative Expenses | 215.6% | 61.1% | 182.5% |
| EBITDA (a) | NM(b) | NM(b) | (57.3%) |

(a) EBITDA and similar measurements of cash flow are commonly used in the telecommunications industry to analyze and compare telecommunications companies on the basis of operating performance, leverage, and liquidity. While EBITDA is not an alternative to operating income as an indicator of operating performance or an alternative to cash flows from operating activities as a measure of liquidity, all as defined by generally accepted accounting principles, and while EBITDA may not be comparable to other similarly titled measures of other companies, the Company's management believes EBITDA is a meaningful measure of performance. (b) Not meaningful

Liquidity and Capital Resources

The development of the Company's business and the installation and expansion of the networks, as well as the development of the markets, combined with the construction and expansion of the Company's NOCC, have resulted in substantial capital expenditures and investments during the past several years. Capital expenditures by the Company were $146.8 million and $453.2 million for the nine months ended December 31, 1998 and the twelve months ended December 31, 1999, respectively. Further, investments made by the Company in nonconsolidated networks and in LMDS licenses were $69.0 million and $24.5 million for the nine months ended December 31, 1998 and the year ended December 31, 1999, respectively. The significant increase in capital expenditures for the year ended December 31, 1999 is largely attributable to capital expenditures necessary to develop the Original Markets and the New Markets, as well as the fiber purchases to interconnect the networks. The Company expects that it will continue to incur substantial capital expenditures in this development effort. The Company also expects to continue to fund operating losses as the Company develops and grows its business. For information regarding recent transactions affecting the Company's liquidity and capital resources, see "Financing Transactions" and "Acquisitions of Partners Interests" above.

The Company has experienced negative operating and investing cash flow since its inception. A combination of operating losses, substantial capital investments required to build the Company's networks and its state-of-the-art NOCC, and incremental investments in the joint ventures has resulted in substantial negative cash flow.

Expansion of the Company's Original Markets and services and the development of New Markets and additional networks and services requires significant capital expenditures. The Company's operations have required and will continue to require substantial capital investment for (i) the installation of electronics for switched services in the Company's networks, (ii) the expansion and improvement of the Company's NOCC and Original Markets, (iii) the design, construction and development of New Markets and (iv) the acquisition of additional ownership interests in the Original Markets. The Company has made substantial capital investments and investments in joint ventures in connection with the installation of 5ESS switches or remote switching modules in all of its Original Markets and plans to install regional super switches in certain key New Markets when such New Markets are operational. To date, the Company has installed switches in all of its Original Markets and plans to provide such services in all of its New Markets on a standard switching platform based on Lucent 5 switch technology. In addition, the Company intends to increase spending on marketing and sales significantly in the foreseeable future in connection with the expansion of its sales force and marketing efforts generally. The Company also plans to purchase its partners' interest in the joint ventures when it can do so at attractive economic terms. The Company estimates that, in addition to the cash and cash equivalents on hand, demand loans to Adelphia and the U.S. government securities pledged as of December 31, 1999, a total of approximately $500 million will be required to fund the Company's capital expenditures, working capital requirements, operating losses and pro rata investments in the joint ventures from January 1, 2000 through the quarter ending December 31, 2000.

In addition, there can be no assurance (i) that the Company's future cash requirements will not vary significantly from those presently planned due to a variety of factors including acquisition of additional networks, continued acquisition of increased ownership in its networks, material variances from expected capital expenditure requirements for Original Markets and New Markets and development of the LMDS spectrum, or (ii) that anticipated financings, Local Partner investments and other sources of capital will become available to the Company on economically attractive terms or at all. In addition, it is possible that expansion of the Company's networks may include the geographic expansion of the Company's existing clusters and the development or acquisition of other new markets not currently planned.

The Company will need substantial additional funds to fully fund its business plan. The Company expects to fund its capital requirements through existing resources, credit facilities and vendor financings at the Company and joint venture levels, internally generated funds, equity invested by Local Partners in joint ventures and additional debt or equity financings, as appropriate, and expects to fund any potential additional purchase of partnership interests of Local Partners through existing resources, internally generated funds and additional debt or equity financings, as appropriate. There can be no assurances, however, that the Company will be successful in generating sufficient cash flow or in raising sufficient debt or equity capital on terms that it will consider acceptable, or at all.

Recent Accounting Pronouncements

Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities," establishes accounting and reporting standards for derivative instruments and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. Management of the Company has not completed its evaluation of the impact of the impact of SFAS No. 133 on the Company's financial statements. In July 1999, SFAS No. 137 was issued to delay the effective date of SFAS No. 133 to fiscal quarters of fiscal years beginning after June 15, 2000.

Impact of Inflation

The Company does not believe that inflation has had a significant impact on the Company's consolidated operations or on the operations of the joint ventures in the year ended March 31, 1998, the nine months ended December 31, 1998 and the year ended December 31, 1999.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The Company uses fixed rate debt to fund its working capital requirements, capital expenditures and acquisitions. These debt arrangements expose the Company to market risk related to changes in interest rates. The table below summarizes the fair values and contract terms of the Company's financial instruments subject to interest rate risk as of December 31, 1999.

| | Expected Maturity | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2000 | 2001 | 2002 | 2003 | 2004 | Thereafter | Total | Fair Value |
| Debt: | --- | --- | --- | 303,840 | 250,000 | 560,848 | 1,114,688 | 1,120,837 |
| Fixed Rate | | | | | | | | |
| Average Interest Rate | 12.53% | 12.53% | 12.53% | 12.42% | 12.61% | 12.61% | | |

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The consolidated financial statements and related notes thereto and independent auditors' report follow.

### ADELPHIA BUSINESS SOLUTIONS, INC. AND SUBSIDIARIES

### INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

**INDEPENDENT AUDITORS' REPORT**

Adelphia Business Solutions, Inc.:

We have audited the accompanying consolidated balance sheets of Adelphia Business Solutions, Inc. and subsidiaries as of December 31, 1998 and 1999, and the related consolidated statements of operations, of common stock and other stockholders' equity (deficiency) and of cash flows for the year ended March 31, 1998, the nine months ended December 31, 1998 and the year ended December 31, 1999. Our audits also included the financial statement schedule listed in the Index at Item 14. These financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Adelphia Business Solutions, Inc. and subsidiaries at December 31, 1998 and 1999, and the results of their operations and their cash flows for the year ended March 31, 1998, the nine months ended December 31, 1998 and the year ended December 31, 1999 in conformity with generally accepted accounting principles. Also, in our opinion such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

**DELOITTE & TOUCHE LLP**

Pittsburgh, Pennsylvania
March 1, 2000

## ADELPHIA BUSINESS SOLUTIONS, INC. AND SUBSIDIARIES
## CONSOLIDATED BALANCE SHEETS
(Dollars in thousands except per share amounts)

| | December 31, | |
|---|---|---|
| | 1998 | 1999 |
| ASSETS: | | |
| Current assets: | | |
| Cash and cash equivalents | $242,570 | $2,133 |
| Due from parent - net | 4,950 | 392,629 |
| Due from affiliates - net | 1,078 | 6,230 |
| Accounts receivable - net | 14,221 | 68,075 |
| Other current assets | 1,362 | 9,852 |
| Total current assets | 264,181 | 478,919 |
| U.S. government securities - pledged | 58,054 | 29,899 |
| Investments | 112,328 | 44,066 |
| Property, plant and equipment--net | 374,702 | 943,756 |
| Other assets--net | 27,077 | 67,063 |
| Total | $836,342 | $1,563,703 |
| LIABILITIES, PREFERRED STOCK, COMMON STOCK AND OTHER STOCKHOLDERS' EQUITY (DEFICIENCY): | | |
| Current liabilities: | | |
| Accounts payable | $20,386 | $150,151 |
| Accrued interest and other liabilities | 19,142 | 27,595 |
| Total current liabilities | 39,528 | 177,746 |
| 13% Senior Discount Notes due 2003 | 220,784 | 253,860 |
| 12 1/4% Senior Secured Notes due 2004 | 250,000 | 250,000 |
| 12% Senior Subordinated Notes due 2007 | --- | 300,000 |
| Other debt | 23,325 | 41,318 |
| Total liabilities | 533,637 | 1,022,924 |
| 12 7/8% Senior Exchangeable Redeemable Preferred Stock | 228,674 | 260,848 |
| Commitments and contingencies (Note 7) | | |
| Common stock and other stockholders' equity (deficiency): | | |
| Class A common stock, $0.01 par value, 800,000,000 shares authorized, 22,376,071 and 34,066,587 shares outstanding, respectively | 224 | 341 |
| Class B common stock, $0.01 par value, 400,000,000 shares authorized, 32,314,761 and 35,371,458 shares outstanding, respectively | 323 | 354 |
| Additional paid in capital | 286,782 | 666,021 |
| Class B common stock warrants | 4,483 | 2,177 |
| Unearned stock compensation | --- | (5,715) |
| Accumulated deficit | (217,781) | (383,247) |
| Total common stock and other stockholders' equity (deficiency) | 74,031 | 279,931 |
| Total | $836,342 | $1,563,703 |

See notes to consolidated financial statements.

**ADELPHIA BUSINESS SOLUTIONS, INC. AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF OPERATIONS**
(Amounts in thousands except per share amounts)

| | Year Ended March 31, 1998 | Nine Months Ended December 31, 1998 | Year Ended December 31, 1999 |
|---|---|---|---|
| Revenues | $13,510 | $34,776 | $154,575 |
| Operating expenses: | | | |
| Network operations | 7,804 | 18,709 | 58,525 |
| Selling, general and administrative | 14,314 | 35,341 | 142,615 |
| Depreciation and amortization | 11,477 | 26,671 | 65,244 |
| Total | 33,595 | 80,721 | 266,384 |
| Operating loss | (20,085) | (45,945) | (111,809) |
| Other income (expense): | | | |
| Interest income | 13,304 | 10,233 | 19,933 |
| Interest income - affiliate | --- | 8,395 | 8,483 |
| Interest expense | (49,334) | (38,638) | (74,314) |
| Other income | --- | 1,113 | --- |
| Loss before income taxes, equity in net loss of joint ventures and extraordinary gain | (56,115) | (64,842) | (157,707) |
| Income tax expense | --- | --- | (1) |
| Loss before equity in net loss of joint ventures and extraordinary gain | (56,115) | (64,842) | (157,708) |
| Equity in net loss of joint ventures | (12,967) | (9,580) | (7,758) |
| Loss before extraordinary gain | (69,082) | (74,422) | (165,466) |
| Extraordinary gain on repurchase of debt | --- | 237 | --- |
| Net loss | (69,082) | (74,185) | (165,466) |
| Dividend requirements applicable to preferred stock | (12,409) | (21,117) | (31,618) |
| Net loss applicable to common stockholders | $(81,491) | $(95,302) | $(197,084) |
| Basic and diluted net loss per weighted average share of common stock before extraordinary gain | $(2.33) | $(1.81) | $(3.47) |
| Basic and diluted extraordinary gain on repurchase of debt per weighted average share of common stock | --- | 0.01 | --- |
| Basic and diluted net loss per weighted average share of common stock | $(2.33) | $(1.80) | $(3.47) |
| Weighted average shares of common stock outstanding | 34,986 | 53,035 | 56,739 |

See notes to consolidated financial statements.

**ADELPHIA BUSINESS SOLUTIONS, INC. AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF COMMON STOCK AND OTHER STOCKHOLDERS' EQUITY (DEFICIENCY)**
(Dollars in thousands except per share amounts)

| | Class A Common Stock | Class B Common Stock | Additional Paid-in Capital | Class A Common Stock Warrant | Class B Common Stock Warrants |
|---|---|---|---|---|---|
| Balance, March 31, 1997 | $3 | $325 | $153 | $--- | $11,087 |
| Issuance of Class A common stock warrant | --- | --- | --- | 13,000 | --- |
| Dividend requirements applicable to preferred stock | --- | --- | --- | --- | --- |
| Other | --- | --- | --- | --- | --- |
| Issuance of Class A common stock bonus | 1 | --- | 26 | --- | --- |
| Net loss | --- | --- | --- | --- | --- |
| Balance, March 31, 1998 | 4 | 325 | 179 | 13,000 | 11,087 |
| Proceeds from issuance of Class A common stock | 129 | --- | 190,731 | --- | --- |
| Proceeds from issuance of Class A common stock to Adelphia | 33 | --- | 49,827 | --- | --- |
| Exercise of Class A common stock warrant | 7 | --- | 12,993 | (13,000) | --- |
| Conversion of note and payables to Adelphia to Class A common stock | 36 | --- | 44,222 | --- | --- |
| Exercise of Class B common stock warrants. | --- | 8 | 6,596 | --- | (6,604) |
| Conversion of Class B common stock to Class A common stock | 10 | (10) | --- | --- | --- |
| Repayment of loan to stockholders | --- | --- | --- | --- | --- |
| Dividend requirements applicable to preferred stock | --- | --- | (18,168) | --- | --- |
| Other | --- | --- | (353) | --- | --- |
| Issuance of Class A | | | | | --- |
| common stock bonus | 5 | --- | 755 | --- | --- |
| Net loss | --- | --- | --- | --- | --- |
| Balance December 31, 1998 | 224 | 323 | 286,782 | --- | 4,483 |
| Proceeds from issuance of Class A common stock | 88 | --- | 252,766 | --- | --- |
| Proceeds from issuance of Class B common stock | --- | 52 | 149,948 | --- | --- |
| Exercise of Class B common stock warrants. | --- | 3 | 2,303 | --- | (2,306) |
| Conversion of Class B common stock to Class A common stock | 24 | (24) | --- | --- | --- |
| Unearned stock compensation | 4 | --- | 6,396 | --- | --- |
| Dividend requirements applicable to preferred stock | --- | --- | (31,618) | --- | --- |
| Other | 1 | --- | (556) | --- | --- |
| Net loss | --- | --- | --- | --- | --- |
| Balance December 31, 1999 | $341 | $354 | $666,021 | $--- | $2,177 |

| | Loans to Stockholders | Unearned Stock Compensation | Accumulated Deficit | Total |
|---|---|---|---|---|
| Balance, March 31, 1997 | $(3,000) | $--- | $(58,822) | $(50,254) |
| Issuance of Class A common stock warrant | --- | --- | --- | 13,000 |
| Dividend requirements applicable to preferred stock | --- | --- | (12,409) | (12,409) |
| Other | --- | --- | (273) | (273) |
| Issuance of Class A common stock bonus | --- | --- | --- | 27 |
| Net loss | --- | --- | (69,082) | (69,082) |
| Balance, March 31, 1998 | (3,000) | --- | (140,586) | (118,991) |

| | | | | |
|---|---|---|---|---|
| Proceeds from issuance of Class A common stock | --- | --- | --- | 190,860 |
| Proceeds from issuance of Class A common stock to Adelphia | --- | --- | --- | 49,860 |
| Exercise of Class A common stock warrant | --- | --- | --- | --- |
| Conversion of note and payables to Adelphia to Class A common stock | --- | --- | --- | 44,258 |
| Exercise of Class B common stock warrants | --- | --- | --- | --- |
| Conversion of Class B common stock to Class A common stock | --- | --- | --- | --- |
| Repayment of loan to stockholders | 3,000 | --- | --- | 3,000 |
| Dividend requirements applicable to preferred stock | --- | --- | (2,949) | (21,117) |
| Other | --- | --- | (61) | (414) |
| Issuance of Class A common stock bonus | --- | --- | --- | 760 |
| Net loss | --- | --- | (74,185) | (74,185) |
| Balance December 31, 1998 | --- | --- | (217,781) | 74,031 |
| Proceeds from issuance of Class A common stock | --- | --- | --- | 252,854 |
| Proceeds from issuance of Class B common stock | --- | --- | --- | 150,000 |
| Exercise of Class B common stock warrants | --- | --- | --- | --- |
| Conversion of Class B common stock to Class A common stock | --- | --- | --- | --- |
| Unearned stock compensation | --- | (5,715) | --- | 685 |
| Dividend requirements applicable to preferred stock | --- | --- | --- | (31,618) |
| Other | --- | --- | --- | (555) |
| Net loss | --- | --- | (165,466) | (165,466) |
| Balance December 31, 1999 | $--- | $(5,715) | $(383,247) | $279,931 |

See notes to consolidated financial statements.

## ADELPHIA BUSINESS SOLUTIONS, INC. AND SUBSIDIARIES
## CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)

| | Year Ended March 31, 1998 | Nine Months Ended December 31, 1998 | Year Ended December 31, 1999 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Net loss | $(69,082) | $(74,185) | $(165,466) |
| Adjustments to reconcile net loss to net cash (used in) provided by operating activities: | | | |
| Depreciation | 9,038 | 23,838 | 59,430 |
| Amortization | 2,439 | 2,833 | 5,814 |
| Equity in net loss of joint ventures | 12,967 | 9,580 | 7,758 |
| Non-cash interest expense | 34,038 | 23,857 | 33,076 |
| Noncash stock compensation | 27 | 761 | 685 |
| Extraordinary gain on repurchase of debt | --- | (237) | --- |
| Changes in operating assets and liabilities, net of effects of acquisitions: | | | |
| Other assets--net | (5,302) | (15,533) | (62,580) |
| Accounts payable | 6,023 | 9,862 | 127,697 |
| Accrued interest and other liabilities | 3,519 | 10,414 | 11,071 |
| Net cash (used in) provided by operating activities | (6,333) | (8,810) | 17,485 |
| Cash flows from investing activities: | | | |
| Net cash used for acquisitions | (65,968) | --- | (129,118) |
| Expenditures for property, plant and equipment | (68,629) | (146,752) | (453,206) |
| Repayment of senior secured note | --- | --- | 20,000 |
| Investments in joint ventures | (64,260) | (69,018) | (24,496) |
| Investments in U.S. government securities - pledged | (83,400) | --- | --- |
| Sale of U.S. government securities - pledged | 15,653 | 15,312 | 30,626 |
| Net cash used in investing activities | (266,604) | (200,458) | (556,194) |
| Cash flows from financing activities: | | | |
| Proceeds from issuance of preferred stock | 194,522 | --- | --- |
| Proceeds from issuance of Class A common stock | --- | 255,462 | 262,500 |
| Proceeds from issuance of Class B common stock | --- | --- | 150,000 |
| Proceeds from sale and leaseback of equipment | 14,876 | --- | --- |
| Proceeds from debt | 250,000 | --- | 300,000 |
| Repayments of debt | (2,326) | (19,868) | (5,668) |
| Costs associated with debt financing | (12,664) | --- | (6,180) |
| Costs associated with issuance of common stock | --- | (14,742) | (9,646) |
| Repayment of loans from stockholders | --- | 3,000 | --- |
| Advances to affiliates | (535) | (2,764) | (392,734) |
| Net cash provided by financing activities | 443,873 | 221,088 | 298,272 |
| Increase (decrease) in cash and cash equivalents | 170,936 | 11,820 | (240,437) |
| Cash and cash equivalents, beginning of period | 59,814 | 230,750 | 242,570 |
| Cash and cash equivalents, end of period | $230,750 | $242,570 | $2,133 |

See notes to consolidated financial statements.

(1) The Company and Summary of Significant Accounting Policies

Organization and Business

The consolidated financial statements include the accounts of Adelphia Business Solutions, Inc. and its more than 50% owned subsidiaries ("Adelphia Business Solutions" or the "Company"). All significant intercompany accounts and transactions have been eliminated in consolidation. The Company was formed in 1991 and is a majority owned subsidiary of Adelphia Communications Corporation ("Adelphia"). On October 25, 1999, the stockholders of the Company elected to change the name of the Company from Hyperion Telecommunications, Inc. to Adelphia Business Solutions, Inc. With this decision, management believes the strengths of Adelphia and the Company are further aligned to develop a single brand in the communications marketplace.

On March 30, 1999, Adelphia Business Solutions elected to change its fiscal year from March 31 to December 31. The decision was made to conform to general industry practice and for administrative purposes. The change became effective for the nine months ended December 31, 1998.

On May 8, 1998, the Company issued and sold 12,500,000 shares of Class A common stock at a price to the public of $16.00 per share (the "IPO"). Simultaneously with the closing of the IPO, the Company issued and sold an additional 3,324,001 shares of Class A common stock to Adelphia at a purchase price of $15.00 per share (or an aggregate of approximately $49,900). In addition, at such closing, the Company issued 3,642,666 shares of Class A common stock to Adelphia in exchange for certain of the Company's indebtedness and payables with a carrying value of $44,258 owed to Adelphia at a purchase price of $15.00 per share (or an aggregate of $54,600). In a related transaction, on June 5, 1998, the Company issued and sold 350,000 shares of Class A common stock at the $16.00 IPO price pursuant to the underwriters' over-allotment option in the IPO.

On November 30, 1999, the Company issued and sold 8,750,000 shares of Class A common stock at a price to the public of $30.00 per share. Simultaneously with the closing of this transaction, the Company issued and sold 5,181,350 shares of Class B common stock to Adelphia at a purchase price of $28.95 per share.

At December 31, 1999, Adelphia owned approximately 60% of Adelphia Business Solutions' outstanding common stock and held approximately 90% of the total voting rights.

The Company is a leading national provider of facilities-based integrated communications services to customers that include businesses, governmental and educational end users and other communications services providers throughout the United States. The Company currently offers a full range of communications services in 53 markets and expects by the end of the year 2000 to be offering services in approximately 115 markets nationwide, including substantially all of the top 40 metropolitan statistical areas in the United States. To serve its customers' broad and expanding communications needs, the Company has assembled a diverse collection of high-bandwidth, local and national network assets. The Company intends to integrate these assets with advanced communications technologies and services in order to provide comprehensive end-to-end communications services over our own national network. The Company provides customers with communications services such as local switch dial tone (also known as local phone service), long distance service, high-speed data transmission and Internet connectivity. The Company offers its customers a choice of receiving these services separately or as a bundled packages which are typically priced at a discount when compared to the price of the separate services.

To develop the original markets and the new markets, as well as the fiber purchases to interconnect the networks, the Company expects that it will continue to incur substantial capital expenditures. A total of approximately $500,000 will be required fund the Company's capital expenditures, working capital requirements, operating losses and pro rata investments in the joint ventures from January 1, 2000 through December 31, 2000. The Company will need substantial additional funds to fully fund its business plan. The Company expects to fund its capital requirements through existing resources, credit facilities and vendor financings at the Company and joint venture levels, internally generated funds, equity invested by local partners in joint ventures and additional debt or equity financings, as appropriate, and expects to fund any potential additional purchase of partnership interest of local partners through existing resources, internally generated funds and additional debt or equity financings, as appropriate. There can be no assurances, however, that the Company will be successful in generating sufficient cash flow or in raising sufficient debt or equity capital on terms that it will consider acceptable, or at all.

(Dollars in thousands except per share amounts)

Joint ventures in which the Company does not have a majority interest are accounted for under the equity method of accounting.

Acquisitions of Partner Interests

On September 12, 1997, the Company consummated an agreement with Time Warner Entertainment - Advance/Newhouse ("TWEAN") to exchange interests in four New York CLEC networks. As a result of the transaction, the Company paid TWEAN $7,638 and increased its ownership in the networks serving Buffalo and Syracuse, New York to 60% and 100%, respectively, and eliminated its interest in the Albany and Binghamton networks, which became wholly owned by TWEAN.

On February 12, 1998, the Company purchased additional partnership interests in Louisville Lightwave (Louisville and Lexington), NHT Partnership (Buffalo), New Jersey Fiber Technologies and Hyperion of Harrisburg. As a result, the Company's ownership in these networks increased to 100%. The aggregate purchase price was comprised of approximately $45,000 in cash and a warrant for 731,624 shares of the Company's Class A common stock. (See Note 6.) In addition, Hyperion paid certain amounts related to fiber lease financings upon consummation of the purchase of the additional partnership interests.

During March 1999, Adelphia Business Solutions consummated purchase agreements with subsidiaries of Multimedia, Inc. and MediaOne of Colorado Inc. to acquire their respective interests in jointly owned networks located in the Wichita, KS, Jacksonville, FL and Richmond, VA markets for an aggregate of approximately $89,750. The agreements increased the Company's ownership interest in each of these networks to 100%.

During June 1999, the Company consummated a purchase agreement with Entergy Corporation ("Entergy"), the parent of its local partner in the Baton Rouge, LA, Little Rock, AR, and Jackson, MS markets, whereby Entergy received approximately $36,518 for its ownership interests in these markets. The agreements increased the Company's ownership interest in each of these networks to 100%.

All of the acquisitions described above were accounted for using the purchase method. Accordingly, the financial results of each acquisition have been included in the Company's consolidated financial statements from the date acquired.

The following unaudited financial information of the Company assumes that each of the transactions described above had occurred on April 1, 1997.

| | Year Ended March 31, 1998 | Nine Months Ended December 31, 1998 | Year Ended December 31, 1999 |
|---|---|---|---|
| Revenues | $28,061 | $49,156 | $162,138 |
| Net loss | (80,293) | (79,745) | (169,282) |
| Net loss applicable to common stockholders | (92,179) | (98,572) | (198,924) |
| Basic and diluted net loss per weighted average share of common stock. | $(2.63) | $(1.86) | $(3.51) |

Cash and cash equivalents

Cash and cash equivalents consist of highly liquid instruments with an initial maturity date of three months or less.

(Dollars in thousands except per share amounts)

U.S. Government Securities - Pledged

U.S. Government Securities - Pledged consist of highly liquid investments which will be used to pay the first six semi-annual interest payments of the 12 1/4% Senior Secured Notes. Such investments are classified as held-to- maturity and the carrying value approximates market value.

Accounts Receivable

An allowance for doubtful accounts of $1,128 and $9,640 is recorded as a reduction of accounts receivable at December 31, 1998 and 1999, respectively.

Property, Plant and Equipment

Property, plant and equipment is stated at cost less accumulated depreciation. Costs capitalized include amounts directly associated with network engineering, design and construction.

Provision for depreciation of property, plant and equipment is computed using the straight-line method over the estimated useful lives of the assets beginning in the month the asset is available for use or is acquired.

The estimated useful lives of the Company's principal classes of property, plant and equipment are as follows:

| | |
|---|---|
| Telecommunications networks | 10-20 years |
| Network monitoring and switching equipment | 5-10 years |
| Fiber optic use rights | 15 years |
| Other | 3-10 years |

Revenue Recognition

The Company recognizes revenue from communications services in the month the related service is provided. Revenues on billings to customers for services in advance of providing such services are deferred and recognized when earned. The Company recognizes revenues related to management and network monitoring of the joint ventures in the month that the related services are provided. Reciprocal compensation revenue is an element of switched service revenue, which represents compensation from Local Exchange Carriers ("LECs") for local exchange traffic originated by other LECs terminated on the Company's facilities. Adelphia Business Solutions recognizes revenue based upon established contracts with the LECs and has established a reserve for a portion of those revenues that are under dispute.

Significant Customers

During the year ended March 31, 1998, Adelphia Business Solutions' sales to AT&T and MCI WorldCom represented 18.3% and 14.5% of total revenues, respectively. During the nine months ended December 31, 1998, Adelphia Business Solutions' sales to AT&T and Bell Atlantic represented 11.4% and 10.1% of total revenues, respectively. During the year ended December 31, 1999, Adelphia Business Solutions' sales to AT&T and Bell Atlantic represented 8.8% and 14.7% of total revenues, respectively.

Basic and Diluted Net Loss per Weighted Average Share of Common Stock

Basic net loss per weighted average share of common stock is computed based upon the weighted average number of common shares and warrants outstanding during the period. Diluted net loss per common share is equal to basic net loss per common share because the Adelphia Warrant discussed in Note 6 had an antidilutive effect for the periods presented; however, the Adelphia Warrant could have a dilutive effect on earnings per share in future periods. A warrant to purchase 731,624 shares of Class A common stock and Class B common stock warrants to purchase shares of Class B common stock have been included as shares outstanding for purposes of the calculation of both basic and diluted net loss per share for, the year ended March 31, 1998, the nine months ended December 31, 1998 and the year ended December 31, 1999.

Other Assets - net

Deferred debt financing costs, included in other assets, are amortized over the term of the related debt. The unamortized amounts of deferred debt financing costs at December 31, 1998 and 1999 were $14,606 and $17,434, respectively. Included in other assets at December 31, 1998 is a Senior Secured Note (See Note 3). Included in other assets at December 31, 1999 is $44,605 relating to 195 31-Ghz licenses, which cover approximately 30% of the nation's population. These licenses are a spectrum for a fixed wireless technology known as local multipoint distribution service ("LMDS").

Asset Impairments

Adelphia Business Solutions periodically reviews the carrying value of its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of these assets may not be recoverable. Measurement of any impairment would include a comparison of estimated future operating cash flows anticipated to be generated during the remaining life of the assets with their net carrying value. An impairment loss would be recognized as the amount by which the carrying value of the assets exceeds their fair value.

Financial Instruments

Financial instruments which potentially subject the Company to concentration of credit risk consist principally of accounts receivable. Concentration of credit risk with respect to accounts receivable is limited due to the dispersion of the Company's customer base among different customers and geographic areas.

The Company's financial instruments include cash and cash equivalents, notes payable and redeemable preferred stock. The fair value of the notes payable exceeded carrying value by approximately $12,016 and $52,058 at December 31, 1998 and 1999, respectively. The carrying value of the redeemable preferred stock exceeded the fair value by approximately $23,938 at December 31, 1998 and was equal to the fair value at December 31, 1999. The fair values of the financial instruments were based upon quoted market prices.

Non-cash Financing and Investing Activities

Capital leases entered into during the year ended March 31, 1998, the nine months ended December 31, 1998 and the year ended December 31, 1999 totaled $24,500, $1,155 and $5,772, respectively (See Note 5). Dividend requirements applicable to preferred stock were satisfied by the issuance of an additional 6,860, 20,624 and 30,733 shares of such preferred stock during the year ended March 31, 1998, the nine months ended December 31, 1998 and the year ended December 31, 1999, respectively (See Note 5). During the nine months ended December 31, 1998, Adelphia Business Solutions converted the Note Payable - Adelphia and certain accounts payable into Class A common stock (See Note 1).

Use of Estimates in the Preparation of Financial Statements

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

Recent Accounting Pronouncements

Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities," establishes accounting and reporting standards for derivative instruments and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. Management of the Company has not completed its evaluation of the impact of SFAS No. 133 on the Company's financial statements. In July 1999, SFAS No. 137 was issued to delay the effective date of SFAS No. 133 to fiscal quarters of fiscal years beginning after June 15, 2000.

(Dollars in thousands except per share amounts)

Reclassifications

Certain March 31, 1998 and December 31, 1998 amounts have been reclassified to conform with the presentation for the year ended December 31, 1999.

(2) Property, Plant and Equipment

Property, plant and equipment consists of the following:

| | December 31, | |
|---|---|---|
| | 1998 | 1999 |
| Telecommunications networks | $59,764 | $139,248 |
| Network monitoring and switching equipment | 165,697 | 431,078 |
| Fiber asset under construction (Note 3) | 11,500 | --- |
| Fiber optic use rights | 44,109 | 108,239 |
| Construction in process | 123,439 | 344,439 |
| Other | 8,282 | 18,270 |
| | 412,791 | 1,041,274 |
| Less accumulated depreciation | (38,089) | (97,518) |
| Total | $374,702 | $943,756 |

Additions to property, plant and equipment are recorded at cost which includes amounts for material, applicable labor and overhead and interest. Capitalized interest amounted to $4,271, $9,986 and $23,282 for the year ended March 31, 1998, the nine months ended December 31, 1998 and the year ended December 31, 1999, respectively.

(3) Investment in Fiber Asset and Senior Secured Note

On February 20, 1997, the Company entered into several agreements regarding the leasing of dark fiber in New York state in furtherance of its strategy to interconnect its networks in the northeastern United States. Pursuant to these agreements and in consideration of a payment of $20,000, the Company received a $20,000 Senior Secured Note bearing interest at 22 1/2% (subject to reduction upon early repayment of principal) due February 2002 (subject to early redemption options), from Telergy, Inc. ("Telergy"), a right to receive 58,752 shares of Telergy Class A common stock ("Telergy Stock"), and a fully prepaid lease from a Telergy affiliate for an initial lease term of 25 years (with two additional ten-year extensions) for 24 strands of dark fiber installed or to be installed in a New York fiber optic telecommunications backbone network. As of December 31, 1998, the Company included $11,500 and $8,500 in Property, Plant and Equipment and Other Assets, respectively, as the allocation of the $20,000 payment between the fiber asset and the Senior Secured Note. No amounts were allocated to the Telergy Stock. The allocation reflected the Company's estimate of the relative fair values of the assets acquired.

On May 15, 1998, Telergy paid the Company $1,000 in exchange for the Telergy Stock and a gain of $1,000 was recorded by the Company, which is included in "other income" in the consolidated statement of operations. On November 10, 1998, the Senior Secured Note was amended to mature on January 20, 2000 in exchange for an indefeasible right to use ("IRU") or long term lease of certain fiber segments in New York City and along Telergy's long haul fiber segments in the northeastern United States and Southeastern Canada.

During May, 1999, the Company received $32,329 from Telergy for the repayment of the Senior Secured Note. The payment represented $20,000 in principal and $12,329 of interest, which is included in "Interest income" in the consolidated statement of operations.

(Dollars in thousands except per share amounts)

(4) Investments

The equity method of accounting is used to account for investments in joint ventures in which the Company owns less than a majority interest. Under this method, the Company's initial investment is recorded at cost and subsequently adjusted for the amount of its equity in the net income or loss of its joint ventures. Dividends or other distributions are recorded as a reduction of the Company's investment. Investments in joint ventures accounted for using the equity method reflect the Company's equity in their underlying net assets.

The Company's nonconsolidated investments are as follows:

| | Ownership Percentage | December 31, 1998 | December 31, 1999 |
|---|---|---|---|
| MediaOne Fiber Technologies (Jacksonville) | 100.0% (1) | $8,150 | $--- |
| Multimedia Hyperion Telecommunications (Wichita) | 100.0% (1) | 5,863 | --- |
| MediaOne of Virginia (Richmond) | 100.0% (1) | 7,284 | --- |
| Entergy Hyperion Telecommunications of Louisiana | 100.0% (2) | 6,714 | --- |
| Entergy Hyperion Telecommunications of Mississippi | 100.0% (2) | 7,130 | --- |
| Entergy Hyperion Telecommunications of Arkansas | 100.0% (2) | 7,586 | --- |
| PECO-Hyperion (Philadelphia) | 50.0% | 33,936 | 42,475 |
| PECO-Hyperion (Allentown, Bethlehem, Easton, Reading) | 50.0% | 7,227 | 7,425 |
| Hyperion of York | 50.0% | 5,721 | 6,525 |
| Allegheny Hyperion Telecommunications | 50.0% | 3,043 | 4,975 |
| Baker Creek Communications | 49.9% (3) | 44,637 | --- |
| Other | Various | 1,323 | --- |
| | | 138,614 | 61,400 |
| Cumulative equity in net losses | | (26,286) | (17,334) |
| Total Investments | | $112,328 | $44,066 |

(1) As discussed in Note 1, the Company has consummated agreements which increased its ownership to 100% in these networks during March 1999. (2) As discussed in Note 1, the Company has consummated an agreement which increased its ownership to 100% in these networks during June 1999. (3) On March 24, 1998, the Federal Communications Commission ("FCC") completed the auction of licenses for LMDS. The Company, through Baker Creek Communications, was the successful bidder for 195 31-Ghz licenses, which cover approximately 30% of the nation's population - in excess of 83 million people in the eastern half of the United States. In connection with the FCC's full review of all bids and the granting of final licenses it was concluded that the Company, through Baker Creek Communications, would acquire the entire interest in the 195 licenses for a total cost of approximately $44,605, all of which was paid as of October 26, 1998. On September 30, 1999, the FCC granted the Company's request to transfer, and the Company transferred the licenses from Baker Creek Communications to a wholly owned subsidiary of the Company. The licenses are included in Other assets - net on the consolidated balance sheet at December 31, 1999 (See Note 1).