

PRIMUS TELECOMMUNICATIONS GROUP INC

Form 10-Q

November 09, 2012

[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 September 30, 2012

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)

Edgar Filing: PRIMUS TELECOMMUNICATIONS GROUP INC - Form 10-Q

**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

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.

| Class                           | Outstanding as of October 31, 2012 |
|---------------------------------|------------------------------------|
| Common Stock, \$0.001 par value | 13,899,543                         |

**Table of Contents**

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**

**INDEX TO FORM 10-Q**

|   | <b>Page No.</b> |
|---|-----------------|
| <b>Part I. FINANCIAL INFORMATION</b>  |                 |
| Item 1. FINANCIAL STATEMENTS (UNAUDITED)  |                 |
| <u>Condensed Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2012 and 2011</u>                  | 3               |
| <u>Condensed Consolidated Balance Sheets as of September 30, 2012 and December 31, 2011</u>   | 4               |
| <u>Condensed Consolidated Statement of Stockholders' Equity for the Nine Months Ended September 30, 2012</u>                            | 5               |
| <u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2012 and 2011</u>                            | 6               |
| <u>Condensed Consolidated Statements of Comprehensive Income (Loss) for the Three and Nine Months Ended September 30, 2012 and 2011</u> | 7               |
| <u>Notes to Condensed Consolidated Financial Statements</u>   | 8               |
| Item 2. <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>                                    | 30              |
| Item 3. <u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>   | 46              |
| Item 4. <u>CONTROLS AND PROCEDURES</u>  | 46              |
| <b><u>Part II. OTHER INFORMATION</u></b>  |                 |
| Item 1. <u>LEGAL PROCEEDINGS</u>  | 48              |
| Item 1A. <u>RISK FACTORS</u>  | 48              |
| Item 2. <u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>  | 49              |
| Item 3. <u>DEFAULTS UPON SENIOR SECURITIES</u>  | 49              |
| Item 4. <u>MINE SAFETY DISCLOSURES</u>  | 49              |
| Item 5. <u>OTHER INFORMATION</u>  | 49              |
| Item 6. <u>EXHIBITS</u>   | 49              |
| <u>SIGNATURES</u>   | 50              |
| <u>EXHIBIT INDEX</u>  | 51              |

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

(in thousands, except per share amounts)

(unaudited)

|  | Three Months Ended<br>September 30, 2011 | Three Months Ended<br>September 30, 2010 | Nine Months Ended<br>September 30, 2011 | Nine Months Ended<br>September 30, 2010 |
|--|--|--|---|---|
| NET REVENUE  | \$ 63,911                                | \$ 74,308                                | \$ 197,301                              | \$ 221,500                              |
| OPERATING EXPENSES   |  |  |   |   |
| Cost of revenue (exclusive of depreciation included below)   | 31,511                                   | 36,808                                   | 97,306                                  | 109,671                                 |
| Selling, general and administrative  | 23,260                                   | 27,242                                   | 78,415                                  | 84,094                                  |
| Depreciation and amortization  | 7,517                                    | 8,630                                    | 22,944                                  | 26,904                                  |
| (Gain) loss on sale or disposal of assets  | 131                                      | 53                                       | 174                                     | 51                                      |
| Total operating expenses   | 62,419                                   | 72,733                                   | 198,839                                 | 220,720                                 |
| INCOME (LOSS) FROM OPERATIONS  | 1,492                                    | 1,575                                    | (1,538)                                 | 780                                     |
| INTEREST EXPENSE   | (6,325)                                  | (7,576)                                  | (20,098)                                | (24,054)                                |
| ACCRETION (AMORTIZATION) ON DEBT PREMIUM/DISCOUNT, net   | (55)                                     | (55)                                     | (170)                                   | (158)                                   |
| GAIN (LOSS) ON EARLY EXTINGUISHMENT OR RESTRUCTURING OF DEBT   | (21,083)                                 | (6,853)                                  | (21,083)                                | (6,853)                                 |
| GAIN (LOSS) FROM CONTINGENT VALUE RIGHTS VALUATION   | 235                                      | 11,367                                   | (4,916)                                 | 7,079                                   |
| INTEREST INCOME AND OTHER INCOME (EXPENSE), net  | (26)                                     | 2,203                                    | 120                                     | 1,797                                   |
| FOREIGN CURRENCY TRANSACTION GAIN (LOSS)   | 2,834                                    | (5,366)                                  | 3,233                                   | (2,794)                                 |
| INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES   | (22,928)                                 | (4,705)                                  | (44,452)                                | (24,203)                                |
| INCOME TAX BENEFIT (EXPENSE)   | 43                                       | 34                                       | 741                                     | 625                                     |
| INCOME (LOSS) FROM CONTINUING OPERATIONS   | (22,885)                                 | (4,671)                                  | (43,711)                                | (23,578)                                |
| INCOME (LOSS) FROM DISCONTINUED OPERATIONS, net of tax   | (2,459)                                  | (4,882)                                  | (18,009)                                | (12,849)                                |
| GAIN (LOSS) FROM SALE OF DISCONTINUED OPERATIONS, net of tax   |  |  | 98,666                                  |   |
| NET INCOME (LOSS)  | (25,344)                                 | (9,553)                                  | 36,946                                  | (36,427)                                |
| Less: Net (income) loss attributable to the noncontrolling interest                                    | 307                                      | (457)                                    | 18                                      | 820                                     |
| NET INCOME (LOSS) ATTRIBUTABLE TO PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED                        | \$ (25,037)                              | \$ (10,010)                              | \$ 36,964                               | \$ (35,607)                             |
| <b>BASIC INCOME (LOSS) PER COMMON SHARE:</b>   |  |  |   |   |
| Income (loss) from continuing operations attributable to Primus Telecommunications Group, Incorporated | \$ (1.63)                                | \$ (0.37)                                | \$ (3.16)                               | \$ (1.78)                               |
| Income (loss) from discontinued operations   | \$ (0.18)                                | \$ (0.36)                                | \$ (1.30)                               | \$ (1.01)                               |
| Gain (loss) from sale of discontinued operations   | \$                                       | \$                                       | \$ 7.14                                 | \$                                      |
| Net income (loss) attributable to Primus Telecommunications Group, Incorporated                        | \$ (1.81)                                | \$ (0.73)                                | \$ 2.68                                 | \$ (2.79)                               |
| <b>DILUTED INCOME (LOSS) PER COMMON SHARE:</b>   |  |  |   |   |
| Income (loss) from continuing operations attributable to Primus Telecommunications Group, Incorporated | \$ (1.63)                                | \$ (0.37)                                | \$ (3.16)                               | \$ (1.78)                               |
| Income (loss) from discontinued operations   | \$ (0.18)                                | \$ (0.36)                                | \$ (1.30)                               | \$ (1.01)                               |
| Gain (loss) from sale of discontinued operations   | \$                                       | \$                                       | \$ 7.14                                 | \$                                      |
| Net income (loss) attributable to Primus Telecommunications Group, Incorporated                        | \$ (1.81)                                | \$ (0.73)                                | \$ 2.68                                 | \$ (2.79)                               |

Edgar Filing: PRIMUS TELECOMMUNICATIONS GROUP INC - Form 10-Q

| WEIGHTED AVERAGE COMMON SHARES OUTSTANDING   |    |          |        |          |                         |
|--|----|----------|--------|----------|-------------------------|
| Basic  |    | 13,890   | 13,715 | 13,825   | 12,759                  |
| Diluted  |    | 13,890   | 13,715 | 13,825   | 12,759                  |
| DIVIDENDS DECLARED PER BASIC WEIGHTED AVERAGE COMMON SHARES OUTSTANDING                      |    |          |        |          |                         |
|  | \$ |          | \$     | 1.02     | \$                      |
| AMOUNTS ATTRIBUTABLE TO COMMON SHAREHOLDERS OF PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED |    |          |        |          |                         |
| Income (loss) from continuing operations, net of tax   | \$ | (22,578) | \$     | (5,128)  | \$ (43,693) \$ (22,758) |
| Income (loss) from discontinued operations, net of tax                                       |    | (2,459)  |        | (4,882)  | (18,009) (12,849)       |
| Gain (loss) from sale of discontinued operations, net of tax                                 |    |          |        | 98,666   |                         |
| Net income (loss)  | \$ | (25,037) | \$     | (10,010) | \$ 36,964 \$ (35,607)   |

See notes to condensed consolidated financial statements.

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

|  | September 30,<br>2012 | December 31,<br>2011 |
|--|-----------------------|----------------------|
| <b>ASSETS</b>  |                       |                      |
| <b>CURRENT ASSETS:</b>   |                       |                      |
| Cash and cash equivalents  | \$ 66,024             | \$ 41,052            |
| Accounts receivable (net of allowance for doubtful accounts receivable of \$1,962 and \$7,552 at September 30, 2012 and December 31, 2011, respectively)   | 19,119                | 81,609               |
| Prepaid expenses and other current assets  | 14,349                | 15,539               |
| Assets held for sale   | 45,527                |                      |
| <b>Total current assets</b>  | <b>145,019</b>        | <b>138,200</b>       |
| RESTRICTED CASH  | 859                   | 11,891               |
| PROPERTY AND EQUIPMENT Net   | 64,680                | 152,180              |
| GOODWILL   | 65,081                | 71,902               |
| OTHER INTANGIBLE ASSETS Net  | 75,787                | 135,677              |
| OTHER ASSETS   | 16,689                | 33,974               |
| <b>TOTAL ASSETS</b>  | <b>368,115</b>        | <b>543,824</b>       |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>   |                       |                      |
| <b>CURRENT LIABILITIES:</b>  |                       |                      |
| Accounts payable   | \$ 11,330             | \$ 46,627            |
| Accrued interconnection costs  | 2,726                 | 24,103               |
| Deferred revenue   | 9,311                 | 12,258               |
| Accrued expenses and other current liabilities   | 20,707                | 44,384               |
| Accrued income taxes   | 7,578                 | 10,617               |
| Accrued interest   | 5,440                 | 5,889                |
| Current portion of long-term obligations   | 116                   | 1,948                |
| Liabilities held for sale  | 35,544                |                      |
| <b>Total current liabilities</b>   | <b>92,752</b>         | <b>145,826</b>       |
| LONG-TERM OBLIGATIONS  | 117,882               | 245,814              |
| DEFERRED TAX LIABILITY   | 15,614                | 31,311               |
| CONTINGENT VALUE RIGHTS  | 21,112                | 16,196               |
| OTHER LIABILITIES  | 894                   | 2,971                |
| <b>Total liabilities</b>   | <b>248,254</b>        | <b>442,118</b>       |
| <b>COMMITMENTS AND CONTINGENCIES (See Note 6)</b>  |                       |                      |
| <b>STOCKHOLDERS EQUITY:</b>  |                       |                      |
| Preferred stock, \$0.001 par value 20,000,000 shares authorized; none issued and outstanding   |                       |                      |
| Common stock, \$0.001 par value 80,000,000 shares authorized; 13,931,169 and 13,772,646 shares issued and 13,899,543 and 13,741,020 shares outstanding at September 30, 2012 and December 31, 2011, respectively | 14                    | 14                   |
| Additional paid-in capital   | 140,860               | 142,796              |
| Accumulated deficit  | (14,121)              | (51,085)             |
|  | (378)                 | (378)                |

## Edgar Filing: PRIMUS TELECOMMUNICATIONS GROUP INC - Form 10-Q

Treasury stock, at cost 31,626 and 31,626 shares at September 30, 2012 and December 31, 2011, respectively

|   |                   |                   |
|---|-------------------|-------------------|
| Accumulated other comprehensive income (loss)             | (6,514)           | 2,416             |
| Total stockholders' equity before noncontrolling interest | 119,861           | 93,763            |
| Noncontrolling interest                                   |                   | 7,943             |
| Total stockholders' equity                                | 119,861           | 101,706           |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>         | <b>\$ 368,115</b> | <b>\$ 543,824</b> |

See notes to condensed consolidated financial statements.

Table of Contents

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**  
**CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY**

(in thousands)

(unaudited)

For the Nine Months Ended September 30, 2012  
Primus Telecommunications Group, Incorporated Shareholders  
Common Stock

|  | Total      | Shares | Amount | Additional<br>Paid-In<br>Capital | Treasury<br>Stock | Accumulated<br>Deficit | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Noncontrolling<br>Interest |
|--|------------|--------|--------|----------------------------------|-------------------|------------------------|--|----------------------------|
| Balance as of December 31, 2011                                  | \$ 101,706 | 13,741 | \$ 14  | \$ 142,796                       | \$ (378)          | \$ (51,085)            | \$ 2,416   | \$ 7,943                   |
| Share-based compensation expense                                 | 5,018      |        |        | 5,018                            |                   |                        |  |                            |
| Proceeds from sale of common stock, net                          | 93         | 159    |        | 93                               |                   |                        |  |                            |
| Taxes paid in lieu of shares issued for share-based compensation | (1,584)    |        |        | (1,584)                          |                   |                        |  |                            |
| Dividends declared   | (14,117)   |        |        | (14,117)                         |                   |                        |  |                            |
| Acquisition of noncontrolling interest                           |            |        |        | 8,654                            |                   |                        |  | (8,654)                    |
| Comprehensive income (loss):                                     |            |        |        |                                  |                   |                        |  |                            |
| Net income (loss)  | 36,946     |        |        |                                  |                   | 36,964                 |  | (18)                       |
| Foreign currency translation adjustment                          | (8,201)    |        |        |                                  |                   |                        | (8,930)  | 729                        |
| Comprehensive income (loss)                                      | 28,745     |        |        |                                  |                   |                        |  |                            |
| Balance as of September 30, 2012                                 | \$ 119,861 | 13,900 | \$ 14  | \$ 140,860                       | \$ (378)          | \$ (14,121)            | \$ (6,514)   | \$                         |

See notes to condensed consolidated financial statements.

**Table of Contents****PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands)****(unaudited)**

|   | <b>Nine Months Ended<br/>September 30, 2012</b> | <b>Nine Months Ended<br/>September 30, 2011</b> |
|---|---|---|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |   |   |
| Net income (loss)   | \$ 36,946                                       | \$ (36,427)                                     |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities:                        |   |   |
| Provision for doubtful accounts receivable  | 3,389   | 6,530   |
| Share-based compensation expense  | 5,018   | 4,094   |
| Depreciation and amortization   | 35,160  | 48,887  |
| (Gain) loss on sale or disposal of assets   | (97,564)  | 61  |
| Impairment of goodwill and long-lived assets  | 10,298  | 14,679  |
| Accretion (amortization) of debt premium/discount, net  | 170   | 158   |
| Change in fair value of Contingent Value Rights   | 4,916   | (7,079)   |
| Deferred income taxes   | 4,045   | (2,151)   |
| (Gain) loss on early extinguishment or restructuring of debt  | 21,083  | 6,853   |
| Unrealized foreign currency transaction (gain) loss on intercompany and foreign debt                            | (6,208)   | 5,419   |
| Changes in assets and liabilities, net of acquisitions:   |   |   |
| (Increase) decrease in accounts receivable  | 15,181  | 1,419   |
| (Increase) decrease in prepaid expenses and other current assets  | 5,011   | 2,123   |
| (Increase) decrease in other assets   | 5,169   | 2,882   |
| Increase (decrease) in accounts payable   | (8,069)   | (12,023)  |
| Increase (decrease) in accrued interconnection costs  | (3,578)   | (2,748)   |
| Increase (decrease) in accrued expenses, deferred revenue, other current liabilities and other liabilities, net | (5,989)   | (10,788)  |
| Increase (decrease) in accrued income taxes   | (978)   | 61  |
| Increase (decrease) in accrued interest   | (146)   | 4,048   |
| <b>Net cash provided by operating activities</b>  | <b>23,854</b>                                   | <b>25,998</b>                                   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |   |   |
| Purchase of property and equipment  | (25,135)  | (22,789)  |
| Sale of property and equipment and intangible assets  | 17  |   |
| Cash from disposition of business, net of cash disposed   | 177,721   |   |
| Cash acquired from business acquisitions, net of cash paid  | (1,707)   | 9,599   |
| Sales of marketable securities  |   | 4,087   |
| Increase in restricted cash   | (85)  | (77)  |
| <b>Net cash provided by (used in) investing activities</b>  | <b>150,811</b>                                  | <b>(9,180)</b>                                  |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |   |   |
| Proceeds from long-term obligations   |   | 11,625  |
| Principal payments on long-term obligations   | (120,725)                                       | (38,329)  |
| Payment of fees on restructuring of debt  | (12,856)  | (2,452)   |
| Proceeds from sale of common stock, net   | 93  | 1,202   |
| Payment of dividends  | (13,804)  |   |
| Payment to noncontrolling interest  |   | (1,205)   |
| Purchase of treasury stock  |   | (378)   |
| Taxes paid in lieu of shares issued for share-based compensation  | (1,584)   |   |
| <b>Net cash used in financing activities</b>  | <b>(148,876)</b>                                | <b>(29,537)</b>                                 |

## Edgar Filing: PRIMUS TELECOMMUNICATIONS GROUP INC - Form 10-Q

|  |           |           |
|--|-----------|-----------|
| EFFECTS OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS                            | (817)     | (1,582)   |
| NET CHANGE IN CASH AND CASH EQUIVALENTS  | 24,972    | (14,301)  |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD   | 41,052    | 41,534    |
| <br>   |           |           |
| CASH AND CASH EQUIVALENTS, END OF PERIOD   | \$ 66,024 | \$ 27,233 |
| <br>   |           |           |
| SUPPLEMENTAL CASH FLOW INFORMATION:  |           |           |
| Cash paid for interest   | \$ 18,070 | \$ 19,356 |
| Cash paid for taxes  | \$ 2,311  | \$ 453    |
| Non-cash investing and financing activities:   |           |           |
| Capital lease additions  | \$        | \$ 14,874 |
| Acquisition purchase consideration recorded in working-capital and long-term liabilities | \$        | \$ 2,507  |
| Business acquisition purchased with Company common stock                                 | \$        | \$ 50,609 |
| Prepayment premium associated with debt restructuring converted into new debt            | \$        | \$ 22,666 |

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</b> | <b>Three Months Ended</b> | <b>Three Months Ended</b> | <b>Three Months Ended</b> |
|---|---------------------------|---------------------------|---------------------------|---------------------------|
|   | <b>September 30,</b>      | <b>September 30,</b>      | <b>September 30,</b>      | <b>September 30,</b>      |
|   | <b>2012</b>               | <b>2011</b>               | <b>2012</b>               | <b>2011</b>               |
| NET INCOME (LOSS)   | \$ (25,344)               | \$ (9,553)                | \$ 36,946                 | \$ (36,427)               |
| OTHER COMPREHENSIVE INCOME (LOSS)   |                           |                           |                           |                           |
| Foreign currency translation adjustment   | 1,114                     | (2,451)                   | (8,201)                   | (2,322)                   |
| COMPREHENSIVE INCOME (LOSS)   | (24,230)                  | (12,004)                  | 28,745                    | (38,749)                  |
| Less: Comprehensive (income) loss attributable to the noncontrolling interest             | (465)                     | (375)                     | (711)                     | 791                       |
| COMPREHENSIVE INCOME (LOSS) ATTRIBUTABLE TO PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED | \$ (24,695)               | \$ (12,379)               | \$ 28,034                 | \$ (37,958)               |

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 ( PTGi and, together with its subsidiaries, Primus, the Company, we and our ) have been prepared in accordance with accounting principles generally accepted in the United States of America ( US GAAP ) 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 US GAAP 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 and nine months ended September 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012.

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 12 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 Annual Report on Form 10-K.

On June 23, 2011, PTGi 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. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Principles of Consolidation* The condensed consolidated financial statements include the Company s accounts, its wholly-owned subsidiaries and all other subsidiaries over which the Company exerts control. Prior to July 31, 2012, the Company owned 45.6% of Globility Communications Corporation ( Globility ) through direct and indirect ownership structures. As a result of changes to the Telecommunications Act in Canada, the Company is no longer restricted by Canadian foreign ownership laws. Given these changes, Primus Telecommunications International, Inc. ( PTII ) purchased the remaining 54.4% of Globility on July 31, 2012. The results of Globility and its subsidiary are consolidated with the Company s results based on guidance from the Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC ) No. 810, Consolidation ( ASC 810 ). All intercompany profits, transactions and balances have been eliminated in consolidation.

*Discontinued Operations* During 2011, the Company sold its Brazilian segment. In the second quarter of 2012, the Company sold its Australian segment and committed to dispose of and is actively soliciting a sale or other disposition of its International Carrier Services ( ICS ) business unit.

The Company has applied retrospective adjustments for the three and nine months ended September 30, 2011 to reflect the effects of the discontinued operations that occurred during 2012. Accordingly, revenue, costs, and expenses of the discontinued operations have been excluded from the respective captions in the condensed consolidated statements of operations. Additionally the assets and liabilities of ICS have been classified as held for sale assets and liabilities and removed from the specific line items on the condensed consolidated balance sheet as of September 30, 2012. See Note 12 Discontinued Operations, for further information regarding these transactions.

**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 associated with such 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.

*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 pursuant to which 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; i.e., 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 each provides 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.

**Table of Contents**

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED**

**(UNAUDITED)**

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, and 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.

Intangible assets not subject to amortization consist of certain 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.

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, pursuant to which 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 pre-Reorganization Plan common stock contingent value rights ("CVRs") to receive up to an aggregate of 2,665,000 shares (the "CVR Shares") of PTGi'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. As a result of the special cash dividend discussed in Note 8 "Stockholders' Equity," effective July 2, 2012, the maximum aggregate number of CVR Shares issuable with respect to the CVRs was adjusted upward from 2,665,000 shares to 2,835,225 shares while the strike price with respect to the CVRs was adjusted downward from \$35.95 to \$33.79.

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. Post-issuance 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 PTGi's common stock price trends; in general, as the value of PTGi'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 PTGi's common stock decreases, the estimated fair value of the CVRs also decreases and as a result the Company recognizes a change in value of the CVRs as gain from contingent value rights valuation. See Note 10 "Fair Value of Financial Instruments and Derivatives."

*Use of Estimates* The preparation of condensed consolidated financial statements in conformity with US GAAP 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

**Table of Contents**

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED**

**(UNAUDITED)**

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 PTGi's stock options required by ASC No. 718, Compensation Stock Compensation, income taxes and various legal and 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. In addition, certain amounts in selling, general and administrative expense related to our Data Center operating segment were reclassified to cost of revenue as part of the Company's new operating segment structure discussed in Note 11 Operating Segment and Related Information.

*Newly Adopted Accounting Principles*

In May 2011, an update was issued to the Fair Value Measurement Topic ASC 820, ASU 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs, which provides guidance on how to measure fair value and on what disclosures to provide about fair value measurements. It seeks to develop a single, converged fair value framework between the FASB and the International Financial Reporting Standards (IFRS) Board. On January 1, 2012, the Company adopted this update, which did not have a material impact on the condensed consolidated financial statements.

In June 2011, an update was issued to the Comprehensive Income Topic ASC 220, ASU 2011-05, Presentation of Comprehensive Income, which provides guidance to all entities that report items of other comprehensive income, in any period presented. Under the amendments in this update, an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. In a single continuous statement, the entity is required to present the components of net income and total net income, the components of other comprehensive income and a total for other comprehensive income, along with the total of comprehensive income in that statement. In the two-statement approach, an entity is required to present components of net income and total net income in the statement of net income. The statement of other comprehensive income should immediately follow the statement of net income and include the components of other comprehensive income and a total for other comprehensive income, along with a total for comprehensive income. ASU 2011-05 also contains a provision that requires the entity to present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statements where the components of net income and the components of other comprehensive income are presented. In December 2011, an update was issued to the Comprehensive Income Topic ASC 220, ASU 2011-12, Deferral of the Effective Date for Amendments to the

**Table of Contents**

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED**

**(UNAUDITED)**

Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05, which indefinitely deferred the requirement to present the reclassification adjustments out of other comprehensive income. On January 1, 2012, the Company adopted these updates, which did not have a material impact on the condensed consolidated financial statements.

In September 2011, an update was issued to the Intangibles Goodwill and Other Topic ASC 350, ASU 2011-08, Testing Goodwill for Impairment, which provides guidance to all entities, both public and nonpublic, that have goodwill reported in their financial statements. Under the amendments in this update, an entity has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. If the carrying amount of a reporting unit exceeds its fair value, then the entity is required to perform the second step of the goodwill impairment test to measure the amount of the impairment loss. An entity has the option to bypass the qualitative assessment for any reporting unit in any period and proceed directly to performing the first step of the two-step goodwill impairment test. An entity may resume performing the qualitative assessment in any subsequent period. On January 1, 2012, the Company adopted this update, which did not have a material impact on the condensed consolidated financial statements.

*New Accounting Pronouncements*

In July 2012, an update was issued to the Intangibles Goodwill and Other Topic ASC 350, ASU 2012-02, Testing Indefinite-Lived Intangible Assets for Impairment, which provides guidance to all entities, both public and nonpublic, that have indefinite-lived intangible assets, other than goodwill, reported in their financial statements. Under the amendments in this update, an entity has the option first to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount. An entity has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. An entity will be able to resume performing the qualitative assessment in any subsequent period. The Company's effective date for adoption is January 1, 2013 and it does not foresee this accounting update having a material effect on its consolidated financials in future periods, although that could change.

**3. ACQUISITIONS**

*Arbinet Corporation Acquisition*

On February 28, 2011, the Company completed its 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 ICS 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 PTGi, PTG Investments, Inc., a Delaware corporation and a wholly-owned subsidiary of PTGi ( Merger Sub ), and Arbinet, Merger Sub merged with and into Arbinet with Arbinet surviving the merger as a wholly-owned subsidiary of PTGi.

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

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 PTGi common stock. Arbinet stockholders received cash in lieu of any fractional shares of PTGi common stock that they were otherwise entitled to receive in the merger. In connection with the merger, PTGi 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> |

- (1) The fair value of PTGi'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. PTGi 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.

*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 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. 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. In accordance with ASC No. 805, Business Combinations (ASC 805), the allocation of the consideration value was completed on February 28, 2012, the one year anniversary of the date of the acquisition.

**4. GOODWILL AND OTHER INTANGIBLE ASSETS**

On February 28, 2011, the Company acquired Arbinet for stock consideration of \$50.6 million in a stock for stock transaction. See Note 3 Acquisitions. Because PTGi'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 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 and liabilities assumed was deemed to be equal to that which was used for the purchase.



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

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 on the Company's condensed consolidated statements of operations. Post acquisition, Arbinet was integrated into the Company's ICS segment.

In conjunction with the decision to discontinue ICS (see Note 12 Discontinued Operations), the Company initiated an impairment assessment analysis of ICS resulting in the full impairment of the goodwill and intangible assets assigned to ICS of \$10.3 million at June 30, 2012. Subsequent to the impairment analysis and resulting impairment charge, the Company determined the adjusted carrying value of its assets and liabilities classified as held for sale approximated the fair value less costs to sell. The following assets were impaired to a value of zero: goodwill of \$5.9 million; license of \$2.4 million; customer relationships of \$1.3 million and trademark of \$0.7 million. As the impairment charge is related to ICS, it is classified within discontinued operations in the condensed consolidated statement of operations.

In conjunction with the sale of the Australian segment in the second quarter of 2012, the Company also assigned the trademarks owned by the Australian segment to M2 Telecommunications Group Ltd. Pursuant to the trademark assignment deed, entered into as part of the transaction, the assignee is restricted from using the specified trademarks in any jurisdiction outside of Australia and New Zealand where the Company continues to hold existing rights. The value of the assigned trademarks was \$39.2 million, less a deferred tax liability of \$15.2 million.

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

|             | September 30,<br>2012 | December 31,<br>2011 |
|-------------|-----------------------|----------------------|
| Goodwill    | \$ 65,081             | \$ 71,902            |
| Trade Names | \$ 37,000             | \$ 76,900            |

The changes in the carrying amount of goodwill and trade names by reporting unit for the nine months ended September 30, 2012 are as follows (in thousands):

**Goodwill**

|   | United States | Canada    | Australia | Total     |
|---|---------------|-----------|-----------|-----------|
| Balance as of December 31, 2011                     | \$ 37,146     | \$ 32,819 | \$ 1,937  | \$ 71,902 |
| Effect of change in foreign currency exchange rates |               | 1,346     | (4)       | 1,342     |
| Acquisition (disposition) of business               | (1,280)       | 956       | (1,933)   | (2,257)   |
| Accumulated impairment loss                         | (5,906)       |           |           | (5,906)   |
| Balance as of September 30, 2012                    | \$ 29,960     | \$ 35,121 | \$        | \$ 65,081 |

**Trade Names**

|   | United States | Canada | Australia | Total     |
|---|---------------|--------|-----------|-----------|
| Balance as of December 31, 2011                     | \$ 76,900     | \$     | \$        | \$ 76,900 |
| Effect of change in foreign currency exchange rates |               |        |           |           |

Edgar Filing: PRIMUS TELECOMMUNICATIONS GROUP INC - Form 10-Q

|                                       |           |    |    |           |
|---------------------------------------|-----------|----|----|-----------|
| Acquisition (disposition) of business | (39,200)  |    |    | (39,200)  |
| Accumulated impairment loss           | (700)     |    |    | (700)     |
| Balance as of September 30, 2012      | \$ 37,000 | \$ | \$ | \$ 37,000 |

**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):

|                        | September 30, 2012    |                          |                | December 31, 2011     |                          |                |
|------------------------|-----------------------|--------------------------|----------------|-----------------------|--------------------------|----------------|
|                        | Gross Carrying Amount | Accumulated Amortization | Net Book Value | Gross Carrying Amount | Accumulated Amortization | Net Book Value |
| Trade Names            | \$ 3,500              | \$ (1,052)               | \$ 2,448       | \$ 3,500              | \$ (790)                 | \$ 2,710       |
| Licenses               |                       |                          |                | 2,800                 | (233)                    | 2,567          |
| Customer relationships | 94,706                | (58,367)                 | 36,339         | 106,199               | (52,699)                 | 53,500         |
| Total                  | \$ 98,206             | \$ (59,419)              | \$ 38,787      | \$ 112,499            | \$ (53,722)              | \$ 58,777      |

Amortization expense for trade names, licenses, and customer relationships for the three and nine months ended September 30, 2012 was \$2.9 million and \$8.5 million, respectively, compared to \$4.2 million and \$12.5 million, respectively, for the three and nine months ended September 30, 2011.

The Company expects amortization expense for trade names, licenses, and customer relationships for the remainder of 2012, the years ending December 31, 2013, 2014, 2015, 2016, and thereafter to be approximately \$2.9 million, \$8.3 million, \$6.1 million, \$4.6 million, \$3.6 million and \$13.3 million, respectively.

**5. LONG-TERM OBLIGATIONS**

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

|   | September 30, 2012 | December 31, 2011 |
|---|--------------------|-------------------|
| Obligations under capital leases and other      | \$ 135             | \$ 11,696         |
| 13% Senior Secured Notes due 2016               | 2,403              | 2,403             |
| 10% Senior Secured Notes due 2017               | 116,196            | 235,231           |
| Subtotal  | \$ 118,734         | \$ 249,330        |
| Original issue discount on Senior Secured Notes | (702)              | (1,568)           |
| Subtotal  | \$ 118,032         | \$ 247,762        |
| Less: Current portion of long-term obligations  | (150)              | (1,948)           |
| Total long-term obligations                     | \$ 117,882         | \$ 245,814        |

The following table reflects the contractual payments of principal and interest for the Company's long-term obligations as of September 30, 2012:

Edgar Filing: PRIMUS TELECOMMUNICATIONS GROUP INC - Form 10-Q

| <b>Year Ending December 31,</b>                        | <b>Capital Leases<br/>and Other</b> | <b>10% Senior<br/>Secured Notes<br/>due 2017</b> | <b>13% Senior<br/>Secured Notes<br/>due 2016</b> | <b>Total</b>      |
|--|-------------------------------------|--|--|-------------------|
| 2012 (as of September 30, 2012)                        | \$ 36                               | \$ 5,810   | \$ 156   | \$ 6,002          |
| 2013   | 74                                  | 11,620   | 312  | 12,006            |
| 2014   | 31                                  | 11,620   | 312  | 11,963            |
| 2015   | 6                                   | 11,620   | 312  | 11,938            |
| 2016   |                                     | 11,620   | 2,716  | 14,336            |
| Thereafter   |                                     | 119,585  |  | 119,585           |
| <b>Total minimum principal &amp; interest payments</b> | <b>147</b>                          | <b>171,875</b>                                   | <b>3,808</b>                                     | <b>175,830</b>    |
| <b>Less: Amount representing interest</b>              | <b>(12)</b>                         | <b>(55,679)</b>                                  | <b>(1,405)</b>                                   | <b>(57,096)</b>   |
| <b>Total long-term obligations</b>                     | <b>\$ 135</b>                       | <b>\$ 116,196</b>                                | <b>\$ 2,403</b>                                  | <b>\$ 118,734</b> |

**Table of Contents**

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED**

**(UNAUDITED)**

**10% Senior Secured Notes due 2017**

*Repurchases of 10% Senior Secured Notes due 2017*

On September 17, 2012, Primus Telecommunications Holding, Inc. ( PTHI ), a subsidiary of PTGi, consummated the repurchase of \$119.0 million aggregate principal amount of PTHI 's 10% Senior Secured Notes due 2017 (the 10% Notes ) for a purchase price equal to 109% of the principal amount thereof, plus accrued but unpaid interest to the date of repurchase, pursuant to agreements with certain selling holders of 10% Notes. The sellers of the 10% Notes, representing a majority in principal amount of the outstanding 10% Notes, consented to amendments of the indenture governing the 10% Notes (the 10% Notes Indenture ) to remove substantially all of the restrictive and reporting covenants under the 10% Notes Indenture, as well as certain events of default and related provisions. PTHI, each of the guarantors of the 10% Notes, including PTGi, and U.S. Bank National Association, as Trustee, entered into a Supplemental Indenture, dated as of September 17, 2012 (the Supplemental Indenture ), to memorialize the 10% Notes Indenture amendments. Also on September 17, 2012, a complaint and motion for temporary restraining order were filed in the Court of Chancery of the State of Delaware (the Court ), which complaint and motion were subsequently amended on September 19, 2012. The amended complaint alleges that the Supplemental Indenture was entered into in breach of certain covenants in the 10% Notes Indenture and seeks among other things to enjoin the Supplemental Indenture from becoming effective and to enjoin PTHI from acting in reliance upon it. On September 28, 2012, PTHI entered into a stipulation pursuant to which PTHI has agreed not to take any actions under the Supplemental Indenture that would not have otherwise been permitted by the 10% Notes Indenture (absent amendment by the Supplemental Indenture) until the matter is finally resolved on the merits or otherwise by the Court. See Note 6 Commitments and Contingencies Litigation and Item 1 of Part II of this Quarterly Report on Form 10-Q Legal Proceedings.

In connection with the September 2012 repurchase, the Company incurred \$10.9 million of premiums and other costs, wrote off \$9.5 million of deferred financing costs and \$0.7 million of original issue discount; all of which are included in gain (loss) on early extinguishment or restructuring of debt on the condensed consolidated statement of operations in the third quarter of 2012.

In addition to the September 2012 repurchase, the Company previously repurchased \$5.0 million in aggregate principal amount of the 10% Notes at 99% of face value in December 2011.

*Asset Sale Tender Offer for 10% Senior Secured Notes due 2017*

On June 20, 2012, PTHI commenced an offer to purchase (the Offer to Purchase ) up to \$183,300,000 aggregate principal amount of the 10% Notes at a purchase price in cash equal to 100% of the principal amount of 10% Notes validly tendered (and not validly withdrawn) and accepted in the Offer to Purchase, plus accrued and unpaid interest thereon to the settlement date for the Offer to Purchase. The Offer to Purchase expired on July 19, 2012. No Notes were tendered pursuant to the Offer to Purchase.

The Offer to Purchase was required by the 10% Notes Indenture as a result of the sale of the Company 's Australia segment and the receipt of proceeds therefrom. The 10% Notes Indenture required PTHI to make the Offer to Purchase using the Excess Proceeds (as defined in the 10% Notes Indenture) from this transaction, which constituted an Asset Sale under the 10% Notes Indenture. The Company determined that the Excess Proceeds from this transaction equaled \$183.3 million.

**Table of Contents****PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED****(UNAUDITED)***Outstanding 10% Senior Secured Notes due 2017*

As of September 30, 2012, there was \$116.2 million aggregate principal amount of the 10% Notes outstanding. The 10% 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 10% Notes will mature on April 15, 2017.

**Exchange Offers**

On July 7, 2011, in connection with the consummation of the private (i) exchange offers (the Exchange Offers ) for any and all outstanding Units representing the 13% Senior Secured Notes due 2016 (the 13% Notes ) issued by PTHI and Primus Telecommunications Canada Inc. ( Primus Canada ), and the 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 ), (ii) consent solicitation (the Consent Solicitation ) to amend the indenture governing the 13% Notes and release the collateral securing the 13% Notes, and (iii) related transactions, PTHI issued \$240.2 million aggregate principal amount of the 10% Notes. An aggregate of \$228.6 million principal amount of 10% Notes was issued pursuant to the Exchange Offers, and PTHI issued an additional \$11.6 million aggregate principal amount of 10% Notes for cash, the proceeds of which were used to redeem all 14<sup>1</sup>/<sub>4</sub>% Notes that were not exchanged pursuant to the Exchange Offers and thereby discharge all of the Company's obligations with respect to the 14<sup>1</sup>/<sub>4</sub>% Notes. In connection with the Exchange Offers, the Company also incurred \$6.9 million of third party costs which are included in gain (loss) on early extinguishment or restructuring of debt on the condensed consolidated statement of operations in the third quarter of 2011.

**13% Senior Secured Notes due 2016**

As of September 30, 2012, there was \$2.4 million aggregate principal amount of the 13% Notes outstanding. The 13% Notes bear interest at a rate of 13.00% per annum, payable semi-annually in arrears in cash on June 15 and December 15 of each year. The 13% Notes will mature on December 16, 2016.

**6. COMMITMENTS AND CONTINGENCIES**

Future minimum lease payments under capital leases and other purchase obligations and non-cancellable operating leases as of September 30, 2012 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> |
|--|-------------------------------------|---------------------------------|-----------------------------|
| 2012 (as of September 30, 2012)                        | \$ 36                               | \$ 1,406                        | \$ 3,457                    |
| 2013   | 74                                  | 4,301                           | 12,266                      |
| 2014   | 31                                  | 3,639                           | 9,145                       |
| 2015   | 6                                   | 41                              | 7,287                       |
| 2016   |                                     |                                 | 5,949                       |
| Thereafter   |                                     |                                 | 19,429                      |
| <b>Total minimum principal &amp; interest payments</b> | <b>147</b>                          | <b>9,387</b>                    | <b>57,533</b>               |
| <b>Less: Amount representing interest</b>              | <b>(12)</b>                         |                                 |                             |
| <b>Total long-term obligations</b>                     | <b>\$ 135</b>                       | <b>\$ 9,387</b>                 | <b>\$ 57,533</b>            |

## Edgar Filing: PRIMUS TELECOMMUNICATIONS GROUP INC - Form 10-Q

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

**Table of Contents**

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED**

**(UNAUDITED)**

be used within the contract term or at rates below or above market value. The Company made payments under purchase commitments of \$7.2 million and \$24.0 million for the nine months ended September 30, 2012 and 2011, respectively.

The Company's rent expense under operating leases was \$0.8 million and \$2.3 million for the three and nine months ended September 30, 2012, respectively, compared to \$1.1 million and \$3.6 million for the three and nine months ended September 30, 2011, respectively.

***Litigation***

***General***

The Company is 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 that the resolution of any such matter will not have a material adverse effect upon the Company's business, condensed 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, condensed consolidated financial position, results of operations or cash flow.

***10% Senior Notes Indenture Litigation***

In addition to the matters described above in Note 6 – Commitments and Contingencies – Litigation – General, on September 17, 2012, a complaint and motion for temporary restraining order were filed in the Court under the caption Whitebox Advisors, LLC and River Ridge Master Fund Ltd. v. Primus Telecommunications Holding, Inc., Civil Action No. 7871-VCG, which complaint and motion were subsequently amended on September 19, 2012. The amended complaint alleges that the Supplemental Indenture was entered into in breach of certain covenants in the 10% Notes Indenture. The amended complaint seeks among other things to enjoin the Supplemental Indenture from becoming effective and to enjoin PTHI from acting in reliance upon it. On September 28, 2012, PTHI entered into a stipulation pursuant to which PTHI has agreed not to take any actions under the Supplemental Indenture that would not have otherwise been permitted by the 10% Notes Indenture (absent amendment by the Supplemental Indenture) until the matter is finally resolved on the merits or otherwise by the Court. A hearing on the relevant motions has been scheduled with the Court for Friday, January 4, 2013. See Item 1 of Part II of this Quarterly Report on Form 10-Q – Legal Proceedings.

**7. SHARE-BASED COMPENSATION**

The Compensation Committee (the Committee) of the Board of Directors of PTGi administers PTGi's Management Compensation Plan, as amended (the Management Compensation Plan). The Committee has broad authority to administer, construe and interpret the Management Compensation Plan; however, except in connection with certain Corporate Transactions (as defined in the Management Compensation Plan), it may not take any action with respect to an award that would be treated, for accounting purposes, as a repricing of an award unless the action is approved by the shareholders of PTGi.

The Management Compensation Plan provides for the grant of incentive stock options, nonqualified stock options, restricted stock, restricted stock units, and other stock-based or cash-based performance awards (collectively, awards). PTGi typically issues new shares of common stock upon the exercise of stock options, as opposed to using treasury shares.

The Company follows guidance which addresses the accounting for share-based payment transactions whereby an entity receives employee services in exchange for either equity instruments of the enterprise or

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

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.

There were 217 thousand options granted during the nine months ended September 30, 2012, while 32.5 thousand options were granted during the nine months ended September 30, 2011.

Total share-based compensation expense recognized by the Company in the three months ended September 30, 2012 and 2011 was \$0.9 million and \$0.7 million, respectively, compared to \$5.0 million and \$4.1 million, respectively, for the nine months ended September 30, 2012 and 2011. Most of PTGi's stock awards vest ratably during the vesting period. The Company recognizes compensation expense for equity awards, reduced by estimated forfeitures, using the straight-line basis.

*Restricted Stock Units (RSUs)*

A summary of PTGi's restricted stock units activity during the nine months ended September 30, 2012 is as follows:

|             |                    | <b>Nine Months Ended<br/>September 30, 2012</b> |   |
|-------------|--------------------|---|---|
|             |                    | <b>Shares</b>                                   | <b>Weighted<br/>Average<br/>Grant Date<br/>Fair Value</b> |
| Unvested    | December 31, 2011  | 651,394   | \$ 13.01  |
| Granted     |                    | 62,000  | \$ 16.48  |
| Vested      |                    | (322,971)                                       | \$ 13.40  |
| Forfeitures |                    | (55,850)  | \$ 15.17  |
| Unvested    | September 30, 2012 | 334,573   | \$ 12.91  |

As of September 30, 2012, PTGi had 0.3 million unvested RSUs outstanding with respect to \$2.3 million of compensation expense that is expected to be recognized over the weighted average remaining vesting period of 1.4 years. The number of unvested RSUs expected to vest is 0.3 million.

On June 27, 2012, the Board of Directors of PTGi accelerated the vesting of 41,333 RSUs awarded to certain employees. This modification of the terms of the instruments did not result in a significant change of fair value before and after the modification date.

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

A summary of PTGi's stock option and stock appreciation rights activity during the nine months ended September 30, 2012 is as follows:

|                       |                    | <b>Nine Months Ended<br/>September 30, 2012</b> |  |
|-----------------------|--------------------|---|--|
|                       |                    | <b>Shares</b>                                   | <b>Weighted<br/>Average<br/>Exercise Price</b> |
| Outstanding           | December 31, 2011  | 129,080   | \$ 11.34                                       |
| Granted               |                    | 216,993   | \$ 12.79                                       |
| Exercised             |                    | (9,728)   | \$ 11.64                                       |
| Forfeitures           |                    | (166,070)                                       | \$ 12.64                                       |
| Outstanding           | September 30, 2012 | 170,275   | \$ 11.90                                       |
| Eligible for exercise |                    | 123,498   | \$ 11.11                                       |

The following table summarizes the intrinsic values and remaining contractual terms of PTGi'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 | September 30, 2012 | \$ 612,599                 | 8.0   |
| Options exercisable | September 30, 2012 | 530,604                    | 7.5   |

As of September 30, 2012, PTGi had approximately 47,000 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 1.4 years. The number of unvested stock options and stock appreciation rights expected to vest is approximately 42,000 shares, with a weighted average remaining life of 8.0 years, a weighted average exercise price of \$11.82, and an intrinsic value of approximately \$0.1 million.

**8. STOCKHOLDERS EQUITY**

As of September 30, 2012, there were 13,899,543 shares of common stock outstanding.

*Special Dividend*

On June 20, 2012, PTGi's Board of Directors declared a special cash dividend (the "Dividend") of \$1.00 per share with respect to PTGi's issued and outstanding common stock. The Dividend of \$13.8 million in the aggregate was paid on July 16, 2012 to holders of record of PTGi common stock as of July 2, 2012. In addition, with respect to unvested RSUs and restricted stock, the Company will pay a dividend equivalent of \$1.00 per RSU or share of restricted stock, as applicable, to holders of RSUs and restricted stock upon vesting. With respect to certain outstanding options, the Company reduced the exercise price and increased the number of shares of common stock issuable upon exercise of such options, in each case in order to prevent dilution of the rights of holders of awards as a result of the Dividend.

## Edgar Filing: PRIMUS TELECOMMUNICATIONS GROUP INC - Form 10-Q

In addition to the mandatory anti-dilution adjustments to the CVR Shares issuable with respect to the CVRs and their strike price discussed in Note 2 Summary of Significant Accounting Policies Derivative Instruments, the Company has issued and outstanding warrants for which the exercise prices and number of

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

shares of PTGi common stock issuable upon exercise were adjusted as a result of the Dividend, effective as of July 3, 2012. With respect to the Class A-1 warrants, the maximum aggregate number of shares of PTGi common stock issuable upon exercise of such warrants was adjusted upward from 1,000,000 shares to 1,063,875 shares, while the exercise price was adjusted downward from \$12.22 to \$11.49; with respect to the Class A-2 warrants, the maximum aggregate number of shares of PTGi common stock issuable upon exercise of such warrants was adjusted upward from 1,000,000 shares to 1,063,875 shares, while the exercise price was adjusted downward from \$16.53 to \$15.54; with respect to the Class A-3 warrants, the maximum aggregate number of shares of PTGi common stock issuable upon exercise of such warrants was adjusted upward from 1,000,000 shares to 1,063,875 shares, while the exercise price was adjusted downward from \$20.50 to \$19.27; and, with respect to the Class B warrants, the maximum aggregate number of shares of PTGi common stock issuable upon exercise of such warrants was adjusted upward from 1,500,000 shares to 1,595,812 shares, while the exercise price was adjusted downward from \$26.01 to \$24.45. Due to the nature of the mandatory anti-dilution provisions applicable to the CVRs and warrants, the Company has evaluated the accounting impact of the modification accounting and concluded that the modification of the terms of such instruments did not result in a significant change of fair value before and after the modification date.

On August 8, 2011, PTGi'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, the Company may repurchase common stock from time to time in the open-market, privately negotiated transactions or block trades. There is no guarantee as to the exact number of shares, if any, that the Company will repurchase. The stock repurchase program may be modified, terminated or extended at any time without prior notice. PTGi 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. During the year ended December 31, 2011, the Company repurchased 31,626 shares at a weighted average price of \$11.92 per share under the stock repurchase plan. There have been no repurchases in the nine months ending September 30, 2012.

**9. INCOME TAXES**

The Company conducts business globally, and as a result, PTGi 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:

| <b>Jurisdiction</b>   | <b>Open Tax Years</b> |
|-----------------------|-----------------------|
| United States Federal | 2002 2011             |
| Canada                | 2004 2011             |
| United Kingdom        | 2004 2011             |
| Netherlands           | 2007 2011             |

The Company is currently under examination in Canada and certain other foreign tax jurisdictions, which, individually and in the aggregate, are 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 nine months ended September 30, 2012, penalties and interest were immaterial. As of September 30, 2012, the gross unrecognized tax benefit on the balance sheet was \$76.8 million.

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

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 Schedule 13D and Schedule 13G filings concerning Company securities, as filed with the SEC. 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. The annual limitation under Section 382 of Arbinet's pre-February 28, 2011 net operating losses is approximately \$2.2 million.

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

The carrying amounts reported in the condensed 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 debt, based on quoted market prices, was \$129.1 million and \$235.4 million at September 30, 2012 and December 31, 2011, respectively. The aggregate carrying value of the Company's debt was \$117.9 million and \$236.1 million at September 30, 2012 and December 31, 2011, respectively.

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

|                                | September 30, 2012 | Fair Value as of September 30, 2012, using:                                   |   |  |
|--------------------------------|--------------------|---|---|--|
|                                |                    | Quoted prices<br>in Active<br>Markets 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) | \$ 21,112          |   | 21,112  |  |
| <b>Total</b>                   | <b>\$ 21,112</b>   |   | <b>21,112</b>   |  |

|                                | December 31, 2011 | Fair Value as of December 31, 2011, using:                                    |   |  |
|--------------------------------|-------------------|---|---|--|
|                                |                   | Quoted prices<br>in Active<br>Markets 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) | \$ 16,196         |   | 16,196  |  |
| <b>Total</b>                   | <b>\$ 16,196</b>  |   | <b>16,196</b>   |  |

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 using the following assumptions: (1) expected life of 6.75 years; (2) risk-free rate of 0.99%; (3) expected volatility of 45.26%; (4) dividend yield of 0%; (5) exercise price of \$33.79; (6) stock price of \$15.27. During the three months ended September 30, 2012 and 2011, (\$0.2) million and (\$11.4) million,

## Edgar Filing: PRIMUS TELECOMMUNICATIONS GROUP INC - Form 10-Q

respectively, of (income) expense was recognized as a result of marking the CVRs to their fair value, and during the nine months ended September 30, 2012 and 2011, \$4.9 million and (\$7.1) million, respectively, of (income) expense was recognized as a result of marking the CVRs to their fair value.

**Table of Contents**

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED**

**(UNAUDITED)**

**11. OPERATING SEGMENT AND RELATED INFORMATION**

The Company currently has two reportable geographic segments United States and Canada. The Company has three reportable operating segments based on management's organization of the enterprise Data Center, North America Telecom, and Other. As a result of the sale of its Australian segment and the classification of its ICS business unit as held for sale, the Company re-organized its remaining operating segments to better reflect its continuing operations. The Data Center ( DC ) segment contains the pure data center operations in Canada, while North America Telecom ( NAT ) combines the retail telecom businesses in the United States and Canada. 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. All inter-segment revenues are eliminated. 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 DC and NAT segments are indistinguishable from the respective geographic segments. Therefore, any reporting related to the DC and NAT segments for assets 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>September 30,<br>2012 | Three Months Ended<br>September 30,<br>2011 | Nine Months Ended<br>September 30,<br>2012 | Nine Months Ended<br>September 30,<br>2011 |
|---|---|---|--|--|
| <b>Net Revenue by Geographic Region</b>           |   |   |  |  |
| United States                                     | \$ 8,788                                    | \$ 11,441                                   | \$ 28,377                                  | \$ 33,737                                  |
| Canada  | 55,123                                      | 62,867                                      | 168,924                                    | 187,763                                    |
| Total   | \$ 63,911                                   | \$ 74,308                                   | \$ 197,301                                 | \$ 221,500                                 |
| <b>Net Revenue by Segment</b>                     |   |   |  |  |
| Data Center                                       | \$ 8,483                                    | \$ 7,697                                    | \$ 24,650                                  | \$ 22,728                                  |
| North America Telecom                             | 55,428                                      | 66,417                                      | 172,651                                    | 198,201                                    |
| Other   |   | 194   |  | 571  |
| Total   | \$ 63,911                                   | \$ 74,308                                   | \$ 197,301                                 | \$ 221,500                                 |
| <b>Provision for Doubtful Accounts Receivable</b> |   |   |  |  |
| Data Center                                       | \$ 66                                       | \$ 60                                       | \$ 90                                      | \$ 260                                     |
| North America Telecom                             | 624   | 972   | 1,575                                      | 3,187                                      |
| Other   |   |   |  |  |
| Total   | \$ 690                                      | \$ 1,032                                    | \$ 1,665                                   | \$ 3,447                                   |
| <b>Income (Loss) from Operations</b>              |   |   |  |  |
| Data Center                                       | \$ 2,829                                    | \$ 3,257                                    | \$ 4,958                                   | \$ 4,889                                   |
| North America Telecom                             | 2,721                                       | 2,163                                       | 12,629                                     | 10,574                                     |
| Other   |   | (125)                                       |  | (331)                                      |
| Total From Operating Segments                     | 5,550                                       | 5,295                                       | 17,587                                     | 15,132                                     |
| Corporate   | (4,058)                                     | (3,720)                                     | (19,125)                                   | (14,352)                                   |
| Total   | \$ 1,492                                    | \$ 1,575                                    | \$ (1,538)                                 | \$ 780                                     |
| <b>Capital Expenditures</b>                       |   |   |  |  |
| Data Center                                       | \$ 4,016                                    | \$ 2,470                                    | \$ 11,280                                  | \$ 5,894                                   |
| North America Telecom                             | 1,791                                       | 2,040                                       | 6,485                                      | 4,122                                      |
| Other (1)   | 509   | 4,349                                       | 7,081                                      | 12,393                                     |
| Total From Operating Segments                     | 6,316                                       | 8,859                                       | 24,846                                     | 22,409                                     |
| Corporate   | 93  | 49  | 289  | 380  |
| Total   | \$ 6,409                                    | \$ 8,908                                    | \$ 25,135                                  | \$ 22,789                                  |

(1) Other includes capital expenditures related to discontinued operations

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

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

|                                   | September 30,<br>2012 | December 31,<br>2011 |
|-----------------------------------|-----------------------|----------------------|
| <b>Property and Equipment Net</b> |                       |                      |
| United States                     | \$ 3,018              | \$ 3,643             |
| Canada                            | 61,662                | 54,674               |
| Other (1)                         |                       | 93,863               |
| <b>Total</b>                      | <b>\$ 64,680</b>      | <b>\$ 152,180</b>    |

|               | September 30,<br>2012 | December 31,<br>2011 |
|---------------|-----------------------|----------------------|
| <b>Assets</b> |                       |                      |
| United States | \$ 134,666            | \$ 122,170           |
| Canada        | 182,194               | 194,531              |
| Other (1)     | 51,255                | 227,123              |
| <b>Total</b>  | <b>\$ 368,115</b>     | <b>\$ 543,824</b>    |

(1) Other includes property and equipment net and assets of discontinued operations.

The Company offers three main products Retail Voice, Data/Internet, and Retail VoIP. Net revenue information with respect to the Company's products is as follows (in thousands):

|               | Three Months Ended<br>September 30,<br>2012 | Three Months Ended<br>September 30,<br>2011 | Nine Months Ended<br>September 30,<br>2012 | Nine Months Ended<br>September 30,<br>2011 |
|---------------|---|---|--|--|
| Retail Voice  | \$ 37,724                                   | \$ 48,917                                   | \$ 120,404                                 | \$ 146,524                                 |
| Data/Internet | 18,431                                      | 17,302                                      | 53,760                                     | 51,506                                     |
| Retail VoIP   | 7,756                                       | 8,089                                       | 23,137                                     | 23,470                                     |
| <b>Total</b>  | <b>\$ 63,911</b>                            | <b>\$ 74,308</b>                            | <b>\$ 197,301</b>                          | <b>\$ 221,500</b>                          |

**12. DISCONTINUED OPERATIONS***Discontinued Operations nine months ended September 30, 2012*

On May 31, 2012, the Company completed the previously announced sale of its Australian segment to M2 Telecommunications Group Ltd., an Australian telecommunications company, for \$195.7 million. The Company recorded a \$98.6 million gain from the sale of this segment during the second quarter of 2012. In connection with the closing of the transaction, \$9.8 million was retained from the purchase price and placed into escrow until May 31, 2013 for purposes of satisfying potential indemnification claims pursuant to the purchase agreement. The purchase price is also subject to a customary post-closing working capital adjustment.

## Edgar Filing: PRIMUS TELECOMMUNICATIONS GROUP INC - Form 10-Q

On June 28, 2012, the Board of Directors of PTGi committed to dispose of the Company's ICS business unit and as a result classified ICS as a discontinued operation. The Company continues to actively solicit a sale or other disposition of its ICS business unit.

**Table of Contents****PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED****(UNAUDITED)***Discontinued Operations year ended December 31, 2011*

During the fourth quarter of 2011, the Company sold its Brazilian segment for \$4.3 million. The Company recorded a \$4.8 million loss from the sale of this segment during the fourth quarter of 2011.

As a result of these events, the Company's condensed consolidated financial statements for all periods presented reflect the Brazilian, Australian and ICS business units as discontinued operations for the three and nine months ended September 30, 2012 and 2011. Additionally, the assets and liabilities of ICS have been classified as held for sale assets and liabilities and removed from the specific line items on the condensed consolidated balance sheet as of September 30, 2012.

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

|  | <b>Three Months Ended<br/>September 30,<br/>2012</b> | <b>Three Months Ended<br/>September 30,<br/>2011</b> |
|--|--|--|
| Net revenue                                | \$ 71,049  | \$ 180,303   |
| Operating expenses                         | 73,698   | 176,885  |
| Income (loss) from operations              | (2,649)  | 3,418  |
| Interest expense                           | (2)  | (2,370)  |
| Interest income and other income (expense) | (7)  | (1,982)  |
| Foreign currency transaction gain (loss)   | 199  | (6,994)  |
| Income (loss) before income tax            | (2,459)  | (7,928)  |
| Income tax (expense) benefit               |  | 3,046  |
| Income (loss) from discontinued operations | \$ (2,459)   | \$ (4,882)   |

|  | <b>Nine Months Ended<br/>September 30,<br/>2012</b> | <b>Nine Months Ended<br/>September 30,<br/>2011</b> |
|--|---|---|
| Net revenue                                | \$ 355,019  | \$ 539,325  |
| Operating expenses                         | 363,917   | 547,412   |
| Income (loss) from operations              | (8,898)   | (8,087)   |
| Interest expense                           | (511)   | (2,496)   |
| Interest income and other income (expense) | 288   | (1,095)   |
| Foreign currency transaction gain (loss)   | (2,546)   | (3,078)   |
| Income (loss) before income tax            | (11,667)  | (14,756)  |
| Income tax (expense) benefit               | (6,342)   | 1,907   |
| Income (loss) from discontinued operations | \$ (18,009)   | \$ (12,849)   |



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

Summarized assets and liabilities of ICS classified as held for sale are as follows (in thousands):

|   |               |
|---|---------------|
| Accounts receivable                       | \$ 17,673     |
| Prepaid expenses and other current assets | 3,108         |
| Restricted cash                           | 488           |
| Property and equipment - net              | 15,385        |
| Other assets                              | 8,873         |
| <br>                                      |               |
| Assets held for sale                      | <br>\$ 45,527 |
| <br>                                      |               |
| Accounts payable                          | \$ 11,940     |
| Accrued interconnection costs             | 7,063         |
| Accrued expenses and other liabilities    | 5,609         |
| Accrued income taxes                      | 222           |
| Current portion of long-term obligations  | 34            |
| Deferred tax liability                    | 8,677         |
| Other liabilities                         | 1,999         |
| <br>                                      |               |
| Liabilities held for sale                 | <br>\$ 35,544 |

**13. 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.

Potentially dilutive common shares include the dilutive effects of common shares issuable under the Management Compensation Plan, including stock options and restricted stock units (RSUs), using the treasury stock method, as well as CVRs and stock warrants.

The Company had no dilutive common share equivalents during the three and nine months ended September 30, 2012, due to the results of operations being a loss from continuing operations, net of tax. For the three and nine months ended September 30, 2012, the following were potentially dilutive but were excluded from the calculation of diluted loss per common share due to their antidilutive effect:

0.5 million shares issuable upon exercise of stock options and RSUs under the Management Compensation Plan;

4.8 million shares issuable upon exercise of stock warrants; and

2.8 million shares issuable upon exercise of CVRs.

The Company had no dilutive common share equivalents during the three and nine months ended September 30, 2011, due to the results of operations being a loss from continuing operations, net of tax. For the three and nine months ended September 30, 2011, the following were

Edgar Filing: PRIMUS TELECOMMUNICATIONS GROUP INC - Form 10-Q

potentially dilutive but were 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 under the Management Compensation Plan;

4.5 million shares issuable upon exercise of stock warrants; and

2.7 million shares issuable upon exercise of CVRs.

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

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

|  | <b>Three Months Ended<br/>September 30,<br/>2012</b> | <b>Three Months Ended<br/>September 30,<br/>2011</b> | <b>Nine Months Ended<br/>September 30,<br/>2012</b> | <b>Nine Months Ended<br/>September 30,<br/>2011</b> |
|--|--|--|---|---|
| Income (loss) from continuing operations, net of tax                         | \$ (22,578)  | \$ (5,128)   | \$ (43,693)   | \$ (22,758)   |
| Income (loss) from discontinued operations, net of tax                       | (2,459)  | (4,882)  | (18,009)  | (12,849)  |
| Gain (loss) from sale of discontinued operations, net of tax                 |  |  | 98,666  |   |
| Net income (loss) attributable to common stockholders-basic                  | \$ (25,037)  | \$ (10,010)  | \$ 36,964   | \$ (35,607)   |
| Net income (loss) attributable to common stockholders-diluted                | \$ (25,037)  | \$ (10,010)  | \$ 36,964   | \$ (35,607)   |
| Weighted average common shares outstanding-basic                             | 13,890   | 13,715   | 13,825  | 12,759  |
| Weighted average common shares outstanding-diluted                           | 13,890   | 13,715   | 13,825  | 12,759  |
| <b>Basic income (loss) per common share:</b>                                 |  |  |   |   |
| Income (loss) from continuing operations attributable to common stockholders | \$ (1.63)  | \$ (0.37)  | \$ (3.16)   | \$ (1.78)   |
| Income (loss) from discontinued operations                                   | \$ (0.18)  | \$ (0.36)  | \$ (1.30)   | \$ (1.01)   |
| Gain (loss) from sale of discontinued operations, net of tax                 | \$   | \$   | \$ 7.14   | \$  |
| Net income (loss) attributable to common stockholders                        | \$ (1.81)  | \$ (0.73)  | \$ 2.68   | \$ (2.79)   |
| <b>Diluted income (loss) per common share:</b>                               |  |  |   |   |
| Income (loss) from continuing operations attributable to common stockholders | \$ (1.63)  | \$ (0.37)  | \$ (3.16)   | \$ (1.78)   |
| Income (loss) from discontinued operations                                   | \$ (0.18)  | \$ (0.36)  | \$ (1.30)   | \$ (1.01)   |
| Gain (loss) from sale of discontinued operations, net of tax                 | \$   | \$   | \$ 7.14   | \$  |
| Net income (loss) attributable to common stockholders                        | \$ (1.81)  | \$ (0.73)  | \$ 2.68   | \$ (2.79)   |

**Table of Contents**

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED**

**(UNAUDITED)**

**14. RELATED PARTY TRANSACTIONS**

On September 17, 2012, PTHI consummated the repurchase of \$119.0 million aggregate principal amount of the 10% Notes for a purchase price equal to 109% of the principal amount thereof, plus accrued but unpaid interest to the date of repurchase, in each case pursuant to agreements with certain selling holders of 10% Notes. Among the sellers of 10% Notes was the Singer Children's Management Trust, which is the beneficial owner of a portion of the outstanding shares of PTGi common stock. The Singer Children's Management Trust sold \$3.9 million aggregate principal amount of 10% Notes at a purchase price equal to \$4.3 million plus accrued but unpaid interest to the date of repurchase. Other entities associated with the Singer family sold \$13.3 million aggregate principal amount of 10% Notes at a purchase price equal to \$14.5 million plus accrued but unpaid interest to the date of repurchase.

## **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 consolidated financial statements and the notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2011. You should review the Risk Factors section in our Annual Report on Form 10-K for the year ended December 31, 2011 and in Part II, Item 1A of this report 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.*

*Unless the context otherwise requires, in this Quarterly Report on Form 10-Q, PTGi means Primus Telecommunications Group, Incorporated and Primus, the Company, we and our mean PTGi together with its subsidiaries.*

#### **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, colocation and data center services to customers located primarily in Canada and the United States. Our primary market is Canada, where we have deployed significant network infrastructure. We currently classify our services into three categories: Growth Services, Traditional Services and International Carrier Services (ICS). Our focus is on expanding our Growth Services, which includes our broadband, SME VoIP, 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 communications traffic to the Internet. We manage our Traditional Services, which includes our domestic and international long-distance voice, local landline services, including wireless, residential VoIP services, prepaid cards, and dial-up Internet services, for cash flow generation that we reinvest to develop and market our Growth Services, particularly in our primary market of Canada. We also provide our ICS voice termination services to other telecommunications carriers and resellers requiring IP or time-division multiplexing access. However, as discussed below under Recent Developments Pursuit of Divestiture of ICS Business Unit, the Company is currently pursuing a sale or other disposition or disposal of its ICS segment, which has been classified as a discontinued operation as a result of being held for sale.

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.

---

## **Table of Contents**

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 or 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; 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.

## **Recent Developments**

### *Repurchase of a Majority of 10% Senior Secured Notes due 2017*

On September 17, 2012, Primus Telecommunications Holding, Inc. ( PTHI ), a subsidiary of PTGi, consummated the repurchase of \$119,035,219 aggregate principal amount of PTHI's 10% Senior Secured Notes due 2017 (the 10% Notes ) for a purchase price equal to 109% of the principal amount thereof, plus accrued but unpaid interest to the date of repurchase, pursuant to agreements with certain selling holders of 10% Notes, the form of which is filed as Exhibit 10.2 to this Quarterly Report on Form 10-Q. The sellers of the 10% Notes, representing a majority in principal amount of the outstanding 10% Notes, consented to amendments of the indenture governing the 10% Notes (the 10% Notes Indenture ) to remove substantially all of the restrictive and reporting covenants under the 10% Notes Indenture, as well as certain events of default and related provisions. PTHI, each of the guarantors of the 10% Notes, including PTGi, and U.S. Bank National Association, as Trustee, entered into a Supplemental Indenture, dated as of September 17, 2012 (the Supplemental Indenture ), to memorialize the 10% Notes Indenture amendments. Also on September 17, 2012, a complaint and motion for temporary restraining order were filed in the Court of Chancery of the State of Delaware (the Court ), which complaint and motion were subsequently amended on September 19, 2012. The amended complaint alleges that the Supplemental Indenture was entered into in breach of certain covenants in the 10% Notes Indenture and seeks among other things to enjoin the Supplemental Indenture from becoming effective and to enjoin PTHI from acting in reliance upon it. On September 28, 2012, PTHI entered into a stipulation pursuant to which PTHI has agreed not to take any actions under the Supplemental Indenture that would not have otherwise been permitted by the 10% Notes Indenture (absent amendment by the Supplemental Indenture) until the matter is finally resolved on the merits or otherwise by the Court. A hearing on the relevant motions has been scheduled with the Court for Friday, January 4, 2013. See Note 6 Commitments and Contingencies Litigation and Item 1 of Part II of this Quarterly Report on Form 10-Q Legal Proceedings for further information on such litigation.

### *Pursuit of Divestiture of ICS Business Unit*

On June 28, 2012, PTGi's Board of Directors committed to dispose of the Company's ICS business unit. As a result of holding the ICS business unit out for sale, such business unit has been classified as a discontinued

## **Table of Contents**

operation. The Company continues to actively solicit a sale or other disposition of its ICS business unit. See Note 12 Discontinued Operations to the notes to our condensed consolidated financial statements included elsewhere in this report.

### *Reclassification of Data Center Costs*

In order to conform to industry best practices, certain amounts in selling, general and administrative expense related to our Data Center operating segment were reclassified to cost of revenue as part of the Company's new operating segment structure discussed in Note 11 Operating Segment and Related Information to the notes to our condensed consolidated financial statements included elsewhere in this report.

## **Foreign Currency**

Foreign currency can have a major impact on our financial results. During the nine months ended September 30, 2012, approximately 86% of our net revenue was derived from sales and operations outside the U.S. The reporting currency for our condensed consolidated financial statements is the United States dollar. 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 from 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: US Dollar ( USD )/Canadian dollar ( CAD ), USD/British pound sterling ( GBP ), 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. In addition, prior to the sale of the Company's Australia operations during the quarterly period ended June 30, 2012, we also experienced risk of loss regarding foreign currency exchange due to fluctuations in the USD/Australian dollar ( AUD ) exchange rate. 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 condensed 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 of our international subsidiaries 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 our Canadian operating segment, depending upon whether the business in our Canadian operating segment 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 against the CAD, there is a positive effect on reported profits and a negative effect on the reported losses for our Canadian operating segment.

**Table of Contents**

In the three and nine months ended September 30, 2012, as compared to the three and nine months ended September 30, 2011, the USD was stronger on average as compared to the CAD, AUD, GBP, and EUR. The following tables demonstrate the impact of currency fluctuations on our net revenue for the three and nine months ended September 30, 2012 and 2011:

Net Revenue by Location, including Discontinued Operations in USD (in thousands)

|                | For the Three Months Ended September 30, |        |          |           | For the Nine Months Ended September 30, |         |           |           |
|----------------|--|--------|----------|-----------|---|---------|-----------|-----------|
|                | 2012                                     | 2011   | Variance | Variance% | 2012                                    | 2011    | Variance  | Variance% |
| Canada         | 55,123                                   | 62,867 | (7,744)  | -12.3%    | 168,924                                 | 187,763 | (18,839)  | -10.0%    |
| Australia      |  | 71,684 | (71,684) | -100.0%   | 114,860                                 | 217,098 | (102,238) | -47.1%    |
| United Kingdom | 50,040                                   | 71,511 | (21,471) | -30.0%    | 156,651                                 | 193,629 | (36,978)  | -19.1%    |
| Europe (1),(2) | 40                                       | 98     | (58)     | -59.2%    | (193)                                   | 87      | (280)     | -321.8%   |
| Brazil (2)     |  | 7,146  | (7,146)  | -100.0%   |   | 21,215  | (21,215)  | -100.0%   |

Net Revenue by Location, including Discontinued Operations in Local Currencies (in thousands)

|                         | For the Three Months Ended September 30, |        |          |           | For the Nine Months Ended September 30, |         |          |           |
|-------------------------|--|--------|----------|-----------|---|---------|----------|-----------|
|                         | 2012                                     | 2011   | Variance | Variance% | 2012                                    | 2011    | Variance | Variance% |
| Canada (in CAD)         | 54,883                                   | 61,457 | (6,574)  | -10.7%    | 169,311                                 | 183,430 | (14,119) | -7.7%     |
| Australia (in AUD)      |  | 68,159 | (68,159) | -100.0%   | 110,408                                 | 208,875 | (98,467) | -47.1%    |
| United Kingdom (in GBP) | 31,681                                   | 44,382 | (12,701) | -28.6%    | 99,368                                  | 119,611 | (20,243) | -16.9%    |
| Europe (1),(2) (in EUR) | 32                                       | 71     | (39)     | -54.9%    | (110)                                   | 64      | (174)    | -271.9%   |
| Brazil (2) (in BRL)     |  | 11,602 | (11,602) | -100.0%   |   | 34,510  | (34,510) | -100.0%   |

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

(2) Table 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, 2011 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, 2011.

**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 ( SEC ) disclosure rules, the Company's results of operations for the three and nine months ended September 30, 2012 as compared to the three and nine months ended September 30, 2011.

We also present detailed changes in results, excluding currency impacts, since a large portion of our revenues is 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 USD to applicable local currency exchange rates that were used for purposes of calculating corresponding preceding period US GAAP presentations.



**Table of Contents**

**Discontinued Operations**

During 2011, the Company sold its Brazilian segment. In the second quarter of 2012, the Company sold its Australian segment and committed to dispose of and is actively soliciting a sale or other disposition of its ICS business unit.

The Company has applied retrospective adjustments for the three and nine months ended September 30, 2011 to reflect the effects of the discontinued operations that occurred during 2012. Accordingly, revenue, costs, and expenses of the discontinued operations have been excluded from the respective captions in the condensed consolidated statements of operations. Additionally the assets and liabilities of ICS have been classified as held for sale assets and liabilities and removed from the specific line items on the condensed consolidated balance sheet as of September 30, 2012. See Note 12 Discontinued Operations, for further information regarding these transactions.

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

|  | <b>Three Months Ended<br/>September 30,<br/>2012</b> | <b>Three Months Ended<br/>September 30,<br/>2011</b> |
|--|--|--|
| Net revenue                                | \$ 71,049  | \$ 180,303   |
| Operating expenses                         | 73,698   | 176,885  |
| Income (loss) from operations              | (2,649)  | 3,418  |
| Interest expense                           | (2)  | (2,370)  |
| Interest income and other income (expense) | (7)  | (1,982)  |
| Foreign currency transaction gain (loss)   | 199  | (6,994)  |
| Income (loss) before income tax            | (2,459)  | (7,928)  |
| Income tax (expense) benefit               |  | 3,046  |
| Income (loss) from discontinued operations | \$ (2,459)   | \$ (4,882)   |

|  | <b>Nine Months Ended<br/>September 30,<br/>2012</b> | <b>Nine Months Ended<br/>September 30,<br/>2011</b> |
|--|---|---|
| Net revenue                                | \$ 355,019  | \$ 539,325  |
| Operating expenses                         | 363,917   | 547,412   |
| Income (loss) from operations              | (8,898)   | (8,087)   |
| Interest expense                           | (511)   | (2,496)   |
| Interest income and other income (expense) | 288   | (1,095)   |
| Foreign currency transaction gain (loss)   | (2,546)   | (3,078)   |
| Income (loss) before income tax            | (11,667)  | (14,756)  |
| Income tax (expense) benefit               | (6,342)   | 1,907   |
| Income (loss) from discontinued operations | \$ (18,009)   | \$ (12,849)   |

**Table of Contents****Results of Operations****Results of operations for the three months ended September 30, 2012 as compared to the three months ended September 30, 2011**

**Net revenue:** Net revenue, exclusive of the currency effect, decreased \$9.4 million, or 12.6%, to \$64.9 million for the three months ended September 30, 2012 from \$74.3 million for the three months ended September 30, 2011. Inclusive of the currency effect which accounted for a decrease of \$1.0 million, net revenue decreased \$10.4 million to \$63.9 million for the three months ended September 30, 2012 from \$74.3 million for the three months ended September 30, 2011.

| (in thousands)           | Exclusive of Currency Effect |                    |                    |                    |                      |               | Currency Effect | Inclusive of Currency Effect |                    |
|--------------------------|------------------------------|--------------------|--------------------|--------------------|----------------------|---------------|-----------------|------------------------------|--------------------|
|                          | Quarter Ended                |                    | Quarter Ended      |                    | Quarter-over-Quarter |               |                 | Quarter Ended                |                    |
|                          | September 30, 2012           | September 30, 2011 | September 30, 2012 | September 30, 2011 | Variance             | Variance %    |                 | September 30, 2012           | September 30, 2011 |
|                          | Net Revenue                  | % of Total         | Net Revenue        | % of Total         |                      |               | Net Revenue     | % of Total                   |                    |
| Data Center              | 8,620                        | 13.3%              | 7,697              | 10.4%              | 923                  | 12.0%         | (137)           | 8,483                        | 13.3%              |
| North America Telecom    | 56,303                       | 86.7%              | 66,417             | 89.4%              | (10,114)             | -15.2%        | (875)           | 55,428                       | 86.7%              |
| Other                    |                              | 0.0%               | 194                | 0.2%               | (194)                | -100.0%       |                 |                              | 0.0%               |
| <b>Total Net Revenue</b> | <b>64,923</b>                | <b>100.0%</b>      | <b>74,308</b>      | <b>100.0%</b>      | <b>(9,385)</b>       | <b>-12.6%</b> | <b>(1,012)</b>  | <b>63,911</b>                | <b>100.0%</b>      |

Data Center: Data Center net revenue, exclusive of the currency effect, increased \$0.9 million, or 12.0%, to \$8.6 million for the three months ended September 30, 2012 from \$7.7 million for the three months ended September 30, 2011. Inclusive of the currency effect which accounted for a \$0.1 million decrease, net revenue increased \$0.8 million to \$8.5 million for the three months ended September 30, 2012 from \$7.7 million for the three months ended September 30, 2011.

North America Telecom: North America Telecom net revenue, exclusive of the currency effect, decreased \$10.1 million, or 15.2%, to \$56.3 million for the three months ended September 30, 2012 from \$66.4 million for the three months ended September 30, 2011. The net revenue decrease is primarily attributable to a decrease of \$4.4 million in retail voice services, a decrease of \$1.9 million in local services, a decrease of \$1.5 million in prepaid voice services, a decrease of \$0.3 million in wireless services, a decrease of \$0.3 million in VoIP services, a decrease of \$0.1 million in data and hosting services, and a decrease of \$2.2 million in other services offset, in part, by an increase of \$0.6 million in Internet services. Inclusive of the currency effect which accounted for a \$0.9 million decrease, net revenue decreased \$11.0 million to \$55.4 million for the three months ended September 30, 2012 from \$66.4 million for the three months ended September 30, 2011.

**Cost of revenue:** Cost of revenue, exclusive of the currency effect, decreased \$4.8 million to \$32.0 million, or 49.3% of net revenue, for the three months ended September 30, 2012 from \$36.8 million, or 49.5% of net revenue, for the three months ended September 30, 2011. Inclusive of the currency effect, which accounted for a \$0.5 million decrease, cost of revenue decreased \$5.3 million to \$31.5 million for the three months ended September 30, 2012 from \$36.8 million for the three months ended September 30, 2011.

| (in thousands)               | Exclusive of Currency Effect |                    |                    |                    |                      |               | Currency Effect | Inclusive of Currency Effect |                    |
|------------------------------|------------------------------|--------------------|--------------------|--------------------|----------------------|---------------|-----------------|------------------------------|--------------------|
|                              | Quarter Ended                |                    | Quarter Ended      |                    | Quarter-over-Quarter |               |                 | Quarter Ended                |                    |
|                              | September 30, 2012           | September 30, 2011 | September 30, 2012 | September 30, 2011 | Variance             | Variance %    |                 | September 30, 2012           | September 30, 2011 |
|                              | Cost of Revenue              | % of Net Revenue   | Cost of Revenue    | % of Net Revenue   |                      |               | Cost of Revenue | % of Net Revenue             |                    |
| Data Center                  | 3,794                        | 44.0%              | 3,243              | 42.1%              | 551                  | 17.0%         | (59)            | 3,735                        | 44.0%              |
| North America Telecom        | 28,225                       | 50.1%              | 33,565             | 50.5%              | (5,340)              | -15.9%        | (449)           | 27,776                       | 50.1%              |
| Other                        |                              | 0.0%               |                    | 0.0%               |                      | 0.0%          |                 |                              | 0.0%               |
| <b>Total Cost of Revenue</b> | <b>32,019</b>                | <b>49.3%</b>       | <b>36,808</b>      | <b>49.5%</b>       | <b>(4,789)</b>       | <b>-13.0%</b> | <b>(508)</b>    | <b>31,511</b>                | <b>49.3%</b>       |



**Table of Contents**

Data Center: Data Center cost of revenue, exclusive of the currency effect, increased \$0.6 million to \$3.8 million, or 44.0% of net revenue, for the three months ended September 30, 2012 from \$3.2 million, or 42.1% of net revenue, for the three months ended September 30, 2011. The increase is primarily attributable to an increase in net revenue of \$0.9 million. Inclusive of the currency effect, which accounted for a \$0.1 million decrease, cost of revenue increased \$0.5 million to \$3.7 million for the three months ended September 30, 2012 from \$3.2 million for the three months ended September 30, 2011.

North America Telecom: North America Telecom cost of revenue, exclusive of the currency effect, decreased \$5.4 million to \$28.2 million, or 50.1% of net revenue, for the three months ended September 30, 2012 from \$33.6 million, or 50.5% of net revenue, for the three months ended September 30, 2011. The decrease is primarily attributable to a decrease in net revenue of \$10.1 million. Inclusive of the currency effect, which accounted for a \$0.4 million decrease, cost of revenue decreased \$5.8 million to \$27.8 million for the three months ended September 30, 2012 from \$33.6 million for the three months ended September 30, 2011.

**Selling, general and administrative expenses:** Selling, general and administrative expenses ( SG&A ), exclusive of the currency effect, decreased \$3.6 million to \$23.6 million, or 36.3% of net revenue, for the three months ended September 30, 2012 from \$27.2 million, or 36.7% of net revenue, for the three months ended September 30, 2011. Inclusive of the currency effect, which accounted for a \$0.3 million decrease, selling, general and administrative expenses decreased \$3.9 million to \$23.3 million for the three months ended September 30, 2012 from \$27.2 million for the three months ended September 30, 2011.

| (in thousands)        | Exclusive of Currency Effect |                    |                      |                  |                    |                    | Currency Effect | Inclusive of Currency Effect |              |
|-----------------------|------------------------------|--------------------|----------------------|------------------|--------------------|--------------------|-----------------|------------------------------|--------------|
|                       | Quarter Ended                |                    | Quarter-over-Quarter |                  | Quarter Ended      |                    |                 |                              |              |
|                       | September 30, 2012           | September 30, 2011 | Variance             | Variance %       | September 30, 2012 | September 30, 2011 |                 |                              |              |
|                       | SG&A                         | % of Net Revenue   | SG&A                 | % of Net Revenue |                    |                    | SG&A            | % of Net Revenue             |              |
| Data Center           | 1,513                        | 17.6%              | 1,341                | 17.4%            | 172                | 12.8%              | (28)            | 1,485                        | 17.5%        |
| North America Telecom | 18,001                       | 32.0%              | 21,919               | 33.0%            | (3,918)            | -17.9%             | (281)           | 17,720                       | 32.0%        |
| Other                 |                              | 0.0%               | 316                  | 162.9%           | (316)              | -100.0%            |                 |                              | 0.0%         |
| Corporate             | 4,055                        | 0.0%               | 3,666                | 0.0%             | 389                | 10.6%              |                 | 4,055                        | 0.0%         |
| <b>Total SG&amp;A</b> | <b>23,569</b>                | <b>36.3%</b>       | <b>27,242</b>        | <b>36.7%</b>     | <b>(3,673)</b>     | <b>-13.5%</b>      | <b>(309)</b>    | <b>23,260</b>                | <b>36.4%</b> |

Data Center: Data Center selling, general and administrative expense, exclusive of the currency effect, increased \$0.2 million to \$1.5 million, or 17.6% of net revenue, for the three months ended September 30, 2012 from \$1.3 million, or 17.4% of net revenue, for the three months ended September 30, 2011. The increase is primarily attributable to an increase of \$0.1 million in salaries and benefits and \$0.1 million in advertising expenses. Inclusive of the currency effect, which accounted for an insignificant decrease, SG&A increased \$0.2 million to \$1.5 million for the three months ended September 30, 2012 from \$1.3 million for the three months ended September 30, 2011.

North America Telecom: North America Telecom selling, general and administrative expense, exclusive of the currency effect, decreased \$3.9 million to \$18.0 million, or 32.0% of net revenue, for the three months ended September 30, 2012 from \$21.9 million, or 33.0% of net revenue, for the three months ended September 30, 2011. The decrease is attributable to a decrease of \$1.9 million in advertising expenses, a decrease of \$0.9 million in general and administrative expenses, a decrease of \$0.6 million in sales and marketing expenses, a decrease of \$0.3 million in occupancy expenses, and a decrease of \$0.2 million in salaries and benefits. Inclusive of the currency effect, which accounted for a \$0.3 million decrease, selling, general and administrative expenses decreased \$4.2 million to \$17.7 million for the three months ended September 30, 2012 from \$21.9 million for the three months ended September 30, 2011.

**Table of Contents**

**Corporate:** Corporate selling, general and administrative expense increased \$0.4 million to \$4.1 million for the three months ended September 30, 2012 from \$3.7 million for the three months ended September 30, 2011. The increase is attributable to an increase of \$0.5 million in general and administrative expenses, an increase of \$0.2 million in occupancy expenses, and an increase of \$0.2 million in professional fees offset, in part, by a decrease of \$0.4 million in salaries and benefits and a decrease of \$0.1 million in travel and entertainment expenses.

**Depreciation and amortization expense:** Depreciation and amortization expense decreased \$1.1 million to \$7.5 million for the three months ended September 30, 2012 from \$8.6 million for the three months ended September 30, 2011. The decrease is attributable to a decrease in the amortization of our Canadian customer list intangible asset. This intangible asset is amortized over a useful life that corresponds to the diminishing projected cash flows in the fresh start valuation model so future amortization expense will continue to decline.

**Interest expense and accretion (amortization) on debt premium/discount, net:** Interest expense and accretion (amortization) on debt premium/discount, net decreased \$1.2 million to \$6.4 million for the three months ended September 30, 2012 from \$7.6 million for the three months ended September 30, 2011. The decrease was due to exchanging our prior higher rate debt for the 10% Notes in July 2011, as well as the repurchase of a portion of the outstanding 10% Notes in September 2012. See Note 5 Long-Term Obligations to the notes to our condensed consolidated financial statements included elsewhere in this report.

**Gain (loss) from contingent value rights valuation:** The gain from the change in fair value of the contingent value rights decreased \$11.2 million to \$0.2 million for the three months ended September 30, 2012 from \$11.4 million for the three months ended September 30, 2011. 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. Upon issuance of the contingent value rights, the Company recorded a liability of \$2.6 million in other liabilities as part of fresh-start accounting, and we will adjust this liability quarterly to its then estimated fair value. The change in fair value of the liability is reflected in our condensed consolidated statements of operations as other income (expense). Estimates of fair value represent the Company's best estimates based on a Black-Scholes pricing model.

**Interest and other income (expense):** Interest and other income decreased \$2.2 million to \$26 thousand of expense for the three months ended September 30, 2012 from \$2.2 million of income for the three months ended September 30, 2011.

**Foreign currency transaction gain (loss):** Foreign currency transaction loss decreased \$8.2 million to a gain of \$2.8 million for the three months ended September 30, 2012 from a loss of \$5.4 million for the three months ended September 30, 2011. The gains and losses 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. We incurred a foreign currency transaction gain on the intercompany payable balances that our Canadian subsidiaries have with our US subsidiaries due to an increase in the exchange rate from July to September 2012, compared to the prior year when we incurred a loss due to a decrease in the exchange rate from July 2011 to September 2011.

**Income tax benefit (expense):** Income tax benefit (expense) was immaterial for the three months ended September 30, 2012 and 2011.

**Table of Contents**

**Results of operations for the nine months ended September 30, 2012 as compared to the nine months ended September 30, 2011**

**Net revenue:** Net revenue, exclusive of the currency effect, decreased \$19.8 million, or 9.0%, to \$201.7 million for the nine months ended September 30, 2012 from \$221.5 million for the nine months ended September 30, 2011. Inclusive of the currency effect which accounted for a decrease of \$4.4 million, net revenue decreased \$24.2 million to \$197.3 million for the nine months ended September 30, 2012 from \$221.5 million for the nine months ended September 30, 2011.

| (in thousands)           | Exclusive of Currency Effect |                    |                    |                    | Year-over-Year  |              | Currency Effect | Inclusive of Currency Effect |                    |
|--------------------------|------------------------------|--------------------|--------------------|--------------------|-----------------|--------------|-----------------|------------------------------|--------------------|
|                          | Nine Months Ended            |                    | September 30, 2011 |                    | Variance        | Variance %   |                 | Nine Months Ended            |                    |
|                          | September 30, 2012           | September 30, 2012 | September 30, 2011 | September 30, 2011 |                 |              |                 | September 30, 2012           | September 30, 2012 |
|                          | Net Revenue                  | % of Total         | Net Revenue        | % of Total         |                 |              |                 | Net Revenue                  | % of Total         |
| Data Center              | 25,262                       | 12.5%              | 22,728             | 10.3%              | 2,534           | 11.1%        | (612)           | 24,650                       | 12.5%              |
| North America Telecom    | 176,390                      | 87.5%              | 198,201            | 89.5%              | (21,811)        | -11.0%       | (3,739)         | 172,651                      | 87.5%              |
| Other                    |                              | 0.0%               | 571                | 0.2%               | (571)           | -100.0%      |                 |                              | 0.0%               |
| <b>Total Net Revenue</b> | <b>201,652</b>               | <b>100.0%</b>      | <b>221,500</b>     | <b>100.0%</b>      | <b>(19,848)</b> | <b>-9.0%</b> | <b>(4,351)</b>  | <b>197,301</b>               | <b>100.0%</b>      |

Data Center: Data Center net revenue, exclusive of the currency effect, increased \$2.5 million, or 11.1%, to \$25.2 million for the nine months ended September 30, 2012 from \$22.7 million for the nine months ended September 30, 2011. Inclusive of the currency effect which accounted for a \$0.6 million decrease, net revenue increased \$1.9 million to \$24.6 million for the nine months ended September 30, 2012 from \$22.7 million for the nine months ended September 30, 2011.

North America Telecom: North America Telecom net revenue, exclusive of the currency effect, decreased \$21.8 million, or 11.0%, to \$176.4 million for the nine months ended September 30, 2012 from \$198.2 million for the nine months ended September 30, 2011. The net revenue decrease is primarily attributable to a decrease of \$10.2 million in retail voice services, a decrease of \$5.1 million in local services, a decrease of \$4.0 million in prepaid services, a decrease of \$2.9 million in other services, a decrease of \$0.7 million in wireless services, and a decrease of \$0.4 million in data and hosting services offset, in part, by an increase of \$1.5 million in Internet services. Inclusive of the currency effect which accounted for a \$3.7 million decrease, net revenue decreased \$25.5 million to \$172.7 million for the nine months ended September 30, 2012 from \$198.2 million for the nine months ended September 30, 2011.

**Cost of revenue:** Cost of revenue, exclusive of the currency effect, decreased \$10.2 million to \$99.5 million, or 49.3% of net revenue, for the nine months ended September 30, 2012 from \$109.7 million, or 49.5% of net revenue, for the nine months ended September 30, 2011. Inclusive of the currency effect, which accounted for a \$2.2 million decrease, cost of revenue decreased \$12.4 million to \$97.3 million for the nine months ended September 30, 2012 from \$109.7 million for the nine months ended September 30, 2011.

| (in thousands)               | Exclusive of Currency Effect |                    |                    |                    | Year-over-Year  |              | Currency Effect | Inclusive of Currency Effect |                    |
|------------------------------|------------------------------|--------------------|--------------------|--------------------|-----------------|--------------|-----------------|------------------------------|--------------------|
|                              | Nine Months Ended            |                    | September 30, 2011 |                    | Variance        | Variance %   |                 | Nine Months Ended            |                    |
|                              | September 30, 2012           | September 30, 2012 | September 30, 2011 | September 30, 2011 |                 |              |                 | September 30, 2012           | September 30, 2012 |
|                              | Cost of Revenue              | % of Net Revenue   | Cost of Revenue    | % of Net Revenue   |                 |              |                 | Cost of Revenue              | % of Net Revenue   |
| Data Center                  | 10,869                       | 43.0%              | 9,313              | 41.0%              | 1,556           | 16.7%        | (265)           | 10,604                       | 43.0%              |
| North America Telecom        | 88,598                       | 50.2%              | 100,358            | 50.6%              | (11,760)        | -11.7%       | (1,896)         | 86,702                       | 50.2%              |
| Other                        |                              | 0.0%               |                    | 0.0%               |                 | 0.0%         |                 |                              | 0.0%               |
| <b>Total Cost of Revenue</b> | <b>99,467</b>                | <b>49.3%</b>       | <b>109,671</b>     | <b>49.5%</b>       | <b>(10,204)</b> | <b>-9.3%</b> | <b>(2,161)</b>  | <b>97,306</b>                | <b>49.3%</b>       |

**Table of Contents**

Data Center: Data Center cost of revenue, exclusive of the currency effect, increased \$1.6 million to \$10.9 million, or 43.0% of net revenue, for the nine months ended September 30, 2012 from \$9.3 million, or 41.0% of net revenue, for the nine months ended September 30, 2011. The increase is primarily attributable to an increase in net revenue of \$2.5 million. Inclusive of the currency effect, which accounted for a \$0.3 million decrease, cost of revenue increased \$1.3 million to \$10.6 million for the nine months ended September 30, 2012 from \$9.3 million for the nine months ended September 30, 2011.

North America Telecom: North America Telecom cost of revenue, exclusive of the currency effect, decreased \$11.8 million to \$88.6 million, or 50.2% of net revenue, for the nine months ended September 30, 2012 from \$100.4 million, or 50.6% of net revenue, for the nine months ended September 30, 2011. The decrease is primarily attributable to a decrease in net revenue of \$21.8 million. Inclusive of the currency effect, which accounted for a \$1.9 million decrease, cost of revenue decreased \$13.7 million to \$86.7 million for the nine months ended September 30, 2012 from \$100.4 million for the nine months ended September 30, 2011.

**Selling, general and administrative expenses:** Selling, general and administrative expenses ( SG&A ), exclusive of the currency effect, decreased \$4.1 million to \$80.0 million, or 39.7% of net revenue, for the nine months ended September 30, 2012 from \$84.1 million, or 38.0% of net revenue, for the nine months ended September 30, 2011. Inclusive of the currency effect, which accounted for a \$1.6 million decrease, selling, general and administrative expenses decreased \$5.7 million to \$78.4 million for the nine months ended September 30, 2012 from \$84.1 million for the nine months ended September 30, 2011.

| (in thousands)        | Exclusive of Currency Effect |                  |                    |                  | Year-over-Year |              | Currency Effect | Inclusive of Currency Effect |                  |
|-----------------------|------------------------------|------------------|--------------------|------------------|----------------|--------------|-----------------|------------------------------|------------------|
|                       | September 30, 2012           |                  | September 30, 2011 |                  | Variance       | Variance %   | Effect          | September 30, 2012           |                  |
|                       | SG&A                         | % of Net Revenue | SG&A               | % of Net Revenue |                |              |                 | SG&A                         | % of Net Revenue |
| Data Center           | 4,280                        | 16.9%            | 4,140              | 18.2%            | 140            | 3.4%         | (109)           | 4,171                        | 16.9%            |
| North America Telecom | 56,605                       | 32.1%            | 64,766             | 32.7%            | (8,161)        | -12.6%       | (1,440)         | 55,165                       | 32.0%            |
| Other                 |                              | 0.0%             | 889                | 155.7%           | (889)          | -100.0%      |                 |                              | 0.0%             |
| Corporate             | 19,079                       | 0.0%             | 14,299             | 0.0%             | 4,780          | 33.4%        |                 | 19,079                       | 0.0%             |
| <b>Total SG&amp;A</b> | <b>79,964</b>                | <b>39.7%</b>     | <b>84,094</b>      | <b>38.0%</b>     | <b>(4,130)</b> | <b>-4.9%</b> | <b>(1,549)</b>  | <b>78,415</b>                | <b>39.7%</b>     |

Data Center: Data Center selling, general and administrative expense, exclusive of the currency effect, increased \$0.2 million to \$4.3 million, or 16.9% of net revenue, for the nine months ended September 30, 2012 from \$4.1 million, or 18.2% of net revenue, for the nine months ended September 30, 2011. The increase is primarily attributable to an increase of \$0.1 million in salaries and benefits and \$0.1 million in general and administrative expenses. Inclusive of the currency effect, which accounted for a \$0.1 million decrease, selling, general and administrative expenses increased \$0.1 million to \$4.2 million for the nine months ended September 30, 2012 from \$4.1 million for the nine months ended September 30, 2011.

North America Telecom: North America Telecom selling, general and administrative expense, exclusive of the currency effect, decreased \$8.2 million to \$56.6 million, or 32.1% of net revenue, for the nine months ended September 30, 2012 from \$64.8 million, or 32.7% of net revenue, for the nine months ended September 30, 2011. The decrease is attributable to a decrease of \$3.8 million in advertising expenses, a decrease of \$1.7 million in general and administrative expenses, a decrease of \$1.4 million in sales and marketing expenses, a decrease of \$0.7 million in salaries and benefits, and a decrease of \$0.6 million in occupancy expenses. Inclusive of the currency effect, which accounted for a \$1.4 million decrease, selling, general and administrative expenses decreased \$9.6 million to \$55.2 million for the nine months ended September 30, 2012 from \$64.8 million for the nine months ended September 30, 2011.

## **Table of Contents**

**Corporate:** Corporate selling, general and administrative expense increased \$4.8 million to \$19.1 million for the nine months ended September 30, 2012 from \$14.3 million for the nine months ended September 30, 2011. The increase is attributable to an increase of \$2.5 million in salaries and benefits, an increase of \$1.5 million in general and administrative expenses and an increase of \$1.0 million in professional fees offset, in part, by a decrease of \$0.1 million in travel and entertainment expenses and a decrease of \$0.1 million in occupancy expenses.

**Depreciation and amortization expense:** Depreciation and amortization expense decreased \$4.0 million to \$22.9 million for the nine months ended September 30, 2012 from \$26.9 million for the nine months ended September 30, 2011. The decrease is attributable to a decrease in the amortization of our Canadian customer list intangible asset. This intangible asset is amortized over a useful life that corresponds to the diminishing projected cash flows in the fresh start valuation model so future amortization expense will continue to decline.

**Interest expense and accretion (amortization) on debt premium/discount, net:** Interest expense and accretion (amortization) on debt premium/discount, net decreased \$3.9 million to \$20.3 million for the nine months ended September 30, 2012 from \$24.2 million for the nine months ended September 30, 2011. The decrease was due to exchanging our prior higher rate debt for the 10% Notes in July 2011, as well as the repurchase of a portion of the outstanding 10% Notes in September 2012. See Note 5 Long-Term Obligations to the notes to our condensed consolidated financial statements included elsewhere in this report.

**Gain (loss) from contingent value rights valuation:** The gain from the change in fair value of the contingent value rights decreased \$12.0 million to a loss of \$4.9 million for the nine months ended September 30, 2012 from a gain of \$7.1 million for the nine months ended September 30, 2011. 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. Upon issuance of the contingent value rights, the Company recorded a liability of \$2.6 million in other liabilities as part of fresh-start accounting, and we will adjust this liability quarterly to its then estimated fair value. The change in fair value of the liability is reflected in our condensed consolidated statements of operations as other income (expense). Estimates of fair value represent the Company's best estimates based on a Black-Scholes pricing model.

**Interest and other income (expense):** Interest and other income decreased \$1.7 million to \$0.1 million for the nine months ended September 30, 2012 from \$1.8 million for the nine months ended September 30, 2011.

**Foreign currency transaction gain (loss):** Foreign currency transaction loss decreased \$6.0 million to a gain of \$3.2 million for the nine months ended September 30, 2012 from a loss of \$2.8 million for the nine months ended September 30, 2011. The gains and losses 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. We incurred a foreign currency transaction gain on the intercompany payable balances that our Canadian subsidiaries have with our US subsidiaries due to an increase in the exchange rate in the third quarter of 2012, compared to the prior year when we incurred a loss due to a decrease in the exchange rate in the second quarter of 2011.

**Income tax benefit (expense):** Income tax benefit increased \$0.1 million to \$0.7 million for the nine months ended September 30, 2012 compared to \$0.6 million for the nine months ended September 30, 2011. The benefit includes a benefit from the release of certain ASC 740 liabilities as a result of the expiration of the statute of limitations, partially offset by expenses consisting of a provision for foreign income taxes and foreign withholding tax on intercompany interest.

---

**Table of Contents**

**Liquidity and Capital Resources**

***Important Long-Term Liquidity and Capital Structure Developments:***

*Repurchase of a Majority of 10% Senior Secured Notes due 2017*

On September 17, 2012, PTHI consummated the repurchase of \$119,035,219 aggregate principal amount of PTHI's 10% Notes for a purchase price equal to 109% of the principal amount thereof, plus accrued but unpaid interest to the date of repurchase, in each case pursuant to agreements with certain selling holders of 10% Notes. The sellers of the 10% Notes, representing a majority in principal amount of the outstanding 10% Notes, consented to amendments of the 10% Notes Indenture to remove substantially all of the restrictive and reporting covenants under the 10% Notes Indenture, as well as certain events of default and related provisions. PTHI, each of the guarantors of the 10% Notes, including PTGi, and U.S. Bank National Association, as Trustee, entered into the Supplemental Indenture to memorialize the 10% Notes Indenture amendments. The repurchase of the 10% Notes and the Supplemental Indenture are the subject of ongoing litigation commenced by certain holders of 10% Notes. In connection with such litigation, on September 28, 2012, PTHI entered into a stipulation pursuant to which PTHI has agreed not to take any actions under the Supplemental Indenture that would not have otherwise been permitted by the 10% Notes Indenture (absent amendment by the Supplemental Indenture) until the matter is finally resolved on the merits or otherwise by the Court. See Note 6 Commitments and Contingencies Litigation and Item 1 of Part II of this Quarterly Report on Form 10-Q Legal Proceedings for further information on such litigation.

*Divestiture of Primus Australia and Subsequent Asset Sale Tender Offer*

On May 31, 2012, the Company completed the sale of 100% of the outstanding equity of Primus Telecom Holdings Pty Ltd. ( Primus Australia ), an indirect wholly owned subsidiary of PTGi, to M2 Telecommunications Group Ltd., an Australian telecommunications company, pursuant to the Equity Purchase Agreement, dated April 15, 2012 (the Purchase Agreement ). The purchase price before adjustment was approximately \$AUD 192.4 million (or approximately \$USD 195.7 million giving effect to a currency hedge that the Company put in place in connection with the transaction). In connection with the closing of the transaction, \$USD 9.8 million was retained from the purchase price and placed in escrow for a period of twelve months following the closing date of the transaction for purposes of satisfying potential indemnification claims pursuant to the Purchase Agreement.

This transaction was approved by PTGi's Board of Directors and the Special Committee of the Board of Directors previously established to explore and evaluate strategic alternatives to enhance shareholder value. Following the consummation of the transaction, the Special Committee continues to explore and evaluate strategic alternatives, which may include (but may not be limited to) a sale, merger or other business combination involving the Company, a recapitalization of the Company, a joint venture arrangement, the sale or spinoff of other Company assets or one or more of its other business units, or the continued execution of the Company's business plans. The Company has not set a timetable for completion of the Special Committee's evaluation process or, except as described above with respect to Primus Australia and below with respect to ICS, made a decision to pursue any particular course of action or transaction, and there can be no assurance that any transaction will be pursued or completed.

On June 20, 2012, PTHI commenced an offer to purchase (the Offer to Purchase ) up to \$183,300,000 aggregate principal amount of the 10% Notes at a purchase price in cash equal to 100% of the principal amount of 10% Notes validly tendered (and not validly withdrawn) and accepted in the Offer to Purchase, plus accrued and unpaid interest thereon to the settlement date for the Offer to Purchase. The Offer to Purchase expired on July 19, 2012. No Notes were tendered pursuant to the Offer to Purchase.

The Offer to Purchase was required by the 10% Notes Indenture as a result of the sale of the Company's Australia segment and the receipt of proceeds therefrom. The 10% Notes Indenture required PTHI to make the

**Table of Contents**

Offer to Purchase using the Excess Proceeds (as defined in the 10% Notes Indenture) from this transaction, which constituted an Asset Sale under the 10% Notes Indenture. The Company determined that the Excess Proceeds from this transaction equaled \$183.3 million (the Offer Amount).

Pursuant to the 10% Notes Indenture, because no 10% Notes were tendered in the Offer to Purchase (and thus no Excess Proceeds were used to purchase 10% Notes), (i) the Company could thereafter use all Excess Proceeds that were the subject of the Offer to Purchase (i.e., the Offer Amount) for general corporate purposes not otherwise prohibited by the 10% Notes Indenture and (ii) the amount of Excess Proceeds for purposes of the 10% Notes Indenture was reset at zero.

*Pursuit of Divestiture of ICS Business Unit*

In connection with the Special Committee's continued evaluation of strategic alternatives discussed above, on June 28, 2012, the Company's Board of Directors committed to dispose of the Company's ICS business unit and continues to actively solicit a sale or other disposition of such business unit. As a result of holding the ICS business unit out for sale, such business unit has been classified as a discontinued operation and its held for sale assets and liabilities have been removed from the specific line items on the condensed consolidated balance sheet as of September 30, 2012. See Note 12 Discontinued Operations to the notes to our condensed consolidated financial statements included elsewhere in this report.

*Exchange Offers and Consent Solicitation; Issuance of the 10% Notes*

On July 7, 2011, in connection with the consummation of the private (i) exchange offers (the Exchange Offers) for any and all outstanding Units representing the 13% Senior Secured Notes due 2016 (the 13% Notes) issued by PTHI and Primus Telecommunications Canada Inc. (Primus Canada), and the 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), (ii) consent solicitation (the Consent Solicitation) to amend the indenture governing the 13% Notes and release the collateral securing the 13% Notes, and (iii) related transactions, PTHI issued \$240.2 million aggregate principal amount of the 10% Notes. An aggregate of \$228.6 million principal amount of 10% Notes was issued pursuant to the Exchange Offers, and PTHI issued an additional \$11.6 million aggregate principal amount of 10% Notes for cash, the proceeds of which were used to redeem all 14<sup>1</sup>/<sub>4</sub>% Notes that were not exchanged pursuant to the Exchange Offers and thereby discharge all of our obligations with respect to the 14<sup>1</sup>/<sub>4</sub>% Notes. In connection with the Exchange Offers, the Company also incurred \$6.9 million of third party costs which are included in gain (loss) on early extinguishment or restructuring of debt on the condensed consolidated statement of operations in the third quarter of 2011.

The 10% 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 PTHI and the guarantors of the 10% Notes, including PTGi (the Guarantors), including a first-priority pledge of all of the capital stock held by PTHI, the Guarantors and each subsidiary of PTGi 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 PTGi that is a foreign subsidiary holding company is limited to 65% of the capital stock of such subsidiary).

The 10% Notes rank senior in right of payment to existing and future subordinated indebtedness of PTHI and the Guarantors. The 10% Notes rank equal in right of payment with all existing and future senior indebtedness of PTHI and the Guarantors. The 10% Notes rank junior to any priority lien obligations entered into by PTHI or the Guarantors in accordance with the 10% Notes Indenture.

Prior to March 15, 2013, PTHI may redeem up to 35% of the aggregate principal amount of the 10% Notes at the redemption premium of 110% of the principal amount of the 10% Notes redeemed, plus accrued and unpaid interest, with the net cash proceeds of certain equity offerings. Prior to March 15, 2013, PTHI may redeem some or all of the 10% Notes at a make-whole premium as set forth in the 10% Notes Indenture. On or after March 15, 2013, PTHI may redeem some or all of the 10% Notes at a premium that will decrease over time as set forth in the 10% Notes Indenture, plus accrued and unpaid interest.

## **Table of Contents**

### ***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 \$23.9 million for the nine months ended September 30, 2012 as compared to \$26.0 million for the nine months ended September 30, 2011. For the nine months ended September 30, 2012, net income, net of non-cash operating activity, provided \$17.3 million of cash. Other major drivers included a decrease in accounts receivable of \$15.2 million, partially offset by a decrease in accounts payable of \$8.1 million.

Net cash provided by investing activities was \$150.8 million for the nine months ended September 30, 2012 as compared to net cash used in investing activities of \$9.2 million for the nine months ended September 30, 2011. Net cash provided by investing activities during the nine months ended September 30, 2012 included \$177.7 million of net proceeds from the sale of Primus Australia, partially offset by \$25.1 million of capital expenditures, \$1.7 million used in the acquisition of businesses and \$0.1 million from the increase in restricted cash.

Net cash used in financing activities was \$148.9 million for the nine months ended September 30, 2012 as compared to \$29.5 million for the nine months ended September 30, 2011. Net cash used in financing activities during the nine months ended September 30, 2012 included \$119.0 million used to repurchase a portion of the 10% Notes, \$13.8 million used to pay a special cash dividend to our shareholders, \$12.9 million used to pay fees related to the repurchase of a portion of the 10% Notes and the Exchange Offers and Consent Solicitation, \$1.7 million used to reduce the principal amounts outstanding on capital leases and \$1.6 million used to satisfy the tax obligations for shares issued under share-based compensation arrangements, partially offset by \$0.1 million in proceeds from the sale of common stock.

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

As of September 30, 2012, we had \$66.0 million of 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, vendor financing and other long-term obligations), and other cash needs for our operations for at least the next twelve months.

As of September 30, 2012, we have \$9.4 million in future minimum purchase obligations, \$57.5 million in future operating lease payments and \$118.7 million of indebtedness.

**Table of Contents****Contractual Obligations**

The obligations reflected in the table below reflect the contractual payments of principal and interest that existed as of September 30, 2012:

| Year Ending December 31,                    | Capital Leases<br>and<br>Other | 13%<br>Senior<br>Secured Notes<br>due 2016 | 10% Senior<br>Secured Notes<br>due 2017 | Purchase<br>Obligations | Operating<br>Leases | Total      |
|---|--------------------------------|--|---|-------------------------|---------------------|------------|
| 2012 (as of September 30, 2012)             | \$ 36                          | \$ 156                                     | \$ 5,810                                | \$ 1,406                | \$ 3,457            | \$ 10,865  |
| 2013  | 74                             | 312  | 11,620                                  | 4,301                   | 12,266              | 28,573     |
| 2014  | 31                             | 312  | 11,620                                  | 3,639                   | 9,145               | 24,747     |
| 2015  | 6                              | 312  | 11,620                                  | 41                      | 7,287               | 19,266     |
| 2016  |                                | 2,716                                      | 11,620                                  |                         | 5,949               | 20,285     |
| Thereafter                                  |                                |  | 119,585                                 |                         | 19,429              | 139,014    |
| Total minimum principal & interest payments | 147                            | 3,808                                      | 171,875                                 | 9,387                   | 57,533              | 242,750    |
| Less: Amount representing interest          | (12)                           | (1,405)                                    | (55,679)                                |                         |                     | (57,096)   |
| Total long-term obligations                 | \$ 135                         | \$ 2,403                                   | \$ 116,196                              | \$ 9,387                | \$ 57,533           | \$ 185,654 |

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.

**New Accounting Pronouncements**

For a discussion of our New Accounting Pronouncements, refer to Note 2 Summary of Significant Accounting Policies to our unaudited condensed consolidated financial statements included elsewhere in this report.

**Related Party Transactions**

For a discussion of our Related Party Transactions, refer to Note 14 Related Party Transactions to our unaudited condensed consolidated financial statements included elsewhere in this report.

**Special Note Regarding Forward-Looking Statements**

This Quarterly Report on Form 10-Q contains or incorporates a number of forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. 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, opportunity, goal, objective, growth, outcome, strategy, provide, commitment, result, seek, pursue, ongoing, include or in the negative of such terms or comparable terminology. Forward-looking statements inherently involve certain risks and uncertainties and are not guarantees of performance, results, or the creation of shareholder value, although they are based on our current plans or assessments which we believe to be reasonable as of the date hereof.

Factors or risks that could cause our actual results to differ materially from the results we anticipate include, but are not limited to:

continuing uncertain global economic conditions;

**Table of Contents**

significant changes in the competitive environment, including as a result of industry consolidation, and the effect of competition in our markets, including our pricing policies;

uncertainties from our announcement of our exploration and evaluation of strategic alternatives that may enhance shareholder value or our ability to complete any transactions arising out of that evaluation, including the pursuit of a divestiture of our ICS business unit;

our possible inability to generate sufficient liquidity, margins, earnings per share, cash flow and working capital;

our ability to attract and retain customers;

our expectations regarding increased competition, pricing pressures, and declining usage patterns in our traditional products;

the effectiveness and profitability of our growth products and bundled service offerings, the pace and cost of customer migration onto our networks, and the successful network platform migration to reduce costs and increase efficiencies;

volatility in the volume and mix of trading activity on the Arbinet Exchange;

strengthening of the U.S. dollar against foreign currencies, which may reduce the amount of U.S. dollars generated from foreign operating subsidiaries and adversely affect our ability to service our significant debt obligations and pay corporate expenses;

our compliance with complex laws and regulations in the U.S. and internationally;

further changes in the telecommunications or Internet industry, including rapid technological, regulatory and pricing changes in our principal markets;

our liquidity and possible inability to service our substantial indebtedness;

an occurrence of a default or event of default under our indentures, including the Company's ability to successfully defend against, and satisfy any liabilities arising out of, the alleged default under the 10% Notes Indenture;

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

management's plans, goals, forecasts, expectations, guidance, objectives, strategies, and timing for future operations, acquisitions, synergies, asset dispositions, fixed asset and goodwill impairment charges, tax and withholding expense, selling, general and administrative expenses, product plans, performance and results;

## Edgar Filing: PRIMUS TELECOMMUNICATIONS GROUP INC - Form 10-Q

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

our possible inability to raise additional capital when needed, on attractive terms, or at all; and

our possible inability to hire and retain qualified executive management, sales, technical and other personnel.

Other unknown or unpredictable factors could also affect our business, financial condition and results. Although we believe that the expectations reflected in the forward-looking statements are reasonable, there can be no assurance that any of the estimated or projected results will be realized. You should not place undue reliance on these forward-looking statements, which apply only as of the date hereof. Subsequent events and developments may cause our views to change. While we may elect to update these forward-looking statements at some point in the future, we specifically disclaim any obligation to do so.

---

**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.

*Foreign currency exchange rates* Foreign currency can have a major impact on our financial results. During the nine months ended September 30, 2012, approximately 86% of our net revenue was derived from sales and operations outside the U.S. The reporting currency for our condensed consolidated financial statements is the United States dollar. 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 from 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, USD/GBP, and USD/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. In addition, prior to the sale of Primus Australia during the quarterly period ended June 30, 2012, we also experienced risk of loss regarding foreign currency exchange due to fluctuations in the USD/Australian dollar ( AUD ) exchange rate. 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 condensed 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 historically have not engaged in hedging transactions. However, in connection with the divestiture of Primus Australia, we entered into a cash flow hedging agreement to mitigate the movements in the AUD versus the USD between the announcement date of the sale to the closing date of the sale, which occurred on May 31, 2012.

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 of our international subsidiaries 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 our Canadian operating segment, depending upon whether the business in our Canadian operating segment 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 against the CAD, there is a positive effect on reported profits and a negative effect on the reported losses for our Canadian operating segment.

In the nine months ended September 30, 2012, as compared to the nine months ended September 30, 2011, the USD was stronger on average as compared to the CAD, AUD, GBP, and EUR. As a result, the revenue of our subsidiaries whose local currency is CAD, AUD, GBP, and EUR increased (decreased) (7.7%), (47.1%), (16.9%), and (271.9%), respectively, in their local currencies compared to the nine months ended September 30, 2011, and increased (decreased) (10.0%), (47.1%), (19.1%), and (321.8%), respectively, in USD.

**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures.**

Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this

**Table of Contents**

report. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were 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, as amended, 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, as amended, 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.**

An evaluation of our internal controls over financial reporting was performed under the supervision of, and with the participation of, management, including our Chief Executive Officer and Chief Financial Officer, to determine whether any changes have occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that no changes in our internal control over financial reporting have occurred during the three months ended September 30, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

*General*

The Company is 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 that the resolution of any such matter will not have a material adverse effect upon the Company's business, condensed consolidated financial position, results of operations or cash flows. The Company does not believe that any of these pending claims and legal proceedings will have a material adverse effect on its business, condensed consolidated financial position, results of operations or cash flows.

*10% Senior Notes Indenture Litigation*

In addition to the matters described above, on September 17, 2012, PTHI consummated the repurchase of \$119,035,219 aggregate principal amount of PTHI's 10% Notes for a purchase price equal to 109% of the principal amount thereof, plus accrued but unpaid interest to the date of repurchase, in each case pursuant to agreements with certain selling holders of 10% Notes. In connection with this repurchase, the sellers of the 10% Notes, representing a majority in principal amount of the outstanding 10% Notes, consented to amendments of the 10% Notes Indenture to remove substantially all of the restrictive and reporting covenants under the 10% Notes Indenture, as well as certain events of default and related provisions, which amendments were memorialized in the Supplemental Indenture. See Item 2 of Part I of this Quarterly Report on Form 10-Q Management's Discussion and Analysis of Financial Condition and Results of Operations Recent Developments Repurchase of a Majority of 10% Senior Secured Notes due 2017.

On September 17, 2012, a complaint and motion for temporary restraining order were filed in the Court of Chancery of the State of Delaware (referred to herein as the Court) under the caption Whitebox Advisors, LLC and River Ridge Master Fund Ltd. v. Primus Telecommunications Holding, Inc., Civil Action No. 7871-VCG, which complaint and motion were subsequently amended on September 19, 2012. The amended complaint alleges that the Supplemental Indenture was entered into in breach of certain covenants in the 10% Notes Indenture. The amended complaint seeks among other things to enjoin the Supplemental Indenture from becoming effective and to enjoin PTHI from acting in reliance upon it. On September 28, 2012, PTHI entered into a stipulation pursuant to which PTHI has agreed not to take any actions under the Supplemental Indenture that would not have otherwise been permitted by the 10% Notes Indenture (absent amendment by the Supplemental Indenture) until the matter is finally resolved on the merits or otherwise by the Court. A hearing on the relevant motions has been scheduled with the Court for Friday, January 4, 2013.

**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, 2011, except as set forth in Part II, Item 1A Risk Factors in our Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2012.

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

PTGi's repurchases of its common stock during the third quarter of 2012 were as follows:

**Issuer Purchases of Equity Securities**

| Period   | Total<br>Number of<br>Shares<br>Purchased | Average<br>Price<br>Paid Per Share | Purchased Under the   |  |
|--|---|------------------------------------|---|--|
|  |   |                                    | Total<br>Number of<br>Shares<br>Announced<br>Plans or<br>Programs | Approximate<br>Dollar<br>Value of Shares<br>that May Yet<br>be<br>Purchased Under the<br>Plans or<br>programs<br>(in millions) |
| <b>Shares purchased in satisfaction of tax withholding obligations (1)</b> |   |                                    |   |  |
| July 1, 2012 to July 31, 2012  | 1,259                                     | \$ 15.73                           |   | \$   |
| August 1, 2012 to August 31, 2012  |   | \$                                 |   | \$   |
| September 1, 2012 to September 30, 2012                                    |   | \$                                 |   | \$   |
| <b>Total</b>   | <b>1,259</b>                              | <b>\$ 15.73</b>                    |   | <b>\$</b>  |
| <b>Shares purchased under a stock repurchase program (2)</b>               |   |                                    |   |  |
| July 1, 2012 to July 31, 2012  |   | \$                                 |   | \$ 14.6  |
| August 1, 2012 to August 31, 2012  |   | \$                                 |   | \$ 14.6  |
| September 1, 2012 to September 30, 2012                                    |   | \$                                 |   | \$ 14.6  |
| <b>Total</b>   |   | <b>\$</b>                          |   | <b>\$ 14.6</b>   |

- Upon vesting of restricted stock units awarded by PTGi to employees, PTGi withholds shares to cover employees' tax withholding obligations, other than for employees who have chosen to satisfy their tax withholding requirements in the form of a cash payment. The table above reflects shares of common stock withheld to satisfy tax withholding obligations during the three months ended September 30, 2012.
- On August 8, 2011, PTGi'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, PTGi may repurchase common stock from time to time in the open-market, privately negotiated transactions or block trades. During the nine months ended September 30, 2012, PTGi did not purchase shares of common stock in connection with our stock repurchase program.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

(a) Exhibits (see Exhibit Index following signatures page below)

**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: November 9, 2012

By: /s/ James C. Keeley  
**James C. Keeley**  
**Chief Financial Officer**  
**(Principal Financial and Accounting Officer)**

**Table of Contents**

**EXHIBIT INDEX**

| <b>Exhibit Number</b> | <b>Description</b>  |
|-----------------------|---|
| 4.1                   | Supplemental Indenture, dated as of September 17, 2012, by and among Primus Telecommunication Holding, Inc., the Guarantors party thereto, and U.S. Bank National Association, as Trustee (incorporated by reference to Exhibit 4.1 to the registrant's Current Report on Form 8-K, filed on September 17, 2012).   |
| 10.1^                 | Separation and Release Agreement, dated July 1, 2012, by and between Kenneth Schwarz and Primus Telecommunications, Inc. (incorporated by reference to Exhibit 10.1 to the registrant's Current Report on Form 8-K, filed on July 3, 2012).   |
| 10.2                  | Form of Letter Agreement relating to the repurchase by Primus Telecommunications Holding, Inc. of a portion of its 10% Senior Secured Notes due 2017 from certain selling holders (filed herewith).   |
| 31                    | Certifications (filed herewith).  |
| 32*                   | Certification (filed herewith).   |
| 101**                 | The following materials from the registrant's Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2012, formatted in extensible business reporting language (XBRL); (i) Unaudited Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2012 and 2011, (ii) Unaudited Condensed Consolidated Balance Sheets at September 30, 2012 and December 31, 2011, (iii) Unaudited Condensed Consolidated Statements of Stockholders' Equity for the nine months ended September 30, 2012, (iv) Unaudited Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2012 and 2011, (v) Unaudited Condensed Consolidated Statements of Comprehensive Income (Loss) for the three and nine months ended September 30, 2012 and 2011, and (vi) Notes to Condensed Consolidated Financial Statements (filed herewith). |

\* These certifications are being furnished and will not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section. Such certifications 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, as amended, 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.

^ Indicates management contract or compensatory plan or arrangement.