

PRIMUS TELECOMMUNICATIONS GROUP INC

Form 10-Q

August 15, 2011

[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended June 30, 2011

OR

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

Commission File No. 001-35210

**PRIMUS TELECOMMUNICATIONS GROUP,  
INCORPORATED**

(Exact name of registrant as specified in its charter)

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

**7901 Jones Branch Drive, Suite 900,**  
**McLean, VA**  
(Address of principal executive offices)

**54-1708481**  
(I.R.S. Employer  
Identification No.)

**22102**  
(Zip Code)

**(703) 902-2800**  
(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

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. (Check one):

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

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Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| <b>Class</b>                   | <b>Outstanding as of August 1, 2011</b> |
|--------------------------------|---|
| Common Stock \$0.001 par value | 13,706,475                              |

**Table of Contents**

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**

**INDEX TO FORM 10-Q**

|   | <b>Page No.</b> |
|---|-----------------|
| Part I. FINANCIAL INFORMATION   |                 |
| Item 1. FINANCIAL STATEMENTS (UNAUDITED)  |                 |
| <u>Condensed Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2011 and 2010</u>                  | 1               |
| <u>Condensed Consolidated Balance Sheets as of June 30, 2011 and December 31, 2010</u>  | 2               |
| <u>Condensed Consolidated Statements of Cash Flows for the Six Months ended June 30, 2011 and 2010</u>                            | 3               |
| <u>Condensed Consolidated Statements of Comprehensive Income (Loss) for the Three and Six Months Ended June 30, 2011 and 2010</u> | 4               |
| <u>Notes to Condensed Consolidated Financial Statements</u>   | 5               |
| Item 2. <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>                              | 28              |
| Item 3. <u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>   | 43              |
| Item 4. <u>CONTROLS AND PROCEDURES</u>  | 44              |
| Part II. <u>OTHER INFORMATION</u>   |                 |
| Item 1. <u>LEGAL PROCEEDINGS</u>  | 45              |
| Item 1A. <u>RISK FACTORS</u>  | 45              |
| Item 2. <u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>  | 45              |
| Item 3. <u>DEFAULTS UPON SENIOR SECURITIES</u>  | 45              |
| Item 4. <u>(REMOVED AND RESERVED)</u>   | 45              |
| Item 5. <u>OTHER INFORMATION</u>  | 45              |
| Item 6. <u>EXHIBITS</u>   | 45              |
| <u>SIGNATURES</u>   | 46              |
| <u>EXHIBIT INDEX</u>  | 47              |

**Table of Contents****PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except per share amounts)

(unaudited)

|   | Three Months Ended<br>June 30, 2011 | Three Months Ended<br>June 30, 2010 | Six Months Ended<br>June 30, 2011 | Six Months Ended<br>June 30, 2010 |
|---|-------------------------------------|-------------------------------------|-----------------------------------|-----------------------------------|
| NET REVENUE   | \$ 282,502                          | \$ 194,593                          | \$ 506,225                        | \$ 387,610                        |
| OPERATING EXPENSES  |                                     |                                     |                                   |                                   |
| Cost of revenue (exclusive of depreciation included below)                                  | 205,522                             | 123,960                             | 357,778                           | 245,951                           |
| Selling, general and administrative   | 59,361                              | 47,854                              | 113,313                           | 97,972                            |
| Depreciation and amortization   | 17,093                              | 18,194                              | 32,214                            | 36,063                            |
| (Gain) loss on sale or disposal of assets   | (19)                                | (189)                               | 34                                | (179)                             |
| Goodwill impairment   |                                     |                                     | 14,679                            |                                   |
| Total operating expenses  | 281,957                             | 189,819                             | 518,018                           | 379,807                           |
| INCOME (LOSS) FROM OPERATIONS   | 545                                 | 4,774                               | (11,793)                          | 7,803                             |
| INTEREST EXPENSE  | (7,912)                             | (8,733)                             | (16,605)                          | (18,059)                          |
| ACCRETION (AMORTIZATION) ON DEBT<br>PREMIUM/DISCOUNT, net                                   | (53)                                | (45)                                | (103)                             | (89)                              |
| GAIN (LOSS) ON EARLY EXTINGUISHMENT OR<br>RESTRUCTURING OF DEBT                             |                                     | 164                                 |                                   | 164                               |
| GAIN (LOSS) FROM CONTINGENT VALUE RIGHTS<br>VALUATION                                       | 96                                  | (382)                               | (4,288)                           | (2,425)                           |
| INTEREST INCOME AND OTHER INCOME<br>(EXPENSE), net  | 174                                 | 153                                 | 119                               | 363                               |
| FOREIGN CURRENCY TRANSACTION GAIN (LOSS)  | 2,365                               | (9,623)                             | 6,413                             | (3,794)                           |
| INCOME (LOSS) FROM CONTINUING OPERATIONS<br>BEFORE REORGANIZATION ITEMS AND INCOME<br>TAXES | (4,785)                             | (13,692)                            | (26,257)                          | (16,037)                          |
| REORGANIZATION ITEMS, net   |                                     |                                     |                                   | 1                                 |
| INCOME (LOSS) FROM CONTINUING OPERATIONS<br>BEFORE INCOME TAXES                             | (4,785)                             | (13,692)                            | (26,257)                          | (16,036)                          |
| INCOME TAX BENEFIT (EXPENSE)  | (1,378)                             | 1,883                               | (548)                             | 4,053                             |
| INCOME (LOSS) FROM CONTINUING OPERATIONS  | (6,163)                             | (11,809)                            | (26,805)                          | (11,983)                          |
| INCOME (LOSS) FROM DISCONTINUED<br>OPERATIONS, net of tax                                   | (89)                                | (1,528)                             | (69)                              | (2,217)                           |
| GAIN (LOSS) FROM SALE OF DISCONTINUED<br>OPERATIONS, net of tax                             |                                     | 193                                 |                                   | 193                               |
| NET INCOME (LOSS)   | (6,252)                             | (13,144)                            | (26,874)                          | (14,007)                          |
| Less: Net (income) loss attributable to the noncontrolling<br>interest                      | (90)                                | 106                                 | 1,277                             | (30)                              |
| NET INCOME (LOSS) ATTRIBUTABLE TO PRIMUS<br>TELECOMMUNICATIONS GROUP, INCORPORATED          | \$ (6,342)                          | \$ (13,038)                         | \$ (25,597)                       | \$ (14,037)                       |

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**BASIC AND DILUTED INCOME (LOSS) PER  
COMMON SHARE:**

|  |        |        |        |        |
|--|--------|--------|--------|--------|
| Income (loss) from continuing operations attributable to Primus Telecommunications Group, Incorporated |        |        |        |        |
|  | (0.47) | (1.20) | (2.08) | (1.24) |
| Income (loss) from discontinued operations   |        |        |        |        |
|  | (0.01) | (0.16) | (0.01) | (0.23) |
| Gain (loss) from sale of discontinued operations   |        |        |        |        |
|  |        | 0.02   |        | 0.02   |
| Net income (loss) attributable to Primus Telecommunications Group, Incorporated                        |        |        |        |        |
|  | (0.48) | (1.34) | (2.09) | (1.45) |

**WEIGHTED AVERAGE COMMON SHARES  
OUTSTANDING**

|                   |        |       |        |       |
|-------------------|--------|-------|--------|-------|
| Basic and Diluted | 13,385 | 9,743 | 12,273 | 9,694 |
|-------------------|--------|-------|--------|-------|

**AMOUNTS ATTRIBUTABLE TO COMMON  
SHAREHOLDERS OF PRIMUS  
TELECOMMUNICATIONS GROUP, INCORPORATED**

|  |            |             |             |             |
|--|------------|-------------|-------------|-------------|
| Income (loss) from continuing operations, net of tax | \$ (6,253) | \$ (11,703) | \$ (25,528) | \$ (12,013) |
| Income (loss) from discontinued operations           | (89)       | (1,528)     | (69)        | (2,217)     |
| Gain (loss) from sale of discontinued operations     |            | 193         |             | 193         |
| Net income (loss)                                    | \$ (6,342) | \$ (13,038) | \$ (25,597) | \$ (14,037) |

See notes to condensed consolidated financial statements.

**Table of Contents****PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED****CONDENSED CONSOLIDATED BALANCE SHEETS****(in thousands, except share amounts)****(unaudited)**

|   | <b>June 30,<br/>2011</b> | <b>December 31,<br/>2010</b> |
|---|--------------------------|------------------------------|
| <b>ASSETS</b>   |                          |                              |
| <b>CURRENT ASSETS:</b>  |                          |                              |
| Cash and cash equivalents   | \$ 31,476                | \$ 41,534                    |
| Accounts receivable (net of allowance for doubtful accounts receivable of \$10,613 and \$6,854 at June 30, 2011 and December 31, 2010, respectively)                      | 99,133                   | 76,828                       |
| Prepaid expenses and other current assets   | 18,593                   | 19,439                       |
| Total current assets  | 149,202                  | 137,801                      |
| RESTRICTED CASH   | 12,523                   | 12,117                       |
| PROPERTY AND EQUIPMENT Net  | 154,346                  | 138,488                      |
| GOODWILL  | 71,113                   | 63,731                       |
| OTHER INTANGIBLE ASSETS Net   | 144,431                  | 147,749                      |
| OTHER ASSETS  | 17,887                   | 14,573                       |
| TOTAL ASSETS  | \$ 549,502               | \$ 514,459                   |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)</b>  |                          |                              |
| <b>CURRENT LIABILITIES:</b>   |                          |                              |
| Accounts payable  | \$ 63,440                | \$ 36,942                    |
| Accrued interconnection costs   | 25,840                   | 29,571                       |
| Deferred revenue  | 12,844                   | 12,891                       |
| Accrued expenses and other current liabilities  | 51,247                   | 46,491                       |
| Accrued income taxes  | 7,541                    | 7,678                        |
| Accrued interest  | 1,857                    | 2,152                        |
| Current portion of long-term obligations  | 910                      | 1,143                        |
| Total current liabilities   | 163,679                  | 136,868                      |
| LONG-TERM OBLIGATIONS   | 218,607                  | 242,748                      |
| DEFERRED TAX LIABILITY  | 31,683                   | 32,208                       |
| CONTINGENT VALUE RIGHTS   | 23,387                   | 19,098                       |
| OTHER LIABILITIES   | 2,954                    | 503                          |
| Total liabilities   | 440,310                  | 431,425                      |
| <b>COMMITMENTS AND CONTINGENCIES (See Note 6.)</b>  |                          |                              |
| <b>STOCKHOLDERS EQUITY (DEFICIT):</b>   |                          |                              |
| Preferred stock, \$0.001 par value 20,000,000 shares authorized; none issued and outstanding  | 0                        | 0                            |
| Common stock, \$0.001 par value 80,000,000 shares authorized; 13,695,236 and 9,801,463 shares issued and outstanding at June 30, 2011 and December 31, 2010, respectively | 14                       | 10                           |
| Additional paid-in capital  | 141,088                  | 86,984                       |
| Accumulated earnings (deficit)  | (37,952)                 | (12,355)                     |
| Accumulated other comprehensive income (loss)   | 4,769                    | 4,751                        |
| Total stockholders equity before noncontrolling interest  | 107,919                  | 79,390                       |

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|  |            |            |
|--|------------|------------|
| Noncontrolling interest                              | 1,273      | 3,644      |
| Total stockholders' equity                           | 109,192    | 83,034     |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT) | \$ 549,502 | \$ 514,459 |

See notes to condensed consolidated financial statements.



**Table of Contents**

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

(unaudited)

|   | Six Months Ended<br>June 30, 2011 | Six Months Ended<br>June 30, 2010 |
|---|-----------------------------------|-----------------------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |                                   |                                   |
| Net income (loss)   | \$ (26,874)                       | \$ (14,007)                       |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities:                        |                                   |                                   |
| Reorganization items, net   |                                   | (1)                               |
| Provision for doubtful accounts receivable  | 4,436                             | 3,449                             |
| Share based compensation expense  | 3,354                             | 204                               |
| Depreciation and amortization   | 32,219                            | 38,413                            |
| (Gain) loss on sale or disposal of assets   | 34                                | (372)                             |
| Goodwill impairment   | 14,679                            |                                   |
| Accretion (amortization) of debt premium/discount, net  | 103                               | 89                                |
| Change in fair value of Contingent Value Rights   | 4,288                             | 2,425                             |
| Deferred income taxes   | 1,299                             | (4,823)                           |
| (Gain) loss on early extinguishment of debt   |                                   | (164)                             |
| Unrealized foreign currency transaction gain on intercompany and foreign debt                                   | (6,458)                           | 4,148                             |
| Changes in assets and liabilities, net of acquisitions:   |                                   |                                   |
| (Increase) decrease in accounts receivable  | (8,615)                           | (2,820)                           |
| (Increase) decrease in prepaid expenses and other current assets  | 2,841                             | (1,114)                           |
| (Increase) decrease in other assets   | (2,323)                           | 342                               |
| Increase (decrease) in accounts payable   | 6,900                             | (2,513)                           |
| Increase (decrease) in accrued interconnection costs  | (4,756)                           | (3,489)                           |
| Increase (decrease) in accrued expenses, deferred revenue, other current liabilities and other liabilities, net | (5,288)                           | (1,984)                           |
| Increase (decrease) in accrued income taxes   | (336)                             | (1,407)                           |
| Increase (decrease) in accrued interest   | (511)                             | 218                               |
| Net cash provided by operating activities before cash reorganization items                                      | 14,992                            | 16,594                            |
| Cash effect of reorganization items   |                                   | (137)                             |
| Net cash provided by operating activities   | 14,992                            | 16,457                            |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |                                   |                                   |
| Purchase of property and equipment  | (13,880)                          | (10,737)                          |
| Sale of property and equipment and intangible assets  |                                   | 530                               |
| Cash acquired from business acquisitions, net of cash paid  | 9,599                             |                                   |
| Sales of marketable securities  | 4,087                             |                                   |
| Increase in restricted cash   | (123)                             | (132)                             |
| Net cash provided by (used in) investing activities   | (317)                             | (10,339)                          |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |                                   |                                   |
| Principal payments on long-term obligations   | (24,462)                          | (13,175)                          |
| Payment to noncontrolling interest  | (1,205)                           |                                   |
| Proceeds from sale of common stock  | 1,168                             |                                   |

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|  |                  |                  |
|--|------------------|------------------|
| Net cash used in financing activities  | (24,499)         | (13,175)         |
| <b>EFFECTS OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS</b>                     | <b>(234)</b>     | <b>(1,505)</b>   |
| <b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>   | <b>(10,058)</b>  | <b>(8,562)</b>   |
| <b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>                                    | <b>41,534</b>    | <b>42,538</b>    |
| <b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>  | <b>\$ 31,476</b> | <b>\$ 33,976</b> |
| <b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>   |                  |                  |
| Cash paid for interest   | \$ 17,008        | \$ 17,879        |
| Cash paid for taxes  | 431              | 899              |
| Non-cash investing and financing activities:   |                  |                  |
| Capital lease additions  | \$               | \$ 51            |
| Acquisition purchase consideration recorded in working-capital and long-term liabilities | 2,507            |                  |
| Business acquisition purchased with Company common stock                                 | 50,609           |                  |

See notes to condensed consolidated financial statements.

**Table of Contents****PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****(in thousands)****(unaudited)**

|   | <b>Three Months Ended<br/>June 30, 2011</b> | <b>Three Months Ended<br/>June 30, 2010</b> | <b>Six Months Ended<br/>June 30, 2011</b> | <b>Six Months Ended<br/>June 30, 2010</b> |
|---|---|---|---|---|
| NET INCOME (LOSS)   | \$ (6,252)                                  | \$ (13,144)                                 | \$ (26,874)                               | \$ (14,007)                               |
| OTHER COMPREHENSIVE INCOME (LOSS)   |   |   |   |   |
| Foreign currency translation adjustment   | (1,057)                                     | (879)                                       | 129                                       | (1,077)                                   |
| COMPREHENSIVE INCOME (LOSS)   | (7,309)                                     | (14,023)                                    | (26,745)                                  | (15,084)                                  |
| Less: Comprehensive (income) loss attributable to the noncontrolling interest             | (102)                                       | 213   | 1,166                                     | (33)                                      |
| COMPREHENSIVE INCOME (LOSS) ATTRIBUTABLE TO PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED | \$ (7,411)                                  | \$ (13,810)                                 | \$ (25,579)                               | \$ (15,117)                               |

See notes to condensed consolidated financial statements.

**Table of Contents**

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**1. BASIS OF PRESENTATION**

The accompanying unaudited condensed consolidated financial statements of Primus Telecommunications Group, Incorporated and subsidiaries (the Company or Primus) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial reporting and Securities and Exchange Commission (SEC) regulations. Certain information and footnote disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such principles and regulations. In the opinion of management, the financial statements reflect all adjustments (all of which are of a normal and recurring nature), which are necessary to present fairly the financial position, results of operations, cash flows and comprehensive income (loss) for the interim periods. The results for the Company's three months and six months ended June 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

The results for all periods presented in this Quarterly Report on Form 10-Q reflect the activities of certain operations as discontinued operations (see Note 11 Discontinued Operations).

The financial statements should be read in conjunction with the Company's audited consolidated financial statements included in the Company's most recently filed Form 10-K.

On June 23, 2011, the Company began to trade its common stock on the New York Stock Exchange under the ticker symbol PTGI. At that time, trading of its common stock on the OTC Bulletin Board under the ticker symbol PMUG ceased.

**2. ACQUISITIONS**

***Arbinet Corporation Acquisition***

On February 28, 2011, the Company completed its previously announced acquisition of Arbinet Corporation, a Delaware corporation (Arbinet). Arbinet is a provider of wholesale telecom exchange services to carriers and the Company purchased Arbinet to supplement its existing International Carrier Services operations. Pursuant to the terms of the Agreement and Plan of Merger dated as of November 10, 2010, as amended by Amendment No. 1 dated December 14, 2010, by and among Primus, PTG Investments, Inc., a Delaware corporation and a wholly-owned subsidiary of Primus (Merger Sub), and Arbinet, Merger Sub merged with and into Arbinet with Arbinet surviving the merger as a wholly-owned subsidiary of Primus.

Upon the closing of the merger, each share of Arbinet common stock was cancelled and converted into the right to receive 0.5817 shares of Primus common stock. Arbinet stockholders received cash in lieu of any fractional shares of Primus common stock that they were otherwise entitled to receive in the merger. In connection with the merger, Primus issued 3,232,812 shares of its common stock to former Arbinet stockholders in exchange for their shares of Arbinet common stock, and reserved for issuance approximately 95,000 additional shares of its common stock in connection with its assumption of Arbinet's outstanding options, warrants, stock appreciation rights and restricted stock units.

The components of the consideration transferred follow (in thousands):

|   |                  |
|---|------------------|
| Consideration attributable to stock issued (1)                  | \$ 50,432        |
| Consideration attributable to earned replaced equity awards (2) | 177              |
| <b>Total consideration transferred</b>                          | <b>\$ 50,609</b> |

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- (1) The fair value of the Company's common stock on the acquisition date was \$15.60 per share based on the closing value of its common stock traded on the over-the-counter bulletin board. The Company issued 3,232,812 shares of stock to effect this merger.
- (2) The portion of the acquisition fair value of Arbinet converted stock-based awards attributable to pre-merger employee service was part of consideration. At the merger closing 50% of the unvested and outstanding Arbinet awards vested. The portion of the fair value-based measure of the replaced awards assigned to past services (including those for which vesting accelerated at the merger closing and those that were already vested at the date of the merger closing) was included in the consideration transferred.

**Table of Contents****PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED****(UNAUDITED)***Preliminary Recording of Assets Acquired and Liabilities Assumed*

The transaction was accounted for using the acquisition method of accounting which requires, among other things, that assets acquired and liabilities assumed be recognized at their estimated fair values as of the acquisition date.

Estimates of fair value included in the financial statements, in conformity with the Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC ) No. 820, Fair Value Measurements and Disclosures, ( ASC 820 ), represent the Company's best estimates and valuations developed with the assistance of independent appraisers and, where the following have not yet been completed or are not available, industry data and trends and by reference to relevant market rates and transactions. The following estimates and assumptions are inherently subject to significant uncertainties and contingencies beyond the control of the Company. Accordingly, the Company cannot provide assurance that the estimates, assumptions, and values reflected in the valuations will be realized, and actual results could vary materially. In accordance with ASC No. 805, Business Combinations, ( ASC 805 ), the allocation of the consideration value is subject to additional adjustment until the Company has completed its analysis. The Company's analysis and any additional adjustments are required to be made by February 28, 2012, the one year anniversary of the date of the acquisition, which was February 28, 2011, to provide the Company with the time to complete the valuation of its assets and liabilities.

The following table summarizes the preliminary estimated fair values of the assets acquired and liabilities assumed (in thousands):

|  |                  |
|--|------------------|
| Cash & cash equivalents                  | \$ 12,415        |
| Marketable securities                    | 4,044            |
| Accounts receivable                      | 16,205           |
| Other current assets                     | 1,309            |
| Property and equipment <sup>(1)</sup>    | 20,233           |
| Intercompany receivable                  | 309              |
| Goodwill <sup>(3)</sup>                  | 19,360           |
| Customer list <sup>(2)</sup>             | 900              |
| Other intangible assets                  | 700              |
| Other assets                             | 1,738            |
| <b>Total assets acquired</b>             | <b>\$ 77,213</b> |
| Trade payables                           | \$ 18,280        |
| Accrued interconnection costs            | 143              |
| Accrued liabilities                      | 2,312            |
| Other current liabilities                | 3,182            |
| Current portion of long-term obligations | 68               |
| Long-term obligations                    | 99               |
| Other long-term liabilities              | 2,520            |
| <b>Total liabilities assumed</b>         | <b>\$ 26,604</b> |
| <b>Net assets acquired</b>               | <b>\$ 50,609</b> |

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- (1) Property and equipment were measured primarily using an income approach. The fair value measurements of the assets were based, in part, on significant inputs not observable in the market and thus represent a Level 3 measurement. The significant inputs included Arbinet resources, assumed future revenue profiles, weighted average cost of capital of 13.0 percent, gross margin at 7.2 percent and assumptions on the timing and amount of future development and operating costs. The property and equipment additions were segmented as part of a new stand-alone reporting unit which will be aggregated with International Carrier Services when integration activities are substantially complete.

**Table of Contents****PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED****(UNAUDITED)**

- (2) Identifiable intangible assets and other assets were measured using a combination of an income approach and a market approach (Level 3). Identifiable intangible assets are subject to amortization and the customer list will be amortized over 15 years.
- (3) Goodwill was the excess of the consideration transferred over the net assets recognized and represents the future economic benefits, primarily as a result of expected synergies expected from the combination, arising from other assets acquired that could not be individually identified and separately recognized. Goodwill was recognized as part of a new stand-alone reporting unit which will be aggregated with International Carrier Services when integration activities are substantially complete. Goodwill is not amortized and is not deductible for tax purposes.

*Arbinet Results and Pro Forma Impact of Merger*

The following table presents revenues for Arbinet for the periods presented (in thousands):

|             | <b>Three months<br/>ended<br/>June 30, 2011</b> | <b>Acquisition Date<br/>through<br/>June 30, 2011</b> |
|-------------|---|---|
| Net revenue | \$ 73,134                                       | \$ 99,914   |

The Company incurred a total of \$1.7 million in transaction costs related to the merger. Transaction-related costs were expensed as incurred except for \$1.0 million of costs incurred to issue common stock to effect the merger which were recorded as an offset to additional paid in capital. The transaction-related costs recognized in the line item selling, general, and administrative expenses, in the condensed consolidated statement of operations during the three and six months ended June 30, 2011 were zero and \$0.2 million, respectively. The fair value of the total consideration paid for the assets acquired and liabilities assumed increased significantly from the date of the merger agreement, November 10, 2010, to the closing date February 28, 2011. This event triggered the Company to perform a Step 1 impairment test as related to the goodwill which arose from this acquisition. See Note 4 Goodwill and Other Intangible Assets, for more details on the testing. The results of the Step 1 and Step 2 tests required the Company to recognize \$14.7 million of impairment expense during the three months ended March 31, 2011. The following table presents pro forma information for the Company as if the merger of Arbinet had occurred at the beginning of each period presented (in thousands, except for per share amounts):

|  | <b>Three months ended<br/>June 30,</b> |             |
|--|--|-------------|
|  | <b>2011</b>                            | <b>2010</b> |
| Net revenue  | \$ 282,502                             | \$ 271,944  |
| Net income (loss) attributable to continuing operations for Primus   | (6,253)                                | (15,495)    |
| Net income (loss) attributable to discontinued operations for Primus | (89)                                   | (1,528)     |
| Income (loss) per common share for continuing operations net of tax  | \$ (0.47)                              | \$ (1.19)   |
| Income (loss) per common share for discontinued operations           | (0.01)                                 | (0.12)      |



**Table of Contents****PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED****(UNAUDITED)**

|  | <b>Six months ended</b> |             |
|--|-------------------------|-------------|
|  | <b>June 30,</b>         |             |
|  | <b>2011</b>             | <b>2010</b> |
| Net revenue  | \$ 558,387              | \$ 549,814  |
| Net income (loss) attributable to continuing operations for Primus   | (24,265)                | (20,745)    |
| Net income (loss) attributable to discontinued operations for Primus | (69)                    | (2,217)     |
| Income (loss) per common share for continuing operations net of tax  | \$ (1.98)               | \$ (1.60)   |
| Income (loss) per common share for discontinued operations           | (0.01)                  | (0.17)      |

The historical financial information was adjusted to give effect to the pro forma events that were directly attributable to the merger and factually supportable. The unaudited pro forma consolidated results are not necessarily indicative of what the consolidated results of operations actually would have been had the Company completed the merger on January 1, 2011 or January 1, 2010. In addition, the unaudited pro forma consolidated results do not purport to project the future results of operations of the combined company.

*Incentive Program*

Under the terms of the merger agreement, outstanding Arbinet stock-based awards were converted into Primus stock-based awards based on the merger exchange ratio. The converted Arbinet awards, granted under Arbinet's 1997 and 2004 Stock Incentive Plans, include restricted stock awards, stock options, stock appreciation rights and restricted stock units. The grant date for the converted Arbinet awards is considered to be the closing date of the merger for purposes of calculating fair value. The maximum term of the Arbinet awards is ten years. No additional awards will be issued under either Arbinet plan.

*Unlimitel Inc. and HMNET Technologies, Inc. Acquisitions*

During the first quarter of 2011 one of the Company's Canadian subsidiaries completed the acquisitions of the customer base and fixed assets of Unlimitel Inc. (Unlimitel) and HMNet Technologies Inc. (HMNet), both commercial VoIP providers. The total consideration transferred to complete the acquisitions was approximately \$3.1 million. The cash payments associated with the acquisitions are as follows: \$1.0 million was paid upon closing, \$0.3 million was paid during the second quarter of 2011, \$1.4 million is payable upon the one-year anniversary of the closing date, and \$0.4 million is payable upon the two-year anniversary of the closing date.

The table below sets forth the final Unlimitel and HMNet purchase price allocation (in thousands). The purchase price allocation resulted in goodwill of \$1.8 million. The valuation of intangible assets was evaluated using Level 3 inputs.

|                                      | <b>As of June 30,</b> |       |
|--------------------------------------|-----------------------|-------|
|                                      | <b>2011</b>           |       |
| Cash and cash equivalents            | \$                    | 331   |
| Property and equipment               |                       | 136   |
| Identifiable intangible asset:       |                       |       |
| Customer relationships               |                       | 1,229 |
| Goodwill                             |                       | 1,842 |
| Other assets and liabilities, net    |                       | (119) |
| Deferred income tax                  |                       | (318) |
| Allocation of purchase consideration | \$                    | 3,101 |



**Table of Contents****PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED****(UNAUDITED)**

The customer relationships above are subject to amortization and have a useful life of five years. The useful life of the customer relationships was estimated at the time of the acquisition based on the period of time from which the Company expects to derive benefits from the customer relationships. The identifiable intangible assets are amortized using the pattern of benefits method, which results in accelerated amortization in the early periods of the useful life.

Goodwill from the Company's Unlimitel and HMNet acquisitions was the excess of the consideration transferred over the net assets recognized, which represents the value of acquired employees along with the expected synergies from the combination of Unlimitel Inc. and HMNet Technologies Inc. and the Company's operations. Goodwill resulting from the acquisition of Unlimitel Inc. and HMNet Technologies Inc. is not deductible for tax purposes.

***Hyperlink Australia Pty Ltd. Acquisition***

During the first quarter of 2011 one of the Company's Australian subsidiaries completed the acquisition of the customer relationships and fixed assets of Hyperlink Australia Pty Ltd. (Hyperlink), a managed data center services provider. The total consideration transferred to complete the acquisition of Hyperlink totaled \$1.5 million which included cash paid of \$0.8 million and routine working capital adjustments of \$0.7 million.

The table below sets forth the final Hyperlink purchase price allocation (in thousands). The fair value of the property and equipment were determined based on Level 3 inputs. The valuation of intangible assets was evaluated using Level 3 inputs.

|   | <b>As of June 30,<br/>2011</b> |
|---|--------------------------------|
| Property and equipment                      | \$ 128                         |
| Identifiable intangible asset:              |                                |
| Customer relationships                      | 1,467                          |
| Other assets and liabilities, net           | (69)                           |
| <b>Allocation of purchase consideration</b> | <b>\$ 1,526</b>                |

The customer relationships above are subject to amortization and have a useful life of three years. The useful life of the customer relationships was estimated at the time of the acquisition based on the period of time from which the Company expects to derive benefits from the customer relationships. The identifiable intangible assets are amortized using the pattern of benefits method, which results in accelerated amortization in the early periods of the useful life.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Principles of Consolidation* The consolidated financial statements include the Company's accounts, its wholly-owned subsidiaries and all other subsidiaries over which the Company exerts control. The Company owns 45.6% of Globility Communications Corporation (GCC) through direct and indirect ownership structures. GCC paid a dividend in April 2011, of which \$1.2 million was attributable to the noncontrolling interest shareholder. The results of GCC and its subsidiary are consolidated with the Company's results based on guidance from ASC No. 810, Consolidation, (ASC 810). All intercompany profits, transactions and balances have been eliminated in consolidation.

Table of Contents

## PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

(UNAUDITED)

ASC No. 810 changed the presentation of outstanding noncontrolling interests in one or more subsidiaries or the deconsolidation of those subsidiaries. Reconciliations at the beginning and the end of the period of the total equity, equity attributable to the Company and equity attributable to the noncontrolling interest for the six months ended June 30, 2011 and six months ended June 30, 2010 are as follows (in thousands):

|  | For the Six Months Ended June 30, 2011                                     |                       |        |        |                                  |                                   |   |                            |
|--|--|-----------------------|--------|--------|----------------------------------|-----------------------------------|---|----------------------------|
|  | Primus Telecommunications Group, Incorporated Shareholders<br>Common Stock |                       |        |        |                                  |                                   |   |                            |
|  | Total  | Comprehensive<br>Loss | Shares | Amount | Additional<br>Paid-In<br>Capital | Accumulated<br>Earnings (Deficit) | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Noncontrolling<br>Interest |
| Balance as of December 31, 2010  | \$ 83,034  |                       | 9,801  | \$ 10  | \$ 86,984                        | \$ (12,355)                       | \$ 4,751  | \$ 3,644                   |
| Share based compensation expense   | 3,354  |                       |        |        | 3,354                            |                                   |   |                            |
| Common shares issued in connection with the Management Compensation Plan, as Amended | 1,168  |                       | 661    | 1      | 1,167                            |                                   |   |                            |
| Transaction costs of merger  | (1,023)  |                       |        |        | (1,023)                          |                                   |   |                            |
| Stock consideration issued for merger  | 50,609   |                       | 3,233  | 3      | 50,606                           |                                   |   |                            |
| Dividend to noncontrolling interest  | (1,205)  |                       |        |        |                                  |                                   |   | (1,205)                    |
| Comprehensive income (loss)  |  |                       |        |        |                                  |                                   |   |                            |
| Net income (loss)  | (26,874)   | (26,874)              |        |        |                                  | (25,597)                          |   | (1,277)                    |
| Other comprehensive income (loss)  | 129  | 129                   |        |        |                                  |                                   | 18  | 111                        |
| Comprehensive income (loss)  | (26,745)   | (26,745)              |        |        |                                  |                                   |   |                            |
| Balance as of June 30, 2011  | \$ 109,192   |                       | 13,695 | \$ 14  | \$ 141,088                       | \$ (37,952)                       | \$ 4,769  | \$ 1,273                   |

|  | For the Six Months Ended June 30, 2010                                     |                       |        |        |                                  |                                   |   |                            |
|--|--|-----------------------|--------|--------|----------------------------------|-----------------------------------|---|----------------------------|
|  | Primus Telecommunications Group, Incorporated Shareholders<br>Common Stock |                       |        |        |                                  |                                   |   |                            |
|  | Total  | Comprehensive<br>Loss | Shares | Amount | Additional<br>Paid-In<br>Capital | Accumulated<br>Earnings (Deficit) | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Noncontrolling<br>Interest |
| Balance as of December 31, 2009  | \$ 99,909  |                       | 9,600  | \$ 10  | \$ 85,533                        | \$ 6,732                          | \$ 4,064  | \$ 3,570                   |
| Share based compensation expense   | 204  |                       |        |        | 204                              |                                   |   |                            |
| Common shares issued in connection with the Management Compensation Plan, as Amended | (344)  |                       | 143    |        | (344)                            |                                   |   |                            |
| Comprehensive income (loss)  |  |                       |        |        |                                  |                                   |   |                            |

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|                                    |                 |                    |       |       |           |            |          |          |    |
|------------------------------------|-----------------|--------------------|-------|-------|-----------|------------|----------|----------|----|
| Net income (loss)                  | (14,007)        | \$ (14,007)        |       |       |           | (14,037)   |          |          | 30 |
| Other comprehensive income (loss)  | (1,077)         | (1,077)            |       |       |           |            | (1,080)  |          | 3  |
| <b>Comprehensive income (loss)</b> | <b>(15,084)</b> | <b>\$ (15,084)</b> |       |       |           |            |          |          |    |
| Balance as of June 30, 2010        | \$ 84,685       |                    | 9,743 | \$ 10 | \$ 85,393 | \$ (7,305) | \$ 2,984 | \$ 3,603 |    |

*Discontinued Operations* During 2010 the Company classified its European retail operations as discontinued operations. The Company has applied retrospective adjustments to the three months and six months ended June 30, 2010 to reflect the effects of the discontinued operations that occurred subsequent to June 30, 2010. Accordingly, revenue, costs, and expenses of the discontinued operations have been excluded from the respective captions in the consolidated statements of operations. See Note 11 *Discontinued Operations*, for further information.

**Table of Contents**

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED**

**(UNAUDITED)**

*Property and Equipment* Property and equipment are recorded at cost less accumulated depreciation, which is provided on the straight-line method over the estimated useful lives of the assets. Cost includes major expenditures for improvements and replacements which extend useful lives or increase capacity of the assets as well as expenditures necessary to place assets into readiness for use. Expenditures for maintenance and repairs are expensed as incurred. The estimated useful lives of property and equipment are as follows: network equipment 5 to 8 years, fiber optic and submarine cable 8 to 25 years, furniture and equipment 5 years, and leasehold improvements and leased equipment shorter of lease or useful life. Costs for internal use software that are incurred in the preliminary project stage and in the post-implementation stage are expensed as incurred. Costs incurred during the application development stage are capitalized and amortized over the estimated useful life of the software.

*Business Combinations* The Company is required to allocate the purchase price of acquired companies to the tangible and intangible assets acquired and liabilities assumed based on their estimated fair values. This valuation requires management to make significant estimates and assumptions, especially with respect to intangible assets. Critical estimates in valuing certain of the intangible assets and subsequently assessing the realizability of such assets include, but are not limited to, future expected cash flows from the revenues, customer contracts and discount rates. Management's estimates of fair value are based on assumptions believed to be reasonable but which are inherently uncertain and unpredictable. Assumptions may be incomplete or inaccurate and unanticipated events and circumstances may occur.

Other estimates associated with the accounting for these acquisitions and subsequent assessment of impairment of the assets may change as additional information becomes available regarding the assets acquired and liabilities assumed.

*Goodwill and Other Intangible Assets* Under ASC No. 350, Intangibles Goodwill and Other, (ASC 350), goodwill and indefinite lived intangible assets are not amortized but are reviewed annually for impairment, or more frequently, if impairment indicators arise. Intangible assets that have finite lives are amortized over their estimated useful lives and are subject to the provisions of ASC No. 360, Property, Plant and Equipment, (ASC 360).

Goodwill impairment is tested at least annually (October 1 for the Company) or when factors indicate potential impairment using a two-step process that begins with an estimation of the fair value of each reporting unit. Step 1 is a screen for potential impairment by comparing the fair value of a reporting unit with its carrying amount. The estimated fair value of each reporting unit is compared to its carrying value. The Company estimates the fair values of each reporting unit by a combination of (i) estimation of the discounted cash flows of each of the reporting units based on projected earnings in the future (the income approach) and (ii) a comparative analysis of revenue and EBITDA multiples of public companies in similar markets (the market approach). If there is a deficiency (the estimated fair value of a reporting unit is less than its carrying value), a Step 2 test is required.

Step 2 measures the amount of impairment loss, if any, by comparing the implied fair value of the reporting unit goodwill with its carrying amount. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination is determined; through an allocation of the fair value of a reporting unit to all of the assets and liabilities of that unit as if the reporting unit had been acquired in a business combination. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss shall be recognized in an amount equal to that excess.

The Company's reporting units are the same as its operating segments, except as discussed in Note 4 related to Arbinet, as each segment's components have been aggregated and deemed a single reporting unit because they have similar economic characteristics. Each component is similar in that they each provide telecommunications services for which all of the resources and costs are drawn from the same pool, and are evaluated using the same business factors by management.

Estimating the fair value of a reporting unit requires various assumptions including projections of future cash flows, perpetual growth rates and discount rates. The assumptions about future cash flows and growth rates are based on the Company's assessment of a number of factors, including the reporting unit's recent performance against budget, performance in the market that the reporting unit serves, as well as industry and general economic data from third party sources. Discount rate assumptions are based on an assessment of the risk inherent in those future cash flows. Changes to the underlying businesses could affect the future cash flows, which in turn could affect the fair value of the reporting unit.

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Intangible assets not subject to amortization consist of trade names. Such indefinite lived intangible assets are tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test shall consist of a comparison of the fair value of an intangible asset with its carrying amount. If the carrying amount of the intangible asset exceeds its fair value an impairment loss shall be recognized in an amount equal to the excess.

**Table of Contents**

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED**

**(UNAUDITED)**

Intangible assets subject to amortization consist of certain trade names and customer relationships. These finite lived intangible assets are amortized based on their estimated useful lives. Such assets are subject to the impairment provisions of ASC 360, wherein impairment is recognized and measured only if there are events and circumstances that indicate that the carrying amount may not be recoverable. The carrying amount is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use of the asset group. An impairment loss is recorded if after determining that it is not recoverable, the carrying amount exceeds the fair value of the asset.

*Derivative Instruments* Pursuant to the terms of the Company's 2009 bankruptcy reorganization (the Reorganization Plan), the Company issued to holders of the Company's common stock prior to the effectiveness of the Reorganization Plan contingent value rights (CVRs) to receive up to an aggregate of 2,665,000 shares (the CVR Shares) of the Company's common stock. In connection with the issuance of the CVRs, the Company entered into a Contingent Value Rights Distribution Agreement (the CVR Agreement), in favor of holders of CVRs thereunder, dated as of July 1, 2009.

Due to the nature of the CVRs, the Company accounted for the instrument in accordance with ASC No. 815, Derivatives and Hedging, as well as related interpretations of this standard. The Company determined the CVRs to be derivative instruments to be accounted for as liabilities and marked to fair value at each balance sheet date. Upon issuance, the Company estimated the fair value of its CVRs using a Black-Scholes pricing model and consequently recorded a liability of \$2.6 million in the balance sheet caption other liabilities as part of fresh-start accounting. The change in value is reflected in the condensed consolidated statements of operations as gain (loss) from contingent value rights valuation. The Company's estimates of fair value of its CVRs are correlated to and reflective of the Company's common stock price trends; in general, as the value of the Company's common stock increases, the estimated fair value of the CVRs also increases and, as a result, the Company recognizes a change in value of its CVRs as loss from contingent value rights valuation. Conversely and also in general, as the value of the Company's common stock decreases, the estimated fair value of the CVRs also decreases and as a result the Company would recognize a change in value of the CVRs as gain from contingent value rights valuation. See Note 9 Fair Value of Financial Instruments and Derivatives.

*Use of Estimates* The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of net revenue and expenses during the reporting period. Actual results may differ from these estimates. Significant estimates include allowance for doubtful accounts receivable, accrued interconnection cost disputes, the fair value of derivatives, market assumptions used in estimating the fair values of certain assets and liabilities, the calculation used in determining the fair value of the Company's stock options required by ASC No. 718, Stock Compensation, income taxes and various tax contingencies.

Estimates of fair value represent the Company's best estimates developed with the assistance of independent appraisals or various valuation techniques including Black-Scholes and, where the foregoing have not yet been completed or are not available, industry data and trends and by reference to relevant market rates and transactions. The estimates and assumptions are inherently subject to significant uncertainties and contingencies beyond the control of the Company. Accordingly, the Company cannot provide assurance that the estimates, assumptions, and values reflected in the valuations will be realized, and actual results could vary materially. Any adjustments to the recorded fair values of these assets and liabilities, as related to business combinations, may impact the amount of recorded goodwill.

*Reclassification* Certain previous year amounts have been reclassified to conform with current year presentations, as related to the reporting of the Company's discontinued operations.

*Newly Adopted Accounting Principles*

In January 2010, an update was issued to the Fair Value Measurements and Disclosures Topic, ASC 820, ASU 2010-06, Improving Disclosures about Fair Value Measurements, which requires new disclosures for fair value measurements and provides clarification for existing disclosures requirements. More specifically, this update requires (a) an entity to disclose





**Table of Contents**

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED**

**(UNAUDITED)**

separately the amounts of significant transfers in and out of Levels 1 and 2 fair value measurements and to describe the reasons for the transfers; and (b) information about purchases, sales, issuances and settlements to be presented separately (i.e., present the activity on a gross basis rather than net) in the reconciliation for fair value measurements using significant unobservable inputs (Level 3 inputs). This update clarifies existing disclosure requirements for the level of disaggregation used for classes of assets and liabilities measured at fair value and requires disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements using Level 2 and Level 3 inputs. This update was effective for the Company on January 1, 2010, except for Level 3 reconciliation disclosures which went into effect on January 1, 2011. On January 1, 2011 the Company adopted this update and did not have a material impact on the disclosures to the condensed consolidated financial statements.

In December 2010, an update was made to the Intangibles – Goodwill and Other Topic, ASC 350, ASU 2010-28, Goodwill Impairment Testing in Reporting Units with a Zero or Negative Carrying Amount, which provides guidance for all entities that have recognized goodwill and have one or more reporting units whose carrying amount for purposes of performing Step 1 of the goodwill impairment test is zero or negative. The update modifies Step 1 so that for those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. The qualitative factors are consistent with existing guidance, which requires that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. This update became effective for us on January 1, 2011. We do not foresee this accounting update having a material effect on our consolidated financial statements in future periods, although that could change.

On February 28, 2011, the Company adopted changes to the disclosure of pro forma information for business combinations ASU 2010-29, Business Combinations – Disclosure of Supplementary Pro-Forma Information, issued by the FASB. These changes clarify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination, that occurred during the current year, had occurred as of the beginning of the comparable prior annual reporting period only. For the Company, this would be as of January 1, 2010, see Note 2 – Acquisitions. Also, the existing supplemental pro forma disclosures were expanded to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings, if any. The adoption of these changes had no impact on our consolidated financial statements.

*New Accounting Pronouncements*

On January 1, 2011, the Company prospectively adopted the FASB update to revenue recognition for multiple-deliverable arrangements. The update requires the establishment of a selling price hierarchy for determining the selling price of a deliverable. The hierarchy is: vendor specific objective evidence if available, third party evidence if vendor-specific objective evidence is not available or estimated selling price if neither of the aforementioned is available. The residual method of revenue allocation is no longer permissible. We believe that this accounting standard update will not change our units of accounting for bundled arrangements, or the allocation of our products and services. We do not foresee this accounting update having a material effect on our consolidated financials in future periods, although that could change.

**4. GOODWILL AND OTHER INTANGIBLE ASSETS**

Generally accepted accounting principles in the United States require the Company to perform a goodwill impairment test, a two-step test, annually and more frequently when negative conditions or triggering events arise.

On February 28, 2011 the Company acquired Arbinet for stock consideration of \$50.6 million in a stock for stock transaction. See Note 2 – Acquisitions. Because the Company's stock price rose significantly between the signing of the merger agreement on November 10, 2010 and the close of the merger on February 28, 2011 from a closing price of \$9.57 per share to \$15.60 per share, the fixed-share consideration fair value also rose. Because Arbinet's enterprise value may not have increased within similar levels over that time period, the Company determined that a goodwill impairment assessment was immediately necessary post-merger. On the day of the merger, Arbinet was a stand-alone business with its

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own cash flows and management structure, and the Company evaluated it as a separate reporting unit. The Company determined the preliminary enterprise value of Arbinet to be \$36.2 million, which was less than the carrying value of \$50.6 million. For Step 2 of the testing, the fair value of the assets acquired

**Table of Contents****PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED****(UNAUDITED)**

and liabilities assumed was deemed to be equal to that which was used for the purchase price allocation. Based on an enterprise value of \$36.2 million and the fair value of the assets acquired and liabilities assumed at purchase, the company calculated \$4.7 million of implied goodwill. Because the carrying value of goodwill was greater than the implied goodwill, \$14.7 million was recorded as goodwill impairment expense in the three months ended March 31, 2011.

The intangible assets not subject to amortization consisted of the following (in thousands):

|             | June 30,<br>2011 | December 31,<br>2010 |
|-------------|------------------|----------------------|
| Trade names | \$ 76,900        | \$ 76,200            |
| Goodwill    | \$ 71,113        | \$ 63,731            |

The changes in the carrying amount of trade names and goodwill by reporting unit for the six months ended June 30, 2011 are as follows (in thousands):

**Goodwill**

|   | United States | Canada    | Australia | Brazil | Total     |
|---|---------------|-----------|-----------|--------|-----------|
| Balance as of December 31, 2010                     | \$ 29,960     | \$ 31,775 | \$ 1,950  | \$ 46  | \$ 63,731 |
| Effect of change in foreign currency exchange rates |               | 772       | 84        | 3      | 859       |
| Acquisition of business                             | 19,360        | 1,842     |           |        | 21,202    |
| Accumulated impairment loss                         | (14,679)      |           |           |        | (14,679)  |
| Balance as of June 30, 2011                         | \$ 34,641     | \$ 34,389 | \$ 2,034  | \$ 49  | \$ 71,113 |

**Trade Names**

|                                 | United States | Canada | Australia | Europe | Brazil | Total     |
|---------------------------------|---------------|--------|-----------|--------|--------|-----------|
| Balance as of December 31, 2010 | \$ 76,200     | \$     | \$        | \$     | \$     | \$ 76,200 |
| Acquisition of business         | 700           |        |           |        |        | 700       |
| Balance as of June 30, 2011     | \$ 76,900     | \$     | \$        | \$     | \$     | \$ 76,900 |

**Table of Contents****PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED****(UNAUDITED)**

Intangible assets subject to amortization consisted of the following (in thousands):

|                        | June 30, 2011         |                          |                  | December 31, 2010     |                          |                  |
|------------------------|-----------------------|--------------------------|------------------|-----------------------|--------------------------|------------------|
|                        | Gross Carrying Amount | Accumulated Amortization | Net Book Value   | Gross Carrying Amount | Accumulated Amortization | Net Book Value   |
| Trade names            | \$ 4,122              | \$ (719)                 | \$ 3,403         | \$ 4,083              | \$ (593)                 | \$ 3,490         |
| Customer relationships | 110,979               | (46,851)                 | 64,128           | 104,553               | (36,494)                 | 68,059           |
| <b>Total</b>           | <b>\$ 115,101</b>     | <b>\$ (47,570)</b>       | <b>\$ 67,531</b> | <b>\$ 108,636</b>     | <b>\$ (37,087)</b>       | <b>\$ 71,549</b> |

Amortization expense for trade names and customer relationships for the three months and six months ended June 30, 2011 was \$4.9 million and \$9.6 million, respectively, compared to \$5.7 million and \$11.1 million, respectively for the three and six months ended June 30, 2010.

The Company expects amortization expense for trade names and customer relationships for the remainder of 2011, the years ending December 31, 2012, 2013, 2014, 2015, and thereafter to be approximately \$10.4 million, \$13.7 million, \$10.1 million, \$7.2 million, \$5.5 million and \$20.6 million, respectively.

**5. LONG-TERM OBLIGATIONS**

Long-term obligations consisted of the following (in thousands):

|  | June 30, 2011     | December 31, 2010 |
|--|-------------------|-------------------|
| Obligations under capital leases and other         | \$ 1,252          | \$ 1,667          |
| 13% Senior Secured Notes due 2016                  | 129,968           | 130,000           |
| 14 1/4% Senior Subordinated Secured Notes due 2013 | 90,000            | 114,015           |
| <b>Subtotal</b>                                    | <b>\$ 221,220</b> | <b>\$ 245,682</b> |
| Original issue discount on Senior Secured Notes    | (1,703)           | (1,791)           |
| <b>Subtotal</b>                                    | <b>\$ 219,517</b> | <b>\$ 243,891</b> |
| Less: Current portion of long-term obligations     | (910)             | (1,143)           |
| <b>Total long-term obligations</b>                 | <b>\$ 218,607</b> | <b>\$ 242,748</b> |

**Table of Contents****PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED****(UNAUDITED)**

The following table reflects the contractual payments of principal and interest for the Company's long-term obligations as of June 30, 2011:

| Year Ending December 31,                               | Capital Leases<br>and Other | 13% Senior<br>Secured<br>Notes<br>due 2016 | 14 <sup>1</sup> / <sub>4</sub> % Senior<br>Subordinated Secured<br>Notes due 2013 | Total             |
|--|-----------------------------|--|---|-------------------|
| 2011 (as of June 30, 2011)                             | \$ 645                      | \$ 8,448                                   | \$ 6,413  | \$ 15,506         |
| 2012   | 423                         | 16,896                                     | 12,825  | 30,144            |
| 2013   | 207                         | 16,896                                     | 96,413  | 113,516           |
| 2014   | 31                          | 16,896                                     |   | 16,927            |
| 2015   |                             | 16,896                                     |   | 16,896            |
| Thereafter   |                             | 146,420                                    |   | 146,420           |
| <b>Total minimum principal &amp; interest payments</b> | <b>1,306</b>                | <b>222,452</b>                             | <b>115,651</b>  | <b>339,409</b>    |
| Less: Amount representing interest                     | (54)                        | (92,484)                                   | (25,651)  | (118,189)         |
| <b>Total long-term obligations</b>                     | <b>\$ 1,252</b>             | <b>\$ 129,968</b>                          | <b>\$ 90,000</b>  | <b>\$ 221,220</b> |

**13% Senior Secured Notes due 2016**

On April 19, 2011, Primus Telecommunications Holding Inc. ( Holding ) and Primus Telecommunications Canada Inc. ( Primus Canada ), both wholly-owned subsidiaries of the Company commenced an offer to purchase (the Offer to Purchase ) up to 5,200 Units, each such Unit consisting of \$1,000 principal amount of 13% Senior Secured Notes due 2016 (the 13% Notes ) issued by Holding and Primus Canada, at a purchase price in cash equal to 100% of the principal amount of 13% Notes validly tendered (and not validly withdrawn) prior to the expiration time, plus accrued but unpaid interest thereon to the settlement date for the Offer to Purchase. The Offer to Purchase was made pursuant to the excess cash flow covenant in the terms of the indenture governing the 13% Notes. The Offer to Purchase expired on May 17, 2011 and \$32,000 principal amount of 13% Notes were tendered and repurchased pursuant to the Offer to Purchase.

**14 <sup>1</sup>/<sub>4</sub>% Senior Subordinated Secured Notes due 2013**

On April 15, 2011, the Company redeemed \$24.0 million principal amount of 14 <sup>1</sup>/<sub>4</sub>% Senior Subordinated Secured Notes due 2013 (the 14 <sup>1</sup>/<sub>4</sub>% Notes ) issued by Primus Telecommunications IHC, Inc. ( IHC ). Accrued interest to, but excluding the redemption date, of \$1.3 million on the redeemed portion of the 14 <sup>1</sup>/<sub>4</sub>% Notes was also paid on the redemption date. There was \$90.0 million principal amount of the 14 <sup>1</sup>/<sub>4</sub>% Notes remaining outstanding after this redemption.

**Exchange Offer**

On June 6, 2011, the Company announced the commencement of private offers to exchange new 10.00% Senior Secured Notes due 2017 issued by Holding for outstanding Units of the 13% Notes and 14 <sup>1</sup>/<sub>4</sub>% Notes and the commencement of consent solicitations by Holding and Primus Canada to amend the indenture governing the 13% Notes to eliminate most restrictive covenants and certain events of default and to release the collateral securing the 13% Notes. On July 7, 2011, Holding and Primus Canada consummated the exchange offers and consent solicitation. See Note 13 Subsequent Events, for further information.



**Table of Contents****PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED****(UNAUDITED)****6. COMMITMENTS AND CONTINGENCIES**

Future minimum lease payments under capital leases and other purchase obligations and non-cancellable operating leases as of June 30, 2011 are as follows (in thousands):

| <b>Year Ending December 31,</b>                        | <b>Capital Leases<br/>and Other</b> | <b>Purchase<br/>Obligations</b> | <b>Operating<br/>Leases</b> |
|--|-------------------------------------|---------------------------------|-----------------------------|
| 2011 (as of June 30, 2011)                             | \$ 645                              | \$ 17,897                       | \$ 9,800                    |
| 2012   | 423                                 | 8,073                           | 17,791                      |
| 2013   | 207                                 | 3,162                           | 14,475                      |
| 2014   | 31                                  | 1,162                           | 10,211                      |
| 2015   |                                     | 54                              | 8,136                       |
| Thereafter   |                                     |                                 | 20,003                      |
| <b>Total minimum principal &amp; interest payments</b> | <b>1,306</b>                        | <b>30,348</b>                   | <b>80,416</b>               |
| <b>Less: Amount representing interest</b>              | <b>(54)</b>                         |                                 |                             |
| <b>Total long-term obligations</b>                     | <b>\$ 1,252</b>                     | <b>\$ 30,348</b>                | <b>\$ 80,416</b>            |

The Company has contractual obligations to utilize an external vendor for certain customer support functions and to utilize network facilities from certain carriers with terms greater than one year. Generally, the Company does not purchase or commit to purchase quantities in excess of normal usage or amounts that cannot be used within the contract term or at rates below or above market value. The Company made payments under purchase commitments of \$17.6 million and \$15.3 million for the six months ended June 30, 2011 and 2010, respectively.

The Company's rent expense under operating leases was \$4.6 million and \$8.8 million for the three and six months ended June 30, 2011, respectively, and \$3.7 million and \$7.5 million for the three and six months ended June 30, 2010, respectively.

***Litigation******Legal Proceedings***

The Company and its subsidiaries are subject to claims and legal proceedings that arise in the ordinary course of business. Each of these matters is inherently uncertain, and there can be no guarantee that the outcome of any such matter will be decided favorably to the Company or its subsidiaries or that the resolution of any such matter will not have a material adverse effect upon the Company's business, consolidated financial position, results of operations or cash flow. The Company does not believe that any of these pending claims and legal proceedings will have a material adverse effect on its business, consolidated financial position, results of operations or cash flow.

**7. SHARE BASED COMPENSATION**

The Company follows guidance which addresses the accounting for stock-based payment transactions whereby an entity receives employee services in exchange for either equity instruments of the enterprise or liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. The guidance generally requires that such transactions be accounted for using a fair-value based method and share based compensation expense be recorded, based on the grant date fair value, estimated in accordance with the guidance, for all new and unvested stock awards that are ultimately expected to vest as the requisite service is rendered.



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The Company typically issues new shares of common stock upon the exercise of stock options, as opposed to using treasury shares.

The Company uses a Black-Scholes option valuation model to determine the fair value of share-based compensation under the accounting guidance. The Black-Scholes model incorporates various assumptions including the expected option life, expected volatility, risk-free interest rates and dividend yield. The expected option life is no less than the award's vesting period and is based on the Company's historical experience. Expected volatility is based on historical realized volatility of the stock of the Company and guideline companies. The risk-free interest rate is approximated using rates available on U.S. Treasury securities in effect at the time of grant with a remaining term similar to the award's expected life. The Company uses a dividend yield of zero in the Black-Scholes option valuation model as it does not anticipate paying cash dividends in the foreseeable future.

Table of Contents**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED****(UNAUDITED)**

No options were granted during the six months ended June 30, 2010, while 2.5 thousand options were granted during the six months ended June 30, 2011. The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions shown as a weighted average for the year:

|                         | <b>Six Months Ended<br/>June 30,</b> |             |
|-------------------------|--------------------------------------|-------------|
|                         | <b>2011</b>                          | <b>2010</b> |
| Expected option life    | 6 Years                              | N/A         |
| Risk-free interest rate | 1.43%                                | N/A         |
| Expected volatility     | 43%                                  | N/A         |
| Dividend yield          | 0.00%                                | N/A         |

Total share-based compensation expense recognized by the Company in the three months ended June 30, 2011 and 2010 was \$2.3 million and \$0.1 million, respectively, compared to \$3.4 million and \$0.2 million, respectively, for the six months ended June 30, 2011 and 2010. Most of the Company's stock options vest ratably during the vesting period. The Company recognizes compensation expense for options using the straight-line basis, reduced by estimated forfeitures.

The Management Compensation Plan, as Amended provides for the grant of incentive stock options, nonqualified stock options, restricted stock, restricted stock units, and other share-based or cash-based performance awards (collectively, "awards").

At the closing of the acquisition of Arbinet on February 28, 2011, the Company reserved approximately 95,000 additional shares of its common stock for issuance in connection with its assumption of Arbinet's outstanding options, warrants, stock appreciation rights and restricted stock units. As of June 30, 2011, 208 shares of common stock were reserved for warrants to purchase common stock. These warrants are exercisable at \$34.32 per share and will expire in 2012.

*Restricted Stock Units (RSUs)*

A summary of the Company's restricted stock units activity during the six months ended June 30, 2011 is as follows:

|             |                   | <b>Six Months Ended<br/>June 30, 2011</b> |   |
|-------------|-------------------|---|---|
|             |                   | <b>Shares</b>                             | <b>Weighted<br/>Average<br/>Grant Date<br/>Fair Value</b> |
| Unvested    | December 31, 2010 | 474,851                                   | \$ 8.14   |
| Granted     |                   | 143,390                                   | \$ 14.27  |
| Vested      |                   | (377,629)                                 | \$ 9.36   |
| Forfeitures |                   | (6,319)                                   | \$ 10.25  |
| Unvested    | June 30, 2011     | 234,293                                   | \$ 9.87   |

As of June 30, 2011, the Company had 0.2 million unvested RSUs outstanding of which \$2.0 million of compensation expense is expected to be recognized over the weighted average remaining period of 1.5 years. The number of unvested RSUs expected to vest is 0.2 million.



**Table of Contents****PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED****(UNAUDITED)***Stock Options and Stock Appreciation Rights*

A summary of the Company's stock option and stock appreciation rights activity during the six months ended June 30, 2011 is as follows:

|                               | <b>Six Months Ended<br/>June 30, 2011</b> |  |
|-------------------------------|---|--|
|                               | <b>Shares</b>                             | <b>Weighted<br/>Average<br/>Exercise Price</b> |
| Outstanding December 31, 2010 | 185,300                                   | \$ 11.34                                       |
| Granted                       | 2,500                                     | \$ 13.75                                       |
| Exercised                     | (106,779)                                 | \$ 12.49                                       |
| Forfeitures                   | (3,804)                                   | \$ 14.77                                       |
| Arbinet merger                | 87,195                                    | \$ 14.99                                       |
| Outstanding June 30, 2011     | 164,412                                   | \$ 12.49                                       |
| Eligible for exercise         | 110,381                                   | \$ 13.42                                       |

The following table summarizes the intrinsic values and remaining contractual terms of the Company's stock options and stock appreciation rights:

|                                   | <b>Intrinsic<br/>Value</b> | <b>Weighted<br/>Average<br/>Remaining<br/>Life in Years</b> |
|-----------------------------------|----------------------------|---|
| Options outstanding June 30, 2011 | \$ 648,676                 | 7.86  |
| Options exercisable June 30, 2011 | 375,180                    | 7.44  |

As of June 30, 2011, the Company had 0.1 million unvested stock options and stock appreciation rights outstanding of which \$0.2 million of compensation expense is expected to be recognized over the weighted average remaining period of 2.0 years. The number of unvested stock options and stock appreciation rights expected to vest is 0.1 million shares, with a weighted average remaining life of 7.8 years, a weighted average exercise price of \$12.52, and an intrinsic value of \$0.2 million.

**8. INCOME TAXES**

The Company conducts business globally, and as a result, the Company or one or more of its subsidiaries files income tax returns in the United States federal jurisdiction and various state and foreign jurisdictions. In the normal course of business the Company is subject to examination by taxing authorities throughout the world.

The following table summarizes the open tax years for each major jurisdiction:

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| <b>Jurisdiction</b>   | <b>Open Tax Years</b> |      |
|-----------------------|-----------------------|------|
| United States Federal | 2002                  | 2010 |
| Australia             | 2002                  | 2010 |
| Canada                | 2004                  | 2010 |
| United Kingdom        | 2004                  | 2010 |
| Netherlands           | 2007                  | 2010 |

**Table of Contents****PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED****(UNAUDITED)**

The Company is currently under examination in Canada and certain other foreign tax jurisdictions, which, in the aggregate, are individually not material.

The Company adopted the provisions of ASC No. 740, *Income Taxes*, on January 1, 2007. It is expected that the amount of unrecognized tax benefits, reflected in the Company's financial statements, will change in the next twelve months; however, the Company does not expect the change to have a significant impact on the results of operations or the financial position of the Company. During the three and six months ended June 30, 2011, penalties and interest were immaterial. As of June 30, 2011, the gross unrecognized tax benefit on the balance sheet was \$88.4 million.

Pursuant to Section 382 of the Internal Revenue Code ( *IRC Sec. 382* ), the Company believes that it underwent an ownership change for tax purposes on February 28, 2011, the Arbinet acquisition date. This conclusion is based on the Schedule 13D and Schedule 13G filings concerning Company securities, as filed with the United States Securities and Exchange Commission. A previous ownership change took place on July 1, 2009, as a result of the emergence from bankruptcy under the Reorganization Plan. As a result, the use of the Company's net operating losses will be subject to an annual limitation under *IRC Sec. 382* of approximately \$1.6 million.

**9. FAIR VALUE OF FINANCIAL INSTRUMENTS AND DERIVATIVES**

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, restricted cash, accounts receivable and accounts payable approximate fair value due to relatively short periods to maturity. The estimated aggregate fair value of the Company's 13% Senior Secured Notes and 14 1/4% Senior Subordinated Secured Notes, based on quoted market prices, was \$224.9 million and \$247.8 million at June 30, 2011 and December 31, 2010, respectively. The aggregate carrying value of the Company's 13% Senior Secured Notes and 14 1/4% Senior Subordinated Secured Notes was \$218.3 million and \$242.2 million at June 30, 2011 and December 31, 2010, respectively.

See table below for a summary of the Company's financial instruments accounted for at fair value on a recurring basis:

|                                | June 30, 2011 | Fair Value as of June 30, 2011, using:  |   |  |
|--------------------------------|---------------|---|---|--|
|                                |               | Quoted prices<br>in<br>Active<br>Markets<br>for<br>Identical Assets<br>(Level<br>1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>Liabilities:</b>            |               |   |   |  |
| Contingent Value Rights (CVRs) | \$ 23,387     |   | \$ 23,387   |  |
| <b>Total</b>                   | \$ 23,387     |   | \$ 23,387   |  |

| December 31, 2010 | Fair Value as of December 31, 2010, using:                          |   |  |
|-------------------|---|---|--|
|                   | Quoted prices<br>in<br>Active<br>Markets<br>for<br>Identical Assets | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|                   |   |   |  |

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(Level 1)

|                                |                  |                  |
|--------------------------------|------------------|------------------|
| <b>Liabilities:</b>            |                  |                  |
| Contingent Value Rights (CVRs) | \$ 19,098        | \$ 19,098        |
| <b>Total</b>                   | <b>\$ 19,098</b> | <b>\$ 19,098</b> |

**Table of Contents**

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED**

**(UNAUDITED)**

The CVRs are marked to fair value at each balance sheet date. The change in value is reflected in our condensed consolidated statements of operations. Estimates of fair value represent the Company's best estimates based on a Black-Scholes pricing model. During the three months ended June 30, 2011 and 2010, (\$0.1) million and \$0.4 million, respectively, of (income) expense was recognized as a result of marking the CVRs to their fair value, and \$4.3 million and \$2.4 million, respectively, of expense during the six months ended June 30, 2011 and 2010.

**10. OPERATING SEGMENT AND RELATED INFORMATION**

The Company has six reportable operating segments based on management's organization of the enterprise: United States, Canada, Europe, Australia, the International Carrier Services (ICS) business from the United States and Europe, which is managed as a separate global segment, into which Arbinet will be integrated, and Other. The Company evaluates the performance of its segments and allocates resources to them based upon net revenue and income (loss) from operations. The accounting policies of the segments are the same as those described in the summary of significant accounting policies. Net revenue by geographic segment is reported on the basis of where services are provided. The Company has no single customer representing greater than 10% of its revenues. Corporate assets, capital expenditures and property and equipment are included in the United States segment, while corporate expenses are presented separately in income (loss) from operations. The assets of the ICS business are indistinguishable from the respective geographic segments. Therefore, any reporting related to the ICS business for assets, capital expenditures or other balance sheet items is impractical.



**Table of Contents****PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED****(UNAUDITED)**

Summary information with respect to the Company's operating segments is as follows (in thousands):

|   | Three Months Ended<br>June 30, 2011 | Three Months Ended<br>June 30, 2010 | Six Months Ended<br>June 30, 2011 | Six Months Ended<br>June 30, 2010 |
|---|-------------------------------------|-------------------------------------|-----------------------------------|-----------------------------------|
| <b>Net Revenue by Geographic Region</b>           |                                     |                                     |                                   |                                   |
| United States                                     | \$ 59,758                           | \$ 29,224                           | \$ 99,307                         | \$ 56,604                         |
| Canada  | 64,060                              | 58,024                              | 124,896                           | 115,500                           |
| Asia-Pacific                                      | 73,908                              | 67,487                              | 145,834                           | 137,385                           |
| Europe  | 77,478                              | 32,808                              | 122,119                           | 65,801                            |
| Brazil  | 7,298                               | 7,050                               | 14,069                            | 12,320                            |
| Total   | \$ 282,502                          | \$ 194,593                          | \$ 506,225                        | \$ 387,610                        |
| <b>Net Revenue by Segment</b>                     |                                     |                                     |                                   |                                   |
| United States                                     | \$ 10,736                           | \$ 12,840                           | \$ 21,919                         | \$ 26,706                         |
| Canada  | 64,060                              | 58,024                              | 124,896                           | 115,500                           |
| Australia   | 73,681                              | 67,487                              | 145,413                           | 137,385                           |
| International Carrier Services                    | 126,529                             | 49,192                              | 199,551                           | 95,699                            |
| Other   | 7,496                               | 7,050                               | 14,446                            | 12,320                            |
| Total   | \$ 282,502                          | \$ 194,593                          | \$ 506,225                        | \$ 387,610                        |
| <b>Provision for Doubtful Accounts Receivable</b> |                                     |                                     |                                   |                                   |
| United States                                     | \$ 230                              | \$ 583                              | \$ 716                            | \$ 1,114                          |
| Canada  | 885                                 | 624                                 | 1,698                             | 1,469                             |
| Australia   | 622                                 | 625                                 | 1,319                             | 1,362                             |
| International Carrier Services                    | 289                                 | (499)                               | 455                               | (989)                             |
| Other   | 129                                 | 110                                 | 236                               | 193                               |
| Total   | \$ 2,155                            | \$ 1,443                            | \$ 4,424                          | \$ 3,149                          |
| <b>Income (Loss) from Operations</b>              |                                     |                                     |                                   |                                   |
| United States                                     | \$ 131                              | \$ 881                              | \$ 546                            | \$ 90                             |
| Canada  | 4,970                               | 3,041                               | 9,497                             | 5,983                             |
| Australia   | 2,793                               | 1,744                               | 6,538                             | 5,880                             |
| International Carrier Services                    | (1,445)                             | 1,794                               | (18,023)                          | 2,645                             |
| Other   | (19)                                | (163)                               | 281                               | (181)                             |
| Total From Operating Segments                     | 6,430                               | 7,297                               | (1,161)                           | 14,417                            |
| Corporate   | (5,885)                             | (2,523)                             | (10,632)                          | (6,614)                           |
| Total   | \$ 545                              | \$ 4,774                            | \$ (11,793)                       | \$ 7,803                          |
| <b>Capital Expenditures</b>                       |                                     |                                     |                                   |                                   |
| United States                                     | \$ 296                              | \$ 427                              | \$ 528                            | \$ 618                            |

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|                                |          |          |           |           |
|--------------------------------|----------|----------|-----------|-----------|
| Canada                         | 2,719    | 2,723    | 5,308     | 4,948     |
| Europe                         |          | 201      |           | 284       |
| Australia                      | 3,792    | 2,037    | 6,844     | 4,311     |
| International Carrier Services | 561      |          | 837       |           |
| Other                          | 139      | 436      | 363       | 576       |
| Total                          | \$ 7,507 | \$ 5,824 | \$ 13,880 | \$ 10,737 |

**Table of Contents****PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED****(UNAUDITED)**

The above capital expenditures exclude assets acquired under terms of capital lease and vendor financing obligations.

|                                   | June 30,<br>2011  | December 31,<br>2010 |
|-----------------------------------|-------------------|----------------------|
| <b>Property and Equipment Net</b> |                   |                      |
| United States                     | \$ 23,138         | \$ 8,039             |
| Canada                            | 54,849            | 56,476               |
| Europe                            | 3,363             | 1,650                |
| Australia                         | 70,044            | 70,261               |
| Brazil                            | 2,952             | 2,062                |
| <b>Total</b>                      | <b>\$ 154,346</b> | <b>\$ 138,488</b>    |
|                                   |                   |                      |
|                                   | June 30,<br>2011  | December 31,<br>2010 |
| <b>Assets</b>                     |                   |                      |
| United States                     | \$ 142,116        | \$ 107,298           |
| Canada                            | 199,774           | 206,310              |
| Europe                            | 56,564            | 52,278               |
| Australia                         | 138,826           | 137,225              |
| Brazil                            | 12,222            | 11,348               |
| <b>Total</b>                      | <b>\$ 549,502</b> | <b>\$ 514,459</b>    |

The Company offers four main products – retail voice, ICS, Data/Internet and retail VoIP. Net revenue information with respect to the Company's products is as follows (in thousands):

|                                | Three Months Ended<br>June 30, 2011 | Three Months Ended<br>June 30, 2010 | Six Months Ended<br>June 30, 2011 | Six Months Ended<br>June 30, 2010 |
|--------------------------------|-------------------------------------|-------------------------------------|-----------------------------------|-----------------------------------|
| Retail voice                   | \$ 94,581                           | \$ 88,922                           | \$ 186,291                        | \$ 179,855                        |
| International carrier services | 126,529                             | 49,192                              | 199,551                           | 95,699                            |
| Data/Internet                  | 53,012                              | 48,291                              | 103,914                           | 95,154                            |
| Retail VoIP                    | 8,380                               | 8,188                               | 16,469                            | 16,902                            |
| <b>Total</b>                   | <b>\$ 282,502</b>                   | <b>\$ 194,593</b>                   | <b>\$ 506,225</b>                 | <b>\$ 387,610</b>                 |

**11. DISCONTINUED OPERATIONS**

In the second quarter 2010, the Company sold certain assets of its Spain retail operations. The sale price was \$0.3 million. The Company recorded a \$0.2 million gain from sale of these retail operations during the second quarter 2010.

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During the third quarter 2010, the Company committed to dispose of and began actively soliciting the disposition of its Europe segment, also known as the Company's remaining European retail operations. The Company sold its Belgian operations, to Webcetra BVBA, for a sale price of approximately \$1.3 million during the third quarter and as a result, recorded a \$40 thousand gain from the sale. In October 2010 the Company completed the sale of its United Kingdom retail operations customer base and certain of its assets to NewCall Telecom Ltd., for a sale price of approximately \$6.8 million, including a note receivable of \$2.1 million, and completed the sale of its Italian retail operations customer base for approximately \$0.2 million; as a result the Company recorded a gain of \$2.4 million and a loss of \$0.3 million, respectively, from the sale of these assets. The Company sold its operations located in France, to AFone, during December 2010 for a sale price of approximately \$4.0 million. In addition,

**Table of Contents****PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED****(UNAUDITED)**

AFone assumed all of the existing liabilities of the France operations. Consequently the Company recognized a gain from the sale of these operations of approximately \$0.9 million. Consideration received from the sale of the France operations included a note receivable of \$1.3 million.

Summarized operating results of the discontinued operations are as follows (in thousands):

|  | <b>Three Months Ended<br/>June 30, 2011</b>   | <b>Three Months Ended<br/>June 30, 2010</b>   |
|--|---|---|
| Net revenue                                | \$ (30)                                       | \$ 11,638                                     |
| Operating expenses                         | 174   | 13,146  |
| Income (loss) from operations              | (204)   | (1,508)                                       |
| Interest expense                           |   | (14)  |
| Interest income and other income           | 30  | 234   |
| Foreign currency transaction gain (loss)   | 86  | (350)   |
| Income (loss) before income tax            | (88)  | (1,638)                                       |
| Income tax (expense) benefit               | (1)   | 110   |
| Income (loss) from discontinued operations | \$ (89)                                       | \$ (1,528)                                    |
|  |   |   |
|  | <b>Six Months<br/>Ended<br/>June 30, 2011</b> | <b>Six Months<br/>Ended<br/>June 30, 2010</b> |
| Net revenue                                | \$ (12)                                       | \$ 24,402                                     |
| Operating expenses                         | 497   | 26,570  |
| Income (loss) from operations              | (509)   | (2,168)                                       |
| Interest expense                           |   | (25)  |
| Interest income and other income           | 365   | 236   |
| Foreign currency transaction gain (loss)   | 76  | (198)   |
| Income (loss) before income tax            | (68)  | (2,155)                                       |
| Income tax expense                         | (1)   | (62)  |
| Income (loss) from discontinued operations | \$ (69)                                       | \$ (2,217)                                    |

**12. BASIC AND DILUTED INCOME (LOSS) PER COMMON SHARE**

Basic income (loss) per common share is calculated by dividing income (loss) attributable to common stockholders by the weighted average common shares outstanding during the period. Diluted income per common share adjusts basic income per common share for the effects of potentially dilutive common share equivalents.

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Potentially dilutive common shares for the Company include the dilutive effects of common shares issuable under our Management Compensation Plan, as amended, including stock options and RSUs, using the treasury stock method, as well as stock warrants and CVRs.

Table of Contents**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED****(UNAUDITED)**

The Company had no dilutive common share equivalents during the three months and six months ended June 30, 2011, due to the results of operations being a net loss. For the three months and six months ended June 30, 2011, the following were potentially dilutive but were excluded from the calculation of diluted loss per common share due to their antidilutive effect:

0.4 million shares issuable upon exercise of stock options and RSUs,

4.5 million shares issuable upon exercise of stock warrants, and

2.7 million shares issuable upon exercise of CVRs.

For the three months and six months ended June 30, 2010, the following could potentially dilute income per common share in the future but was excluded from the calculation of diluted loss per common share due to their antidilutive effect:

0.6 million shares issuable upon exercise of stock options and RSUs,

4.5 million shares issuable upon exercise of stock warrants, and

2.7 million shares issuable upon exercise of CVRs.

A calculation of basic income (loss) per common share to diluted income (loss) per common share is below (in thousands, except per share amounts):

|  | <b>Three Months<br/>Ended<br/>June 30,<br/>2011</b> | <b>Three Months<br/>Ended<br/>June 30,<br/>2010</b> | <b>Six Months<br/>Ended<br/>June<br/>30, 2011</b> | <b>Six Months<br/>Ended<br/>June 30, 2010</b> |
|--|---|---|---|---|
| Income (loss) from continuing operations                                   | \$ (6,253)  | \$ (11,703)   | \$ (25,528)                                       | \$ (12,013)                                   |
| Income (loss) from discontinued operations, net of tax                     | (89)  | (1,528)   | (69)  | (2,217)                                       |
| Gain (loss) from sale of discontinued operations, net of tax               |   | 193   |   | 193   |
| Net income (loss) attributable to common stockholders<br>basic and diluted | (6,342)   | (13,038)  | (25,597)  | (14,037)                                      |
| Weighted average common shares outstanding basic and<br>diluted            | 13,385  | 9,743   | 12,273  | 9,694   |

Basic and diluted income (loss) per common share:

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|  |           |           |           |           |
|--|-----------|-----------|-----------|-----------|
| Income (loss) from continuing operations attributable to common stockholders | \$ (0.47) | \$ (1.20) | \$ (2.08) | \$ (1.24) |
| Income (loss) from discontinued operations                                   | (0.01)    | (0.16)    | (0.01)    | (0.23)    |
| Gain (loss) from sale of discontinued operations                             |           | 0.02      |           | 0.02      |
| Net income (loss) attributable to common stockholders                        | \$ (0.48) | \$ (1.34) | \$ (2.09) | \$ (1.45) |

### 13. SUBSEQUENT EVENTS

#### *Exchange Offer and Consent Solicitation*

On July 7, 2011, Holding in connection with the consummation of the private (i) exchange offers (the *Exchange Offers*) for any and all outstanding Units representing the 13% Notes issued by Holding and Primus Canada, and the 14.25% Notes issued by IHC, and (ii) consent solicitation (the *Consent Solicitation*) to amend the indenture governing the 13% Notes and release the collateral securing the 13% Notes, issued \$240.2 million aggregate principal amount of 10.00% Senior Secured Notes due 2017 (the *New Notes*). The New Notes were issued pursuant to an exemption from the registration requirements of the Securities Act of 1933, as amended (the *Securities Act*), only (i) to qualified institutional buyers (as defined in Rule 144A under the Securities Act), (ii) outside the United States, to persons who are not U.S. persons (as defined in Regulation S under the Securities Act), and (iii) to institutional accredited investors (as defined in Rule 501(a)(1), (2), (3) or (7) under the Securities Act).



**Table of Contents**

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED**

**(UNAUDITED)**

The New Notes are governed by an indenture, dated as of July 7, 2011 (the New Notes Indenture), by and among Holding, the guarantors of the New Notes named therein, including the Company (the Guarantors), and U.S. Bank National Association, as trustee and collateral trustee. The New Notes bear interest at a rate of 10.00% per annum, payable semi-annually in arrears in cash on April 15 and October 15 of each year, commencing October 15, 2011. The New Notes will mature on April 15, 2017.

The New Notes and related guarantees are secured by a pledge of and first lien security interest in (subject to certain exceptions) substantially all of the assets of Holding and the Guarantors, including a first-priority pledge of all of the capital stock held by Holding, the Guarantors and each subsidiary of the Company that is a foreign subsidiary holding company (which pledge, in the case of the capital stock of each non-U.S. subsidiary and each subsidiary of the Company that is a foreign subsidiary holding company is limited to 65% of the capital stock of such subsidiary).

The New Notes rank senior in right of payment to existing and future subordinated indebtedness of Holding and the Guarantors. The New Notes rank equal in right of payment with all existing and future senior indebtedness of Holding and the Guarantors. The New Notes rank junior to any priority lien obligations entered into by Holding or the Guarantors in accordance with the New Notes Indenture.

Prior to March 15, 2013, Holding may redeem up to 35% of the aggregate principal amount of the New Notes at the redemption premium of 110.00% of the principal amount of the New Notes redeemed, plus accrued and unpaid interest, with the net cash proceeds of certain equity offerings. Prior to March 15, 2013, Holding may redeem some or all of the New Notes at a make-whole premium as set forth in the New Notes Indenture. On or after March 15, 2013, Holding may redeem some or all of the New Notes at a premium that will decrease over time as set forth in the New Notes Indenture, plus accrued and unpaid interest.

Upon the occurrence of certain Changes of Control (as defined in the New Notes Indenture) with respect to the Company, Holding must give holders of the New Notes an opportunity to sell their New Notes to Holding at a purchase price of 101% of the principal amount of such New Notes, plus accrued and unpaid interest, if any, to the date of purchase. If the Company or any of its restricted subsidiaries sells certain assets and does not use all of the net proceeds of such sale for specified purposes, Holding may be required to use the remaining net proceeds from such sale to offer to repurchase some of the New Notes at 100% of their principal amount, plus accrued and unpaid interest.

The New Notes Indenture contains covenants that, subject to certain exceptions, limit the ability of each of the Company and its restricted subsidiaries to, among other things: (i) incur additional indebtedness; (ii) pay dividends on, repurchase or make distributions in respect of the Company's capital stock or make other restricted payments; (iii) make certain investments; (iv) sell, transfer or otherwise convey certain assets; (v) create certain liens; (vi) designate future subsidiaries as unrestricted subsidiaries; (vii) consolidate, merge, sell or otherwise dispose of all or substantially all of its assets; and (viii) enter into certain transactions with affiliates. The New Notes Indenture contains other customary terms, including, but not limited to, events of default, which, if any of them occurs, would permit or require the principal, premium, if any, and interest, if any, on all of the then outstanding New Notes to be due and payable immediately.

Under the New Notes Indenture, either Holding or any Guarantor may incur additional senior secured debt, equal in right of payment to the New Notes, in the future that is subject to security interests in the same collateral as the New Notes and the related guarantees, in an aggregate principal amount outstanding (including the aggregate principal amount outstanding under the New Notes) equal to 2.25 times consolidated EBITDA of the Company for the prior four fiscal quarters.

Holding has no obligation or intention to register the New Notes for resale under the Securities Act or the securities laws of any other jurisdiction or to offer to exchange the New Notes for securities registered under the Securities Act or the securities laws of any other jurisdiction.

Following the completion of the Exchange Offers and Consent Solicitation, Units representing \$2.4 million aggregate principal amount of 13% Notes remain outstanding, and the indenture governing the 13% Notes has been amended to eliminate most restrictive covenants and certain events of default and to release the collateral securing the 13% Notes.

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Following the completion of the Exchange Offers and Consent Solicitation, \$11.6 million aggregate principal of 14 1/4% Notes continued to be outstanding. Holding issued \$11.6 million aggregate principal amount of New Notes for cash to certain former holders of 13% Notes. The proceeds of such issuance were used to redeem the remaining 14 1/4% Notes, and as a result IHC has discharged all of its obligations with respect to the 14 1/4% Notes.

**Table of Contents**

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED**

**(UNAUDITED)**

*Stock Repurchase Program*

On August 9, 2011, the Company's board of directors authorized a stock repurchase program of up to \$15 million of its common stock through August 8, 2013.

Under the stock repurchase program, stock will be repurchased from time to time in open-market and privately negotiated transactions and block trades. There is no guarantee as to the exact number of shares, if any, that the Company will repurchase. The share repurchase program may be modified, terminated or extended at any time without prior notice. The Company has established a committee consisting of its lead director, chief executive officer and chief financial officer to oversee the administration of the stock repurchase program.

*Globility's Agreement to Sell Canadian Wireless Spectrum Assets*

On August 10, 2011, Globility Communications Corporation (Globility), a Canadian local exchange carrier in which the Company indirectly owns a 45.6% interest in compliance with Canadian telecommunication laws, entered into a definitive agreement to sell its fixed wireless spectrum licenses in 29 rural and urban markets across Canada for CAD\$15 million (approximately USD\$15 million). The license transfer is subject to Industry Canada approval and therefore the closing of the sale is expected to occur following receipt of such approval.

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**Table of Contents**

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

*You should read the following discussion and analysis of our financial condition and results of operations together with our unaudited condensed consolidated financial statements and the notes thereto included herein, as well as our audited condensed consolidated financial statements and the notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2010. You should review the Risk Factors section (Part II, Item 1A) for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis.*

**Introduction and Overview of Operations**

We are an integrated facilities-based communications services provider offering a portfolio of international and domestic voice, wireless, Internet, VoIP, data and data center services to customers located primarily in Australia, Canada, the United States and Brazil. Our primary markets are Australia and Canada where we have deployed significant network infrastructure. We classify our services into three categories: Growth Services, Traditional Services and International Carrier Services. Our focus is on expanding our Growth Services, which includes our broadband, IP-based voice, local, wireless, data and data center services, to fulfill the demand for high quality, competitively priced communications services. This demand is being driven, in part, by the globalization of the world's economies, the global trend toward telecommunications deregulation and the migration of communication traffic to the Internet. We manage our Traditional Services, which includes our domestic and international long-distance voice, prepaid cards, dial-up Internet services and Australian off-network local services for cash flow generation that we reinvest to develop and market our Growth Services, particularly in our primary markets of Australia and Canada. We provide our International Carrier Services voice termination services to other telecommunications carriers and resellers requiring IP or time-division multiplexing access.

Generally, we price our services competitively with the major carriers and service providers operating in our principal service regions. We seek to generate net revenue through sales and marketing efforts focused on customers with significant communications needs, including small and medium enterprises (SMEs), multinational corporations, residential customers, and other telecommunications carriers and resellers.

Industry trends have shown that the overall market for domestic and international long-distance voice, prepaid cards and dial-up internet services has declined in favor of Internet-based, wireless and broadband communications. Our challenge concerning net revenue in recent years has been to overcome declines in long-distance voice minutes of use per customer as more customers are using wireless devices and the Internet as alternatives to the use of wireline phones. Also, product substitution (e.g., wireless/Internet for fixed line voice) has resulted in revenue declines in our long-distance voice services. Additionally, we believe that because deregulatory influences have begun to affect telecommunications markets outside the United States, the deregulatory trend is resulting in greater competition from the existing wireline and wireless competitors and from more recent entrants, such as cable companies and VoIP companies, which could continue to affect adversely our net revenue per minute, as well as minutes of use. More recently, adverse global economic conditions have resulted in a contraction of spending by business and residential customers generally which, we believe, has had an adverse effect on our net revenues.

In order to manage our network transmission costs, we pursue a flexible approach with respect to the management of our network capacity. In most instances, we (1) optimize the cost of traffic by using the least expensive cost routing, (2) negotiate lower variable usage based costs with domestic and foreign service providers, (3) negotiate additional and lower cost foreign carrier agreements with the foreign incumbent carriers and others, and (4) continue to expand/reduce the capacity of our network when traffic volumes justify such actions.

Our overall margin may fluctuate based on the relative volumes of international versus domestic long-distance services; international carrier services versus business and residential long-distance services; prepaid services versus traditional post-paid voice services; Internet, VoIP and data services versus fixed line voice services; the amount of services that are resold; and the proportion of traffic carried on our network versus resale of other carriers' services. Our margin is also affected by customer transfer and migration fees. We generally pay a charge to install and transfer a new customer onto our network and to migrate broadband and local customers. However, installing and migrating customers to our network infrastructure enables us to increase our margin on such services as compared to resale of services using other carriers' networks.

Selling, general and administrative expenses are comprised primarily of salaries and benefits, commissions, occupancy costs, sales and marketing expenses, advertising, professional fees, and other administrative costs. All selling, general and administrative expenses are expensed when incurred. Emphasis on cost containment and the shift of expenditures from non-revenue producing expenses to sales and marketing expenses has been heightened since growth in net revenue has been under pressure.

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## **Table of Contents**

### **Recent Developments**

#### *Acquisition of Arbinet Corporation*

On February 28, 2011, the Company completed the merger of PTG Investments, Inc. ( *Merger Sub* ), a Delaware corporation and a wholly-owned subsidiary of the Company with and into Arbinet Corporation ( *Arbinet* ), pursuant to the Agreement and Plan of Merger dated November 10, 2010, as amended by Amendment No. 1 dated December 14, 2010 (collectively, the *Merger Agreement* ) by and among the Company, Merger Sub and Arbinet. As a result of the merger, Arbinet became a wholly-owned subsidiary of the Company.

In connection with the merger, each share of Arbinet's common stock, par value \$0.001 per share, issued and outstanding immediately prior to the effective time of the merger was canceled and converted into the right to receive 0.5817 of a share of Company common stock.

The value of Primus shares issued as merger consideration is based upon the closing price of Primus common stock as of February 25, 2011 of \$15.60 per share. The exchange of 5,557,525 eligible Arbinet shares for 3,232,812 Primus common stock equivalents equated to a purchase value of approximately \$50.6 million. This includes the issued and outstanding shares of Arbinet and Arbinet's outstanding warrants, options, stock appreciation rights and other equity awards that were exercised prior to the effective date of the merger or subject to accelerated vesting features due to a change in control.

The Company is in the process of integrating Arbinet's operations into its International Carrier Services segment. The combined company is expected to be well positioned to capitalize on its long established experience in carrier telecom operations and to expand its global voice and data operations to meet the evolving demands of telecom operators worldwide. With its enhanced scale and market position, the combined company is expected to enable international carrier services customers to access additional networks and termination routes at competitive rates. The combined company is expected to have a diversified product portfolio of international voice and data services across all international carrier services customer segments. The combined company would become the only major global provider to offer international carrier services customers options to either acquire direct international connections through traditional interconnect arrangements or manage their access needs through The Exchange.

The Arbinet acquisition is accounted for under the acquisition method of accounting in accordance with ASC 805, *Business Combinations* . Under the acquisition method of accounting, assets acquired and liabilities assumed are measured at fair value as of February 28, 2011. The fair value of the consideration transferred and the assets acquired and liabilities assumed were determined by the Company and in doing so management relied in part upon a third-party valuation report to measure the identifiable intangible assets, property and equipment acquired. The third-party valuation reports are not final at the time of filing this quarterly report. This means that the assets and liabilities of Arbinet are recorded at their preliminary fair values and added to those of the Company, including an amount for goodwill representing the difference between the purchase price and fair value of the identifiable net assets. The condensed consolidated financial statements of the Company issued after the merger will reflect only the operations of the combined business after the merger and will not be restated retroactively to reflect the historical financial position or results of operations of Arbinet.

The Company's acquisition of Arbinet was an all stock transaction and the Merger Agreement was based upon a Primus common stock per share price of \$9.57. The initial purchase price valuation of Arbinet was based in part upon consultation with a third-party. The Merger Agreement provided that increases in the market price of Primus's common stock would have the effect of increasing the total fair value of the consideration and therefore would increase the amount of the purchase price allocable to goodwill. The base-exchange formula provided by the Merger Agreement established the number of common shares required to consummate the merger. The number of common shares established by the Merger Agreement remained constant from the execution of the Merger Agreement through the closing date, February 28, 2011, and was not affected by the increase in the value of Primus's stock which occurred after the Merger Agreement was executed. On February 28, 2011, the final consideration to be allocated to Arbinet's net assets under ASC No. 805 was valued at approximately \$50.6 million and was based upon a Primus common stock per share price of \$15.60.

The significant increase in the fair value of the consideration to be allocated to Arbinet's net assets as compared to the Company's initial valuation of Arbinet triggered the requirement for the Company to perform a goodwill impairment test upon completion of its acquisition accounting. The Company recorded the preliminary purchase accounting during the first quarter of 2011, see Note 2 *Acquisitions* and Note 4 *Goodwill and Other Intangible Assets* .

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**Table of Contents**

Given the above, the Company had goodwill arising from the acquisition of Arbinet that was considered impaired upon implementing the purchase accounting of Arbinet's net assets. The Company performed Step 1 and Step 2 testing for goodwill impairment during the first quarter 2011 and, as a result, recognized an impairment expense \$14.7 million during the first quarter 2011.

*Recent Developments Involving Existing Notes That May Impact Future Results and Liquidity*

On July 7, 2011, Holding in connection with the consummation of the Exchange Offers and the Consent Solicitation, issued \$240.2 million aggregate principal amount of New Notes. The New Notes bear interest at a rate of 10.00% per annum, payable semi-annually in arrears in cash on April 15 and October 15 of each year, commencing October 15, 2011. The New Notes will mature on April 15, 2017.

The New Notes and related guarantees are secured by a pledge of and first lien security interest in (subject to certain exceptions) substantially all of the assets of Holding and the Guarantors, including a first-priority pledge of all of the capital stock held by Holding, the Guarantors and each subsidiary of the Company that is a foreign subsidiary holding company (which pledge, in the case of the capital stock of each non-U.S. subsidiary and each subsidiary of the Company that is a foreign subsidiary holding company is limited to 65% of the capital stock of such subsidiary).

The New Notes rank senior in right of payment to existing and future subordinated indebtedness of Holding and the Guarantors. The New Notes rank equal in right of payment with all existing and future senior indebtedness of Holding and the Guarantors. The New Notes rank junior to any priority lien obligations entered into by Holding or the Guarantors in accordance with the New Notes Indenture.

Prior to March 15, 2013, Holding may redeem up to 35% of the aggregate principal amount of the New Notes at the redemption premium of 110.00% of the principal amount of the New Notes redeemed, plus accrued and unpaid interest, with the net cash proceeds of certain equity offerings. Prior to March 15, 2013, Holding may redeem some or all of the New Notes at a make-whole premium as set forth in the New Notes Indenture. On or after March 15, 2013, Holding may redeem some or all of the New Notes at a premium that will decrease over time as set forth in the New Notes Indenture, plus accrued and unpaid interest.

Upon the occurrence of certain Changes of Control (as defined in the New Notes Indenture) with respect to the Company, Holding must give holders of the New Notes an opportunity to sell their New Notes to Holding at a purchase price of 101% of the principal amount of such New Notes, plus accrued and unpaid interest, if any, to the date of purchase. If the Company or any of its restricted subsidiaries sells certain assets and does not use all of the net proceeds of such sale for specified purposes, Holding may be required to use the remaining net proceeds from such sale to offer to repurchase some of the New Notes at 100% of their principal amount, plus accrued and unpaid interest.

The New Notes Indenture contains covenants that, subject to certain exceptions, limit the ability of each of the Company and its restricted subsidiaries to, among other things: (i) incur additional indebtedness; (ii) pay dividends on, repurchase or make distributions in respect of the Company's capital stock or make other restricted payments; (iii) make certain investments; (iv) sell, transfer or otherwise convey certain assets; (v) create certain liens; (vi) designate future subsidiaries as unrestricted subsidiaries; (vii) consolidate, merge, sell or otherwise dispose of all or substantially all of its assets; and (viii) enter into certain transactions with affiliates. The New Notes Indenture contains other customary terms, including, but not limited to, events of default, which, if any of them occurs, would permit or require the principal, premium, if any, and interest, if any, on all of the then outstanding New Notes to be due and payable immediately.

Under the New Notes Indenture, either Holding or any Guarantor may incur additional senior secured debt, equal in right of payment to the New Notes, in the future that is subject to security interests in the same collateral as the New Notes and the related guarantees, in an aggregate principal amount outstanding (including the aggregate principal amount outstanding under the New Notes) equal to 2.25 times consolidated EBITDA of the Company for the prior four fiscal quarters.

Following the completion of the Exchange Offers and Consent Solicitation, Units representing \$2.4 million aggregate principal amount of 13% Notes remain outstanding, and the indenture governing the 13% Notes has been amended to eliminate most restrictive covenants and certain events of default and to release the collateral securing the 13% Notes.

Following the completion of the Exchange Offers and Consent Solicitation, \$11.6 million aggregate principal of 14<sup>1</sup>/<sub>4</sub>% Notes continued to be outstanding. Holding issued \$11.6 million aggregate principal amount of New Notes for cash to certain former holders of 13% Notes. The proceeds of such issuance were used to redeem the remaining 14<sup>1</sup>/<sub>4</sub>% Notes, and as a result IHC has discharged all of its obligations with respect to the 14<sup>1</sup>/<sub>4</sub>% Notes.



**Table of Contents**

*New York Stock Exchange Listing*

On June 23, 2011, we began to list our common stock on the New York Stock Exchange under the ticker symbol, PTGI. At that time, trading of our common stock on the OTC Bulletin Board under the ticker symbol PMUG ceased.

*Globility's Agreement to Sell Canadian Wireless Spectrum Assets*

On August 10, 2011, Globility Communications Corporation (Globility), a Canadian local exchange carrier in which Primus indirectly owns a 45.6% interest in compliance with Canadian telecommunication laws, entered into a definitive agreement to sell its fixed wireless spectrum licenses in 29 rural and urban markets across Canada for CAD\$15 million (approximately USD\$15 million). The license transfer is subject to Industry Canada approval and therefore the closing of the sale is expected to occur following receipt of such approval.

**Foreign Currency**

Foreign currency can have a major impact on our financial results. During 2011, approximately 80% of our net revenue was derived from sales and operations outside the U.S. The reporting currency for our consolidated financial statements is the United States dollar (USD). The local currency of each country is the functional currency for each of our respective entities operating in that country. Although the European dispositions and the Arbinet merger should reduce the percentage of our net revenue derived outside the U.S., in the future, we expect to continue to derive the majority of our net revenue and incur a significant portion of our operating costs from outside the U.S. Therefore, changes in exchange rates have had and may continue to have a significant, and potentially adverse, effect on our results of operations. Our primary risk of loss regarding foreign currency exchange rate risk is caused primarily by fluctuations in the following exchange rates: USD/Canadian dollar (CAD), USD/Australian dollar (AUD), USD/British pound (GBP), USD/Brazilian Real (BRL) and USD/Euro (EUR). Due to the large percentage of our revenue derived outside of the U.S., changes in the USD relative to one or more of the foregoing currencies could have an adverse impact on our future results of operations. We have agreements with certain subsidiaries for repayment of a portion of the investments and advances made to these subsidiaries. As we anticipate repayment in the foreseeable future, we recognize the unrealized gains and losses in foreign currency transaction gain (loss) on the consolidated statements of operations. The exposure of our income from operations to fluctuations in foreign currency exchange rates is reduced in part because a majority of the costs that we incur in connection with our foreign operations are also denominated in local currencies.

We are exposed to financial statement gains and losses as a result of translating the operating results and financial position of our international subsidiaries. We translate the local currency statements of operations of our foreign subsidiaries into USD using the average exchange rate during the reporting period. Changes in foreign exchange rates affect the reported profits and losses and cash flows and may distort comparisons from year to year. By way of example, when the USD strengthens compared to the CAD, there could be a negative or positive effect on the reported results for Canada, depending upon whether Canada is operating profitably or at a loss. It takes more profits in CAD to generate the same amount of profits in USD and a greater loss in CAD to generate the same amount of loss in USD. The opposite is also true. For instance, when the USD weakens there is a positive effect on reported profits and a negative effect on the reported losses for Canada.

In the three and six months ended June 30, 2011, as compared to the three and six months ended June 30, 2010, the USD was weaker on average as compared to the CAD, AUD, GBP, BRL and EUR. The following tables demonstrate the impact of currency fluctuations on our net revenue for the three and six months ended June 30, 2011 and 2010 (in thousands, except percentages):

Net Revenue by Location, including Discontinued Operations in USD

|                 | For the Three Months Ended June 30, |        |          |           | For the Six Months Ended June 30, |         |          |           |
|-----------------|-------------------------------------|--------|----------|-----------|-----------------------------------|---------|----------|-----------|
|                 | 2011                                | 2010   | Variance | Variance% | 2011                              | 2010    | Variance | Variance% |
| Canada          | 64,060                              | 58,024 | 6,036    | 10.4%     | 124,896                           | 115,500 | 9,396    | 8.1%      |
| Australia       | 73,681                              | 67,487 | 6,194    | 9.2%      | 145,413                           | 137,385 | 8,028    | 5.8%      |
| United Kingdom  | 77,478                              | 24,907 | 52,571   | 211.1%    | 122,119                           | 45,754  | 76,365   | 166.9%    |
| Europe (1), (2) | (30)                                | 19,461 | (19,491) | -100.2%   | (12)                              | 44,284  | (44,296) | -100.0%   |
| Brazil          | 7,298                               | 7,050  | 248      | 3.5%      | 14,069                            | 12,320  | 1,749    | 14.2%     |



**Table of Contents**

Net Revenue by Location, including Discontinued Operations in Local Currencies

|                           | For the Three Months Ended June 30, |        |          |           | For the Six Months Ended June 30, |         |          |           |
|---------------------------|-------------------------------------|--------|----------|-----------|-----------------------------------|---------|----------|-----------|
|                           | 2011                                | 2010   | Variance | Variance% | 2011                              | 2010    | Variance | Variance% |
| Canada (in CAD)           | 61,983                              | 59,630 | 2,353    | 3.9%      | 121,973                           | 119,475 | 2,498    | 2.1%      |
| Australia (in AUD)        | 69,375                              | 76,401 | (7,026)  | -9.2%     | 140,716                           | 153,744 | (13,028) | -8.5%     |
| United Kingdom (in GBP)   | 47,496                              | 16,699 | 30,797   | 184.4%    | 75,228                            | 30,124  | 45,104   | 149.7%    |
| Europe (1) , (2) (in EUR) | (21)                                | 14,367 | (14,388) | -100.1%   | (7)                               | 30,882  | (30,889) | -100.0%   |
| Brazil (in BRL)           | 11,622                              | 12,709 | (1,087)  | -8.6%     | 22,909                            | 22,205  | 704      | 3.2%      |

(1) Europe includes only subsidiaries whose functional currency is the Euro.

(2) Includes revenues from discontinued operations which are subject to currency risk.

**Critical Accounting Policies**

See Management's Discussion and Analysis of Financial Condition and Results of Operations in our Form 10-K for the year ended December 31, 2010 for a detailed discussion of our critical accounting policies. These policies include revenue recognition, determining our allowance for doubtful accounts receivable, accounting for cost of revenue, valuation of long-lived assets, goodwill and other intangible assets, and accounting for income taxes.

No significant changes in our critical accounting policies have occurred since December 31, 2010.

**Financial Presentation Background**

In the following presentations and narratives within this Management's Discussion and Analysis of Financial Condition and Results of Operations, we compare, pursuant to accounting principles generally accepted in the United States of America ( US GAAP ) and Securities and Exchange Commission disclosure rules, the Company's results of operations for the three months and six months ended June 30, 2011 as compared to the three months and six months ended June 30, 2010.

We also present detailed changes in results, excluding currency impacts, since a large portion of our revenues are derived outside of the U.S., and currency changes can influence or mask underlying changes in foreign operating unit performance. For purposes of calculating constant currency rates between periods in connection with presentations that describe changes in values excluding currency effects herein, we have taken results from foreign operations for a given year (that were computed in accordance with US GAAP using local currency) and converted such amounts utilizing the same U.S. dollar to applicable local currency exchange rates that were used for purposes of calculating corresponding preceding period US GAAP presentations.

**Discontinued Operations**

*2010 Developments* During 2010 the Company classified its Europe segment, which is also known as European retail operations, as discontinued operations. As a result, the Company has applied retrospective adjustments to reflect the effects of the discontinued operations during 2010. Accordingly, revenue, costs, and expenses of the discontinued operations have been excluded from the respective captions in the condensed consolidated statements of operations. The Company did not retrospectively adjust its condensed consolidated balance sheet as held for sale criteria was not met until the third quarter of 2010, as such, financial information for the Europe segment will appear, as applicable, where certain balance sheet information is presented, see Note 11 Discontinued Operations, for further information.

**Table of Contents**

Summarized operating results of the discontinued operations are as follows (in thousands):

|  | <b>Three Months<br/>Ended<br/>June 30, 2011</b> | <b>Three Months<br/>Ended<br/>June 30, 2010</b> |
|--|---|---|
| Net revenue                                | \$ (30)   | \$ 11,638                                       |
| Operating expenses                         | 174   | 13,146  |
| Income (loss) from operations              | (204)   | (1,508)   |
| Interest expense                           |   | (14)  |
| Interest income and other income           | 30  | 234   |
| Foreign currency transaction gain (loss)   | 86  | (350)   |
| Income (loss) before income tax            | (88)  | (1,638)   |
| Income tax (expense) benefit               | (1)   | 110   |
| Income (loss) from discontinued operations | \$ (89)   | \$ (1,528)                                      |
|  | <b>Six Months<br/>Ended<br/>June 30, 2011</b>   | <b>Six Months<br/>Ended<br/>June 30, 2010</b>   |
| Net revenue                                | \$ (12)   | \$ 24,402                                       |
| Operating expenses                         | 497   | 26,570  |
| Income (loss) from operations              | (509)   | (2,168)   |
| Interest expense                           |   | (25)  |
| Interest income and other income           | 365   | 236   |
| Foreign currency transaction gain (loss)   | 76  | (198)   |
| Income (loss) before income tax            | (68)  | (2,155)   |
| Income tax expense                         | (1)   | (62)  |
| Income (loss) from discontinued operations | \$ (69)   | \$ (2,217)                                      |

**Results of Operations*****Results of operations for the three months ended June 30, 2011 as compared to the three months ended June 30, 2010***

**Net revenue:** Net revenue, exclusive of the currency effect, increased \$64.3 million, or 33.0%, to \$258.9 million for the three months ended June 30, 2011 from \$194.6 million for the three months ended June 30, 2010. This increase is primarily attributable to the inclusion of Arbinet revenue within ICS, following the merger, offset in part principally by revenue declines in Australia, exclusive of currency effect, and U.S. retail voice and VoIP. Inclusive of the currency effect, which accounted for an increase of \$23.6 million, net revenue increased \$87.9 million to \$282.5 million for the three months ended June 30, 2011 from \$194.6 million for the three months ended June 30, 2010.

**Table of Contents**

| (in thousands)                 | Exclusive of Currency Effect |            |               |            |                      |            | Currency Effect | Inclusive of Currency Effect |        |
|--------------------------------|------------------------------|------------|---------------|------------|----------------------|------------|-----------------|------------------------------|--------|
|                                | Quarter Ended                |            |               |            | Quarter-over-Quarter |            |                 | Quarter Ended                |        |
|                                | June 30, 2011                |            | June 30, 2010 |            |                      |            |                 | June 30, 2011                |        |
|                                | Net Revenue                  | % of Total | Net Revenue   | % of Total | Variance             | Variance % | Net Revenue     | % of Total                   |        |
| Canada                         | 60,308                       | 23.3%      | 58,024        | 29.8%      | 2,284                | 3.9%       | 3,752           | 64,060                       | 22.7%  |
| Australia                      | 61,268                       | 23.7%      | 67,486        | 34.7%      | (6,218)              | -9.2%      | 12,413          | 73,681                       | 26.1%  |
| International Carrier Services | 119,905                      | 46.3%      | 49,192        | 25.3%      | 70,713               | 143.7%     | 6,624           | 126,529                      | 44.8%  |
| United States                  | 10,736                       | 4.1%       | 12,841        | 6.6%       | (2,105)              | -16.4%     |                 | 10,736                       | 3.8%   |
| Other                          | 6,660                        | 2.6%       | 7,050         | 3.6%       | (390)                | -5.5%      | 836             | 7,496                        | 2.6%   |
| Total Revenue                  | 258,877                      | 100.0%     | 194,593       | 100.0%     | 64,284               | 33.0%      | 23,625          | 282,502                      | 100.0% |

Canada: Canada net revenue, exclusive of the currency effect, increased \$2.3 million, or 3.9%, to \$60.3 million for the three months ended June 30, 2011 from \$58.0 million for the three months ended June 30, 2010. The net revenue increase is primarily attributable to an increase of \$5.8 million in local services, and an increase of \$1.5 million in Internet, VoIP, data and hosting services offset, in part, by a decrease of \$2.6 million in retail long distance, a decrease of \$2.2 million in prepaid voice services and a decrease of \$0.2 million in wireless services. Inclusive of the currency effect, which accounted for a \$3.8 million increase, net revenue increased \$6.1 million to \$64.1 million for the three months ended June 30, 2011 from \$58.0 million for the three months ended June 30, 2010.

Australia: Australia net revenue, exclusive of the currency effect, decreased \$6.2 million, or 9.2%, to \$61.3 million for the three months ended June 30, 2011 from \$67.5 million for the three months ended June 30, 2010. The net revenue decrease is primarily attributable to a decrease of \$2.7 million in business voice services, a decrease of \$1.8 million in residential voice, a decrease of \$1.6 million in Internet services, a decrease of \$0.3 million in DSL services, and a decrease of \$0.1 million in other services offset, in part, by an increase of \$0.3 million in data center, wireless and VoIP services. Inclusive of the currency effect, which accounted for a \$12.4 million increase, net revenue increased \$6.2 million to \$73.7 million for the three months ended June 30, 2011 from \$67.5 million for the three months ended June 30, 2010.

International Carrier Services: ICS net revenue, exclusive of the currency effect, increased \$70.7 million, or 143.7%, to \$119.9 million for the three months ended June 30, 2011 from \$49.2 million for the three months ended June 30, 2010. The net revenue increase is primarily due to the acquisition of Arbinet, which provided net revenue of \$69.1 million, and an increase of \$6.6 million in US carrier services offset, in part, by a decrease of \$5.0 million in Europe carrier services. Inclusive of the currency effect, which accounted for a \$6.6 million increase, net revenue increased \$77.3 million to \$126.5 million for the three months ended June 30, 2011, from \$49.2 million for the three months ended June 30, 2010.

United States: United States net revenue decreased \$2.1 million, or 16.4%, to \$10.7 million for the three months ended June 30, 2011 from \$12.8 million for the three months ended June 30, 2010. The decrease is primarily attributable to a decrease of \$1.2 million in retail voice services, a decrease of \$0.8 million in VoIP services and a decrease of \$0.1 million in Internet services.

Other: Other net revenue, exclusive of the currency effect, decreased \$0.4 million, or 5.5%, to \$6.7 million for the three months ended June 30, 2011 from \$7.1 million for the three months ended June 30, 2010. The revenue decrease is primarily due to a decrease in carrier voice services. Inclusive of the currency effect, which accounted for a \$0.8 million increase, net revenue increased \$0.4 million to \$7.5 million for the three months ended June 30, 2011 from \$7.1 million for the three months ended June 30, 2010.

**Cost of revenue:** Cost of revenue, exclusive of the currency effect, increased \$65.2 million to \$189.2 million, or 73.1% of net revenue, for the three months ended June 30, 2011 from \$124.0 million, or 63.7% of net revenue, for the three months ended June 30, 2010 primarily due to a shift to higher volume lower margin products resulting from the acquisition of Arbinet. Inclusive of the currency effect, which accounted for a \$16.3 million increase, cost of revenue increased \$81.5 million to \$205.5 million for the three months ended June 30, 2011 from \$124.0 million for the three months ended June 30, 2010.

**Table of Contents**

| (in thousands)                 | Exclusive of Currency Effect |               |                      |               |               |               | Currency Effect | Inclusive of Currency Effect |  |
|--------------------------------|------------------------------|---------------|----------------------|---------------|---------------|---------------|-----------------|------------------------------|--|
|                                | Quarter Ended                |               | Quarter-over-Quarter |               | Quarter Ended |               |                 |                              |  |
|                                | June 30, 2011                | June 30, 2010 | June 30, 2011        | June 30, 2010 | June 30, 2011 | June 30, 2011 |                 |                              |  |
|                                | Cost of Revenue              | Net Revenue   | Cost of Revenue      | Net Revenue   | Variance      | Variance %    | Cost of Revenue | % of Net Revenue             |  |
| Canada                         | 28,799                       | 47.8%         | 25,939               | 44.7%         | 2,860         | 11.0%         | 30,587          | 47.7%                        |  |
| Australia                      | 36,942                       | 60.3%         | 41,303               | 61.2%         | (4,361)       | -10.6%        | 44,357          | 60.2%                        |  |
| International Carrier Services | 113,422                      | 94.6%         | 45,784               | 93.1%         | 67,638        | 147.7%        | 119,851         | 94.7%                        |  |
| United States                  | 4,865                        | 45.3%         | 5,137                | 40.0%         | (272)         | -5.3%         | 4,865           | 45.3%                        |  |
| Other                          | 5,194                        | 78.0%         | 5,797                | 82.2%         | (603)         | -10.4%        | 5,862           | 78.2%                        |  |
| Total Cost of Revenue          | 189,222                      | 73.1%         | 123,960              | 63.7%         | 65,262        | 52.6%         | 205,522         | 72.8%                        |  |

Canada: Canada cost of revenue, exclusive of the currency effect, increased \$2.9 million to \$28.8 million, or 47.8% of net revenue, for the three months ended June 30, 2011 from \$25.9 million, or 44.7% of net revenue, for the three months ended June 30, 2010. The increase is primarily attributable to an increase of \$3.8 million in the costs of local services, an increase of \$0.5 million in the costs of Internet and VoIP services offset, in part, by a decrease of \$1.2 million in costs of prepaid services and a decrease of \$0.2 million in costs of voice services. Inclusive of the currency effect, which accounted for a \$1.8 million increase, cost of revenue increased \$4.7 million to \$30.6 million for the three months ended June 30, 2011 from \$25.9 million for the three months ended June 30, 2010.

Australia: Australia cost of revenue, exclusive of the currency effect, decreased \$4.4 million to \$36.9 million, or 60.3% of net revenue, for the three months ended June 30, 2011 from \$41.3 million, or 61.2% of net revenue, for the three months ended June 30, 2010. The decrease is primarily attributable to a \$6.2 million decrease in net revenue. Inclusive of the currency effect, which accounted for a \$7.4 million increase, cost of revenue increased \$3.0 million to \$44.3 million for the three months ended June 30, 2011 from \$41.3 million for the three months ended June 30, 2010.

International Carrier Services: ICS cost of revenue, exclusive of the currency effect, increased \$67.6 million to \$113.4 million, or 94.6% of net revenue, for the three months ended June 30, 2011 from \$45.8 million, or 93.1% of net revenue, for the three months ended June 30, 2010. The increase is primarily due to the acquisition of Arbinet, which provided cost of revenue of \$64.8 million, and an increase of \$7.6 million in US carrier services offset, in part, by a decrease of \$4.8 million in Europe carrier services. Inclusive of the currency effect, which accounted for a \$6.4 million increase, cost of revenues increased \$74.0 million to \$119.8 million for the three months ended June 30, 2011 from \$45.8 million for the three months ended June 30, 2010.

United States: United States cost of revenue decreased \$0.3 million to \$4.9 million, or 45.3% of net revenue, for the three months ended June 30, 2011 from \$5.1 million, or 40.0% of net revenue, for the three months ended June 30, 2010. The decrease is primarily attributable to a \$2.1 million decrease in net revenue.

Other: Other cost of revenue, exclusive of the currency effect, decreased \$0.6 million to \$5.2 million, or 78.0% of net revenue, for the three months ended June 30, 2011 from \$5.8 million, or 82.2% of net revenue, for the three months ended June 30, 2010. The decrease is primarily attributable to a decrease in net revenue of \$0.4 million. Inclusive of the currency effect, which accounted for a \$0.7 million increase, cost of revenue increased \$0.1 million to \$5.9 million for the three months ended June 30, 2011 from \$5.8 million for the three months ended June 30, 2010.

**Selling, general and administrative expenses:** Selling, general and administrative expenses, exclusive of the currency effect, increased \$6.6 million to \$54.4 million, or 21.0% of net revenue, for the three months ended June 30, 2011 from \$47.8 million, or 24.6% of net revenue, for the three months ended June 30, 2010. Inclusive of the currency effect, which accounted for a \$5.0 million increase, selling, general and administrative expenses increased \$11.6 million to \$59.4 million for the three months ended June 30, 2011 from \$47.8 million for the three months ended June 30, 2010.

**Table of Contents**

|                                | Exclusive of Currency Effect |                |               |                |                      |              | Currency<br>Effect | Inclusive of<br>Currency Effect |                |
|--------------------------------|------------------------------|----------------|---------------|----------------|----------------------|--------------|--------------------|---------------------------------|----------------|
|                                | Quarter Ended                |                |               |                | Quarter-over-Quarter |              |                    | Quarter Ended                   |                |
|                                | June 30, 2011                |                | June 30, 2010 |                |                      |              |                    | June 30, 2011                   |                |
|                                | % of                         |                | % of          |                |                      |              | % of               |                                 |                |
| (in thousands)                 | SG&A                         | Net<br>Revenue | SG&A          | Net<br>Revenue | Variance             | Variance %   |                    | SG&A                            | Net<br>Revenue |
| Canada                         | 19,099                       | 31.7%          | 20,183        | 34.8%          | (1,084)              | -5.4%        | 1,189              | 20,288                          | 31.7%          |
| Australia                      | 17,336                       | 28.3%          | 17,035        | 25.2%          | 301                  | 1.8%         | 3,520              | 20,856                          | 28.3%          |
| International Carrier Services | 6,202                        | 5.2%           | 1,605         | 3.3%           | 4,597                | 286.4%       | 107                | 6,309                           | 5.0%           |
| United States                  | 4,567                        | 42.5%          | 5,367         | 41.8%          | (800)                | -14.9%       |                    | 4,567                           | 42.5%          |
| Other                          | 1,327                        | 19.9%          | 1,141         | 16.2%          | 186                  | 16.3%        | 129                | 1,456                           | 19.4%          |
| Corporate                      | 5,885                        |                | 2,523         |                | 3,362                | 133.3%       |                    | 5,885                           |                |
| <b>Total SG&amp;A</b>          | <b>54,416</b>                | <b>21.0%</b>   | <b>47,854</b> | <b>24.6%</b>   | <b>6,562</b>         | <b>13.7%</b> | <b>4,945</b>       | <b>59,361</b>                   | <b>21.0%</b>   |

Canada: Canada selling, general and administrative expenses, exclusive of the currency effect, decreased \$1.1 million to \$19.1 million, or 31.7% of net revenue, for the three months ended June 30, 2011 from \$20.2 million, or 34.8% of net revenue, for the three months ended June 30, 2010. The decrease is attributable to a decrease of \$0.8 million in sales and marketing expenses, a decrease of \$0.2 million in salaries and benefits, a decrease of \$0.2 million in professional fees and a decrease of \$0.1 million in general and administrative expense offset, in part, by an increase of \$0.2 million in advertising expenses. Inclusive of the currency effect, which accounted for a \$1.2 million increase, selling, general and administrative expenses increased \$0.1 million to \$20.3 million for the three months ended June 30, 2011 from \$20.2 million for the three months ended June 30, 2010.

Australia: Australia selling, general and administrative expense, exclusive of the currency effect, increased \$0.3 million to \$17.3 million, or 28.3% of net revenue, for the three months ended June 30, 2011 from \$17.0 million, or 25.2% of net revenue, for the three months ended June 30, 2010. The increase is primarily attributable to an increase of \$0.5 million in salaries and benefits, an increase of \$0.3 million in advertising expenses offset, in part, by a decrease of \$0.3 million in general and administrative expense and a decrease of \$0.2 million in sales and marketing expenses. Inclusive of the currency effect, which accounted for a \$3.5 million increase, selling, general and administrative expense increased \$3.8 million to \$20.8 million for the three months ended June 30, 2011 from \$17.0 million for the three months ended June 30, 2010.

International Carrier Services: ICS selling, general and administrative expenses, exclusive of the currency effect, increased \$4.6 million to \$6.2 million, or 5.2% of net revenue, for the three months ended June 30, 2011 from \$1.6 million, or 3.3% of net revenue, for the three months ended June 30, 2010. The increase is primarily due to the acquisition of Arbinet, which provided selling, general and administrative expense of \$4.0 million, and an increase of \$0.6 million in US carrier services. Inclusive of the currency effect, which accounted for a \$0.1 million increase, selling, general and administrative expense increased \$4.7 million to \$6.3 million for the three months ended June 30, 2011 from \$1.6 million for the three months ended June 30, 2010. Inclusive within the acquisition of Arbinet has been \$0.3 million of integration expenses and \$28 thousand in severance expense.

United States: United States selling, general and administrative expenses decreased \$0.8 million to \$4.6 million, or 42.5% of net revenue, for the three months ended June 30, 2011 from \$5.4 million, or 41.8% of net revenue, for the three months ended June 30, 2010. The decrease is attributable to a decrease of \$0.5 million in salaries and benefits, a decrease of \$0.5 million in general and administrative expenses, a decrease of \$0.1 million in professional fees offset, in part, by an increase of \$0.3 million in advertising expense.

Other: Other selling, general and administrative expenses, exclusive of the currency effect, increased \$0.2 million to \$1.3 million, or 19.9% of net revenue, for the three months ended June 30, 2011 from \$1.1 million, or 16.2% of net revenue, for the three months ended June 30, 2010. The increase is attributable to an increase of \$0.1 million in sales and marketing expenses and an increase of \$0.1 million in all other expenses. Inclusive of the currency effect, which accounted for a \$0.1 million increase, selling, general and administrative expenses increased \$0.3 million to \$1.4 million for the three months ended June 30, 2011 from \$1.1 million for the three months ended June 30, 2010.

Corporate: Corporate selling, general and administrative expense increased \$3.4 million to \$5.9 million for the three months ended June 30, 2011 from \$2.5 million for the three months ended June 30, 2010. The increase is attributable to an increase of \$2.7 million in salaries and benefits, an increase of \$0.6 million in professional fees, and an increase of \$0.1 million in travel and entertainment expense.



**Table of Contents**

**Depreciation and amortization expense:** Depreciation and amortization expense decreased \$1.1 million to \$17.1 million for the three months ended June 30, 2011 from \$18.2 million for the three months ended June 30, 2010. The decrease was primarily the result of certain assets revalued at the time of fresh start accounting and depreciated over a one year life which ended on June 30, 2010, offset in part, by additional depreciation and amortization from Arbinet.

**Interest expense and accretion (amortization) on debt discount/premium, net:** Interest expense and accretion (amortization) on debt discount/premium, net decreased \$0.8 million to \$7.9 million for the three months ended June 30, 2011 from \$8.7 million for the three months ended June 30, 2010. The decrease was due to the \$24.0 million principal payment of the 14<sup>1</sup>/<sub>4</sub>% Senior Secured Notes in April 2011.

**Gain (loss) from contingent value rights valuation:** The change in value of the contingent value rights increased \$0.5 million to a gain of \$0.1 million for the three months ended June 30, 2011 from a loss of \$0.4 million for the three months ended June 30, 2010. This increase is attributable to the change of the fair market value. The Company determined these contingent value rights to be derivative instruments to be accounted for as liabilities and marked to fair value at each balance sheet date. Estimates of fair value represent the Company's best estimates based on a Black-Scholes pricing model.

**Foreign currency transaction gain (loss):** Foreign currency transaction gain increased \$12.0 million to a gain of \$2.4 million for the three months ended June 30, 2011 from a loss of \$9.6 million for the three months ended June 30, 2010. The gains are attributable to the impact of foreign currency exchange rate changes on intercompany debt balances and on receivables and payables denominated in a currency other than the subsidiaries' functional currency.

**Income tax benefit (expense):** Income tax expense was \$1.4 million for the three months ended June 30, 2011 compared to a \$1.9 million benefit for the three months ended June 30, 2010. The expense includes withholding tax related to cross-border payments and state income tax expense expected in states without net operating loss coverage.

**Results of operations for the six months ended June 30, 2011 as compared to the six months ended June 30, 2010**

**Net revenue:** Net revenue, exclusive of the currency effect, increased \$81.9 million, or 21.1%, to \$469.5 million for the six months ended June 30, 2011 from \$387.6 million for the six months ended June 30, 2010. This increase was due primarily to the inclusion of Arbinet revenue within ICS, following the merger, offset in part principally by revenue declines in Australia, exclusive of currency effect, and U.S. retail voice and VoIP. Inclusive of the currency effect, which accounted for an increase of \$36.7 million, net revenue increased \$118.6 million to \$506.2 million for the six months ended June 30, 2011 from \$387.6 million for the six months ended June 30, 2010.

|                                | Exclusive of Currency Effect |               |                  |               | Year-over-Year |              | Currency Effect | Inclusive of Currency Effect |               |
|--------------------------------|------------------------------|---------------|------------------|---------------|----------------|--------------|-----------------|------------------------------|---------------|
|                                | Six Months Ended             |               | Six Months Ended |               | Variance       | Variance %   |                 | Six Months Ended             |               |
|                                | June 30, 2011                | June 30, 2010 | June 30, 2011    | June 30, 2010 |                |              |                 | June 30, 2011                | June 30, 2011 |
| (in thousands)                 | Net Revenue                  | % of Total    | Net Revenue      | % of Total    |                |              |                 | Net Revenue                  | % of Total    |
| Canada                         | 117,924                      | 25.1%         | 115,500          | 29.8%         | 2,424          | 2.1%         | 6,972           | 124,896                      | 24.7%         |
| Australia                      | 125,737                      | 26.8%         | 137,386          | 35.4%         | (11,649)       | -8.5%        | 19,676          | 145,413                      | 28.7%         |
| International Carrier Services | 190,866                      | 40.7%         | 95,699           | 24.7%         | 95,167         | 99.4%        | 8,685           | 199,551                      | 39.4%         |
| United States                  | 21,919                       | 4.6%          | 26,706           | 6.9%          | (4,787)        | -17.9%       |                 | 21,919                       | 4.3%          |
| Other                          | 13,085                       | 2.8%          | 12,319           | 3.2%          | 766            | 6.2%         | 1,361           | 14,446                       | 2.9%          |
| <b>Total Revenue</b>           | <b>469,531</b>               | <b>100.0%</b> | <b>387,610</b>   | <b>100.0%</b> | <b>81,921</b>  | <b>21.1%</b> | <b>36,694</b>   | <b>506,225</b>               | <b>100.0%</b> |

Canada: Canada net revenue, exclusive of the currency effect, increased \$2.4 million, or 2.1%, to \$117.9 million for the six months ended June 30, 2011 from \$115.5 million for the six months ended June 30, 2010. The net revenue increase is primarily attributable to an increase of \$4.3 million in retail voice services, an increase of \$2.7 million in Internet, VoIP, data and hosting services offset, in part, by a decrease of \$3.8 million in prepaid voice services, a decrease of \$0.4 million in wireless services and a decrease of \$0.4 million in local services. Inclusive of the currency effect, which accounted for a \$7.0 million increase, net revenue increased \$9.4 million to \$124.9 million for the six months ended June 30, 2011 from \$115.5 million for the six months ended June 30, 2010.





**Table of Contents**

Australia: Australia net revenue, exclusive of the currency effect, decreased \$11.7 million, or 8.5%, to \$125.7 million for the six months ended June 30, 2011 from \$137.4 million for the six months ended June 30, 2010. The net revenue decrease is primarily attributable to a decrease of \$4.2 million in business voice services, a decrease of \$3.6 million in residential voice, a decrease of \$3.4 million in Internet services, a decrease of \$0.4 million in DSL services, and a decrease of \$1.0 million in other services offset, in part, by an increase of \$0.7 million in wireless services and an increase of \$0.2 million in VoIP services. Inclusive of the currency effect, which accounted for a \$19.7 million increase, net revenue increased \$8.0 million to \$145.4 million for the six months ended June 30, 2011 from \$137.4 million for the six months ended June 30, 2010.

International Carrier Services: ICS net revenue, exclusive of the currency effect, increased \$95.2 million, or 99.4%, to \$190.9 million for the six months ended June 30, 2011 from \$95.7 million for the six months ended June 30, 2010. The net revenue increase is primarily due to the acquisition of Arbinet, which provided net revenue of \$94.7 million, and an increase of \$11.8 million in US carrier services offset, in part, by a decrease of \$11.3 million in Europe carrier services. Inclusive of the currency effect, which accounted for an \$8.7 million increase, net revenue increased \$103.9 million to \$199.6 million for the six months ended June 30, 2011, from \$95.7 million for the six months ended June 30, 2010.

United States: United States net revenue decreased \$4.8 million, or 17.9%, to \$21.9 million for the six months ended June 30, 2011 from \$26.7 million for the six months ended June 30, 2010. The decrease is primarily attributable to a decrease of \$2.7 million due to customer attrition in retail voice services, a decrease of \$1.9 million in VoIP services and a decrease of \$0.2 million in Internet services.

Other: Other net revenue, exclusive of the currency effect, increased \$0.8 million, or 6.2% to \$13.1 million for the six months ended June 30, 2011 from \$12.3 million for the six months ended June 30, 2010. The revenue increase is primarily due to an increase in wireless services. Inclusive of the currency effect, which accounted for a \$1.4 million increase, net revenue increased \$2.2 million to \$14.5 million for the six months ended June 30, 2011 from \$12.3 million for the six months ended June 30, 2010.

**Cost of revenue:** Cost of revenue, exclusive of the currency effect, increased \$87.1 million to \$333.1 million, or 71.0% of net revenue, for the six months ended June 30, 2011 from \$246.0 million, or 63.5% of net revenue, for the six months ended June 30, 2010 primarily due to a shift to higher volume lower margin products resulting from the acquisition of Arbinet. Inclusive of the currency effect, which accounted for a \$24.7 million increase, cost of revenue increased \$111.8 million to \$357.8 million for the six months ended June 30, 2011 from \$246.0 million for the six months ended June 30, 2010.

|                                | Exclusive of Currency Effect |               |                  |               | Year-over-Year |              | Currency      | Inclusive of     |               |
|--------------------------------|------------------------------|---------------|------------------|---------------|----------------|--------------|---------------|------------------|---------------|
|                                | Six Months Ended             |               | Six Months Ended |               | Variance       | Variance %   | Effect        | Six Months Ended |               |
|                                | June 30, 2011                | June 30, 2010 | June 30, 2011    | June 30, 2010 |                |              |               | June 30, 2011    | June 30, 2011 |
|                                | Cost of Revenue              | Net Revenue   | Cost of Revenue  | Net Revenue   |                |              |               | Cost of Revenue  | Net Revenue   |
| (in thousands)                 |                              | % of          |                  | % of          |                |              |               |                  | % of          |
| Canada                         | 56,289                       | 47.7%         | 52,206           | 45.2%         | 4,083          | 7.8%         | 3,327         | 59,616           | 47.7%         |
| Australia                      | 76,020                       | 60.5%         | 82,903           | 60.3%         | (6,883)        | -8.3%        | 11,811        | 87,831           | 60.4%         |
| International Carrier Services | 180,740                      | 94.7%         | 89,772           | 93.8%         | 90,968         | 101.3%       | 8,416         | 189,156          | 94.8%         |
| United States                  | 9,904                        | 45.2%         | 11,164           | 41.8%         | (1,260)        | -11.3%       |               | 9,904            | 45.2%         |
| Other                          | 10,185                       | 77.8%         | 9,906            | 80.4%         | 279            | 2.8%         | 1,086         | 11,271           | 78.0%         |
| <b>Total Cost of Revenue</b>   | <b>333,138</b>               | <b>71.0%</b>  | <b>245,951</b>   | <b>63.5%</b>  | <b>87,187</b>  | <b>35.4%</b> | <b>24,640</b> | <b>357,778</b>   | <b>70.7%</b>  |

Canada: Canada cost of revenue, exclusive of the currency effect, increased \$4.1 million to \$56.3 million, or 47.7% of net revenue, for the six months ended June 30, 2011 from \$52.2 million, or 45.2% of net revenue, for the six months ended June 30, 2010. The increase is primarily attributable to an increase of \$7.0 million in the costs of voice services, an increase of \$0.7 million in the costs of Internet services, and an increase of \$0.3 million in the costs of VoIP services offset, in part, by a decrease of \$2.6 million in costs of prepaid services and a decrease of \$1.3 million in the costs of local services. Inclusive of the currency effect, which accounted for a \$3.3 million increase, cost of revenue increased \$7.4 million to \$59.6 million for the six months ended June 30, 2011 from \$52.2 million for the six months ended June 30, 2010.

Australia: Australia cost of revenue, exclusive of the currency effect, decreased \$6.9 million to \$76.0 million, or 60.5% of net revenue, for the six months ended June 30, 2011 from \$82.9 million, or 60.3% of net revenue, for the six months ended June 30, 2010. The decrease is primarily attributable to an \$11.7 million decrease in net revenue. Inclusive of the currency effect, which accounted for an \$11.8 million increase, cost of revenue increased \$4.9 million to \$87.8 million for the six months ended June 30, 2011 from \$82.9 million for the six months ended June 30,

2010.

**Table of Contents**

International Carrier Services: ICS cost of revenue, exclusive of the currency effect, increased \$90.9 million to \$180.7 million, or 94.7% of net revenue, for the six months ended June 30, 2011 from \$89.8 million, or 93.8% of net revenue, for the six months ended June 30, 2010. The increase is primarily due to the acquisition of Arbinet, which provided cost of revenue of \$88.8 million, and an increase of \$12.9 million in US carrier services offset, in part, by a decrease of \$10.8 million in Europe carrier services. Inclusive of the currency effect, which accounted for an \$8.4 million increase, cost of revenues increased \$99.3 million to \$189.1 million for the six months ended June 30, 2011 from \$89.8 million for the six months ended June 30, 2010.

United States: United States cost of revenue decreased \$1.3 million to \$9.9 million, or 45.2% of net revenue, for the six months ended June 30, 2011 from \$11.2 million, or 41.8% of net revenue, for the six months ended June 30, 2010. The decrease is primarily attributable to a \$4.8 million decrease in net revenue.

Other: Other cost of revenue, exclusive of the currency effect, increased \$0.3 million to \$10.2 million, or 77.8% of net revenue, for the six months ended June 30, 2011 from \$9.9 million, or 80.4% of net revenue, for the six months ended June 30, 2010. The increase is primarily attributable to an increase in net revenue of \$0.8 million. Inclusive of the currency effect, which accounted for a \$1.1 million increase, cost of revenue increased \$1.4 million to \$11.3 million for the six months ended June 30, 2011 from \$9.9 million for the six months ended June 30, 2010.

**Selling, general and administrative expenses:** Selling, general and administrative expenses, exclusive of the currency effect, increased \$7.3 million to \$105.3 million, or 22.4% of net revenue, for the six months ended June 30, 2011 from \$98.0 million, or 25.3% of net revenue, for the six months ended June 30, 2010. Inclusive of the currency effect, which accounted for an \$8.0 million increase, selling, general and administrative expenses increased \$15.3 million to \$113.3 million for the six months ended June 30, 2011 from \$98.0 million for the six months ended June 30, 2010.

| (in thousands)                 | Exclusive of Currency Effect |               |                  |               | Year-over-Year |             | Currency Effect | Inclusive of Currency Effect |               |
|--------------------------------|------------------------------|---------------|------------------|---------------|----------------|-------------|-----------------|------------------------------|---------------|
|                                | Six Months Ended             |               | Six Months Ended |               | Variance       | Variance %  |                 | Six Months Ended             |               |
|                                | June 30, 2011                | June 30, 2010 | June 30, 2011    | June 30, 2010 |                |             |                 | June 30, 2011                | June 30, 2011 |
|                                | % of                         |               | % of             |               |                |             |                 |                              |               |
| SG&A                           | Net Revenue                  | SG&A          | Net Revenue      |               |                | SG&A        | Net Revenue     |                              |               |
| Canada                         | 37,643                       | 31.9%         | 39,795           | 34.5%         | (2,152)        | -5.4%       | 2,225           | 39,868                       | 31.9%         |
| Australia                      | 34,584                       | 27.5%         | 33,718           | 24.5%         | 866            | 2.6%        | 5,463           | 40,047                       | 27.5%         |
| International Carrier Services | 10,991                       | 5.8%          | 3,264            | 3.4%          | 7,727          | 236.7%      | 142             | 11,133                       | 5.6%          |
| United States                  | 9,121                        | 41.6%         | 12,333           | 46.2%         | (3,212)        | -26.0%      |                 | 9,121                        | 41.6%         |
| Other                          | 2,315                        | 17.7%         | 2,249            | 18.3%         | 66             | 2.9%        | 197             | 2,512                        | 17.4%         |
| Corporate                      | 10,632                       |               | 6,613            |               | 4,019          | 60.8%       |                 | 10,632                       |               |
| <b>Total SG&amp;A</b>          | <b>105,286</b>               | <b>22.4%</b>  | <b>97,972</b>    | <b>25.3%</b>  | <b>7,314</b>   | <b>7.5%</b> | <b>8,027</b>    | <b>113,313</b>               | <b>22.4%</b>  |

Canada: Canada selling, general and administrative expenses, exclusive of the currency effect, decreased \$2.2 million to \$37.6 million, or 31.9% of net revenue, for the six months ended June 30, 2011 from \$39.8 million, or 34.5% of net revenue, for the six months ended June 30, 2010. The decrease is attributable to a decrease of \$1.6 million in sales and marketing expenses, a decrease of \$0.5 million in advertising expenses, a decrease of \$0.3 million in professional fees, a decrease of \$0.1 million in occupancy expenses and a decrease of \$0.1 million in other expenses offset, in part, by an increase of \$0.4 million in salaries and benefits. Inclusive of the currency effect, which accounted for a \$2.3 million increase, selling, general and administrative expense increased \$0.1 million to \$39.9 million for the six months ended June 30, 2011 from \$39.8 million for the six months ended June 30, 2010.

Australia: Australia selling, general and administrative expense, exclusive of the currency effect, increased \$0.9 million to \$34.6 million, or 27.5% of net revenue, for the six months ended June 30, 2011 from \$33.7 million, or 24.5% of net revenue, for the six months ended June 30, 2010. The increase is attributable to an increase of \$1.0 million in salaries and benefits, an increase of \$0.4 million in advertising expenses and an increase of \$0.2 million in occupancy expenses offset, in part, by a decrease of \$0.3 million in sales and marketing expenses, a decrease of \$0.3 million in general and administrative expenses and a decrease of \$0.1 million in professional fees. Inclusive of the currency effect, which accounted for a \$5.4 million increase, selling, general and administrative expense increased \$6.3 million to \$40.0 million for the six months ended June 30, 2011 from \$33.7 million for the six months ended June 30, 2010.



**Table of Contents**

**International Carrier Services:** ICS selling, general and administrative expenses, exclusive of the currency effect, increased \$7.7 million to \$11.0 million, or 5.8% of net revenue, for the six months ended June 30, 2011 from \$3.3 million, or 3.4% of net revenue, for the six months ended June 30, 2010. The increase is primarily due to the acquisition of Arbinet, which provided selling, general and administrative expense of \$7.1 million, and an increase of \$0.7 million in US carrier services offset, in part, by a decrease of \$0.1 million in Europe carrier services. Inclusive of the currency effect, which accounted for a \$0.1 million increase, selling, general and administrative expense increased \$7.8 million to \$11.1 million for the six months ended June 30, 2011 from \$3.3 million for the six months ended June 30, 2010. Inclusive within the acquisition of Arbinet has been \$0.6 million of integration expenses and \$1.1 million in severance expense.

**United States:** United States selling, general and administrative expenses decreased \$3.2 million to \$9.1 million, or 41.6% of net revenue, for the six months ended June 30, 2011 from \$12.3 million, or 46.2% of net revenue, for the six months ended June 30, 2010. The decrease is attributable to a decrease of \$2.0 million in general and administrative expenses, a decrease of \$1.1 million in salaries and benefits, a decrease of \$0.4 million in occupancy expenses, a decrease of \$0.1 million in professional fees and a decrease of \$0.1 million in sales and marketing expenses offset, in part, by an increase of \$0.5 million in advertising expenses.

**Other:** Other selling, general and administrative expense, exclusive of the currency effect, increased \$0.1 million to \$2.3 million, or 17.7% of net revenue, for the six months ended June 30, 2011 from \$2.2 million, or 18.3% of net revenue, for the six months ended June 30, 2010. The increase is primarily attributable to an increase of \$0.1 million in sales and marketing expenses. Inclusive of the currency effect, which accounted for a \$0.2 million increase, selling, general and administrative expense increased \$0.3 million to \$2.5 million for the six months ended June 30, 2011 from \$2.2 million for the six months ended June 30, 2010.

**Corporate:** Corporate selling, general and administrative expense increased \$4.0 million to \$10.6 million for the six months ended June 30, 2011 from \$6.6 million for the six months ended June 30, 2010. The increase is attributable to an increase of \$1.9 million in salaries and benefits, an increase of \$0.9 million in professional fees, an increase of \$0.7 million in general and administrative expenses, an increase of \$0.3 million in occupancy expenses and an increase of \$0.2 million in travel and entertainment expense.

**Depreciation and amortization expense:** Depreciation and amortization expense decreased \$3.8 million to \$32.2 million for the six months ended June 30, 2011 from \$36.0 million for the six months ended June 30, 2010. The decrease was primarily the result of certain assets revalued at the time of fresh start accounting and depreciated over a one year life which ended on June 30, 2010, offset in part, by additional depreciation and amortization from Arbinet.

**Goodwill impairment expense:** The Company expensed \$14.7 million of goodwill in the first quarter of 2011 due to the acquisition price of Arbinet Corporation. See Note 2 Acquisitions and Note 4 Goodwill and Other Intangible Assets, for further information.

**Interest expense and accretion (amortization) on debt discount/premium, net:** Interest expense and accretion (amortization) on debt discount/premium, net decreased \$1.4 million to \$16.7 million for the six months ended June 30, 2011 from \$18.1 million for the six months ended June 30, 2010. The decrease was due to the \$24.0 million principal payment of the 14 1/4% Senior Secured Notes in April 2011.

**Gain (loss) from contingent value rights valuation:** The change in value of the contingent value rights decreased \$1.9 million to a loss of \$4.3 million for the six months ended June 30, 2011 from a loss of \$2.4 million for the six months ended June 30, 2010. This decrease is attributable to the change of the fair market value. The Company determined these contingent value rights to be derivative instruments to be accounted for as liabilities and marked to fair value at each balance sheet date. Estimates of fair value represent the Company's best estimates based on a Black-Scholes pricing model.

**Foreign currency transaction gain (loss):** Foreign currency transaction gain increased \$10.2 million to a gain of \$6.4 million for the six months ended June 30, 2011 from a loss of \$3.8 million for the six months ended June 30, 2010. The gains are attributable to the impact of foreign currency exchange rate changes on intercompany debt balances and on receivables and payables denominated in a currency other than the subsidiaries' functional currency.

**Income tax benefit (expense):** Income tax expense was \$0.5 million for the six months ended June 30, 2011 compared to a \$4.1 million benefit for the six months ended June 30, 2010. The expense includes withholding tax related to cross-border payments and state income tax expense expected in states without net operating loss coverage.

**Table of Contents**

**Liquidity and Capital Resources**

*Changes in Cash Flows*

Our principal liquidity requirements arise from cash used in operating activities, purchases of network equipment including switches, related transmission equipment and capacity, development of back-office systems, expansion of data center facilities, interest and principal payments on outstanding debt and other obligations and income taxes. We have financed our growth and operations to date through public offerings and private placements of debt and equity securities, vendor financing, capital lease financing and other financing arrangements.

Net cash provided by operating activities was \$15.0 million for the six months ended June 30, 2011. For the six months ended June 30, 2011, net income, net of non-cash operating activity, provided \$27.1 million of cash. In addition, cash was increased by an increase in accounts payable of \$6.9 million. For the six months ended June 30, 2011, we used \$8.6 million to increase accounts receivable, \$5.3 million to reduce our accrued expenses, deferred revenue, other current liabilities and other liabilities, net, and \$4.8 million to reduce our accrued interconnection costs.

Net cash provided by investing activities was \$0.3 million for the six months ended June 30, 2011, which included \$13.9 million used for capital expenditures, offset by \$9.6 million provided by cash acquired from acquisition of businesses and \$4.1 million from sale of marketable securities.

*Short- and Long-Term Liquidity Considerations and Risks*

As of June 30, 2011, we had \$31.5 million of unrestricted cash and cash equivalents. We believe that our existing cash and cash equivalents will be sufficient to fund our debt service requirements, other fixed obligations (such as capital leases), and other cash needs for our operations for at least the next twelve months. The Company and/or its subsidiaries will evaluate and determine on a continuing basis the most efficient use of the Company's capital and resources, including efforts to invest in the Company's network, systems and product initiatives and to strengthen its balance sheet through debt repurchase or other means.

As of June 30, 2011, we have \$30.3 million in future minimum purchase obligations, \$80.4 million in future operating lease payments and \$221.2 million of indebtedness. At June 30, 2011, approximately \$88 million of unrecognized tax benefits have been recorded as liabilities in accordance with ASC No. 740; however, we are uncertain as to if or when such amounts may be settled, so we have not included these amounts in the table below. Included in the unrecognized tax benefits not included in the table below, we have recorded a liability for potential penalties and interest of \$0.2 million for the six months ended June 30, 2011.

*Contractual Obligations*

The obligations reflected in the table below reflect the contractual payments of principal and interest that existed as of June 30, 2011:

| Year Ending December 31,                    | Capital Leases<br>and Other | 13% Senior                   | 14 1/4% Senior                         | Purchase<br>Obligations | Operating<br>Leases | Total      |
|---|-----------------------------|------------------------------|--|-------------------------|---------------------|------------|
|   |                             | Secured<br>Notes<br>due 2016 | Subordinated Secured<br>Notes due 2013 |                         |                     |            |
| 2011 (as of June 30, 2011)                  | \$ 645                      | \$ 8,448                     | \$ 6,413                               | \$ 17,897               | \$ 9,800            | \$ 43,203  |
| 2012  | 423                         | 16,896                       | 12,825                                 | 8,073                   | 17,791              | 56,008     |
| 2013  | 207                         | 16,896                       | 96,413                                 | 3,162                   | 14,475              | 131,153    |
| 2014  | 31                          | 16,896                       |  | 1,162                   | 10,211              | 28,300     |
| 2015  |                             | 16,896                       |  | 54                      | 8,136               | 25,086     |
| Thereafter                                  |                             | 146,420                      |  |                         | 20,003              | 166,423    |
| Total minimum principal & interest payments | 1,306                       | 222,452                      | 115,651                                | 30,348                  | 80,416              | 450,173    |
| Less: Amount representing interest          | (54)                        | (92,484)                     | (25,651)                               |                         |                     | (118,189)  |
| Total long-term obligations                 | \$ 1,252                    | \$ 129,968                   | \$ 90,000                              | \$ 30,348               | \$ 80,416           | \$ 331,984 |

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We have contractual obligations to utilize network facilities from certain carriers with terms greater than one year. We generally do not purchase or commit to purchase quantities in excess of normal usage or amounts that cannot be used within the contract term.

## **Table of Contents**

### **New Accounting Pronouncements**

For a discussion of our New Accounting Pronouncements, refer to Note 3 to our unaudited condensed consolidated financial statements in Item 1 of this Quarterly Report on Form 10-Q.

### **Special Note Regarding Forward Looking Statements**

Certain statements in this Quarterly Report on Form 10-Q and, in particular, our Management's Discussion and Analysis of Financial Condition and Results of Operations set forth in Part I Item 2, contain or incorporate a number of forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Such statements are based on current expectations, and are not strictly historical statements. In some cases, you can identify forward-looking statements by terminology such as if, may, should, believe, anticipate, future, forward, potential, estimate, reinstate, opportunity, goal, objective, exchange, expect, intend, plan, strategy, provide, commitment, result, seek, pursue, ongoing, include or in the negative of such terms terminology. These forward-looking statements inherently involve certain risks and uncertainties, although they are based on our current plans or assessments which are believed to be reasonable as of the date of this filing. Forward-looking statements in this Quarterly Report on Form 10-Q include statements regarding:

our financial condition, Arbinet business integration and synergy efforts, financing requirements, prospects and cash flow;

expectations of future growth, creation of shareholder value, revenue, foreign revenue contributions and net income, as well as income from operations, margins, earnings per share, cash flow and cash sufficiency levels, working capital, network development, customer migration and related costs, spending on and success with growth products, including broadband Internet, VoIP, wireless, local, data and hosting services, traffic development, capital expenditures, selling, general and administrative expenses, income tax and withholding tax expense, fixed asset and goodwill impairment charges, service introductions, cash requirements and potential asset sales;

increased competitive pressures, declining usage patterns, and our growth products, bundled service offerings, the pace and cost of customer migration onto our networks, the effectiveness and profitability of the growth products;

financing, refinancing, debt extension, de-leveraging, restructuring, exchange or tender plans or initiatives, and potential dilution of existing equity holders from such initiatives;

liquidity and debt service forecast;

assumptions regarding currency exchange rates;

timing, extent and effectiveness of cost reduction initiatives and management's ability to moderate or control discretionary spending;

management's plans, goals, expectations, guidance, objectives, strategies, and timing for future operations, acquisitions, synergies, asset dispositions, product plans, performance and results;

management's assessment of market factors and competitive developments, including pricing actions and regulatory rulings; and



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the ability to generate net cash proceeds from the disposition of selective assets without material impairment to profitability. Any or all of our forward-looking statements in this Quarterly Report on Form 10-Q may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Many factors mentioned in our discussion in this Quarterly Report on Form 10-Q will be important in determining future results. Consequently, no forward-looking statement can be guaranteed. Actual future results may vary materially from expected results. We also provide a cautionary discussion of risks and uncertainties under Risk Factors in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2010, which are updated and supplemented by Part II Item 1A Risk Factors of our Quarterly Reports on Form 10-Q. These are factors that we think could cause our actual results to differ materially from expected results. Other factors besides those listed could also adversely affect us. In addition, the forward-looking statements contained herein represent our estimate only as of the date of this filing and should not be relied upon as representing our estimate as of any subsequent date. While we may elect to update these forward-looking statements at some point in the future, we specifically disclaim any obligation to do so to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking statements.

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**Table of Contents**

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

Our primary market risk exposures relate to changes in foreign currency exchange rates, valuations of derivatives and changes in interest rates.

*Foreign currency exchange rates* Foreign currency can have a major impact on our financial results. As of June 30, 2011, approximately 80% of our net revenue is derived from sales and operations outside the United States. The reporting currency for our consolidated financial statements is the USD. The local currency of each country is the functional currency for each of our respective entities operating in that country. In the future, we expect to continue to derive the majority of our net revenue and incur a significant portion of our operating costs outside the U.S., and therefore changes in exchange rates have had and may continue to have a significant, and potentially adverse, effect on our results of operations. Our primary risk of loss regarding foreign currency exchange rate risk is caused primarily by fluctuations in the following exchange rates: USD/CAD and USD/AUD. Due to the large percentage of our revenue derived outside of the U.S., changes in the USD relative to one or more of the foregoing currencies could have an adverse impact on our future results of operations. We have agreements with certain subsidiaries for repayment of a portion of the investments and advances made to these subsidiaries. As we anticipate repayment in the foreseeable future, we recognize the unrealized gains and losses in foreign currency transaction gain (loss) on the consolidated statements of operations. We historically have not engaged in hedging transactions.

We are exposed to financial statement gains and losses as a result of translating the operating results and financial position of our international subsidiaries. We translate the local currency statements of operations of our foreign subsidiaries into USD using the average exchange rate during the reporting period. Changes in foreign exchange rates affect the reported profits and losses and cash flows and may distort comparisons from year to year. By way of example, when the USD strengthens compared to the AUD, there could be a negative or positive effect on the reported results for Australia, depending upon whether our Australia unit is operating profitably or at a loss. It takes more profits in AUD to generate the same amount of profits in USD and a greater loss in AUD to generate the same amount of loss in USD. The opposite is also true. For instance, when the USD weakens there is a positive effect on reported profits and a negative effect on reported losses for Australia.

In the six months ended June 30, 2011, as compared to the six months ended June 30, 2010, the USD was weaker on average as compared to the CAD and AUD. As a result, the revenue of our subsidiaries whose local currency is CAD and AUD increased (decreased) 2.1% and (8.5)%, respectively, in their local currencies compared to the six months ended June 30, 2010, and increased 8.1% and 5.8%, respectively, in USD.

*Valuation of derivatives* We issued Contingent Value Rights (CVRs) to certain shareholders pursuant to the terms of the Reorganization Plan. Upon issuance, we estimated the fair value of the CVRs using a Black-Scholes pricing model and consequently recorded a liability of \$2.6 million as part of fresh-start accounting. We adjust the estimated fair value of our CVRs quarterly. Our estimates of fair value of the CVRs are correlated to and reflective of our common stock price trends. In general, as the value of the our common stock increases, the estimated fair value of the CVRs also increases and as a result we recognize a change in value of the CVRs as loss from contingent valuation rights valuation, conversely and also in general, as the value of our common stock decreases, the estimated fair value of the CVRs also decreases and as a result we recognize a change in value of the CVRs as gain from contingent rights valuation. Because the value of our common stock fluctuates, the gain or loss recognized in our financial statements may vary from quarter to quarter.

*Interest rates* Our 13% Senior Secured Notes and 14<sup>1</sup>/<sub>4</sub>% Senior Subordinated Secured Notes are at a fixed interest rate of 13% and 14<sup>1</sup>/<sub>4</sub>%, respectively. Subsequent to June 30, 2011, we refinanced our debt with 10% Senior Secured Notes at a fixed interest rate of 10%.

**Table of Contents**

**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures.**

Our management, with the participation of our Chief Executive Officer, Chief Financial Officer, and Principal Accounting Officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation, and as a result of the material weakness described in the Company's 2010 Annual Report on Form 10-K, our principal executive officer and our acting principal financial officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were not effective. Disclosure controls and procedures mean our controls and other procedures that are designed to ensure that information required to be disclosed by us in our reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in 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 our reports that we file or submit under the Securities Exchange Act of 1934 is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

**Changes in Internal Control.**

There were no changes in our internal control over financial reporting that occurred during the quarter ended June 30, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. As a result of the Company's determination that the controls in place over accounting for income taxes did not operate effectively as of December 31, 2010, we engaged our former Corporate Tax Director as a consultant to coordinate and work with our new Corporate Tax Director to fully document tax processes and controls and to perform a complete knowledge transfer of the existing procedures. We have also hired third party tax consultants to evaluate, document and make recommendations to improve the current tax reporting process and documentation of tax positions. Management believes that once controls have been fully documented and the knowledge transfer has been successfully completed, our new Corporate Tax Director will be able to take on an effective supervisory role and will be well positioned to ensure the effective enhancement and implementation of our tax controls. Notwithstanding the existence of a material weakness in our internal controls over accounting for income taxes, we believe, to the best of our knowledge, our previously filed financial statements (as amended) fairly present, in all material respects, our financial condition and results of operations in conformity with U.S GAAP.

**Table of Contents**

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

The Company and its subsidiaries are subject to claims and legal proceedings that arise in the ordinary course of its business. Each of these matters is inherently uncertain, and there can be no guarantee that the outcome of any such matter will be decided favorably to the Company or its subsidiaries or that the resolution of any such matter will not have a material adverse effect upon the Company's business, consolidated financial position, results of operations or cash flow. The Company does not believe that any of these pending claims and legal proceedings will have a material adverse effect on its business, consolidated financial position, results of operations or cash flow.

**ITEM 1A. RISK FACTORS**

There have been no material changes to the risk factors included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, except as set forth in our Quarterly Report on Form 10-Q for the period March 31, 2011.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. (REMOVED AND RESERVED)**

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

(a) Exhibits (see index)

**Table of Contents**

**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.

PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED

Date: August 15, 2011

By: /s/ Kenneth D. Schwarz  
**Kenneth D. Schwarz**  
**Chief Financial Officer**  
**(Principal Financial Officer)**

**Table of Contents**

**EXHIBIT INDEX**

**Exhibit**

| <b>Number</b> | <b>Description</b>  |
|---------------|---|
| 10.1          | Support Agreement dated as of May 13, 2011 (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed with the SEC on May 17, 2011).  |
| 10.2          | Offer letter between the Company and Kenneth D. Schwarz dated June 17, 2011 (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission on June 23, 2011).   |
| 10.3*         | Form of Indemnification Agreement between the Company and its Directors and Executive Officers.   |
| 31*           | Certifications.   |
| 32**          | Certifications.   |
| 101***        | The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2011, formatted in XBRL (eXtensible Business Reporting Language); (i) Unaudited Condensed Consolidated Balance Sheets at June 30, 2011 and December 31, 2010, (ii) Unaudited Condensed Consolidated Statements of Operations for the three months ended June 30, 2011 and 2010 and for the six months ended June 30, 2011 and 2010, (iii) Unaudited Condensed Consolidated Statements of Comprehensive Income (Loss) for the three months ended June 30, 2011 and 2010 and for the six months ended June 30, 2011 and 2010, (iv) Unaudited Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2011 and 2010, and (v) Notes to Unaudited Condensed Consolidated Financial Statements. |

\* Filed herewith

\*\* These certification are being furnished and will not be deemed filed for purposes of Section 18 of the Securities Exchange Act (15 U.S.C. 78r) and will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that the registrant specifically incorporates it by reference.

\*\*\* Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.