URITIES AND EXCHANGE COMMISSIO
Washington, D.C. 20549

# *FORM 10-K*

______ Annual Report under Section 13 or 15(d) of the Securities Exchange Act of 1934

__X__ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period

**from April 1, 1998 to December 31, 1998.**

Commission File Number: 000-21605

# *HYPERION TELECOMMUNICATIONS, INC.*

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| ***Delaware*** | ***25-1669404*** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| ***Main at Water Street Coudersport, PA*** | ***16915*** |
| *(Address of principal executive offices)* | *(Zip code)* |

***814-274-9830***

(Registrant's telephone number including area code)

Securities registered pursuant to Section 12(b) of the Act: None.
Securities registered pursuant to Section 12(g) of the Act:
Class A Common Stock, $0.01 par value

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 __X__ No____

Aggregate market value of outstanding Class A Common Stock, par value $0.01 and Class B Common Stock, par value $0.01, held by non-affiliates of the Registrant at May 21, 1999 was $303.1 million based on the closing sale price of the Class A Common Stock as computed by the NASDAQ National Market system as of that date. For purposes of this calculation only, affiliates are deemed to be Adelphia Communications Corporation and directors and executive officers of the Registrant.

At May 21, 1999, 22,393,821 shares of Class A Common Stock, par value $0.01, and 32,300,041 shares of Class B Common Stock, par value $0.01, of the registrant were outstanding.

Documents Incorporated by Reference: Portions of the Proxy Statement for the 1999 Annual Meeting of Stockholders are incorporated by reference into Part III hereof.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of the Form 10-K or any amendment to the Form 10-K

## HYPERION TELECOMMUNICATIONS, INC.

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## PART I

## ITEM 1. BUSINESS

### The Company

Hyperion Telecommunications, Inc. ("Hyperion" or the "Company") is a super-regional provider of communications services offering a full range of communications services to customers that include businesses, governmental and educational end users and other telecommunications service providers throughout the eastern United States. The Company provides these customers with communications services such as local switch dial tone, long distance service, high-speed data, and Internet connectivity. The customer has a choice of receiving these services individually or as part of a bundle of services, which is typically priced at a discount when compared to the price of the individual services. In order to take advantage of the improved economic returns from providing services over the Company's own network system (having "on-net" traffic), the Company is in the process of significantly expanding the reach of its network system. This network system expansion includes the purchase, lease or construction of fiber optic network facilities in more than 50 new markets and the interconnection of all of the Company's existing and new markets with the Company's own fiber optic network facilities, as well as implementing various technologies including Dense Wave Division Multiplexing ("DWDM") to provide greater bandwidth capacity on the Company's local and long-haul network system.

By the year 2001, Hyperion expects to serve most of the major cities in the eastern half of the United States. The Company currently provides communications services in 46 markets and plans to introduce services in more than 50 new markets, expanding Hyperion's presence to approximately 30 states. At December 31, 1998, the Company had installed 20 Lucent 5ESS switches or remote switching modules and plans to put in operation during 1999 nine additional regional switches (the "super switches"). Once fully installed, the Company's fiber optic backbone will connect each of the Company's markets. This fully redundant, 16,000 route mile network system will support Hyperion's full line of communications service offerings. The Company has chosen the eastern half of the United States as its overall target market because it presents an opportunity for rapid growth. Once fully deployed, management believes that the Company's network system will encompass over 26 million addressable business access lines (approximately 34% of the nation's population), which currently generate annual estimated communications services revenues of over $50 billion.

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements. Certain information included in this Transition Report on Form 10-K, including Management's Discussion and Analysis of Financial Condition and Results of Operations, is forward-looking, such as information relating to the effects of future regulation, future capital commitments and the effects of competition. Such forward-looking information involves important risks and uncertainties that could significantly affect expected results in the future from those expressed in any forward-looking statements made by, or on behalf of, the Company. These "forward looking statements" can be identified by the use of forward-looking terminology such as "believes," "expects," "may," "will," "should," "intends" or "intends" or "anticipates" or the negative thereof or other variations thereon or comparable terminology, or by discussions of strategy that involve risks and uncertainties. These risks and uncertainties include, but are not limited to, uncertainties relating to economic conditions, acquisitions and divestitures, the cost of availability of capital, government and regulatory policies, the pricing and availability of equipment, materials, inventories and programming, Year 2000 issues, product acceptance, technological developments and changes in the competitive environment in which the Company operates. Persons reading this Transition Report on Form 10-K are cautioned that forward-looking statements herein are only predictions, that no assurance can be given that the future results will be achieved, and that actual events or results may differ materially as a result of the risks and uncertainties facing the Company.

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

**Recent Developments**

*Expansion of Fiber Network.* Since April 1, 1998, Hyperion has entered into agreements with Qwest Communications, Williams Communications, NorthEast Optic Network, Inc. ("NEON"), Metromedia Fiber Network, Inc., e.spire Communications, Inc., Telergy Inc. and Interpath Communications to acquire local and long-haul fiber optic transmission infrastructure to provide facilities-based services in a number of new markets throughout the eastern United States and to interconnect Hyperion's existing markets and these new markets. The agreements entitle the Company to a long-term lease or an indefeasible right of use ("IRU") to approximately 9,000 route miles of local and long-haul fiber for a total cost of approximately $126 million.

The markets reached through these agreements are important to the Company's network system expansion strategy. For example, fiber obtained through the contract with NEON enables Hyperion to quickly enter markets throughout New England including Boston, Massachusetts. The agreement with Metromedia Fiber Network supplements an earlier agreement and provides Hyperion with broad coverage in the New York metropolitan area, as well as new entry into Chicago, Illinois, Washington, DC and northern Virginia. Hyperion will gain cost-effective access to Atlanta, Georgia through the agreement with e.spire. The agreement with Telergy will allow Hyperion to efficiently enter Manhattan, New York along with interconnection from our upstate New York markets and the agreement with Interpath Communications will allow us to enter the Raleigh-Durham/Chapel Hill, North Carolina market. The long-haul agreements with Qwest, Williams, Telergy and others provide the basis for the Company's dedicated long-haul fiber network system, which in turn increases our addressable market approximately 50%. This increased addressable market opportunity, resulting from the signing of the agreements currently in place, can be achieved without a proportionate increase in the number of switches deployed through the use of super switches serving multiple markets in a geographical region.

On April 15, 1999, Hyperion entered into an agreement with e.spire Communications, Inc. ("e.spire") to acquire an IRU for approximately 576 miles of network fiber and construction services which allows the Company access to 14 new markets. In exchange, the Company granted e.spire an IRU to a 432-strand fiber optic cable in south Florida that is currently under construction.

*Data Services Agreement.* On February 9, 1999, Hyperion entered into a 3 year agreement with Intermedia Communications ("ICI") whereby it will purchase from ICI wholesale frame relay and ATM services, which will be branded under the Hyperion name. As the long-haul portions of Hyperion's network system become operational and data switches are placed in the networks, we expect to migrate customers to our network system. The agreement provides for a discount pricing structure based upon volume purchases, and we believe that this market-entry strategy provides a cost-effective, economical approach to creating market presence and a customer base until our data networks are operational. Over time, we expect most of our customers' data traffic will be carried on our own network system.

*Partnership Rollups.* During March 1999, Hyperion consummated purchase agreements with subsidiaries of Multimedia, Inc. and MediaOne of Colorado Inc. to acquire their respective interests in our jointly owned networks located in the Wichita, KS, Jacksonville, FL and Richmond, VA markets for an aggregate of approximately $90 million. The agreements increased the Company's ownership interest in each of these networks to 100%. The consummated acquisitions are collectively referred to as the "Roll-ups."

In addition, on March 31, 1999, Hyperion entered into purchase agreements with Entergy Corporation ("Entergy"), the parent of its local partner in the Baton Rouge, LA, Little Rock, AR and Jackson, MS markets, whereby Entergy will receive $36 million in cash for Entergy's ownership interests in each of these markets. Upon consummation of this transaction, which is subject to normal closing conditions and regulatory approvals, the Company's ownership interest in each of these networks will increase to 100%.

*LMDS Licenses.* During 1998, through a partnership in which Hyperion is a 49.9% limited partner, the Company was the successful bidder, at a cost of approximately $45 million, all of which has been fully paid, for 195 31-GHz licenses, which cover approximately 83 million people in the eastern United States, representing coverage in most of Hyperion's network system territory. The Company and its partner are currently in the process of dissolving the partnership, and the licenses are to be transferred to the Company, at no additional cost to the Company, upon the consent of such transfer by the Federal Communications Commission (the "FCC"), which may not be unreasonably withheld. Hyperion plans to use the local multipoint distribution service ("LMDS") spectrum in most of its markets, and believes the spectrum to be highly complementary to our fiber-based systems as an economical means to provide "last-mile" connectivity for customers that otherwise could not be economically addressed with broadband wireline connectivity.

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

*Hyperion IPO.* In the June 30, 1998 quarter, Hyperion issued and sold 12,850,000 shares of Class A Common Stock at a price to the public of $16.00 per share including the underwriters' over-allotment option. Simultaneously with the closing of the IPO, Hyperion issued and sold 6,966,667 additional shares of Class A Common Stock to Adelphia at a purchase price of $15.00 per share in exchange for certain of Hyperion's indebtedness and payables owed to Adelphia and for cash of $49.9 million. These transactions raised approximately $241 million of net proceeds to continue the expansion of Hyperion's existing markets and to build new markets.

## Growth Strategy

The key components of the Company's strategy as a leading provider of competitive telecommunications services are:

*Focus On Telecommunications-Intensive Customers.* Hyperion provides their services to telecommunications-intensive customers that include businesses, governmental and educational end users, and other telecommunications service providers. Hyperion believes that its target customers are a large and under-served universe who generally have limited choices in their communications services purchasing decisions. These customers generally seek reliability, high quality, broad geographic coverage, end-to-end service, solutions-oriented customer service and timely introduction of new and innovative services. The Company offers dedicated access services on a wholesale basis to interchange or long distance carriers ("IXCs") and has entered into national service agreements with AT&T and MCIWorldCom to be their preferred supplier.

*Expansion of Sales and Customer Care Effort.* Hyperion's goal is to create better customer retention and become the principal and preferred cost-effective alternative to the incumbent communications services provider. To achieve this and to capitalize on the Company's expanded addressable market, Hyperion has rapidly increased and intends to continue to increase its direct sales and support team consisting of sales professionals and engineers. The Company has expanded its sales force from 128 salespeople at December 31, 1997 to 251 salespeople at December 31, 1998 and expects to increase its sales force to approximately 450 salespeople by December 31, 1999.

In addition, Hyperion believes that the best way to care for a customer is to provide local customer service after the sale. Each of Hyperion's markets has a dedicated team of trained customer care professionals committed to ensuring that we meet or exceed our customers' expectations. At December 31, 1998, Hyperion had approximately 136 professionals committed to its customer care effort which Hyperion expects will increase to approximately 250 professionals by December 31, 1999.

*Focus on Providing Bundled Packages of Communications Services.* In response to market demands and to maximize our selling efforts, the Company offers a full suite of communications services to our customers. Hyperion offers its services individually to suit specific customer needs or bundled together to provide customers with a cost-effective and comprehensive communications solution. In addition to the pricing benefits Hyperion's customers receive from purchasing bundled communications services, the Company believes that bundled services provide Hyperion with increased customer retention, higher operating margins and a reduced cost of acquiring new customers.

The Company's service offerings currently include a wide range of local dial tone and long-distance services in all of its operating markets. In addition, Hyperion has launched internet access services, frame relay and ATM services in certain of our markets and plans to extend these services to all of our markets during 1999. To accelerate its frame relay and ATM service offerings, Hyperion recently entered into a wholesale provider agreement with ICI, whereby it will use ICI's frame relay network and data switches to offer data services to its customers and then move its customers' traffic onto its own network system as it becomes operational. The Company believes this approach provides an efficient market-entry strategy and allows it to build a market presence under the Hyperion trade name, while providing better long-term operating margins through the use of its own network system.

*Drive On-Net Traffic Over High Capacity Fiber Optic Network System.* The broad deployment of fiber optic cable in Hyperion's markets typically enables connectivity among the Company, the incumbent local exchange carrier ("LEC") central offices and the Company's customers. Hyperion expects this strategy to result in a high proportion of traffic that is both originated and terminated on its network system, which would provide the Company with higher long-term operating margins. As of December 31, 1998, the Company has collocated in 123 incumbent LEC central offices, a figure which is expected to increase to over 300 during 1999. In addition, as of December 31, 1998, in Hyperion's six most mature markets, 78% of the access lines in service have been provisioned completely on its own network system. Overall the Company had 110,005 installed access lines at December 31, 1998, approximately 63% of which are provisioned completely on Hyperion's network system.

In addition to the broad deployment of fiber optic cable in its markets, Hyperion has been aggressively adding fiber over long distances to create a fiber optic network system that connects its various markets. Once fully deployed, this fiber optic backbone will enhance the Company's ability to originate and terminate Hyperion's customers' communications traffic over our networks. We believe long-term operating margins on Hyperion's long distance and data transfer businesses will increase significantly as a result of connecting these markets.

As an alternative to fiber optic cable, Hyperion also plans to utilize wireless technologies to deliver the "last mile" of communications services where the use of fiber optic cable is not economical. Through the use of a fixed wireless technology known as LMDS, the Company will be able to provide in most of its markets an alternative means for establishing the connectivity that links Hyperion's customers to its network system. See "Recent Developments—LMDS Licenses." These customers might otherwise have limited access to a high speed fiber optic network. Therefore, the Company expects LMDS to increase the amount of on-net traffic we carry in the future.

*Expand Market Roll-out Throughout Eastern United States.* The Company recently announced that it is expanding the scope of its business plan to add 50 new markets to the existing 46 markets, expanding its presence to approximately 30 states throughout the eastern United States. These 96 markets will provide Hyperion with a market opportunity of more than 26 million addressable business access lines (approximately 34% of the nation's population), which currently generate over $50 billion of annual communications services revenues. Hyperion plans to roll out service in these new markets by installing nine new super switches that, together with remote switch modules, will serve several markets in geographic proximity to each super switch. Each of these markets will be connected to the system network by inter-city fiber that has been or will be purchased or leased from a number of fiber optic transmission providers.

### Products and Services

Hyperion's products and services are designed to appeal to the sophisticated telecommunications needs of its business, governmental and educational customers.

*Local Services.* Hyperion provides local dial-tone services to customers, which allows them to complete calls in its calling area and to access a long distance calling area. Local services and long distance services can be bundled together using the same transport facility. Hyperion's networks are designed to allow a customer to easily increase or decrease capacity and alter enhanced services as the telecommunications requirements of the business change. In addition to its core local services, Hyperion also provides access to third party directory assistance and operator services.

*Long Distance Services.* Hyperion provides domestic and international long distance services for completing intrastate, interstate and international calls. Long distance service is offered as an additional service to Hyperion's local exchange customers. Long distance calls which do not terminate on Hyperion's networks (which are currently the bulk of such calls) are passed to long distance carriers which route the remaining portion of the call.

*Enhanced Services.* In addition to providing typical enhanced services such as voicemail, call transfer and conference calling, Hyperion offers additional value-added enhanced services to complement its core local and long distance services. These enhanced service offerings include:

> *Access to Internet Services*—Enables customers to use its available capacity for access to Internet Service Providers ("ISP"s).
>
> *Data Networking Services*—The Company can provide high-speed, broadband services to use for data and Internet access such as Integrated Services Digital Network (ISDN) and Primary Rate Interface (PRI).
>
> *Specialized Application Services*—The Company can create products and services that are tailored for target industries with special telecommunications needs such as the hospitality industry. These services typically include non-measured rate local calling, expanded local calling area, discounted long distance rates and tailored trunking configurations.

### Ownership of the Company and the Operating Companies

As of December 31, 1998, Hyperion was a 64.7% owned subsidiary, on a fully diluted basis, of Adelphia. In addition, senior executives of the Company owned 4.6% of the common stock of the Company. Unless the context otherwise requires, references to the "networks" or the "Company's networks" mean the (a) 22 telecommunications networks (serving 46 markets) in operation or under construction (the "Existing Networks") and (b) additional networks under development (the "New Networks"). The Company's 22 Existing Networks were owned by ten wholly owned subsidiaries (through which the Company has an interest in 11 networks), one partnership (through which the Company has an interest in one network) in which it is the majority owner and nine joint venture investments (through which the Company has an interest in 10 networks) in which the Company owns at least 50%. The Company is responsible for the network design, management, billing and operation of the operating companies, for which it receives management fees.

The following is an overview of Hyperion's networks and respective ownership interests as of December 31, 1998.

| **Company Networks** | **Actual or Expected Date of Operation (a)** | **Hyperion Interest** | **Local Partner** |
|---|---|---|---|
| Northeast Cluster | | | |
| Vermont | 11/94 | 100.0% | |
| Syracuse, NY | 8/92 | 100.0 | |
| Buffalo, NY | 1/95 | 100.0 | |
| Albany, NY | 6/99 | 100.0 | |
| Mid-Atlantic Cluster | | | |
| Charlottesville, VA | 1/95 | 100.0 | |
| Scranton/Wilkes-Barre, PA | 5/98 | 100.0 | |
| Harrisburg, PA | 4/95 | 100.0 | |
| Morristown, NJ | 7/96 | 100.0 | |
| New Brunswick, NJ | 11/95 | 100.0 | |
| Philadelphia, PA | 8/96 | 50.0 | PECO Energy |
| Allentown/Bethlehem/Easton/Reading, PA | 5/98 | 50.0 | PECO Energy |
| York, PA | 5/97 | 50.0 | Susquehanna Cable |
| State College/Altoona, PA | 10/98 | 50.0 | Allegheny Energy |
| Richmond, VA | 9/93 | 100.0(b) | |
| Mid-South Cluster | | | |
| Lexington, KY | 6/97 | 100.0 | |
| Louisville, KY | 3/95 | 100.0 | |
| Nashville, TN | 11/94 | 95.0 | InterMedia Partners |
| Baton Rouge, LA | 12/97 | 100.0(b) | |
| Jackson, MS | 12/97 | 100.0(b) | |
| Little Rock, AR | 12/97 | 100.0(b) | |
| Other Networks | | | |
| Wichita, KS | 9/94 | 100.0(b) | |
| Jacksonville, FL | 9/92 | 100.0(b) | |
| **Weighted Average Ownership** | — | **90%(c)** | |

(a) Refers to the date on which (i) the network is connected to at least one IXC POP, (ii) the network is capable of accepting traffic from IXCs and end users, (iii) the Company's central office is fully functional and (iv) the initial network SONET fiber ring has been completed.

(b) Gives effect to the Rollups and the pending purchase of the Entergy network interests as if such events occurred December 31, 1998.

(c) Based upon gross property, plant and equipment of the Company and the networks as of December 31, 1998, as adjusted for the purchase of certain partners' interests pursuant to the Rollups.

## Operating Agreements

Generally, subsidiaries of the Company historically entered into partnership agreements (or limited liability agreements) with local partners to take advantage of the benefits of building networks in conjunction with local cable television or utility operators. Typically operating partnerships have been formed and operated pursuant to three key agreements: (i) a partnership or limited liability company agreement between the Company or one of its wholly owned subsidiaries and a cable operator or utility company (the "Local Partner Agreement"); (ii) a fiber capacity lease agreement between the local partner and the operating partnership (the "Fiber Lease Agreement"); and (iii) a management agreement between the operating partnership and the Company or one of its subsidiaries (the "Management Agreement"). As of December 31, 1998, 10 of the Company's 22 Existing Networks were 50% or less owned by the Company, excluding the effect of the rollups and the Entergy acquisition.

### *Local Partner Agreements*

As part of its business development strategy, Hyperion has purchased its local partners' interests or entered into agreements to purchase these interests in most of its Existing Networks. Upon completion of these acquisitions, the original Local Partner Agreements are terminated. For the remaining Local Partnership Agreements, the summary below provides a brief description of the general terms and provisions.

Each Local Partner Agreement establishes the structure of the applicable operating partnership by determining, among other things, the partner's capital contribution requirements, capital structure, purpose and scope of business activities, transfer restrictions, dissolution procedures, duration and competition restrictions, as well as the voting and buy/sell rights and rights of first refusal of the partners of the operating partnership. The following discussion applies to partnership and limited liability company agreements.

*Ownership and Capital Contributions.* The initial capital contributions and percentage of ownership of the operating partnerships vary. Some of the Local Partner Agreements establish maximum capital contributions such that each partner's ultimate aggregate capital contribution is determined at the operating partnership's inception. Capital contributions in excess of the initial capital contribution may be required in several Local Partner Agreements, but generally either must be initiated by the manager of the operating partnership or approved by at least a majority vote of the management committee. Generally, the percentage of ownership is also fixed at the operating partnership's inception. Absent an agreement by the partners, generally, the only circumstances that result in the dilution of such partner's ownership interest are a partner's failure to make a capital contribution or its failure to exercise a right of first refusal.

*Matters Requiring a Vote.* Most partner or management committee votes of an operating partnership require only a majority vote; however, a unanimous or supermajority vote of the partners or management committee is generally required for, among other things, expansion of the scope of the business activities in the defined business area, admission of additional partners and merger or consolidation with any other entity if the operating partnership is not the surviving entity.

*Distributions.* Generally, the Local Partner Agreements allow for distributions to the partners; however, the Local Partner Agreements vary with regard to the procedure for determining if, when and how much of a distribution should be made. The partners or the partnership's managing committee makes such determinations by either majority approval or unanimous consent. All distributions are required to be made in proportion to each partner's percentage interest in the partnership.

*Transfer of Ownership.* The Local Partner Agreements generally prohibit the transfer of partnership interests, including most changes in control, or impose restrictions that significantly limit a partner's ability to transfer its partnership interest. Generally, transfers of entire partnership interests to subsidiaries of a partner's parent corporation and the sale or disposition of all or substantially all of the stock or assets of a partner's affiliates are expressly permitted in the typical Local Partner Agreement.

*Rights of First Refusal; Buy/Sell Agreements.* The partners of most of the operating partnerships also retain certain rights of first refusal and buy/sell rights. Generally, after a specified period of time, usually three to six years after the inception of the operating partnership, either partner may transfer its interest to an unrelated third party if such partner first offers its interest to the other partner at the same terms and the other partner elects not to purchase the interest. The right of first refusal usually requires that the selling partner sell all, and not less than all, of its partnership interest pursuant to an offer by a bona fide third party. The selling party must first give the other partner the opportunity to purchase the interest at the same price and under the same terms as the third party's offer.

In addition, in most of the operating partnerships, either partner can, after a specified period of time, usually five to eight years after the inception of the partnership, make an offer to the other partner to sell its own interest. Within 30 to 60 days of submitting a price which generally must be based on a written third party valuation of the partnership interest, the other partner must respond to the offer indicating its election to either accept the offer to buy or sell at the offered price. A partner in one of the partnerships has the right after a specified period of time to put its interest in the respective partnership to the Company at an amount equal to the partner's capital contributions plus interest less any distributions pursuant to the other agreement.

*Term.* Most of the operating partnerships were created in the last five years and have a duration of 10 to 25 years unless earlier dissolved. Generally, each partner and certain of its affiliates are restricted from competing with the operating partnership in the defined business area so long as the partner is a partner plus two or three years thereafter.

*Fiber Lease Agreements*

Generally, the operating partnerships lease fiber optic capacity from their local partners or former local partners. In some instances, the operating partnerships lease existing fiber optic capacity and in other instances, the operating partnerships request the local partners or former local partners to construct new fiber optic capacity. In many cases, local partners or former local partners upgrade the capacity of their cable or utility infrastructure, and as a result, share construction costs with the operating partnership. Monthly lease payments in both instances are based on the amortization of the operating partnership's share of the local partner's cost of construction and material costs over the term of the Fiber Lease Agreement. Because construction and material costs are amortized over the then current term of the Fiber Lease Agreement, it is possible for the amount of a monthly lease payment to be significantly lower during a renewal term unless the construction of additional fiber optic cable is scheduled for such renewal term. Typically, the amount of the lease payments in a renewal period equals the amount of monthly maintenance costs for the leased fiber optic cable.

Substantially all of the Fiber Lease Agreements are in their initial terms. Most of the initial terms vary from five to 25 years in length. The Fiber Lease Agreements contain various renewal options. Generally, either party can terminate the Fiber Lease Agreement at the end of the then current term if the terminating party provides prior written notice to the other party. Several of the Fiber Lease Agreements contain termination rights which provide the lessor with the option to terminate the lease if the lessor becomes subject to telecommunications regulation, an action is brought against the lessor challenging or seeking to adversely modify the lessor's continued validity or authority to operate, legal or regulatory determination renders it unlawful or impossible for the lessor to satisfy its obligations under the lease or in case of an imposition of public utility or common carrier status on the lessor as a result of its performance of the lease.

Throughout the term of the Fiber Lease Agreements and thereafter, title to the fiber optic cable remains with the local partner or former local partners. Similarly, the operating partnerships retain title to all of their own electronics and switches that become a part of the network. A local partner or former local partner cannot sell the fiber subject to the Fiber Lease Agreement to a third party unless its obligations under the Fiber Lease Agreement are assumed by the third party.

The amount of the lease payments could be affected by the costs the local partners or former local partners incur for attachments to poles, or use of conduit, owned by incumbent LECs or electric utilities. Various state public utilities commissions ("State PUCs") and the FCC are reviewing whether use of local partner or former local partners facilities for telecommunications purposes (as occurs when the operating companies lease fiber optic capacity from local partners or former local partners) should entitle incumbent LECs and electric utilities to raise pole attachment or conduit occupancy fees. Such increased fees could result in an increase in the amount of the lease payments made by the operating companies to the local partners or former local partners. In some cases, State PUCs attempt to directly regulate the fiber lease contracts between the operating companies and their local partners or former local partners.

In cases where the Company acquires 100% of the ownership interest of an operating partnership by an acquisition of interests from the local partner, the Fiber Lease Agreement typically is amended to provide for a 10 to 25 year lease of fiber optic capacity from the former local partner that exited the partnership.

On February 20, 1997, the Company entered into several agreements with Telergy, Inc. and certain of its affiliates regarding the lease of dark fiber in New York State. Pursuant to these agreements and in consideration of a payment of $20 million, the Company received (i) a $20 million senior secured note from Telergy, Inc., and (ii) a fully prepaid lease from a Telergy affiliate for at least 25 years (with two additional ten-year extensions) for 24 strands of dark fiber installed or to be installed in a New York fiber optic telecommunications backbone network. The fiber optic backbone network will cover approximately 500 miles from Buffalo to Syracuse to Albany to New York City, New York, and will provide interconnection capability for the Company's operating networks in the state of New York.

*IRU Agreements*

The Company has entered into several agreements that entitle the Company to a long-term lease or an IRU to approximately 9,000 route miles of local and long-haul dark fiber. Generally each agreement requires Hyperion to pay an aggregate price consisting of an initial payment, followed by installments during the construction period based upon achieving certain milestones (e.g., commencement of construction, conduit installation and fiber installation). The final payment for each segment will be made at the time of acceptance.

Each agreement provides for the sharing of certain maintenance and operating costs. The agreements establish anticipated delivery dates for construction and delivery of segments along the route of Hyperion's networks. The agreements provide for penalties in the event of delay of segments and, in certain circumstances, allow Hyperion to terminate non-delivered segments of the contracts.

*AT&T Lease Agreement*

On December 31, 1997 the Company consummated an agreement for a $24.5 million long term lease facility from AT&T Capital Corporation (the "AT&T Lease Agreement"). The AT&T Lease Agreement provides financing for certain of the operating companies' switching equipment. Included in the AT&T Lease Agreement is the sale and leaseback of certain switching equipment for which the Company received $14.9 million. The terms of the switching equipment leases under the AT&T Lease Agreement are seven and one half years, commencing December 31, 1997. The AT&T Lease Agreement requires the Company to maintain and insure the leased equipment and prohibits the Company from subleasing the equipment, except to certain designated Company subsidiaries. Under the AT&T Lease Agreement, the Company is required to indemnify AT&T Capital Corporation for certain claims with respect to the leased equipment and for certain tax liabilities.

*Management Agreements*

Generally, the Company or a wholly owned subsidiary of the Company provides the operating partnerships with the following services pursuant to the Management Agreement for a fee based on the Company's cost of providing such services: general management, monitoring, marketing, regulatory processing, accounting, engineering, designing, planning, construction, maintenance, operations, service ordering and billing. The term of the typical Management Agreement is three or five years and automatically renews for continuous one-year periods unless one party provides the other with written notice that it intends to terminate the agreement.

**Sales and Marketing**

The Company targets its network sales and marketing activities to medium and large businesses, government and educational end users and resellers, including IXCs. The Company services its customers through a dedicated sales force of 251 professionals at December 31, 1998 focused on selling the Company's portfolio of service offerings, and currently has over 136 technicians, customer service representatives and administrative support staff at December 31, 1998, enabling the Company to provide its customers with continuous support and superior service. The Company expects to increase its marketing efforts by increasing the size of its current sales force during 1999 to approximately 450 professionals as it increases the breadth of its product offerings to satisfy the growing telecommunications needs of its customers. In addition, the Company has initiated direct marketing and sales of local telecommunications services on an unbundled loop basis to or through total service resale to small business customers in certain markets, generally offering such services under either the Hyperion name or a co-branded name that includes the name of the particular local partner. The Company's networks offer their services in accordance with tariffs filed with the FCC for interstate services and State PUCs for intrastate services. The operating companies are classified as non-dominant carriers by the FCC and therefore have substantial pricing flexibility and in many cases may enter into customer and product specific agreements.

*End Users*

The Company targets end users which include medium and large businesses, governmental and educational institutions and other telecommunications service providers. End users are currently marketed through Company direct sales representatives in each market. The national sales organization also provides support for the local sales groups and develops new product offerings and customized telecommunications applications and solutions which address the specific requirements of particular customers. In addition, the Company markets the operating companies' products through advertisements, media relations, direct mail and participation in trade conferences. End users typically commit to a service agreement for a term of three to five years which is either renegotiated or automatically converted to a month-to-month arrangement at the end of the contract term. The Company believes it will be able to continue to compete effectively for end users by offering superior reliability, product diversity, service and custom solutions to end user needs at competitive prices. A significant component of an operating company's reliability will be its ability to offer customers end-to-end SONET ring construction for many localized applications. The operating companies' construction of SONET rings combined with the Company's large network size will enable the operating companies to offer fiber optic coverage superior to the incumbent LEC in its markets.

*Resellers*

Resellers utilize the operating companies' services primarily as a local component of their own service offerings to end-users. The Company has national supplier agreements with all of the major IXCs. The Company believes it can effectively provide IXCs with a full complement of traditional access services as well as switched services. Factors that increase the value of the Company's networks to IXCs include reliability, state-of-the-art technology, route diversity, and ease of ordering and customer service. The Company also generally prices the services of an operating company at a discount relative to the incumbent LEC. In order to further complement the services provided to the IXCs, the Company integrates its networks with IXC networks to enable the IXC to (i) access service, billing and other data directly from the Company and (ii) electronically send automated service requests to the Company. In pursuing this strategy, the Company has entered into the National Service Agreement with AT&T pursuant to which the Company through its networks is an AT&T preferred supplier of dedicated special access and switched access transport services. The National Service Agreement requires the Company to provide such services to AT&T at a discount from the tariffed or published LEC rates. In addition, the Company has entered into the MCIWorldCom Preferred Provider Agreement pursuant to which the Company is designated MCIWorldCom's preferred provider of new end user dedicated access circuits and of end user dedicated access circuits resulting from conversions from the incumbent LEC in the Company's markets.

*Special Purpose Networks*

The Company develops special purpose networks in conjunction with the operating companies in order to meet specific customer network requirements. To date, these special purpose networks have included construction of IXC backbone networks, campus networks, private carriage networks and other similar network applications. The terms and conditions for these special purpose networks are generally specified in agreements with three to five year terms which automatically renew on a month-to-month basis. In addition, special customer networks are normally constructed with excess fiber band width capacity, which allows the Company to make additional capacity available to other end users.

**The Company's Networks**

*Network Development and Design*

Prior to any network construction in a particular market, the Company's corporate development staff reviews the demographic, economic, competitive and telecommunications demand characteristics of the market. These characteristics generally include market location, the size of the telecommunications market, the number and size of business, educational and government end users and the economic prospects for the area. In addition, the Company also carefully analyzes Local Exchange Carriers Central Office ("LEC-CO") access line demographic data. The Company also analyzes market size utilizing a variety of data, including available estimates of the number of interstate access and intrastate private lines in the region, which is available from the FCC.

If a particular market targeted for development is deemed to have sufficiently attractive demographic, economic, competitive and telecommunications demand characteristics, the Company's network planning and design personnel, generally working in conjunction with the Company's local partner, Adelphia, or one of Adelphia's affiliates, design a large regional network targeted to provide access to the identified business, educational and government end user revenue base and to the IXC POPs and the LEC-COs in the geographic area covered by the proposed network. The actual network design is influenced by a number of market, cost and technical factors including: (i) availability and ease of fiber deployment; (ii) location of LEC-COs and IXC POPs; (iii) the Company's market information; and (iv) cost of construction.

*Network Construction*

The Company's networks are constructed to cost-effectively access areas of significant end user telecommunications traffic, as well as the majority of the LEC-COs, POPs and most of the IXCs. The Company establishes with its local partner or Adelphia general requirements for network design including engineering specifications, fiber type and amount, construction timelines and quality control. The Company's engineering personnel provide project management, including contract negotiation and overall supervision of the construction, testing and certification of all facilities. The construction period for a new network varies depending upon the number of route miles to be installed, the initial number of buildings targeted for connection to the network, the general deployment of the network and other factors. Networks that the Company has installed to date have generally become operational within six to ten months after the beginning of construction.

*Network Operating Control Center*

In Coudersport, Pennsylvania, the Company has built the Network Operating Control Center ("NOCC"), which is equipped with state-of-the-art system monitoring and control technology. The NOCC is a single point interface for monitoring all of the Company's networks and provisioning all services and systems necessary to operate the networks. The NOCC supports all of the Company's networks including the management of 1,748 building connections, 20 switches or remote switching modules and 15,005 network route miles as of December 31, 1998. The NOCC is designed to accommodate the Company's anticipated growth.

The NOCC is utilized for a variety of network management and control functions including monitoring, managing and diagnosing the Company's SONET networks, central office equipment, customer circuits and signals and the Company's switches and associated equipment. The NOCC is also the location where the Company provisions, coordinates, tests and accepts all orders for switched and dedicated circuit orders. In addition, the NOCC maintains the database for the Company's circuits and network availability. Network personnel at the NOCC also develop and distribute a variety of software utilized to manage and maintain the networks.

*Equipment Supply*

The Company and the operating companies purchase fiber optic transmission and other electronic equipment from Lucent, Fujitsu, Tellabs, and other suppliers at negotiated prices. The Company expects that fiber optic cable, equipment and supplies for the construction and development of its networks will continue to be readily available from Lucent, Fujitsu, Tellabs and other suppliers as required. The Company has negotiated multi-year contracts for equipment with Lucent, Fujitsu, and Tellabs. The Company and the operating companies have deployed 17 Lucent switches and three Lucent remote switching modules, which deliver full switching functionality, in 20 of its current markets. The Company plans to deploy an additional nine regional super switches during 1999.

*Connections to Customer Locations*

Office buildings are connected by network backbone extensions to one of a number of physical rings of fiber optic cable, which originate and terminate at the operating company's central office. Signals are sent simultaneously on both primary and alternate protection paths through a network backbone to the operating company's central office. Within each building, operating company-owned internal wiring connects the operating company's fiber optic terminal equipment to the customer premises. Customer equipment is connected to operating company-provided electronic equipment generally located where customer transmissions are digitized, combined and converted to an optical signal. The traffic is then transmitted through the network backbone to the operating company's central office where it can be reconfigured for routing to its ultimate destination on the network.

The operating company locates its fiber optic equipment in space provided by the building owner or, more typically, on a customer's premises. IXCs often enter into discussions with building owners to allow the Company to serve the IXCs' customers. This network configuration enables the Company to share electronic equipment among multiple customers, causes little interruption for customers during installation and maintenance and allows the Company to introduce new services rapidly and at low incremental cost.

**Employees**

As of December 31, 1998, the operating companies and the Company employed 969 employees. In support of the operating companies' and the Company's operations, the Company also regularly uses the services of its local partners, employees and contract technicians for the installation and maintenance of its networks. None of the operating companies' or the Company's employees is represented by a collective bargaining agreement. The Company believes that the operating companies' and the Company's relations with their respective employees are good.

**Competition**

The Company faces competition from many competitors with significantly greater financial resources, well-established brand names and large, existing installed customer bases. Moreover, we expect the level of competition to intensify in the future.

In each of the markets served by the Company's networks, the services offered by the Company compete principally with the services offered by the incumbent LEC serving that area. Incumbent LECs have long-standing relationships with their customers, have the potential to subsidize competitive services from monopoly service revenues, and benefit from favorable state and federal regulations. In light of the passage of the Telecommunications

Act of 1996 (the "Telecommunications Act"), federal and state regulatory initiatives will provide increased business opportunities to competitive local exchange carriers ("CLECs") such as the Company, but regulators are likely to provide incumbent LECs with increased pricing flexibility for their services as competition increases. Further, if a Regional Bell Operating Company ("RBOC") is authorized to provide in region long distance service in one or more states by fulfilling the market operating provisions of the Telecommunications Act, the RBOC may be able to offer "one stop shopping" that would be competitive with the Company's offerings. To date, each request for such authority has been denied by the FCC. An approval could result in decreased market share for the major IXCs, which are among the operating companies' significant customers. Any of these results could have an adverse effect on the Company.

There has been significant merger activity among the RBOCs in anticipation of entry into the long distance market, including the completed merger of Bell Atlantic and NYNEX, whose combined territory covers a substantial portion of the Company's markets. Other combinations have occurred in the industry, which may have an effect on the Company, such as the combination of AT&T Corp. and Teleport Communications Group Inc. ("TCG") and the pending combination of Bell Atlantic and GTE. The effects of these combinations are unknown at this time. The Company believes that combinations of RBOCs and others will also affect the Company's strategy of originating and terminating a significant proportion of its customers' communications traffic over its own networks, rather than relying on the network of the incumbent LEC.

The Company also faces, and will continue to face, competition from other current and potential market entrants, including other CLECs, incumbent LECs which are not subject to RBOC restrictions on long distance, AT&T, MCIWorldCom, Sprint and other IXCs, cable television companies, electric utilities, microwave carriers, wireless telecommunications providers and private networks built by large end users. In addition, new carriers, such as Williams, Qwest Communications International and Level 3 Communications are building and managing nationwide networks which, in some cases, are designed to provide local services. Further, AT&T's acquisition of TCI and MediaOne will exploit ubiquitous local cable infrastructure for telecommunications and other services provided by the operating companies. Finally, although the Company has generally good relationships with the other existing IXCs, there are no assurances that any of these IXCs will not build their own facilities, purchase other carriers or their facilities, or resell the services of other carriers rather than use the Company's services when entering the market for local exchange services.

## Regulation

### Government Overview

A significant portion of the services provided by the Company and its networks are subject to regulation by federal, state and local government agencies. Future federal or state regulations and legislation may be less favorable to us than current regulation and legislation and therefore may have a material and adverse impact on our business and financial projects. In addition, we may expand significant financial and managerial resources to participate in proceedings setting rules at either federal or state level, without achieving a favorable result.

### Federal Legislation and Regulation

The Telecommunications Act ("Telecommunications Act") enacted on February 21, 1996, substantially departs from prior legislation in the telecommunications industry by establishing local exchange competition as a national policy. This act removes state regulatory barriers to competition, and imposes numerous requirements to facilitate the provision of local telecommunications services by multiple providers. For instance, carriers must provide to each other services for resale, number portability, dialing parity, access to rights of way, and compensation for traffic they exchange. Incumbent Local Exchange Carriers ("ILECs") must provide competitors with network interconnection, access to unbundled network elements, and collocation at ILEC premises, among other things. Finally, the FCC is responsible for implementing and presiding over regimes for universal service subsidiaries and access.

The FCC is charged with the broad responsibility of implementing the local competition provisions of the Telecommunications Act. It has done so by promulgating rules which encourage increased local competition. In 1997, a federal appeals court for the Eighth Circuit vacated some of these rules. In January 1999, the United States Supreme Court reversed elements of the Eighth Circuit's ruling, finding that the FCC has broad authority to interpret the Telecommunications Act and issue rules for its implementation. Specifically, the Court stated that the FCC has authority to set pricing guidelines for unbundled network elements, to prevent ILECs from dismantling existing combinations of network elements, and to establish rules allowing competitors to "pick and choose" among provisions of existing interconnection agreements. However, the Court vacated the FCC's rules that identified the unbundled network elements that ILECs must provide to CLECs. The FCC recently initiated a new proceeding to reexamine which unbundled network elements ILECs must provide. In addition, because the Eighth Circuit had only ruled on the FCC's jurisdiction to set a pricing methodology, the ILECs have renewed their opposition to the actual methodology.

Many new carriers have experienced difficulties in working with the ILECs, with respect to provisioning, interconnection, rights-of-way, collocation and implementing the systems used by these new carriers to order and receive unbundled network elements and wholesale service from the ILECs. Coordination with ILECs is necessary for new carriers such as us to provide local service to customers on a timely and competitive basis. The Telecommunications Act created incentives for ILECs to cooperate with new carriers and permit access to their facilities satisfied statutory conditions designed to open their local markets to competition. The ILECs in the Company's proposed markets are not yet permitted by the FCC to offer long distance services and the Company cannot be assured that these ILECs will be accommodating to the Operating Companies once they are permitted to offer long distance service. If the operating companies are unable to obtain the cooperation of a ILEC in a region, whether or not such ILEC has been authorized to offer long distance service, ability to offer local services in such region on a timely and cost effective basis would be adversely affected.

The FCC recently adopted new rules designed to make it easier and less expensive for CLECs to obtain collocation at ILEC central offices by, among other things, restricting the ILECs' ability to prevent certain types of equipment from being collocated and requiring ILECs to offer alternative collocation arrangements to CLECs. The FCC also initiated a new proceeding to address line sharing which, if implemented, would allow CLECs to offer data services over the same line that a consumer uses for voice services without the CLEC having to provide the voice service. While the Company expects that the FCC's new collocation rules will be beneficial to the Operating Companies, it remains uncertain that these new rules will be implemented in a favorable manner. Moreover, ILECs or other parties may ask that FCC to reconsider some or all of its new collocation rules, or may appeal these rules in federal court.

A number of ILECs around the country have been contesting whether the obligation to pay reciprocal compensation to CLECs should apply to local telephone calls terminating ISPs. The ILECs claim that this traffic is interstate in nature and therefore should be exempt from compensation arrangements applicable to local, intrastate calls. Most states have required ILEC to pay ISPs reciprocal compensation. However, on February 25, 1999, the FCC adopted an order in which it determined that calls to ISPs are interstate in nature and proposed rules to govern compensation to carriers for transmitting these calls. It stated, however, that its action was not intended to dislodge previous state decisions interpreting interconnection agreements between ILECs and CLECs to require reciprocal compensation between two local carriers jointly delivering dial-up traffic to ISPs. Although the FCC does not intend to require ISPs to pay access charges to contribute to universal service funds, the FCC's order could affect the costs incurred by ISPs and the demand for their offerings. An unfavorable outcome could materially affect the Company's potential future revenues.

Several ILECs have recently filed petitions at the FCC requesting a waiver of certain obligations imposed on incumbent LECs in the Telecommunications Act with respect to ILEC-provisioned high-speed data services, including, among other things, the obligation to unbundle and offer for resale such services. In addition, the ILECs are seeking to provide high-speed data services on an interLATA basis without complying with the market opening provisions of the competitive checklist set forth in the Telecommunications Act, which would be otherwise required of them. The FCC has subsequently approved that such services are subject to interstate jurisdiction and to the resale and unbundling obligation of the Telecommunications Act. However, the FCC has initiated a proceeding to determine whether ILECs can create separate affiliates for their high speed data services that would be free from these obligations. This outcome could have a material adverse effect on the Company.

Any of the regulatory changes discussed above could require renegotiation of relevant portions of existing interconnection agreements, or subject them to additional court and regulatory proceedings. It remains to be seen whether the operating companies can continue to obtain and maintain interconnection agreements on terms acceptable to them in every state, though most states have already adopted pricing rules, if not interim prices, which are for the most part consistent with the FCC's related pricing provisions.

In an exercise of its "forbearance authority," the FCC has ruled that following a transition period nondominant IXCs will no longer be able to file tariffs with the FCC concerning their interexchange long distance services (the "IXC Detariffing Order"). Tariffs set forth the terms and conditions under which the operating companies provide services. This would deprive the Company of the advantages of being able to rely on terms and conditions contained in a filed tariff, requiring instead reliance on individual contracts. The IXC Detariffing Order has been stayed pending review in the U.S. Court of Appeals for the District of Columbia.

In May 1997, the FCC released an order establishing a significantly expanded federal universal service subsidy regime. For example, the FCC established new subsidies for telecommunications and information services provided to qualifying schools and libraries with an annual cap of $2.3 billion and for services provided to rural health care providers with an annual cap of $400 million. The FCC also expanded the federal subsidies for local exchange telephone service provided to low-income consumers. Providers of interstate telecommunications services, such as the Company, as well as certain other entities, must pay for these programs. The Company's share of the payments into these federal subsidy funds will be based on its share of certain defined telecommunications end-users revenues. Currently, the FCC is assessing such payments on the basis of a provider's revenue for the previous year. In the May 1997 order, the FCC also announced that it will soon revise its rules for subsidizing service provided to consumers in high cost areas, which may result in further substantial increases in the overall cost of the subsidy program. Several parties have appealed the May 1997 order. Such appeals have been consolidated and transferred to the United States Court of Appeals for the Fifth Circuit where oral argument was heard in December 1998. Various states area also in the process of implementing their own universal service programs.

To the extent that the operating companies provide interexchange telecommunications service, access charges are required to be paid to ILECs when the facilities of those companies are used to originate or terminate interexchange calls. Also, as CLECs, the operating companies provide access service to other interexchange service providers. The interstate access charges of ILECs are subject to extensive regulation by the FCC, while those of CLECs are subject to a lesser degree of FCC regulation but remain subject to the requirement that all charges be just, reasonable, and not unreasonably discriminatory. In two orders released in December 1996 and May 1997, the FCC made major changes in the interstate access charge structure. In the December 1996 order, the FCC removed restrictions on ILECs ability to lower access prices and relaxed the regulation of new switched access services in those markets where there are other providers of access service. If this increased pricing flexibility is not effectively monitored by federal regulators, it could have a material adverse effect on the Company's ability to compete in providing interstate access services. The May 1997 order substantially increased the cost that ILECs subject to the FCC's price cap rules ("price cap LECs") recover through a monthly, non-traffic-sensitive access charges. In the May 1997 order, the FCC also announced its plan to bring interstate access rate levels more in line with cost. Th plan will include rules that are expected to be established sometime in 1999 that may grant price cap LECs increased pricing flexibility upon demonstration of increased competition (or potential competition) in relevant markets. The manner in which the FCC implements this approach to lowering access charge levels could have a material effect on the Company's ability to compete in providing interstate access services.

In addition, the operating companies assess access charges to companies that use their facilities to originate or terminate long distance calls. Some of these companies, including AT&T and Sprint, have announced plans to resist paying access charges that exceed the access charges of the ILEC in any given geographic area. While operating companies have not experienced any such challenges to their rights to collect access charges, they could experience them in the future. If so, the effect upon the Company's business could be material and adverse.

The Telecommunications Act prohibits state and local governments from enforcing any law, rule or legal requirement that prohibits or has the effect of prohibiting any entity from providing interstate or intrastate telecommunications services. States retain jurisdiction under the Telecommunications Act to adopt laws necessary to preserve universal service, protect public safety and welfare, ensure the continued quality of telecommunications services and safeguard the rights of consumers. The Company has challenged states' attempts to limit competition in certain rural areas. An FCC order is pending. Depending on the result, the Company's expansion plans may be adversely affected.

The FCC also presides over ongoing proceedings addressing a variety of other matters, including number portability, internet telephony, slamming, and pole attachment. The outcome of any such proceedings may adversely affect the Company and its ability to offer service in competition with LECs.

**State Regulation**

Most State PUCs require companies that wish to provide intrastate common carrier services to be certified to provide such services. These certifications generally require a showing that the carrier has adequate financial, managerial and technical resources to offer the proposed services in a manner consistent with the public interest.

In addition, operating companies have been certificated or are otherwise authorized to provide telecommunications services in Alabama, Arkansas, Connecticut, Delaware, District of Columbia, Florida, Indiana, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Mississippi, New Hampshire, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, South Carolina, Tennessee, Texas, Vermont and Virginia and West Virginia. The certificates or other authorizations permit the operating companies to provide a full range of local telecommunications services, including basic local exchange service. In certain states, each of the Company, its subsidiaries and the operating companies may be subject to additional state regulatory requirements, including tariff filing requirements, to begin offering the telecommunications services for which such entities have been certificated. In some states, and operating company's tariff lists a rate range or sets prices on an individual case basis. Many states also may have additional regulatory requirements such as reporting and customer service and quality requirements, Y2K compliance, unbundling and universal service contributions all of which are subject to change and may adversely affect the Company. In addition, in virtually every state, the Company's certificate or other authorization is subject to the outcome of proceedings by the state commission that address regulation of LECs and CLECs, competition, geographic build-out, mandatory detariffing, and service requirements, and universal service issues.

In addition to obtaining certification, an operating company must negotiate terms of interconnection with the incumbent LEC before it can begin providing switched services. To date, the operating companies have negotiated interconnection agreements with one or more of the incumbent LECs, in each state in which they have been certificated. Agreements are subject to state PUC approval.

**Local Government Authorizations**

An operating company may be required to obtain from municipal authorities street opening and construction permits, or operating franchises, to install and expand its fiber optic networks in certain cities. In some cities, the local partners or subcontractors may already possess the requisite authorizations to construct or expand the Company's networks. An operating company or its local partners also may be required to obtain a license to attach facilities to utility poles in order to build and expand facilities. Because utilities that are owned by a cooperative or municipality are not subject to federal pole attachment regulation, there are no assurances that an operating company or its local partners will be able to obtain pole attachments from these utilities at reasonable rates, terms and conditions.

In some of the areas where the operating companies provide service, their local partners pay license or franchise fees based on a percent of fiber lease payment revenues. In addition, in areas where the Company does not use facilities constructed by a local partner, the operating company may be required to pay such fees. There are no assurances that certain municipalities that do not currently impose fees will not seek to impose fees in the future, nor is there any assurance that, following the expiration of existing franchises, fees will remain at their current levels. In addition, some municipalities may seek to impose requirements or fees on users of transmission facilities, even though they do not own such facilities.

In many markets, other companies providing local telecommunications services, particularly the incumbent LECs, currently are excused from paying license or franchise fees or pay fees that are materially lower than those required to be paid by the operating company or local partner. The Telecommunications Act requires municipalities to charge nondiscriminatory fees to all telecommunications providers, but it is uncertain how quickly this requirement will be implemented by particular municipalities in which the Company operates or plans to operate or whether it will be implemented without a legal challenge initiated by the Company or another CLEC.

If any of the existing Local Partner Agreements or Fiber Lease Agreements held by a local partner or an operating company for a particular market were terminated prior to its expiration date and the local partner or operating company were forced to remove its fiber optic cables from the streets or abandon its network in place, even with compensation, such termination could have a material adverse effect on the Company.

## ITEM 2. PROPERTIES

The Company leases its principal executive offices from Adelphia in Coudersport, Pennsylvania and leases its offices in Pittsburgh, Pennsylvania. Additionally, the Company owns its NOCC facilities.

All of the fiber optic cable, fiber optic telecommunications equipment and other properties and equipment used in the networks, are owned or leased by the applicable operating company. Fiber optic cable plant used in providing service is primarily on or under public roads, highways or streets, with the remainder being on or under private property. As of December 31, 1998, the Company's total telecommunications equipment in service consists of fiber optic telecommunications equipment, fiber optic cable, switches, furniture and fixtures, leasehold improvements and construction in progress. Such properties do not lend themselves to description by character and location of principal units.

Substantially all of the fiber optic telecommunications equipment used in the Company's networks is housed in multiple leased facilities in various locations throughout the metropolitan areas served by the Company. The Company believes that its properties and those of its operating companies are adequate and suitable for their intended purpose.

## ITEM 3. LEGAL PROCEEDINGS

On February 24, 1999, the Company was served with a summons and complaint filed in the United States District Court for the Northern District of New York, Case Number 99-CV-268, by Hyperion Solutions Corporation ("Solutions"), which is described in the complaint as a company in the business of developing, marketing and supporting comprehensive computer software tools, executive information systems and applications that companies use to improve their business performance. The complaint alleges, among other matters, that the Company's use of the name "Hyperion" in its business infringes upon various trademarks and service marks of Solutions in violation of federal trademark laws and violates various New York business practices, advertising and business reputation laws. The complaint seeks, among other matters, to enjoin the Company from using the name or mark "Hyperion" in the Company's business as well as to recover unspecified damages, treble damages and attorneys' fees. Management of the Company believes that the Company has meritorious defenses to the complaint and intends to vigorously defend this lawsuit. Although management believes that this lawsuit will not in any event have a material adverse effect upon the Company, no assurance can be given regarding the effect upon the Company if Solutions were to prevail in this lawsuit.

## ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the quarter ended December 31, 1998, other than those previously reported on the Company's Form 10-Q for the quarterly period ended December 31, 1998.

**Executive Officers of the Registrant**

The executive officers of the Company are:

| Name | Age | Position |
|---|---|---|
| *Executive Officers* | | |
| John J. Rigas | 74 | Chairman and Director |
| James P. Rigas | 41 | Vice Chairman, Chief Executive Officer and Director |
| Michael J. Rigas | 45 | Vice Chairman and Director |
| Timothy J. Rigas | 42 | Vice Chairman, Chief Financial Officer, Treasurer and Director |
| Daniel R. Milliard | 51 | Vice Chairman, President, Secretary and Director |
| *Other Officers* | | |
| Edward E. Babcock, Jr. | 36 | Vice President, Finance |
| Thomas W. Cady | 44 | Vice President, Sales and Marketing |
| Mark Erickson | 45 | Vice President, Operations |
| John B. Glicksman | 38 | Vice President, General Counsel, Assistant Secretary |
| Theodore A. Huf | 57 | Vice President, Engineering |
| John D. Lasater | 46 | Vice President, National Accounts |
| Jeffrey J. Miller | 36 | Vice President, Business Development |

**Executive Officers**

*John J. Rigas* is the Chairman of the Board of the Company. He also is the founder, Chairman, Chief Executive Officer and President of Adelphia. Mr. Rigas has owned and operated cable television systems since 1952. Among his business and community service activities, Mr. Rigas is Chairman of the Board of Directors of Citizens Bank Corp., Inc., Coudersport, Pennsylvania and a member of the Board of Directors of the Charles Cole Memorial Hospital. He is a director of the National Cable Television Association and a member of its Pioneer Association and a past President of the Pennsylvania Cable Television Association. He is also a member of the Board of Directors of C-SPAN and the Cable Advertising Bureau, and is a Trustee of St. Bonaventure University. He graduated from Rensselaer Polytechnic Institute with a B.S. in Management Engineering in 1950.

John J. Rigas is the father of Michael J. Rigas, Timothy J. Rigas and James P. Rigas, each of whom currently serves as a director and executive officer of the Company.

*James P. Rigas* is Vice Chairman, Chief Executive Officer and a Director of the Company, Executive Vice President, Strategic Planning and a Director of Adelphia and a Vice President and Director of Adelphia's other subsidiaries. Mr. Rigas currently spend substantially all of his time on concerns of the Company. He has been with Adelphia since 1986. Mr. Rigas graduated from Harvard University (magna cum laude) in 1980 and received a Juris Doctor degree and an M.A. degree in Economics from Stanford University in 1984. From June 1984 to February 1986, he was a consultant with Bain & Co., a management consulting firm.

*Michael J. Rigas* is Vice Chairman and a Director of the Company, Executive Vice President, Operations and a Director of Adelphia and a Vice President and Director of Adelphia's other subsidiaries. He has been with Adelphia since 1981. From 1979 to 1981, he worked for Webster, Chamberlain & Bean, a Washington, D.C. law firm. Mr. Rigas graduated from Harvard University (magna cum laude) in 1976 and received his Juris Doctor degree from Harvard Law School in 1979.

*Timothy J. Rigas* is Vice Chairman, Chief Financial Officer, Treasurer and a Director of the Company, Executive Vice President, Chief Accounting Officer, Treasurer and a Director of Adelphia, and a Vice President and Director of Adelphia's other subsidiaries. He has been with Adelphia since 1979. Mr. Rigas graduated from the University of Pennsylvania, Wharton School, with a B.S. degree in Economics (cum laude) in 1978.

*Daniel R. Milliard* is Vice Chairman, President, Secretary and a Director of the Company, and Senior Vice President and Secretary and a Director of Adelphia and its other subsidiaries. Mr. Milliard currently spends substantially all of his time on concerns of the Company. He has been with Adelphia since 1982. He served as outside general counsel to Adelphia's predecessors from 1979 to 1982. Mr. Milliard graduated from American University in 1970 with a B.S. degree in Business Administration. He received an M.A. degree in Business from Central Missouri State University in 1971, where he was an Instructor in the Department of Finance, School of Business and Economics, from 1971-73, and received his Juris Doctor degree from the University of Tulsa School of Law in 1976. He is a member of the Board of Directors of Citizens Bank Corp., Inc. in Coudersport, Pennsylvania and is President of the Board of Directors of the Charles Cole Memorial Hospital.

**Other Officers**

*Edward E. Babcock, Jr.*, CPA, is Vice President, Finance of Hyperion. Mr. Babcock joined Adelphia in May 1995 and previously held the position of Director of Financial Administration and Chief Accounting Officer of Adelphia. Prior to joining Adelphia, Mr. Babcock was the Vice President of Finance and Administration of Pure Industries. Before joining Pure Industries, Mr. Babcock spent eight years with the Pittsburgh office of Deloitte & Touche LLP. Mr. Babcock received his B.S. degree in Accounting from The Pennsylvania State University in 1984.

*Thomas W. Cady*, Vice President of Sales and Marketing, joined Hyperion in March 1998. His responsibilities include the development of marketing and sales programs for all of Hyperion's end user products and services. Prior to joining Hyperion, Mr. Cady spent seven years with Xerox, five years with IBM/ROLM and two years with Sprint Telenet in a variety of sales, marketing and management positions. Most recently, Mr. Cady held the position of Senior Vice President of Marketing and Business Development for Cadmus Communications. Mr. Cady graduated from Virginia Tech with a B.S. in Business Administration in 1977, and received an MBA from the University of Richmond in 1984.

*Mark Erickson*, Vice President of Operations, joined Hyperion in June 1998. Prior to joining Hyperion, Mr. Erickson spent 25 years with Bell of PA and Bell Atlantic in a variety of technical and management positions. Mr. Erickson graduated from the Pennsylvania Technical College in 1973.

*John B. Glicksman* is Vice President, General Counsel and Assistant Secretary. Mr. Glicksman joined Adelphia in February 1992 and previously held the position of Deputy General Counsel for Operations. Prior to joining Adelphia, Mr. Glicksman was in private practice with the Washington, D.C. law firms of Leventhal, Senter & Lerman; Fleischman and Walsh; and Howrey & Simon. Mr. Glicksman received his J.D. degree, with honors, from the National Law Center, George Washington University, Washington, D.C. and his B.A. degree, with high honors, from Trinity College, Hartford, Connecticut.

*Theodore A. Huf* has served as Vice President of Engineering since March 1998, with responsibilities for both network and switch engineering. Mr. Huf previously served as Director of Operations and Engineering for Hyperion since December 1991, and was responsible for all city operations and network engineering. Prior to joining Hyperion, Mr. Huf worked for Adelphia since 1971 in various engineering and operations management positions.

*John D. Lasater*, Vice President of National Accounts, joined Hyperion in January 1998 and is responsible for national account marketing and sales. Mr. Lasater joined MCI in 1991 as Manager of Major Accounts for Nashville, Tennessee. In 1993 he was appointed Executive Manager, National Accounts for MCI, managing the national account sales and marketing organization for Tennessee and Kentucky. Prior to joining MCI, Mr. Lasater held sales and marketing positions with South Central Bell and AT&T Information Systems. Mr. Lasater is a 1975 summa cum laude graduate of Belmont University.

*Jeffrey J. Miller*, Vice President of Business Development, joined Hyperion in April 1998 and is responsible for leading business development efforts and contract negotiations. Mr. Miller joined Adelphia in December 1990 and held the positions of Director of Wireless Operations and Regional Controller. Prior to joining

Adelphia, Mr. Miller spent seven years with the Stamford, Connecticut office of Arthur Young and Company. Mr. Miller graduated magna cum laude from Lehigh University in 1984 with a B.S. in Accounting.

## PART II

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

*Market Information*

The Company's Class A common stock is quoted on the National Association of Securities Dealers Automated Quotations System National Market System (NASDAQ-NMS). Hyperion's NASDAQ-NMS symbol is "HYPT". There was no established public trading market for the Company's Class A common stock until the completion of its initial public offering in May 1998.

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

**CLASS A COMMON STOCK**

| QUARTER ENDED: | HIGH | LOW |
|---|---|---|
| June 30, 1998 | $18 1/6 | $ 14 1/4 |
| September 30, 1998 | $16 5/8 | $ 5 7/8 |
| December 31, 1998 | $15 1/8 | $ 4 1/2 |

As of May 21, 1999 there were 144 holders of record of the Company's Class A common stock, par value $0.01 per share and 25 holders of record of the Company's Class B common stock, par value $0.01 per share.

*Dividends*

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

## ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data as of and for each of the four years in the period ended March 31, 1998 and the nine months ended December 31, 1998 have been derived from the audited consolidated financial statements of the Company and the related notes thereto. These data should be read in conjunction with the consolidated financial statements and related notes thereto for the years ended March 31, 1997 and 1998 and the nine months ended December 31, 1998 and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this Transition Report on Form 10-K. The balance sheet data as of March 31, 1995, 1996 and 1997 and the statement of operations data and the other Company data with respect to the fiscal years ended March 31, 1995 and 1996 have been derived from audited consolidated financial statements of the Company not included herein.

| | Year Ended March 31, | | | | Nine Months Ended December 31, |
|---|---|---|---|---|---|
| | 1995 | 1996 | 1997 | 1998 | 1998 |
| **Statement of Operations Data (a):** | (Dollars in thousands, except per share amounts) | | | | |
| Revenues | $ 1,729 | $ 3,322 | $ 5,088 | $ 13,510 | $ 34,776 |
| Operating expenses: | | | | | |
| Network operations | 1,382 | 2,690 | 3,432 | 7,804 | 18,709 |
| Selling, general and administrative | 2,524 | 3,084 | 6,780 | 14,314 | 35,341 |
| Depreciation and amortization | 463 | 1,184 | 3,945 | 11,477 | 26,671 |
| Operating loss | (2,640) | (3,636) | (9,069) | (20,085) | (45,945) |
| Gain on sale of investment | --- | --- | 8,405 | --- | --- |
| Interest income | 39 | 199 | 5,976 | 13,304 | 10,233 |
| Interest income – affiliate | --- | --- | --- | --- | 8,395 |
| Interest expense and fees | (3,321) | (6,088) | (28,377) | (49,334) | (38,638) |
| Other income | --- | --- | --- | --- | 1,113 |
| Equity in net loss of joint ventures | (1,799) | (4,292) | (7,223) | (12,967) | (9,580) |
| Net loss | (7,692) | (13,620) | (30,547) | (69,082) | (74,185) |
| Dividend requirements applicable to preferred stock | --- | --- | --- | (12,409) | (21,117) |
| Net loss applicable to common stockholders | (7,692) | (13,620) | (30,547) | (81,491) | (95,302) |
| Basic and diluted net loss per weighted average share of common stock | $ (0.24) | $ (0.42) | $ (0.89) | $ (2.33) | $ (1.80) |
| Common stock dividends | --- | --- | --- | --- | --- |
| **Other Company Data (a):** | | | | | |
| EBITDA (b) | $ (2,177) | $ (2,452) | $ (5,124) | $ (8,608) | $ (19,274) |
| Capital expenditures and Company investments (c) | 10,376 | 18,899 | 79,396 | 132,889 | 215,770 |
| Cash used in operating activities | (2,130) | (833) | (4,823) | (6,333) | (8,810) |
| Cash used in investing activities | (10,376) | (18,899) | (72,818) | (266,604) | (200,458) |
| Cash provided by financing activities | 12,506 | 19,732 | 137,455 | 443,873 | 221,088 |

| | As of March 31, | | | | As of December 31, |
|---|---|---|---|---|---|
| | 1995 | 1996 | 1997 | 1998 | 1998 |
| | (Dollars in thousands) | | | | |
| **Balance Sheet Data (a):** | | | | | |
| Cash and cash equivalents | $ --- | $ --- | $ 59,814 | $ 230,750 | $ 242,570 |
| Total assets | 23,212 | 35,269 | 174,601 | 639,992 | 836,342 |
| Long term debt and exchangeable redeemable preferred stock | 35,541 | 50,855 | 215,675 | 735,980 | 722,783 |
| Common stock and other stockholders' equity (deficiency) | (13,703) | (27,323) | (50,254) | (118,991) | 74,031 |

(a) The data presented represents financial information for the Company and its consolidated subsidiaries. As of December 31, 1998, 10 of the Company's networks were owned by joint ventures in which it owned an interest of 50% or less, and for which the Company reports its interest pursuant to the equity method of accounting consistent with generally accepted accounting principles.

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

(c) For the fiscal years ended March 31, 1995, 1996, 1997 and 1998 and the nine months ended December 31, 1998, the Company's capital expenditures (including capital expenditures relating to its wholly owned operating companies) were $2.9, $6.1, $24.6, $68.6 and $146.8 million, respectively, and the Company's investments in its less than wholly owned operating companies were $7.5, $12.8, $34.8, $64.3 and $69.0 million, respectively, for the same periods. Furthermore, during the fiscal year ended March 31, 1997, the Company invested $20.0 million in fiber assets and a senior secured note.

## Supplemental Operating Company Financial and Operating Data

The following supplemental unaudited financial results and network operating data of Hyperion and its operating companies is derived from Company information. All financial results are presented on an Adjusted GAAP basis (see note (a) below). See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Supplementary Operating Company Financial Analysis." The Company reports its interest in its 50% or less owned networks pursuant to the equity method of accounting consistent with generally accepted accounting principles. As a result, the financial information set forth below is not indicative of the Company's overall financial position or results of operations.

### ADJUSTED GAAP (a)

| | Unaudited | | |
|---|---|---|---|
| | Year Ended March 31, | | Nine Months Ended December 31, |
| | 1997 | 1998 | 1998 |
| | (Dollars in thousands) | | |
| Operating revenue | $ 14,159 | $ 27,255 | $ 47,336 |
| Direct operating expenses | 8,018 | 12,894 | 22,432 |
| Gross margin | 6,141 | 14,361 | 24,904 |
| Selling, general and administrative expenses | 11,829 | 21,845 | 39,608 |
| Depreciation and amortization expense | 26,793 | 36,079 | 39,101 |
| Operating loss | (32,481) | (43,563) | (53,805) |
| Interest income | 6,035 | 13,175 | 10,345 |
| Interest income – affiliate | --- | 527 | 8,396 |
| Interest expense | (30,948) | (52,420) | (39,597) |
| Other income | 8,146 | --- | 1,113 |
| Net loss | (52,874) | (90,005) | (82,309) |
| Dividend requirements applicable to preferred stock | --- | (12,409) | (21,117) |
| Net loss applicable to common stockholders | $ (52,874) | $ (102,414) | $ (103,426) |
| Basic and diluted net loss per weighted average share of common stock | $ (1.54) | $ (2.93) | $ (1.95) |
| Weighted average shares of common stock outstanding (in thousands) | 34,421 | 34,986 | 53,035 |
| **Other Operating Data:** | | | |
| EBITDA (b) | $ (5,688) | $ (7,484) | $ (14,704) |
| Capital Expenditures | 74,170 | 115,519 | 158,059 |

| | As of March 31, | | December 31, |
|---|---|---|---|
| | 1997 | 1998 | 1998 |
| **Other Network Data:** | | | |
| Gross property, plant & equipment (in thousands) (c) | $ 169,174 | $ 336,473 | $ 533,719 |
| Networks (d) | 21 | 22 | 22 |
| Markets served (e) | 33 | 46 | 46 |
| Route miles (e) | 3,461 | 5,363 | 15,005 |
| Fiber miles (e) | 166,131 | 249,672 | 369,777 |
| Buildings w/ customers | 1,270 | 1,909 | 6,460 |
| LEC central offices collocated | 104 | 113 | 123 |
| Access lines sold | 7,000 | 41,500 | 133,686 |
| Access lines installed | 1,450 | 23,200 | 110,005 |
| Switches installed (f) | 7 | 17 | 20 |
| Employees (g) | 261 | 571 | 969 |

(a) The adjusted GAAP financial data presented represents the collective sum of Hyperion and Hyperion's economic interest in each of the operating companies it owns and manages at Hyperion's ownership percentage adjusted for the consolidation of certain joint ventures (Buffalo, Syracuse, New Jersey, Louisville, Lexington, Harrisburg, Richmond, Jacksonville and Wichita). While this presentation format is not in accordance with generally accepted accounting principles ("GAAP"), management of Hyperion believes that this format depicts the operational progress, and the associated economic effect on Hyperion, of the Company's results of operations. Network Data is derived from the operating companies' records and presents information for the Company's networks.

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

(c) Represents adjusted GAAP property, plant and equipment (before accumulated depreciation) of the networks, the NOCC and the Company.

(d) Includes networks under construction.

(e) Data as of March 31, 1997 excludes networks under construction. Data as of March 31, 1998 and December 31, 1998 includes networks under construction.

(f) Represents Lucent 5ESS switches or remote switch modules which deliver full switch functionality.

(g) Employees includes employees of both the operating companies and the Company.

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

**(Dollars in thousands except per share amounts)**

**Overview**

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements. Certain information included in this Transition Report on Form 10-K, including Management's Discussion and Analysis of Financial Condition and Results of Operations, is forward-looking, such as information relating to the effects of future regulation, future capital commitments and the effects of competition. Such forward-looking information involves important risks and uncertainties that could significantly affect expected results in the future from those expressed in any forward-looking statements made by, or on behalf of, the Company. These "forward looking statements" can be identified by the use of forward-looking terminology such as "believes," "expects," "may," "will," "should," "intends" or "intends" or "anticipates" or the negative thereof or other variations thereon or comparable terminology, or by discussions of strategy that involve risks and uncertainties. These risks and uncertainties include, but are not limited to, uncertainties relating to economic conditions, acquisitions and divestitures, the cost of availability of capital, government and regulatory policies, the pricing and availability of equipment, materials, inventories and programming, Year 2000 issues, product acceptance, technological developments and changes in the competitive environment in which the Company operates. Persons reading this Transition Report on Form 10-K are cautioned that forward-looking statements herein are only predictions, that no assurance can be given that the future results will be achieved, and that actual events or results may differ materially as a result of the risks and uncertainties facing the Company.

The "Company" or "Hyperion" means Hyperion Telecommunications, Inc. together with its majority-owned subsidiaries, except where the context otherwise requires. Unless the context otherwise requires, references herein to the "networks" or the "Company's networks" mean the (a) 22 telecommunications networks (in 46 markets served) in operation or under construction (the "Existing Networks") owned as of December 31, 1998 by 20 Operating Companies (which, as defined herein, are (i) wholly and majority owned subsidiaries of the Company or (ii) joint venture partnerships and corporations managed by the Company and in which the Company holds less than a majority equity interest with one or more other partners) and (b) additional networks under development (the "New Networks") as of such date.

Hyperion is a super-regional provider of communications services offering a full range of communications services to customers that include businesses, governmental and educational end users and other telecommunications service providers throughout the eastern United States. The Company provides these customers with communications services such as local switch dial tone, long distance service, high speed data, and Internet connectivity. The customer has a choice of receiving these services individually or as part of a bundle of services, which is typically priced at a discount when compared to the price of the individual services. In order to take advantage of the improved economic returns from providing services over the Company's own network system (having "on-net" traffic), the Company is in the process of significantly expanding the reach of its network system. This network system expansion includes the purchase, lease or construction of fiber optic network facilities in more than 50 new markets and the interconnection of all of the Company's existing and new markets with the Company's own fiber optic network facilities, as well as implementing various technologies including Dense Wave Division Multiplexing ("DWDM") to provide greater bandwidth capacity on the Company's local and long-haul network system.

By the year 2001, Hyperion expects to serve most of the major cities in the eastern half of the United States. The Company currently provides communications services in 46 markets and plans to introduce services in more than 50 new markets, expanding Hyperion's presence to approximately 30 states. At December 31, 1998, the Company had installed 20 Lucent 5ESS switches or remote switching modules and plans to put in operation during 1999 nine additional regional switches (the "super switches"). Once fully installed, the Company's fiber optic backbone will connect each of the Company's markets. This fully redundant, 16,000 route mile network system will support Hyperion's full line of communications service offerings. The Company has chosen the eastern half of the United States as its overall target market because it presents an opportunity for rapid growth. Once fully deployed, management believes that the Company's network system will encompass over 26 million addressable business access lines (approximately 34% of the nation's population), which currently generate annual estimated communications services revenues of over $50,000,000.

The Company has experienced initial success in the sale of business access lines with approximately 133,686 access lines sold as of December 31, 1998, of which approximately 110,005 lines are installed. This represents an addition of 39,726 access lines sold and 32,871 access lines installed during the quarter ended December 31, 1998. As of December 31, 1998, approximately 63% of these access lines are provisioned entirely on the Company's network ("on-net lines") with the remainder being a combination of unbundled loops or total service resale from LEC networks.

*Financing and Acquisition Transactions*

On May 8, 1998, Hyperion issued and sold 12,500,000 shares of Class A common stock at a price to the public of $16.00 per share (the "IPO"). Simultaneously with the closing of the IPO, Hyperion issued and sold an additional 3,324,001 shares of Class A common stock to Adelphia at a purchase price of $15.00 per share (or an aggregate of approximately $49,900). In addition, at such closing, Hyperion issued 3,642,666 shares of Class A common stock to Adelphia in exchange for certain of Hyperion's indebtedness and payables owed to Adelphia at a purchase price of $15.00 per share (or an aggregate of $54,600). In a related transaction, on June 5, 1998, Hyperion issued and sold 350,000 shares of Class A common stock at the $16.00 IPO price pursuant to the underwriters' over-allotment option in the IPO. At December 31, 1998, Adelphia owned approximately 66% of the Hyperion outstanding common stock and approximately 86% of the total voting power.

On March 2, 1999 Hyperion issued $300,000 of 12% Senior Subordinated Notes due 2007 (the "Subordinated Notes"). An entity controlled by members of the Rigas family, controlling stockholders of Adephia, purchased $100,000 of the Subordinated Notes directly from Hyperion at a price equal to the aggregate principal amount less the discount to the initial purchasers. The net proceeds of approximately $295,000 were or will be used to fund Hyperion's acquisition of interests held by local partners in certain of its markets and will be used to fund capital expenditures and investments in its networks and for general corporate and working capital purposes.

On March 23, 1999, Hyperion consummated a purchase agreement with Multimedia, Inc. ("Multimedia"), the parent of its local partner in the Wichita, KS market, whereby Multimedia received approximately $9,778 in cash for Multimedia's ownership interest in this network. In addition, Hyperion will be responsible for the payment of fiber lease liabilities due to Multimedia in the amount of approximately $2,800 which are payable over the next six years. As a result of the transaction, the Hyperion ownership in Wichita increased to 100%.

On March 31, 1999, Hyperion consummated purchase agreements with subsidiaries of MediaOne of Colorado, Inc. ("MediaOne"), its local partners in the Jacksonville, FL and Richmond, VA networks, whereby MediaOne received approximately $81,520 in cash for MediaOne's ownership interests in these networks. In addition, Hyperion will be responsible for the payment of fiber lease liabilities due to MediaOne in the amount of approximately $14,500 which are generally payable over the next ten years. As a result of the transactions, Hyperion's ownership interest in each of these networks increased to 100%. Together with the Multimedia acquisition, these transactions are referred to below as the "Roll-ups."

On March 31, 1999, Hyperion entered into purchase agreements with Entergy Corporation ("Entergy"), the parent of its local partner in the Baton Rouge, LA, Little Rock, AR and Jackson, MS markets, whereby Entergy will receive $35,776 in cash for Entergy's ownership interests in these markets. Upon consummation of this transaction, which is subject to normal closing conditions and regulatory approvals, the Company's ownership interest in each of these networks will increase to 100%.

**Results of Operations**

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

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

*Revenues* increased 300% to $34,776 for the nine months ended December 31, 1998, from $8,690 for the same period in the prior fiscal year. Growth in revenues of $26,086 resulted from an increase in revenues from majority and wholly-owned Operating Companies of approximately $27,171 as compared to the same period in the prior fiscal year due to the continued expansion of the Company's customer base, its success in the roll out of switched services as a result of the retail end user strategy adopted by the Company and the consolidation of the Buffalo, Syracuse, New Jersey, Louisville, Lexington and Harrisburg networks. Management fees from non-consolidated subsidiaries decreased $1,085 as compared to the same period in the prior fiscal year primarily due to the consolidation of the above mentioned networks.

*Network operations expense* increased 255% to $18,709 for the nine months ended December 31, 1998 from $5,263 for the same period in the prior fiscal year. The increase was attributable to the expansion of operations at the NOCC, and the increased number and size of the operations of the Operating Companies which resulted in increased employee related costs and equipment maintenance costs and the consolidation of the Buffalo, Syracuse, New Jersey, Louisville, Lexington and Harrisburg networks.

*Selling, general and administrative expense* increased 288% to $35,341 for the nine months ended December 31, 1998 from $9,099 for the same period in the prior fiscal year. The increase was due primarily to increased expense associated with the network expansion plan, an increase in the sales force in the Existing Networks and an increase in corporate overhead costs to accommodate the growth in the number, size and operations of Operating Companies managed and monitored by the Company, as well as the consolidation of the Buffalo, Syracuse, New Jersey, Louisville, Lexington and Harrisburg networks.

*Depreciation and amortization expense* increased 280% to $26,671 during the nine months ended December 31, 1998 from $7,027 for the same period in the prior fiscal year primarily as a result of increased amortization of deferred financing costs and increased depreciation resulting from the higher depreciable asset base at the NOCC and the majority and wholly owned Operating Companies and the consolidation of the Buffalo, Syracuse, New Jersey, Louisville, Lexington and Harrisburg networks.

*Interest income* for the nine months ended December 31, 1998 increased 33% to $10,233 from $7,675 for the same period in the prior fiscal year as a result of increased cash and cash equivalents and U.S. Government securities due to the investment of the proceeds of the 12 1/4% Senior Secured Notes, the 12 7/8% Senior Exchangeable Redeemable Preferred Stock and the IPO, partially offset by demand advances made to Adelphia.

*Interest income – affiliate* for the nine months ended December 31, 1998 increased to $8,395 from $276 as a result of demand advances made to Adelphia during the current period.

*Interest expense* increased 8% to $38,638 during the nine months ended December 31, 1998 from $35,934 for the same period in the prior fiscal year. The increase was attributable to the interest on the 12 1/4% Senior Secured Notes partially offset by the reduction of interest expense associated with the reduced amounts payable to Adelphia and higher interest capitalized on networks under construction.

*Equity in net loss of joint ventures* increased to $9,580 during the nine months ended December 31, 1998 from $9,284 for the same period in the prior fiscal year. The net losses of the nonconsolidated Operating Companies for the nine months ended December 31, 1998 were primarily the result of increased revenues only partially offsetting startup and other costs and expenses associated with design, construction, operation and management of the networks of the Operating Companies, and the effect of the typical lag time between the incurrence of such costs and expenses and the subsequent generation of revenues by a network. The increase was partially offset by the consolidation of the Buffalo, Syracuse, New Jersey, Louisville, Lexington and Harrisburg networks for the current period.

The number of non-consolidated Operating Companies paying management fees to the Company was 8 at December 31, 1998. These Operating Companies and networks under construction paid management and monitoring fees to the Company, which are included in revenues, aggregating approximately $2,724 for the nine months ended December 31, 1998, as compared with $3,809 for the same period in the prior fiscal year. The non-consolidated Operating Companies' net losses, including networks under construction, for the nine months ended December 31, 1997 and 1998 aggregated approximately $13,719 and $22,325 respectively.

*Preferred stock dividends* increased by 264% to $21,117 for the nine months ended December 31, 1998 from $5,794 for the same period in the prior fiscal year. The increase is due to the preferred stock which was issued in October 1997.

*Year ended March 31, 1998 in comparison with year ended March 31, 1997*

*Revenues* increased 166% to $13.5 million for the fiscal year ended March 31, 1998, from $5.1 million in the prior fiscal year. Growth in revenues of $8.4 million resulted primarily from majority and wholly-owned Operating Companies' revenues which increased approximately $6.8 million as compared to the prior fiscal year due to increases in the customer base and the impact of consolidation of the Buffalo, Syracuse, New Jersey, Louisville, Lexington and Harrisburg Operating Companies. Management fees from nonconsolidated Operating Companies increased $1.6 million over the prior fiscal year due to a full year of operation in Philadelphia and the commencement of operations in the markets served in partnership with Entergy.

*Network operations expense* increased 127% to $7.8 million in Fiscal 1998 from $3.4 million in the prior fiscal. The increase was attributable to the expansion of operations at the NOCC, and the increased number and size of the operations of the Operating Companies which resulted in increased employee related costs and equipment maintenance costs and the consolidation of the Buffalo, Syracuse, New Jersey, Louisville, Lexington and Harrisburg Operating Companies.

*Selling, general and administrative expense* increased 111% to $14.3 in Fiscal 1998 from $6.8 million in the prior fiscal year. The increase was due to an increase in the sales required to support the existing networks, corporate and NOCC overhead cost increases to accommodate the growth in the number and size of the Operating Companies and the consolidation of the Buffalo, Syracuse, New Jersey, Louisville, Lexington and Harrisburg Operating Companies.

*Depreciation and amortization expense* increased 191% to $11.5 million during Fiscal 1998 from $3.9 million in the prior fiscal year primarily as a result of increased depreciation resulting from higher capital expenditures at the NOCC and the consolidated Operating Companies and the amortization of costs incurred in connection with the issuance of the 12 1/4% Senior Secured Notes.

*Gain on sale of investment* for Fiscal 1997 was due to the sale of the Company's 15.7% partnership interest in TCG of South Florida to Teleport Communications Group Inc. on May 16, 1996 for an aggregate sale price of approximately $11.6 million. This sale resulted in a gain of $8.4 million. No such sale occurred during Fiscal 1998.

*Interest income* for Fiscal 1998 increased to $13.3 million from $6.0 in the prior fiscal year as a result of interest income earned on investment of the proceeds of the 12 1/4% Senior Secured Notes, the 12 7/8% Senior Exchangeable Redeemable Preferred.

*Interest expense and fees increased* 74% to $49.3 million during Fiscal 1998 from $28.4 million in the prior fiscal year. The increase was attributable to incremental non-cash interest expense associated with the 13% Senior Discount Notes and interest expense associated with the 12 1/4% Senior Secured Notes.

*Equity in net loss of joint ventures* increased by 80% to $13 million Fiscal 1998 from $7.2 million in the prior fiscal year as more non-consolidated Operating Companies began operations. The net losses of the non-consolidated Operating Companies for Fiscal 1998 were primarily the result revenues only partially offsetting startup and other costs and expenses associated with design, construction, operation and management of the networks of the non-consolidated Operating Companies, and the effect of the typical lag time between the incurrence of such costs and expenses and the subsequent generation of revenues by a network.

The number of non-consolidated Operating Companies paying management fees to the Company decreased form 12 at March 31, 1997 to 8 at March 31, 1998. These networks paid management and monitoring fees to the Company, which are included in revenues, aggregating approximately $4.8 million for Fiscal 1998, an increase of approximately $1.6 million over prior fiscal year. The non-consolidated networks' net losses, including networks under construction, for Fiscal 1998 aggregated approximately $19.9 million.

*Dividend requirements applicable to preferred stock* during the year ended March 31, 1998 resulted from the 12 7/8% Senior Exchangeable Redeemable Preferred Stock issued in October 1997.

**Supplementary Operating Company Financial Analysis**

The Company believes that historically, working with local partners to develop markets has enabled the Company to build larger networks in a rapid and more cost effective manner then it could have on its own. As of December 31, 1998, the Company had joint ventures covering 10 networks with local partners where the Company owns 50% or less of each joint venture. In three of these joint ventures, the Company has recently purchased its local partners' interest. As a result of the Company's historic ownership position in these joint ventures, a substantial portion of the Operating Companies' historic results are reported by the Company on the equity method of accounting for investments which only reflects the Company's pro rata share of net income or loss of the unconsolidated Operating Companies. Because of the recently completed Roll-ups, the historical Generally Accepted Accounting Principles ("GAAP") presentation of the assets, liabilities and results of operations of the Company does not represent a complete measure of the financial position, growth or operations of the Company.

In order to provide an additional measure of the financial position, growth and performance of the Company and its Operating Companies, management of the Company analyzes financial information of the Operating Companies on an adjusted GAAP basis. Adjusted GAAP reflects Hyperion's consolidated GAAP financial position and results of operations adjusted for the inclusion of certain operating companies (Buffalo, Syracuse, New Jersey, Louisville, Lexington, Harrisburg, Richmond, Jacksonville, and Wichita) which were either purchased in February 1998 or are involved in the Roll-ups, as more fully described in "Item 1-Business, Recent Developments". All adjusted GAAP results of operations are presented as if Hyperion consolidated all Operating Companies which were either purchased in February 1998 or are involved in the Roll-ups during the entire period presented. This financial information, however, is not indicative of the Company's overall historical financial position or results of operations.

Summary adjusted GAAP information:

| | Nine Months Ended December 31, 1997 | Nine Months Ended December 31, 1998 |
|---|---|---|
| Adjusted GAAP revenue | $ 18,715 | $ 47,336 |
| Adjusted GAAP EBITDA | (5,086) | (14,704) |
| Adjusted GAAP operating loss | (31,719) | (53,805) |
| Adjusted GAAP net loss applicable to common stockholders | (72,913) | (103,426) |
| Adjusted GAAP capital expenditures | 76,029 | 158,059 |
| Adjusted GAAP gross property, plant and equipment | 386,089 | 533,719 |

For the nine months ended December 31, 1998, adjusted GAAP revenue increased 153% to $47,336 as compared to $18,715 for the same period in the prior fiscal year. The increase in revenues resulted from the continued expansion of the Company's customer base and its success in the roll out of switched services as a result of the retail end user strategy adopted by the Company.

For the nine months ended December 31, 1998, adjusted GAAP EBITDA loss was $14,704 as compared to $5,086 for the same period in the prior fiscal year. The increase in adjusted GAAP EBITDA loss for the nine months ended December 31, 1998 was due primarily to increased selling, general, and administrative expenses as a result of the increase in direct sales and marketing distribution channels as the Company has aggressively moved to an end-user strategy over the past year, focusing on medium to large business customers, governmental and educational end-user and other telecommunications service providers, and was also due to increased costs associated with the Company's New Network expansion efforts.

For the nine months ended December 31, 1998, adjusted GAAP operating loss was $53,805 as compared to $31,719 for the same period in the prior fiscal year. The increase in adjusted GAAP operating loss was due primarily to the above mentioned increase in selling, general and administrative expenses and increased depreciation and amortization expense resulting from a higher depreciable asset base.

For the nine months ended December 31, 1998, adjusted GAAP net loss applicable to common stockholders was $103,426 as compared to $72,913 for the same period in the prior fiscal year. The increase in adjusted GAAP net loss applicable to common stockholders was due primarily to the above mentioned increase in selling, general and administrative expenses, increased depreciation and amortization, increased equity in net loss of joint ventures and increased preferred stock dividends associated with the Company's financing activities. In particular, depreciation and amortization increased substantially due to the significant capital investment the Company has made and the consolidation of the Operating Companies involved in the February 1998 acquisitions and the Roll-ups.

During the nine months ended December 31, 1998, the Company and its Operating Companies invested $200,331 in capital expenditures, of which Hyperion's adjusted GAAP share was $158,059.

**Liquidity and Capital Resources**

The development of the Company's business and the installation and expansion of the Operating Companies' networks, as well as the development of the New Networks, combined with the construction of the

Company's NOCC, have resulted in substantial capital expenditures and investments during the past several years. Capital expenditures by the Company were $39,775 and $146,752 for the nine months ended December 31, 1997 and 1998, respectively. Further, investments made by the Company in nonconsolidated Operating Companies and in LMDS licenses were $53,194 and $69,018 for the nine months ended December 31, 1997 and 1998, respectively. The significant increase in capital expenditures for the nine months ended December 31, 1998 as compared with the same period in the prior fiscal year is largely attributable to capital expenditures necessary to develop the Existing Networks and the New Networks, as well as the fiber purchases to interconnect the networks. The Company expects that it will continue to incur substantial capital expenditures in this development effort. The Company also expects to continue to fund operating losses as the Company develops and grows its business. For information regarding recent transactions affecting the Company's liquidity and capital resources, see "Financing and Acquisition Transactions."

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

Expansion of the Company's Existing Networks and services and the development of New Networks and additional networks and services requires significant capital expenditures. The Company's operations have required and will continue to require substantial capital investment for (i) the installation of electronics for switched services in the Company's networks, (ii) the expansion and improvement of the Company's NOCC and Existing Networks, (iii) the design, construction and development of New Networks and (iv) the acquisition of additional ownership interests in Existing Networks or New Networks. The Company has made substantial capital investments and investments in Operating Companies in connection with the installation of 5ESS switches or remote switching modules in all of its Existing Networks and plans to install regional super switches in certain key New Networks when such New Networks are operational. To date, the Company has installed switches in 20 of its Existing Networks and plans to provide such services in all of its New Networks on a standard switching platform based on Lucent 5 switch technology. In addition, the Company intends to increase spending on marketing and sales significantly in the foreseeable future in connection with the expansion of its sales force and marketing efforts generally. The Company also plans to purchase its partners' interest in the Operating Companies when it can do so at attractive economic terms. The Company estimates that it will require approximately $400,000 to fund the Roll-ups, the Entergy acquisition, anticipated capital expenditures, working capital requirements and operating losses and pro rata investments in the Operating Companies from January 1999 through the end of March 2000. The Company believes that the net proceeds from the offering of the Subordinated Notes, together with its existing cash balance and internally generated funds, will be sufficient to fund the Rollups, the Entergy acquisition, the Company's capital expenditures, working capital requirements, operating losses and pro rata investments in the Operating Company's capital expenditures through the fiscal quarter ended September 30, 2000. In addition, there can be no assurance (i) that the Company's future cash requirements will not vary significantly from those presently planned due to a variety of factors including acquisition of additional networks, development of the LMDS spectrum, continued acquisition of increased ownership in its networks and material variances from expected capital expenditure requirements for Existing Networks and New Networks or (ii) that anticipated financings, local partner investments and other sources of capital will become available to the Company. In addition, it is possible that expansion of the Company's networks may include the geographic expansion of the Company's existing clusters and the development or acquisition of other new markets not currently planned. The Company expects to continue to build new networks in additional markets, which have broader geographic coverage and require higher capital outlays than those with partners in the past. The Company also has funded the purchase of certain partnership interests and expects to fund additional purchases of partnership interests.

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

**Recent Accounting Pronouncements**

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

Statement of Position ("SOP") 98-5, "Reporting on the Cost of Start-Up Activities", has been issued and is effective for fiscal years beginning after December 15, 1998. SOP 98-5 provides guidance on the financial reporting of start up costs and organizational costs. It requires such costs to be expensed as incurred. Management of the Company believes that SOP 98-5 will not have a material impact on the Company's financial statements.

**Year 2000 Issues**

The year 2000 issue refers to the inability of computerized systems and technologies to recognize and process dates beyond December 31, 1999. This could present risks to the operation of the Company's business in several ways. The Company is evaluating the impact of the year 2000 issue on its business applications and its products and services. The evaluation includes a review of the Company's information technology systems, telephony equipment and other embedded technologies. A significant portion of the Company's computerized systems and technologies have been developed, installed or upgraded in recent years and are generally more likely to be year 2000 ready. The Company is also evaluating the potential impact as a result of its reliance on third-party systems that may have year 2000 issues.

Computerized business applications that could be adversely affected by the year 2000 issue include:

- information processing and financial reporting systems,
- customer billing systems,
- customer service systems,
- telecommunication transmission and reception systems, and
- facility systems.

System failure or miscalculation could result in an inability to process transactions, send invoices, accept customer orders or provide customers with products and services. Customers could also experience a temporary inability to receive or use the Company's products and services.

The Company has developed a program to assess and address the year 2000 issue. This program consists of the following phases:

- inventorying and assessing the impact on affected technology and systems,
- developing solutions for affected technology and systems,
- modifying or replacing affected technology and systems,
- testing and verifying solutions,

- implementing solutions, and
- developing contingency plans.

The Company has substantially completed inventorying and assessing the affected computerized systems and technologies. The Company is in various stages of its year 2000 compliance program with respect to the remaining phases as it relates to the affected systems and technologies.

The Company has engaged a consulting firm familiar with its financial reporting systems. This firm has developed and tested year 2000 solutions that the Company is in the process of implementing. The Company expects its financial reporting systems to be year 2000 compliant by July 1999.

A third-party billing vendor currently facilitates customer billing. The Company is currently in the process of testing an in-house service ordering, provisioning, maintenance and billing system that would replace the third-party billing vendor. The Company expects to have this new system implemented by September 1999. On a contingency basis, the third-party vendor has provided a written statement that it will certify it is fully year 2000 compliant by August 1999.

Telecommunication plant rebuilds and upgrades in recent years have minimized the potential impact of the year 2000 issue on the Company's facilities, customer service, telecommunication transmission and reception systems. The Company is engaged in a comprehensive internal inventory and assessment of all hardware components and component controlling software throughout its telecommunication networks. The Company expects to implement any hardware and software modifications, upgrades or replacements resulting from the internal review by August 1999.

Through December 31, 1998, costs incurred directly related to addressing the year 2000 issue totaled $350. The Company has also redeployed internal resources to meet the goals of its year 2000 program. The Company currently estimates the total cost of its year 2000 remediation program to be approximately $775. Although the Company will continue to incur substantial capital expenditures in the ordinary course of meeting its telecommunications system upgrade goals through the year 2000, it will not specifically accelerate its expenditures to facilitate year 2000 readiness, and accordingly such expenditures are not included in the above estimate.

The Company has begun communicating with others with whom it does significant business to determine their year 2000 readiness and to determine the extent to which the Company is vulnerable to year 2000 issues related to those third parties. The Company purchases much of its technology from third parties. There can be no assurance that the systems of other companies on which the Company's systems rely will be year 2000 ready or timely converted into systems compatible with the Company systems. The Company's failure or a third-party's failure to become year 2000 ready or the Company's inability to become compatible with third parties with which the Company has a material relationship, may have a material adverse effect on the Company, including significant service interruption or outages; however the Company can not currently estimate the extent of any such adverse effects.

The Company is in the process of identifying secondary sources to supply its systems or services in the event it becomes probable that any of its systems will not be year 2000 ready prior to the end of 1999. The Company is also in the process of identifying secondary vendors and service providers to replace those vendors and service providers whose failure to be year 2000 ready could lead to a significant delay in the company's ability to provide its service to its customers.

**Impact of Inflation**

The Company does not believe that inflation has had a significant impact on the Company's consolidated operations or on the operations of the Operating Companies in the past two fiscal years in the period ended March 31, 1998 and the nine months ended December 31, 1998.

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

The Company uses fixed rate debt to fund its working capital requirements, capital expenditures and acquisitions. These debt arrangements expose the Company to market risk related to changes in interest rates. The table below summarizes the fair values and contract terms of the Company's financial instruments subject to interest rate risk as of December 31, 1998.

| | Expected Maturity | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 1999 | 2000 | 2001 | 2002 | 2003 | Thereafter | Total | Fair Value |
| Debt: | --- | --- | --- | --- | 303,840 | 478,674 | 782,514 | 669,924 |
| Fixed Rate Average Interest Rate | 12.72% | 12.72% | 12.72% | 12.72% | 12.62% | 12.62% | | |

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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

## HYPERION TELECOMMUNICATIONS, INC. AND SUBSIDIARIES

## INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

**INDEPENDENT AUDITORS' REPORT**

Hyperion Telecommunications, Inc.:

We have audited the accompanying consolidated balance sheets of Hyperion Telecommunications, Inc. and subsidiaries as of March 31, 1998 and December 31, 1998; and the related consolidated statements of operations, of common stock and other stockholders' equity (deficiency) and of cash flows for the years ended March 31, 1997 and 1998 and the nine months ended December 31, 1998. Our audits also included the financial statement schedule listed in the Index at Item 14. These financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Hyperion Telecommunications, Inc. and subsidiaries at March 31, 1998 and December 31, 1998, and the results of their operations and their cash flows for the years ended March 31, 1997 and 1998 and the nine months ended December 31, 1998 in conformity with generally accepted accounting principles. Also, in our opinion such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

DELOITTE & TOUCHE LLP

Pittsburgh, Pennsylvania
May 17, 1999

**HYPERION TELECOMMUNICATIONS, INC. AND SUBSIDIARIES**
**CONSOLIDATED BALANCE SHEETS**
**(Dollars in thousands except per share amounts)**

| | March 31, 1998 | December 31, 1998 |
|---|---|---|
| ASSETS: | | |
| Current assets: | | |
| Cash and cash equivalents | $ 230,750 | $ 242,570 |
| Due from parent – net | --- | 4,950 |
| Due from affiliates – net | 2,151 | 1,078 |
| Accounts receivable – net | 4,434 | 15,583 |
| Total current assets | 237,335 | 264,181 |
| U.S. government securities – pledged | 70,535 | 58,054 |
| Investments | 53,064 | 112,328 |
| Property, plant and equipment—net | 250,633 | 374,702 |
| Other assets—net | 28,425 | 27,077 |
| Total | $ 639,992 | $ 836,342 |
| LIABILITIES, PREFERRED STOCK, COMMON STOCK AND OTHER STOCKHOLDERS' EQUITY (DEFICIENCY): | | |
| Current liabilities: | | |
| Accounts payable | $ 11,775 | $ 20,386 |
| Due to parent—net | 6,541 | --- |
| Accrued interest and other liabilities | 4,687 | 19,142 |
| Total current liabilities | 23,003 | 39,528 |
| 13% Senior Discount Notes due 2003 | 215,213 | 220,784 |
| 12 1/4% Senior Secured Notes due 2004 | 250,000 | 250,000 |
| Note payable—Adelphia | 35,876 | --- |
| Other debt | 27,687 | 23,325 |
| Total liabilities | 551,779 | 533,637 |
| 12 7/8% Senior Exchangeable Redeemable Preferred Stock | 207,204 | 228,674 |
| Commitments and contingencies (Note 7) | | |
| Common stock and other stockholders' equity (deficiency): | | |
| Class A common stock, $0.01 par value, 300,000,000 shares authorized, 396,500 and 22,376,071 shares outstanding, respectively | 4 | 224 |
| Class B common stock, $0.01 par value, 150,000,000 shares authorized, 32,500,000 and 32,314,761 shares outstanding, respectively | 325 | 323 |
| Additional paid in capital | 179 | 286,782 |
| Class A common stock warrant | 13,000 | --- |
| Class B common stock warrants | 11,087 | 4,483 |
| Loans to stockholders | (3,000) | --- |
| Accumulated deficit | (140,586) | (217,781) |
| Total common stock and other stockholders' equity (deficiency) | (118,991) | 74,031 |
| Total | $ 639,992 | $ 836,342 |

See notes to consolidated financial statements.

**HYPERION TELECOMMUNICATIONS, INC. AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF OPERATIONS**
**(Amounts in thousands except per share amounts)**

| | Year Ended March 31, 1997 | Year Ended March 31, 1998 | Nine Months Ended December 31, 1998 |
|---|---|---|---|
| Revenues | $ 5,088 | $ 13,510 | $ 34,776 |
| Operating expenses: | | | |
| Network operations | 3,432 | 7,804 | 18,709 |
| Selling, general and administrative | 6,780 | 14,314 | 35,341 |
| Depreciation and amortization | 3,945 | 11,477 | 26,671 |
| Total | 14,157 | 33,595 | 80,721 |
| Operating loss | (9,069) | (20,085) | (45,945) |
| Other income (expense): | | | |
| Gain on sale of investment | 8,405 | --- | --- |
| Interest income | 5,976 | 13,304 | 10,233 |
| Interest income – affiliate | --- | --- | 8,395 |
| Interest expense and fees | (28,377) | (49,334) | (38,638) |
| Other income | --- | --- | 1,113 |
| Loss before income taxes, equity in net loss of joint ventures and extraordinary gain | (23,065) | (56,115) | (64,842) |
| Income tax expense | (259) | --- | --- |
| Loss before equity in net loss of joint ventures and extraordinary gain | (23,324) | (56,115) | (64,842) |
| Equity in net loss of joint ventures | (7,223) | (12,967) | (9,580) |
| Loss before extraordinary gain | (30,547) | (69,082) | (74,422) |
| Extraordinary gain on repurchase of debt | --- | --- | 237 |
| Net loss | (30,547) | (69,082) | (74,185) |
| Dividend requirements applicable to preferred stock | --- | (12,409) | (21,117) |
| Net loss applicable to common stockholders | $ (30,547) | $ (81,491) | $ (95,302) |
| Basic and diluted net loss per weighted average share of common stock before extraordinary gain | $ (0.89) | $ (2.33) | $ (1.81) |
| Basic and diluted extraordinary gain on repurchase of debt per weighted average share of common stock | --- | --- | 0.01 |
| Basic and diluted net loss per weighted average share of common stock | $ (0.89) | $ (2.33) | $ (1.80) |
| Weighted average shares of common stock outstanding | 34,421 | 34,986 | 53,035 |

See notes to consolidated financial statements.

## HYPERION TELECOMMUNICATIONS, INC. AND SUBSIDIARIES
## CONSOLIDATED STATEMENTS OF COMMON STOCK AND OTHER STOCKHOLDERS' EQUITY (DEFICIENCY)
### (Dollars in thousands except per share amounts)

| | Class A Common Stock | Class B Common Stock | Additional Paid-in Capital | Class A Common Stock Warrant | Class B Common Stock Warrants | Loans to Stockholders | Accumulated Deficit | Total |
|---|---|---|---|---|---|---|---|---|
| Balance, March 31, 1996 | $ --- | $ 325 | $ --- | $ --- | $ --- | $ --- | $ (27,648) | $ (27,323) |
| Proceeds from issuance of Class B common stock warrants | --- | --- | --- | --- | 11,087 | --- | --- | 11,087 |
| Loans to stockholders | --- | --- | --- | --- | --- | (3,000) | --- | (3,000) |
| Excess of purchase price of acquired assets over related party predecessor owner's carrying value | --- | --- | --- | --- | --- | --- | (627) | (627) |
| Issuance of Class A common stock bonus | 3 | --- | 153 | --- | --- | --- | --- | 156 |
| Net loss | --- | --- | --- | --- | --- | --- | (30,547) | (30,547) |
| Balance, March 31, 1997 | 3 | 325 | 153 | --- | 11,087 | (3,000) | (58,822) | (50,254) |
| Issuance of Class A common stock warrant | --- | --- | --- | 13,000 | --- | --- | --- | 13,000 |
| Dividend requirements applicable to preferred stock | --- | --- | --- | --- | --- | --- | (12,409) | (12,409) |
| Other | --- | --- | --- | --- | --- | --- | (273) | (273) |
| Issuance of Class A common stock bonus | 1 | --- | 26 | --- | --- | --- | --- | 27 |
| Net loss | --- | --- | --- | --- | --- | --- | (69,082) | (69,082) |
| Balance, March 31, 1998 | 4 | 325 | 179 | 13,000 | 11,087 | (3,000) | (140,586) | (118,991) |
| Proceeds from issuance of Class A common stock | 129 | --- | 190,731 | --- | --- | --- | --- | 190,860 |
| Proceeds from issuance of Class A common stock to Adelphia | 33 | --- | 49,827 | --- | --- | --- | --- | 49,860 |
| Exercise of Class A common stock warrant | 7 | --- | 12,993 | (13,000) | --- | --- | --- | --- |
| Conversion of note and payables to Adelphia to Class A common stock | 36 | --- | 44,222 | --- | --- | --- | --- | 44,258 |
| Exercise of Class B common stock warrants | --- | 8 | 6,596 | --- | (6,604) | --- | --- | --- |
| Conversion of Class B common stock to Class A common stock | 10 | (10) | --- | --- | --- | --- | --- | --- |
| Repayment of loan to stockholders | --- | --- | --- | --- | --- | 3,000 | --- | 3,000 |
| Dividend requirements applicable to preferred stock | --- | --- | (18,168) | --- | --- | --- | (2,949) | (21,117) |
| Other | --- | --- | (353) | --- | --- | --- | (61) | (414) |
| Issuance of Class A common stock bonus | 5 | --- | 755 | --- | --- | --- | --- | 760 |
| Net loss | --- | --- | --- | --- | --- | --- | (74,185) | (74,185) |
| Balance December 31, 1998 | $ 224 | $ 323 | $286,782 | $ --- | $ 4,483 | $ --- | $(217,781) | $ 74,031 |

See notes to consolidated financial statements.

## HYPERION TELECOMMUNICATIONS, INC. AND SUBSIDIARIES
## CONSOLIDATED STATEMENTS OF CASH FLOWS
### (Dollars in thousands)

| | Year Ended March 31, 1997 | Year Ended March 31, 1998 | Nine Months Ended December 31, 1998 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Net loss | $ (30,547) | $ (69,082) | $ (74,185) |
| adjustments to reconcile net loss to net cash used in operating activities: | | | |
| Depreciation | 2,604 | 9,038 | 23,838 |
| Amortization | 1,341 | 2,439 | 2,833 |
| Equity in net loss of joint ventures | 7,223 | 12,967 | 9,580 |
| Non-cash interest expense | 23,467 | 34,038 | 23,857 |
| Deferred income taxes | 257 | --- | --- |
| Gain on sale of investment | (8,405) | --- | --- |
| Issuance of Class A common stock bonus | 156 | 27 | 761 |
| Extraordinary gain on repurchase of debt | --- | --- | (237) |
| Changes in operating assets and liabilities, net of effects of acquisitions: | | | |
| Other assets—net | (624) | (5,302) | (15,533) |
| Accounts payable | (264) | 6,023 | 9,862 |
| Accrued interest and other liabilities – net | (31) | 3,519 | 10,414 |
| Net cash used in operating activities | (4,823) | (6,333) | (8,810) |
| Cash flows from investing activities: | | | |
| Net cash used for acquisitions | (5,040) | (65,968) | --- |
| Expenditures for property, plant and equipment | (24,627) | (68,629) | (146,752) |
| Investment in fiber asset and senior secured note | (20,000) | --- | --- |
| Proceeds from sale of investment | 11,618 | --- | --- |
| Investments in joint ventures | (34,769) | (64,260) | (69,018) |
| Investments in U.S. government securities – pledged | --- | (83,400) | --- |
| Sale of U.S. government securities – pledged | --- | 15,653 | 15,312 |
| Net cash used in investing activities | (72,818) | (266,604) | (200,458) |
| Cash flows from financing activities: | | | |
| Proceeds from issuance of preferred stock | --- | 194,522 | --- |
| Proceeds from issuance of Class A common stock | --- | --- | 255,462 |
| Proceeds from sale and leaseback of equipment | --- | 14,876 | --- |
| Proceeds from debt | 163,705 | 250,000 | --- |
| Repayments of debt | --- | (2,326) | (19,868) |
| Proceeds from issuance of Class B common stock warrants | 11,087 | --- | --- |
| Costs associated with debt financing | (6,555) | (12,664) | --- |
| Costs associated with issuance of Class A common stock | --- | --- | (14,742) |
| (Loans to) repayment from stockholders | (3,000) | --- | 3,000 |
| Repayment of note payable—Adelphia | (25,000) | --- | --- |
| Advances to affiliates | (2,782) | (535) | (2,764) |
| Net cash provided by financing activities | 137,455 | 443,873 | 221,088 |
| Increase in cash and cash equivalents | 59,814 | 170,936 | 11,820 |
| Cash and cash equivalents, beginning of period | --- | 59,814 | 230,750 |
| Cash and cash equivalents, end of period | $ 59,814 | $ 230,750 | $ 242,570 |

See notes to consolidated financial statements.

## HYPERION TELECOMMUNICATIONS, INC. AND SUBSIDIARIES
## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
## (Dollars in thousands except per share amounts)

### (1) The Company and Summary of Significant Accounting Policies

*Organization and Business*

The consolidated financial statements include the accounts of Hyperion Telecommunications, Inc. and it's wholly and majority owned subsidiaries ("Hyperion" or the "Company"). All significant intercompany accounts and transactions have been eliminated in consolidation. The Company was formed in 1991 and is a majority owned subsidiary of Adelphia Communications Corporation ("Adelphia").

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

On May 8, 1998, the Company issued and sold 12,500,000 shares of Class A common stock at a price to the public of $16.00 per share (the "IPO"). Simultaneously with the closing of the IPO, the Company issued and sold an additional 3,324,001 shares of Class A common stock to Adelphia at a purchase price of $15.00 per share (or an aggregate of approximately $49,900). In addition, at such closing, the Company issued 3,642,666 shares of Class A common stock to Adelphia in exchange for certain of the Company's indebtedness and payables with a carrying value of $44,258 owed to Adelphia at a purchase price of $15.00 per share (or an aggregate of $54,600). In a related transaction, on June 5, 1998, the Company issued and sold 350,000 shares of Class A common stock at the $16.00 IPO price pursuant to the underwriters' over-allotment option in the IPO. At December 31, 1998, Adelphia owned approximately 66% of Hyperion's outstanding common stock and approximately 86% of total voting power.

The Company provides facilities-based telecommunications services through its subsidiaries and joint ventures, in which it has less than a majority ownership interest. The Company's efforts have been directed primarily toward becoming an owner and manager of competitive local exchange carrier ("CLEC") business telecommunications services in selected mid-sized cities. The Company has historically partnered with a local cable television or utility company, whose fiber facilities are located in the market areas, to build competitive access fiber optic networks. The Company then operates the networks for a management fee. Most networks provide local switch dial tone, long distance service, high-speed data and internet connectivity to businesses, governmental and educational end users and other telecommunication service providers. The Company's revenues are derived from a combination of direct business telecommunication services provided by its subsidiaries and management fees from its unconsolidated joint ventures.

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

*Acquisitions and Sale of Partner Interests*

On May 16, 1996, the Company sold its 15.7% interest in TCG of South Florida for approximately $11,618 resulting in a pre-tax gain of $8,405. Amounts related to TCG of South Florida included in the Company's equity in net loss of joint ventures for the year ended March 31, 1997 were $221.

On August 1, 1996, the Company purchased additional general and limited partnership interests in Hyperion of Tennessee for approximately $5,000, which increased the Company's ownership of Hyperion of Tennessee to 95%.

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

**(Dollars in thousands except per share amounts)**

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

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

The following unaudited financial information of the Company assumes that the August 1, 1996, September 12, 1997 and February 12, 1998 transactions had occurred on April 1, 1996.

| | Year Ended March 31, 1997 | Year Ended March 31, 1998 | Nine Months Ended December 31, 1998 |
|---|---|---|---|
| Revenues | $ 8,495 | $ 17,919 | $ 34,776 |
| Net loss | (38,744) | (80,004) | (74,185) |
| Net loss applicable to common stockholders | (38,744) | (92,413) | (95,302) |
| Net loss per weighted average share of common stock | (1.10) | (2.59) | (1.80) |

See Note 4 for discussion of other partnership interest purchases subsequent to December 31, 1998.

*Cash and cash equivalents*

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

*U.S. Government Securities – Pledged*

U.S. Government Securities – Pledged consist of highly liquid investments which will be used to pay the first six semi-annual interest payments of the 12 ¼% Senior Secured Notes. Such investments are classified as held-to-maturity and the carrying value approximates market value.

*Accounts Receivable*

An allowance for doubtful accounts of $1,128 is recorded as a reduction of accounts receivable at December 31, 1998. There was no allowance for doubtful accounts at March 31, 1998.

*Property, Plant and Equipment*

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

(Dollars in thousands except per share amounts)

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

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

| | |
|---|---|
| Telecommunications networks | 10-20 years |
| Network monitoring and switching equipment | 5-10 years |
| Other | 3-10 years |

*Revenue Recognition*

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

*Significant Customers*

During the nine months ended December 31, 1998, Hyperion's sales to AT&T and Bell Atlantic represented 11.4% and 10.1% of total revenues, respectively. During the year ended March 31, 1998, Hyperion sales to AT&T and MCIWorldCom ("MCI"), represented 18.3% and 14.5% of total revenues, respectively.

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

Basic net loss per weighted average share of common stock is computed based upon the weighted average number of common shares and warrants outstanding during the period. Diluted net loss per common share is equal to basic net loss per common share because the Adelphia Warrant discussed in Note 6 had an antidilutive effect for the periods presented; however, the Adelphia Warrant could have a dilutive effect on earnings per share in future periods. A warrant to purchase 731,624 shares of Class A common stock and Class B common stock warrants to purchase shares of Class B common stock have been included as shares outstanding for purposes of the calculation of both basic and diluted net loss per share for the years ended March 31, 1997 and 1998 and the nine months ended December 31, 1998. All references in the accompanying consolidated financial statements to the number of shares of common stock have been retroactively restated to reflect the stock split (See Note 6).

*Other Assets - net*

Costs incurred in developing new networks or expanding existing networks negotiating rights-of-way and obtaining legal/regulatory authorizations are deferred and amortized over five years. Pre-operating costs, included in other assets, represent certain non-development costs incurred during the pre-operating phase of a newly constructed network and are amortized over five-year periods commencing with the start of operations. Deferred debt financing costs, included in other assets, are amortized over the term of the related debt. The unamortized amounts of deferred debt financing costs at March 31, 1998 and December 31, 1998 were $16,566 and $14,606, respectively. Also included in other assets at March 31, 1998 and December 31, 1998 is a Senior Secured Note (See Note 3).

*Asset Impairments*

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

*Financial Instruments*

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

The Company's financial instruments include cash and cash equivalents, Note payable—Adelphia, Senior Secured Notes, Senior Discount Notes and Redeemable Preferred Stock. The fair value of the Note payable – Adelphia exceeded the carrying value by $11,443 at March 31, 1998. The fair value of the Senior Secured Notes exceeded carrying value by approximately $31,250 and $2,500 at March 31, 1998 and December 31, 1998, respectively. The fair value of the Redeemable Preferred Stock exceeded the carrying value by approximately $15,688 at March 31, 1998; the carrying value of the Redeemable Preferred Stock exceeded the fair value by approximately $23,938 at December 31, 1998. The fair value of the Senior Discount Notes exceeded the carrying value by approximately $35,649 and $9,516 at March 31, 1998 and December 31, 1998, respectively. The fair value of the Note payable—Adelphia was estimated based upon the terms in comparison with other similar instruments. The fair value of the Senior Discount Notes, the Senior Secured Notes and the Redeemable Preferred Stock were based upon quoted market prices.

*Non-cash Financing and Investing Activities*

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

*Use of Estimates in the Preparation of Financial Statements*

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

(Dollars in thousands except per share amounts)

*Recent Accounting Pronouncements*

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

Statement of Position ("SOP") 98-5, "Reporting on the Costs of Start-Up Activities," has been issued and is effective for fiscal years beginning after December 15, 1998. SOP 98-5 provides guidance on the financial reporting of start up costs and organization costs. It requires such costs to be expensed as incurred. Management of the Company believes that SOP 98-5 will not have a material impact on the Company's financial statements.

*Reclassifications*

For the fiscal years ended March 31, 1997 and 1998, certain amounts have been reclassified to conform with the presentation for the nine months ended December 31, 1998.

**(2) Property, Plant and Equipment**

Property, plant and equipment consists of the following:

| | March 31, 1998 | December 31, 1998 |
|---|---|---|
| Telecommunications networks | $ 50,421 | $ 59,764 |
| Network monitoring and switching equipment | 130,283 | 165,697 |
| Fiber asset under construction (Note 3) | 11,500 | 11,500 |
| Fiber optic use rights | --- | 44,109 |
| Construction in process | 66,075 | 123,439 |
| Other | 6,605 | 8,282 |
| | 264,884 | 412,791 |
| Less accumulated depreciation | (14,251) | (38,089) |
| Total | $250,633 | $374,702 |

Depreciation is computed on the straight-line method using estimated useful lives of 5 to 20 years for operating plant and equipment and 3 to 20 years for support equipment and real estate. Additions to property, plant and equipment are recorded at cost which includes amounts for material, applicable labor and overhead and interest. Depreciation expense amounted to $2,604, $9,038 and $23,838 for the years ended March 31, 1997 and 1998 and the nine months ended December 31, 1998, respectively. Capitalized interest amounted to $4,271 and $9,986 for the year ended March 31, 1998 and the nine months ended December 31,1998, respectively.

**(3) Investment in Fiber Asset and Senior Secured Note**

On February 20, 1997, the Company entered into several agreements regarding the leasing of dark fiber in New York state in furtherance of its strategy to interconnect its networks in the northeastern United States. Pursuant to these agreements and in consideration of a payment of $20,000, the Company received a $20,000 Senior Secured

(Dollars in thousands except per share amounts)

Note bearing interest at 22 1/2% (subject to reduction upon early repayment of principal) due February 2002 (subject to early redemption options), from Telergy, Inc. ("Telergy"), a right to receive 58,752 shares of Telergy Class A common stock ("Telergy Stock"), and a fully prepaid lease from a Telergy affiliate for an initial lease term of 25 years (with two additional ten-year extensions) for 24 strands of dark fiber installed or to be installed in a New York fiber optic telecommunications backbone network. The Company has included $11,500 and $8,500 in Property, Plant and Equipment and Other Assets, respectively, as the allocation of the $20,000 payment between the fiber asset and the Senior Secured Note. No amounts were allocated to the Telergy Stock. The allocation reflects the Company's estimate of the relative fair values of the assets acquired. Hyperion will recognize the interest income on the Senior Secured Note when received.

During the nine months ended December 31, 1998, construction of the fiber has continued and no repayments have been received on the Senior Secured Note. On May 15, 1998, Telergy paid Hyperion $1,000 in exchange for the Telergy Stock and a gain of $1,000 was recorded by the Company, which is included in "other income" in the consolidated statement of operations.

On November 10, 1998, the Senior Secured Note was amended to mature on January 20, 2000 in exchange for an indefeasible right to use ("IRU") or long term lease of certain fiber segments in New York City and along Telergy's long haul fiber segments in the northeastern United States and Southeastern Canada.

**(4) Investments**

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

The Company's nonconsolidated investments are as follows:

| | Ownership Percentage | March 31, 1998 | December 31, 1998 |
|---|---|---|---|
| MediaOne Fiber Technologies (Jacksonville) | 20.0% (1) | $ 7,984 | $ 8,150 |
| Multimedia Hyperion Telecommunications (Wichita) | 49.9% (2) | 3,537 | 5,863 |
| MediaOne of Virginia (Richmond) | 37.0% (1) | 7,213 | 7,284 |
| PECO-Hyperion (Philadelphia) | 50.0% | 21,229 | 33,936 |
| PECO-Hyperion (Allentown, Bethlehem, Easton, Reading) | 50.0% | 2,753 | 7,227 |
| Hyperion of York | 50.0% | 4,256 | 5,721 |
| Allegheny Hyperion Telecommunications | 50.0% | --- | 3,043 |
| Entergy Hyperion Telecommunications of Louisiana | 50.0% (3) | 3,407 | 6,714 |
| Entergy Hyperion Telecommunications of Mississippi | 50.0% (3) | 3,666 | 7,130 |
| Entergy Hyperion Telecommunications of Arkansas | 50.0% (3) | 4,209 | 7,586 |
| Baker Creek Communications | 49.9% (4) | 10,009 | 44,637 |
| Other | Various | 1,333 | 1,323 |
| | | 69,596 | 138,614 |
| Cumulative equity in net losses | | (16,532) | (26,286) |
| Total Investments | | $ 53,064 | $ 112,328 |

## HYPERION TELECOMMUNICATIONS, INC. AND SUBSIDIARIES
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### (Dollars in thousands except per share amounts)

(1) As discussed below, the Company consummated agreements on March 31, 1999 which increased its ownership to 100% in these networks.
(2) As discussed below, the Company consummated agreements on March 23, 1999 which increased its ownership to 100% in this network.
(3) As discussed below, the Company entered into a definitive agreement on March 31, 1999 to increase its ownership to 100% in these networks.
(4) On March 24, 1998, the Federal Communications Commission ("FCC") completed the auction of licenses for Local Multipoint Distribution Service ("LMDS"). In connection with the FCC's full review of all bids and the granting of final licenses, the Company, through Baker Creek Communications, acquired 195 licenses for a total cost of approximately $44,605, $10,000 of which was paid upon submission of the Company's bid in January 1998 with the remainder paid as of October 1998.

Summarized unaudited combined financial information for the Company's nonconsolidated investments listed above being accounted for using the equity method of accounting as of the dates and for the periods ended, is as follows:

| | March 31, 1998 | December 31, 1998 |
|---|---|---|
| Current assets | $ 7,476 | $ 11,315 |
| PP&E-net | 153,495 | 190,552 |
| Non-current assets | 13,454 | 47,522 |
| Current liabilities | 13,422 | 18,599 |
| Non-current liabilities | 58,004 | 48,635 |

| | Year Ended March 31, | | Nine months ended December 31, |
|---|---|---|---|
| | 1997 | 1998 | 1998 |
| Revenues | $ 7,251 | $ 11,999 | $ 24,986 |
| Net loss | (9,881) | (19,923) | (22,325) |

During 1998, through a partnership in which Hyperion is a 49.9% limited partner, the Company was the successful bidder, at a cost of approximately $45,000, for 195 31-GHz licenses (see above), which cover approximately 83 million people in the eastern United States representing coverage in most of its network system territory. Hyperion and its partner are currently in the process of dissolving the partnership and the licenses are to become the property of Hyperion at no additional cost to Hyperion. As of December 31, 1998, the partnership had fully funded its obligation due to the FCC. The Company plans to use the LMDS spectrum in most of its markets, and believes the spectrum to be highly complementary to its fiber-based systems as an economical means to provide "last-mile" connectivity for customers which otherwise could not be economically addressed with broadband connectivity. The Company is in the process of further refining its plans for utilization of the LMDS spectrum, which could involve substantial additional funds.

On March 23, 1999, Hyperion consummated a purchase agreement with Multimedia, Inc. ("Multimedia"), the parent of its local partner in the Wichita, KS market, whereby Multimedia received approximately $9,778 in cash for Multimedia's ownership interest in this network. In addition, Hyperion will be responsible for the payment of fiber lease liabilities due to Multimedia in the amount of approximately $2,800 which are payable over the next six years. As a result of the transaction, the Hyperion ownership in Wichita increased to 100%.

On March 31, 1999, Hyperion consummated purchase agreements with subsidiaries of MediaOne of Colorado, Inc. ("MediaOne"), its local partners in the Jacksonville, FL and Richmond, VA networks, whereby MediaOne received approximately $81,520 in cash for MediaOne's ownership interests in these networks. In addition, Hyperion will be responsible for the payment of fiber lease liabilities due to MediaOne in the amount of approximately $14,500 which are generally payable over the next ten years. As a result of the transactions, Hyperion's ownership interest in each of these networks increased to 100%.

On March 31, 1999, Hyperion entered into purchase agreements with Entergy Corporation ("Entergy"), the parent of its local partner in the Baton Rouge, LA, Little Rock, AR, and Jackson, MS markets, whereby Entergy will receive $35,776 in cash for Entergy's ownership interests in each of these markets. Upon consummation of this transaction, which is subject to normal closing conditions and regulatory approvals, the Company's ownership interest in each of these networks will increase to 100%.

**(5) Financing Arrangements**

*Note payable - Adelphia*

The Company had an unsecured credit arrangement with Adelphia which had no repayment terms prior to April 15, 1996. On April 15, 1996, $25,000 of the proceeds from the sale of the 13% Senior Discount Notes (the "Senior Discount Notes") and Class B Common stock Warrants discussed below were used to repay a portion of this obligation. Interest expense and fees on this credit arrangement were based upon the weighted average cost of unsecured borrowings of Adelphia during the corresponding periods. The total amount of interest converted to note principal through April 15, 1996 was $9,007.

Effective April 15, 1996, the remaining balance due on the Note payable-Adelphia was evidenced by an unsecured subordinated note due April 16, 2003. This obligation had an interest rate of 16.5% per annum. Interest accrued through May 8, 1998 on the amount outstanding to Adelphia totaled $10,645. On May 8, 1998, the Note payable – Adelphia and all accrued interest was converted into shares of Class A common stock simultaneously with the closing of the IPO (See Note 1).

*13% Senior Discount Notes and Class B Common Stock Warrants*

On April 15, 1996, the Company issued $329,000 of 13% Senior Discount Notes due April 15, 2003 and 329,000 warrants to purchase an aggregate of 1,993,638 shares of its Class B common stock. Proceeds to the Company, net of discounts, commissions, and other transaction costs were approximately $168,600. Prior to April 15, 2001, interest on the Senior Discount Notes is not payable in cash, but is added to principal. Thereafter, interest is payable semi-annually commencing October 15, 2001. The Senior Discount Notes are unsecured and are senior to all future subordinated indebtedness. On or before April 15, 1999 and subject to certain restrictions, the Company may redeem, at its option, up to 25% of the aggregate principal amount of the Senior Discount Notes at a price of 113% of the Accreted Value (as defined in the Indenture). On or after April 15, 2001, the Company may redeem, at its option, all or a portion of the Senior Discount Notes at 106.5% which declines to par in 2002, plus accrued interest.

The holders of the Senior Discount Notes may put the Senior Discount Notes to the Company at any time at a price of 101% of accreted principal upon the occurrence of a Change of Control (as defined in the Indenture). In addition, the Company will be required to offer to purchase Senior Discount Notes at a price of 100% with the proceeds of certain asset sales (as defined in the Indenture). The Indenture stipulates, among other things, limitations on additional borrowings, issuance of equity instruments, payment of dividends and other distributions, repurchase of equity interests or subordinated debt, sale—leaseback transactions, liens, transactions with affiliates, sales of Company assets, mergers and consolidations.

The Class B common stock warrants are exercisable at $0.00308 per share, upon the earlier of May 1, 1997 or a Change of Control. Unless exercised, the Class B common stock warrants expire on April 1, 2001. The number of shares and the exercise price for which a warrant is exercisable are subject to adjustment under certain circumstances. Through December 31, 1998, 195,965 warrants were exercised and converted into 1,187,541 shares of Class B common stock. Of the 1,187,541 shares issued, 1,172,391 shares had been converted into Class A common stock as of December 31, 1998. The Company received $3 in consideration for the exercise of the warrants.

During the nine months ended December 31, 1998, the Company paid $17,313 to repurchase a portion of the Senior Discount Notes which had a face value of $25,160 and a carrying value of $17,750. The notes were retired upon repurchase which resulted in a $237 gain.

*12 1/4% Senior Secured Notes*

On August 27, 1997, the Company issued $250,000 aggregate principal amount of 12 1/4% Senior Secured Notes due September 1, 2004 (the "Senior Secured Notes"). The Senior Secured Notes are collateralized through the pledge of the common stock of certain of the Company's wholly owned subsidiaries. A portion of the proceeds was invested in U.S. government securities and placed in an escrow account for payment in full when due of the first six scheduled semi-annual interest payments on the Senior Secured Notes as required by the Indenture.

Interest is payable semi-annually commencing March 1, 1998. The Senior Secured notes rank *pari passu* in right of payment with all existing and future senior Indebtedness (as defined in the Indenture) of the Company and will rank senior in right of payment to future subordinated Indebtedness of the Company. On or before September 1, 2000 and subject to certain restrictions, the Company may redeem, at its option, up to 25% of the aggregate principal amount of the Senior Secured Notes at a price of 112.25% of principal with the net proceeds of one or more Qualified Equity Offerings (as defined in the Indenture). On or after September 1, 2001, the Company may redeem, at its option, all or a portion of the Senior Secured Notes at 106.125% of principal which declines to par in 2003, plus accrued interest. The holders of the Senior Secured Notes may put them to the Company at a price of 101% of principal upon the occurrence of a Change of Control (as defined in the Indenture). The Indenture stipulates, among other things, limitations on additional borrowing, payment of dividends and other distributions, repurchase of equity interests, transactions with affiliates and the sale of assets.

*12 7/8% Senior Exchangeable Redeemable Preferred Stock*

On October 9, 1997, the Company issued $200,000 aggregate liquidation preference of 12 7/8% Senior Exchangeable Redeemable Preferred Stock due October 15, 2007 (the "Preferred Stock"). Proceeds to the Company, net of commissions and other transaction costs, were approximately $194,500.

Dividends are payable quarterly commencing January 15, 1998 at 12 7/8% of the liquidation preference of outstanding Preferred Stock. Through October 15, 2002, dividends are payable in cash or additional shares of Preferred Stock at the Company's option. Subsequent to October 15, 2002, dividends are payable in cash. The Preferred Stock ranks junior in right of payment to all indebtedness and other obligations of the Company, its subsidiaries and joint ventures. On or before October 15, 2000, and subject to certain restrictions, the Company may redeem, at its option, up to 35% of the initial aggregate liquidation preference of the Preferred Stock originally issued with the net cash proceeds of one or more Qualified Equity Offerings (as defined in the Certificate of Designation) at a redemption price equal to 112.875% of the liquidation preference per share of the Preferred Stock, plus, without duplication, accumulated and unpaid dividends to the date of redemption; provided that, after any such redemption, there are remaining outstanding shares of Preferred Stock having an aggregate liquidation preference of at least 65% of the initial aggregate liquidation preference of the Preferred Stock originally issued. On or after October 15, 2002, the Company may redeem, at its option, all or a portion of the Preferred Stock at 106.438% of the liquidation preference thereof declining to 100% of the liquidation preference in 2005, plus accrued interest. The Company is required to redeem all of the shares of Preferred Stock outstanding on October 15, 2007 at a redemption price equal to 100% of the liquidation preference thereof, plus, without duplication, accumulated and unpaid dividends to the date of redemption.

(Dollars in thousands except per share amounts)

The holders of the Preferred Stock may put the Preferred Stock to the Company at any time at a price of 101% of the liquidation preference thereof upon the occurrence of a Change of Control (as defined in the Certification of Designation). The Certificate of Designation stipulates, among other things, limitations on additional borrowings, payment of dividends and other distributions, transactions with affiliates and the sale of assets. The Company may, at its option, on any dividend payment date, exchange in whole, but not in part, the then outstanding shares of Preferred Stock for 12 7/8% Senior Subordinated Debentures due October 15, 2007 (the "Exchange Debentures"). Interest, redemption and registration rights provisions of the Exchange Debentures are consistent with the provisions of the Preferred Stock.

*Long Term Lease Facility*

On December 31, 1997, the Company consummated an agreement for a $24,500 long-term lease facility with AT&T Capital Corporation. The lease facility provides financing for certain of the switching equipment. Included in the lease facility is the sale and leaseback of certain switch equipment for which the Company received $14,876.

*Other Debt*

Other debt consists primarily of capital leases entered into in connection with the acquisition of fiber leases for use in the telecommunications networks and the long-term lease facility described above. The interest rate on such debt ranges from 7.5% to 15.0%.

Maturities of other debt for the five years after December 31, 1998 are as follows:

| | |
|---|---|
| 1999 | $ 3,288 |
| 2000 | 3,117 |
| 2001 | 3,266 |
| 2002 | 3,653 |
| 2003 | 3,635 |

*12% Senior Subordinated Notes*

On March 2, 1999, Hyperion issued $300,000 of 12% Senior Subordinated Notes due 2007 (the "Subordinated Notes"). An entity controlled by members of the Rigas family, controlling stockholders of Adelphia, purchased $100,000 of the Subordinated Notes directly from Hyperion at a price equal to the aggregate principal amount less the discount to the other initial purchasers. The net proceeds of approximately $295,000 were or will be used to fund Hyperion's acquisition of interests held by local partners in certain of its markets and will be used to fund capital expenditures and investments in its networks, and for general corporate and working capital purposes.

**(6) Common Stock and Other Stockholders' Equity (Deficiency)**

Hyperion's authorized capital stock consists of 300,000,000 shares of Class A common stock, par value $0.01 per share, 150,000,000 shares of Class B common stock, par value $0.01 per share, and 5,000,000 shares of preferred stock, par value $0.01 per share. On May 8, 1998, Hyperion completed the IPO of its Class A common stock (See Note 1).

**Common Stock**

Shares of Class A common stock and Class B common stock are substantially identical, except that holders of Class A common stock are entitled to one vote per share and holders of Class B common stock are entitled to 10 votes per share on all matters submitted to a vote of stockholders. The Class B common stock is convertible into one share of Class A common stock. In the event a cash dividend is paid, the holders of the Class A and the Class B common stock will be paid an equal amount.

Prior to the IPO, certain key company officers (the "Officers") were parties to a stockholder agreement, as amended (the "Stockholder Agreement") with Adelphia. The Stockholder Agreement provided, among other things, (i) that upon the earlier of (a) the termination of employment of any of the officers or (b) after October 7, 1998, such officers may put their shares to Adelphia for fair market value, unless such put rights are terminated as a result of the registration of the Company's common stock under the Securities Act of 1933 (the "Securities Act") and (ii) for certain buy/sell and termination rights and duties among Adelphia and the Officers. The Stockholder Agreement terminated automatically upon the date of the IPO. Adelphia also agreed to vote its shares in the Company to elect each officer to the Board of Directors of the Company as long as such person is both an employee and a stockholder of the Company.

The Company also entered into Term Loan and Stock Pledge Agreements ("Loan Agreements") with each of the Officers. Pursuant to the Loan Agreements, each Officer borrowed $1,000 from the Company. Each of these loans accrued interest at the average rate at which the Company could invest cash on a short-term basis, was secured by a pledge of the borrower's common stock in the Company, and would mature upon the earlier of (i) October 8, 1998 or (ii) the date of the IPO and the Officers have the right to sell at least $1,000 worth of their shares. Each Loan Agreement also provided that any interest accruing on a loan from the date six months after the date of such loan would be offset by a bonus payment when principal and interest thereon are due and which would include additional amounts to pay income taxes applicable to such bonus payment.

Pursuant to agreements among the Company, Adelphia and the Officers, simultaneous with the consummation of the IPO, (i) the Stockholder Agreement and Loan Agreements terminated, (ii) the Officers each repaid the $1,000 borrowed from the Company pursuant to the Loan Agreements plus accrued interest thereon by each selling 66,667 shares of Class B common stock to Adelphia and using the proceeds therefrom to repay such loans and (iii) the Company has paid to the Management Stockholders bonus payments in the amount of interest accruing on the Loans from the date six months after the date of the Loan Agreements and any additional amounts necessary to pay income taxes applicable to such bonus payments.

On April 8, 1998, the Board of Directors of the Company approved a 3.25-for-one stock split of its Class A and Class B common stock payable to stockholders of record on April 28, 1998. The stock split was effected in the form of a dividend of 2.25 shares for every outstanding share of common stock. All references in the accompanying consolidated financial statements to the number of shares of common stock and the par value have been retroactively restated to reflect the stock split on April 28, 1998.

## HYPERION TELECOMMUNICATIONS, INC. AND SUBSIDIARIES
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## (Dollars in thousands except per share amounts)

**Warrants**

*Class A Common Stock Warrant*

On February 12, 1998, the Company consummated an agreement with Lenfest Telephony, Inc. ("Lenfest") whereby Lenfest received a warrant to obtain 731,624 shares of Class A common stock of the Company (the "Lenfest Warrant") in exchange for its partnership interest in the Harrisburg, Pennsylvania network. The Lenfest Warrant was exercised during May 1998 for no additional consideration.

*Class B Common Stock Warrants*

The Class B common stock warrants were issued on April 15, 1996 in connection with the issuance of the Senior Discount Notes (See Note 5).

*Adelphia Warrant*

On June 13, 1997, the Company entered into agreements with MCI. Pursuant to these agreements the Company is designated MCI's preferred provider for new end user dedicated access circuits and of conversions of end user dedicated access circuits as a result of conversions from the incumbent LEC in the Company's markets. Hyperion also has certain rights of first refusal to provide MCI with certain telecommunications services. Under this arrangement, the Company issued a warrant to purchase 913,380 shares of Class A common stock for $6.15 per share to MCI (the "MCI Warrant") representing 2 ½% of the common stock of the Company on a fully diluted basis. MCI could receive additional warrants to purchase up to an additional 6% of the shares of the Company's Class A common stock, on a fully diluted basis, at fair value, if MCI met certain purchase volume thresholds over the term of the agreement.

In connection with the IPO and the related over-allotment option, the Company and MCI entered into an agreement that provides as follows with respect to the MCI Warrant and MCI's right to receive additional MCI warrants as a result of the IPO (the "Additional MCI Warrants"): (i) the Additional MCI Warrants issued with respect to the shares sold to the public in the IPO, the over-allotment option and with respect to the Adelphia shares purchased will have an exercise price equal to the lower of $6.15 per share or the price per share to the public in the IPO (the "IPO Price"), and (ii) Adelphia purchased from MCI the MCI Warrant and the Additional MCI Warrants for a purchase price equal to the number of Class A common stock shares issuable under the warrants being purchased times the IPO Price minus the underwriting discount, less the aggregate exercise price of such warrants. Furthermore, in consideration of the obligations undertaken by Adelphia to facilitate the agreements between MCI and Hyperion, Hyperion paid to Adelphia a fee of $500 and issued a warrant to Adelphia, which expires three years after its issuance, to purchase 200,000 shares of Class A common stock at an exercise price equal to the IPO Price.

**Long-Term Incentive Compensation Plan**

On October 3, 1996, the Board of Directors and stockholders of the Company approved the Company's 1996 Long-Term Incentive Compensation Plan (the "1996 Plan"). The 1996 Plan provides for the grant of (i) options which qualify as "incentive stock options" within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, (ii) options which do not so qualify, (iii) share awards (with or without restrictions on vesting), (iv) stock appreciation rights and (v) stock equivalent or phantom units. The number of shares of Class A common stock available for issuance initially was 5,687,500. Such number is to increase each year by 1% of outstanding shares of all classes of the Company's common stock, up to a maximum of 8,125,000 shares. Options, awards and units may be granted under the 1996 Plan to directors, officers, employees and consultants. The 1996

(Dollars in thousands except per share amounts)

Plan provides the incentive stock options must be granted with an exercise price of not less than the fair market value of the underlying common stock on the date of grant. Options outstanding under the Plan may be exercised by paying the exercise price per share through various alternative settlement methods. On March 4, 1997, April 1, 1997 and April 1, 1998, the Company issued 338,000 shares, 58,500 shares and 58,500 shares, respectively, of Class A common stock to Daniel R. Milliard pursuant to his employment agreement with the Company.

In April 1998 and in recognition for valuable past service to the Company and as an incentive for future services, the Company authorized the issuance under the 1996 Plan to each of John J. Rigas, Michael J. Rigas, Timothy J. Rigas and James P. Rigas of (i) stock options (the "Rigas Options") covering 100,000 shares of Class A common stock, which options will vest in equal one-third amounts on the third, fourth and fifth year anniversaries of grant (vesting conditioned on continued service as an employee or director) and which shall be exercisable at the IPO price and (ii) phantom stock awards (the "Rigas Grants") covering 100,000 shares of Class A common stock, which phantom awards will vest in equal one-third amounts on the third, fourth and fifth year anniversaries of grant(vesting conditioned on continued service as an employee or director). At December 31, 1998, no Rigas Options or Rigas Grants have been granted. Also in April 1998, pursuant to the then existing Stockholder Agreement, the Company authorized the issuance under the 1996 Plan to certain Officers of stock options (the "Management Stockholder Options") currently covering a total of 13,047 shares of Class A common stock with exercise price and vesting terms identical to the Rigas Options. In addition to the Rigas Options, the Rigas Grants and the employment agreement, the Company currently expects to issue under the 1996 Plan stock options, restrictive stock grants, phantom stock awards or other awards to other 1996 Plan participants covering up to a total of 325,000 shares of Class A common stock during 1999.

## (7) Commitments and Contingencies

The Company rents office space, node space and fiber under leases with terms which are generally less than one year or under agreements that are generally cancelable on short notice. Total rental expense under all operating leases aggregated $1,103, $1,236 and $1,893 for the years ended March 31, 1997 and 1998 and the nine months ended December 31, 1998, respectively.

The minimum future lease obligations under the noncancelable operating leases as of December 31, 1998 are approximately:

| Period ending December 31, | |
|---|---|
| 1999 | $3,296 |
| 2000 | 2,888 |
| 2001 | 2,779 |
| 2002 | 2,659 |
| 2003 | 2,645 |
| Thereafter | 8,176 |

The Company has entered into an employment agreement with the President of the Company, the terms of which expire on March 31, 2001, unless extended by the Company for additional one year periods. The employment agreement provides for base salary, benefits, stock options or stock grants and cash and stock bonuses payable if specified management goals are attained as established annually by the Board of Directors. In addition, the employment agreement contains noncompetition and nondisclosure provisions.

The telecommunications industry and Hyperion are subject to extensive regulation at the federal, state and local levels. On February 8, 1996, President Clinton signed the Telecommunications Act of 1996 ("Telecommunications Act"), the most comprehensive reform of the nation's telecommunications laws since the

**(Dollars in thousands except per share amounts)**

the Commununications Act of 1934. Management of Hyperion is unable to predict the effect that the Telecommunications Act, related rulemaking proceedings or other future rulemaking proceedings will have on its business and results of operations in future periods.

Hyperion has entered into a series of agreements with several local and long-haul fiber optic network providers that will allow Hyperion to significantly increase its presence in the eastern half of the United States. These agreements, totaling approximately $126,000, provide Hyperion with ownership or an IRU to over 9,000 route miles of local and long-haul fiber optic cable. Through December 31, 1998, Hyperion has paid $42,604 of the total due under the agreements, which was included in property, plant and equipment. Hyperion believes this will allow it to expand its business strategy to include on-net provisioning of regional, local and long distance, internet and data communications and to cost-effectively further interconnect most of its 46 existing markets and to enter and interconnect approximately 50 new markets by the end of 2001.

**(8) Related Party Transactions**

The following table summarizes the Company's transactions with related parties:

| | Year Ended March 31, 1997 | Year Ended March 31, 1998 | Nine Months Ended December 31, 1998 |
|---|---|---|---|
| **Revenues:** | | | |
| Management fees | $ 2,600 | $ 3,809 | $ 2,135 |
| Network monitoring fees | 604 | 977 | 589 |
| Special access fees | 540 | 500 | --- |
| Total | $ 3,744 | $ 5,286 | $ 2,724 |
| **Interest Income** | $ 230 | $ 617 | $ 8,395 |
| **Expenses:** | | | |
| Interest expense and fees | $ 4,731 | $ 5,997 | $ 737 |
| Allocated corporate costs | 1,199 | 1,656 | 2,981 |
| Fiber leases | 738 | 47 | 139 |
| Total | $ 6,668 | $ 7,700 | $ 3,857 |

Management fees from related parties represent fees received by the Company from its unconsolidated joint ventures for the performance of financial, legal, regulatory, network design, construction and other administrative services.

Network monitoring fees represent fees received by the Company for technical support for the monitoring of each individual joint venture's telecommunications system.

Special access fees represent amounts charged to joint ventures for use of the network of a wholly owned subsidiary of the Company.

Interest income represents interest charged on certain affiliate receivable balances with joint ventures and with Adelphia.

Interest expense and fees relate to the Note payable—Adelphia (See Note 5).

Allocated corporate costs represent costs incurred by Adelphia on behalf of the Company for the administration and operation of the Company. These costs include charges for office space, corporate aircraft and shared services such as finance activities, information systems, computer services, human resources, and taxation. Such costs were estimated by Adelphia and do not necessarily represent the actual costs that would be incurred if the Company was to secure such services on its own.

Fiber lease expense represents amounts paid to various subsidiaries of Adelphia for the utilization of existing cable television plant for development and operation of the consolidated operating networks.

During the year ended March 31, 1997, the Company purchased from Adelphia for approximately $6,485, Adelphia's historical cost to acquire the assets, certain fiber that had previously been leased from Adelphia. Because the entities involved in the transaction are under the common control of Adelphia, the excess of the purchase price of the assets over the predecessor owner's net book value was charged to accumulated deficit.

During the year ended March 31, 1998 and the nine months ended December 31, 1998, Hyperion paid $299 and $1,044, respectively, to entities owned by certain shareholders of Adelphia primarily for property, plant and equipment and services.

**(9) Income Taxes**

Adelphia and its corporate subsidiaries (including the Company) filed consolidated federal income tax returns for the years ended March 31, 1997 and 1998. For the nine months ended December 31, 1998, Hyperion will not be included within Adelphia's consolidated federal income tax return. For financial reporting purposes, current and deferred income tax assets and liabilities are computed on a separate company basis. The net operating loss carryforwards and the valuation allowance for the year ended March 31, 1998 are adjusted for the effects of filing a consolidated income tax return, similar to provisions of the Internal Revenue Code. At December 31, 1998, the Company had net operating loss carryforwards for federal income tax purposes of $178,503 expiring through 2018.

Deferred income taxes reflect the net tax effects of (a) temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes and (b) operating loss carryforwards.

(Dollars in thousands except per share amounts)

The Company's net deferred tax asset included in other assets - net is comprised of the following:

| | March 31, 1998 | December 31, 1998 |
|---|---|---|
| **Deferred tax assets:** | | |
| Differences between book and tax basis of intangible assets | $ 188 | $ 138 |
| Net operating loss carryforwards | 33,918 | 71,391 |
| Other | 77 | 77 |
| Total | 34,183 | 71,606 |
| Valuation allowance | (17,379) | (48,746) |
| Total | 16,804 | 22,860 |
| **Deferred tax liabilities:** | | |
| Differences between book and tax basis of property, plant and Equipment | 12,959 | 19,015 |
| Investment in partnerships | 3,808 | 3,808 |
| Total | 16,767 | 22,823 |
| Net deferred tax asset | $ 37 | $ 37 |

The net change in the valuation allowance for the year ended March 31, 1998 and the nine months ended December 31, 1998 was an increase of $5,023 and $31,367, respectively.

Income tax expense for the years ended March 31, 1997 and 1998 and the nine months ended December 31, 1998 is as follows:

| | Year Ended March 31, 1997 | Year Ended March 31, 1998 | Nine Months Ended December 31, 1998 |
|---|---|---|---|
| Current | $ (2) | $ --- | $ --- |
| Deferred | (257) | --- | --- |
| Total | $ (259) | $ --- | $ --- |

**HYPERION TELECOMMUNICATIONS, INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
**(Dollars in thousands except per share amounts)**

A reconciliation of the statutory federal income tax rate and the Company's effective income tax rate is as follows:

| | Year Ended March 31, 1997 | Year Ended March 31, 1998 | Nine Months Ended December 31, 1998 |
|---|---|---|---|
| Statutory federal income tax rate | 35.0% | 35.0% | 35.0% |
| Change in valuation allowance | (34.6) | (35.0) | (35.0) |
| State taxes, net of federal benefit and other | (1.2) | --- | --- |
| Income tax expense | (0.8)% | ---% | ---% |

## HYPERION TELECOMMUNICATIONS, INC. AND SUBSIDIARIES
## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
### (Dollars in thousands except per share amounts)

**(10) Quarterly Financial Data (unaudited)**

The following tables summarize the financial results of the Company for each of the quarters in the year ended March 31, 1998 and the nine months ended December 31, 1998:

| | Three Months Ended | | | |
|---|---|---|---|---|
| | June 30, 1997 | September 30, 1997 | December 31, 1997 | March 31, 1998 |
| Revenues | $ 1,520 | $ 2,187 | $ 4,983 | $ 4,820 |
| Operating expenses: | | | | |
| Network operations | 1,180 | 1,426 | 2,657 | 2,541 |
| Selling, general and administrative | 2,380 | 2,879 | 3,840 | 5,215 |
| Depreciation and amortization | 1,372 | 2,311 | 3,344 | 4,450 |
| Total | 4,932 | 6,616 | 9,841 | 12,206 |
| Operating loss | (3,412) | (4,429) | (4,858) | (7,386) |
| Other income (expense): | | | | |
| Interest income | 763 | 1,463 | 5,725 | 5,353 |
| Interest expense and fees | (8,077) | (11,087) | (16,770) | (13,400) |
| Loss before income taxes and equity in net loss of joint ventures | (10,726) | (14,053) | (15,903) | (15,433) |
| Income tax expense | --- | --- | --- | --- |
| Loss before equity in net loss of joint ventures | (10,726) | (14,053) | (15,903) | (15,433) |
| Equity in net loss of joint ventures | (2,540) | (3,886) | (2,858) | (3,683) |
| Net loss | (13,266) | (17,939) | (18,761) | (19,116) |
| Dividend requirements applicable to preferred stock | --- | --- | (5,794) | (6,615) |
| Net loss applicable to common stockholders | $ (13,266) | $ (17,939) | $ (24,555) | $ (25,731) |
| Basic and diluted net loss per weighted average share of common stock | $ (0.38) | $ (0.51) | $ (0.70) | $ (0.73) |
| Weighted average shares of common stock outstanding (in thousands) | 34,890 | 34,890 | 34,890 | 35,272 |

**(10) Quarterly Financial Data (unaudited), continued**

| | June 30, 1998 | September 30, 1998 | December 31, 1998 |
|---|---|---|---|
| Revenues | $ 7,635 | $ 12,098 | $ 15,043 |
| Operating expenses: | | | |
| Network operations | 4,989 | 7,056 | 6,664 |
| Selling, general and administrative | 8,432 | 10,391 | 16,518 |
| Depreciation and amortization | 6,120 | 9,843 | 10,708 |
| Total | 19,541 | 27,290 | 33,890 |
| Operating loss | (11,906) | (15,192) | (18,847) |
| Other income (expense): | | | |
| Interest income | 4,235 | 4,169 | 1,829 |
| Interest income – affiliate | 1,824 | 2,995 | 3,576 |
| Interest expense and fees | (13,704) | (12,535) | (12,399) |
| Other income | 1,000 | 113 | --- |
| Loss before income taxes, equity in net loss of joint ventures and extraordinary gain | (18,551) | (20,450) | (25,841) |
| Income tax expense | --- | --- | --- |
| Loss before equity in net loss of joint ventures and extraordinary gain | (18,551) | (20,450) | (25,841) |
| Equity in net loss of joint ventures | (3,190) | (2,614) | (3,776) |
| Loss before extraordinary gain | (21,741) | (23,064) | (29,617) |
| Extraordinary gain on repurchase of debt | --- | 237 | --- |
| Net loss | (21,741) | (22,827) | (29,617) |
| Dividend requirements applicable to preferred stock | (6,807) | (7,026) | (7,284) |
| Net loss applicable to common stockholders | $ (28,548) | $ (29,853) | $ (36,901) |
| Basic and diluted net loss per weighted average share of common stock | $ (0.59) | $ (0.54) | $ (0.66) |
| Weighted average shares of common stock outstanding (in thousands) | 48,110 | 55,497 | 55,497 |

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

## PART III

## ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information set forth above in Part 1 under the caption "Executive Officers of the Registrant" is incorporated herein by reference. The other information required by this item is incorporated herein by reference to the information set forth under the caption "Election of Directors" and the information, if any, under the caption "Section 16(a) Beneficial Ownership Reporting Compliance," in the Company's definitive proxy statement for the 1998 Annual Meeting of Stockholders filed pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended, or by reference to a filing amending this Transition Report on Form 10-K.

## ITEM 11. EXECUTIVE COMPENSATION

The information required by this item is incorporated herein by reference to the information set forth under the caption "Executive Compensation" in the Company's definitive proxy statement for the 1999 Annual Meeting of Stockholders filed pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended, or by reference to a filing amending this Transition Report on Form 10-K.

## ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by this item is incorporated herein by reference to the information set forth under the caption "Principal Stockholders" in the Company's definitive proxy statement for the 1999 Annual Meeting of Stockholders filed pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended, or by reference to a filing amending this Transition Report of Form 10-K.

## ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this item is incorporated herein by reference to the information set forth under the caption "Certain Transactions" in the Company's definitive proxy statement for the 1999 Annual Meeting of Stockholders filed pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended, or by reference to a filing amending this Transition Report on Form 10-K.

## PART IV

## ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

Financial Statements, schedules and exhibits not listed have been omitted where the required information is included in the consolidated financial statements or notes thereto, or is not applicable or required.

(a)(1) A listing of the consolidated financial statements, notes and independent auditors' report required by Item 8 are listed on in the index in Item 8 of this Transition Report on Form 10-K.

(2) Financial Statement Schedules: Schedule II – Valuation and Qualifying Accounts

(3) Exhibits

SCHEDULE II
HYPERION TELECOMMUNICATIONS, INC. AND SUBSIDIARIES
VALUATION AND QUALIFYING ACCOUNTS
(Dollars in thousands)

| | Balance at Beginning of Period | Charged to Costs and Expenses | Deductions Write-Offs | Balance at End of Period |
|---|---|---|---|---|
| Year Ended March 31, 1997: | | | | |
| Allowance for Doubtful Accounts | $ --- | $ --- | $ --- | $ --- |
| Valuation allowance for derferred tax assets | $ 10,459 | $ 1,897 | $ --- | $ 12,356 |
| Year Ended March 31, 1998: | | | | |
| Allowance for Doubtful Accounts | $ --- | $ --- | $ --- | $ --- |
| Valuation allowance for deferred tax assets | $ 12,356 | $ 5,023 | $ --- | $ 17,379 |
| Nine Months Ended December 31, 1998: | | | | |
| Allowance for Doubtful Accounts | $ --- | $ 1,128 | $ --- | $ 1,128 |
| Valuation allowance for deferred tax assets | $ 17,379 | $ 31,367 | $ --- | $ 48,746 |

| EXHIBIT NO. | DESCRIPTION |
|---|---|
| 3.1 | Certificate of Incorporation of Registrant, together with all amendments thereto. (Incorporated herein by reference is Exhibit 3.01 to Registrant's Current Report on Form 8-K for the event dated October 9, 1997.) |
| 3.2 | Bylaws of Registrant. (Incorporated herein by reference is Exhibit 3.2 to Registration Statement No. 333-12619 on Form S-1.) |
| 4.1 | Indenture, dated as of April 15, 1996, between the Registrant and Bank of Montreal Trust Company. (Incorporated herein by reference is Exhibit 4.1 to Registration Statement No. 333-06957 on Form S-4.) |
| 4.2 | First Supplemental Indenture, dated as of September 11, 1996, between, the Registrant and Bank of Montreal Trust Company. (Incorporated herein by reference is Exhibit 4.2 to Statement No. 333-12619 on Form S-4.) |
| 4.3 | Form of 13% Senior Discount Note. (Incorporated herein reference is Exhibit 4.3 to Registration Statement No. 333-12619 on Form S-4.) |
| 4.4 | Form of Class A Common Stock Certificate. (Incorporated herein by reference is Exhibit 4.1 to Registrant's Registration Statement on Form 8-A, dated October 23, 1996.) |
| 4.5 | Indenture, dated as of August 27, 1997, with respect to the Registrant's 12 ¼% Senior Secured Notes due 2004, between the Registrant and the Bank of Montreal Trust Company. (Incorporated herein by reference is Exhibit 4.01 to Form 8-K dated August 27, 1997.) (File No. 0-21605) |
| 4.6 | Form of 12 1/4% Senior Secured Note due 2004 (contained in Exhibit 4.5). |
| 4.7 | Pledge Agreement between the Registrant and the Bank of Montreal Trust Company as Collateral Agent, dated as of August 27, 1997. (Incorporated herein by reference is Exhibit 4.03 to Form 8-K dated August 27, 1997.) (File No. 0-21605) |
| 4.8 | Pledge, Escrow and Disbursement Agreement, between the Registrant and the Bank of Montreal Trust Company, dated as of August 27, 1997. (Incorporated herein by reference is Exhibit 4.05 to Form 8-K dated August 27, 1997.) (File No. 0-21605) |
| 4.9 | Second Supplemental Indenture, dated as of August 27, 1997, between the Registrant and the Bank of Montreal Trust Company, regarding the Registrant's 13% Senior Discount Notes due 2003. (Incorporated herein by reference is Exhibit 4.06 to Form 8-K dated August 27, 1997.) (File No. 0-21605) |
| 4.10 | Certificate of Designation for 12 7/8% Series A and Series B Senior Exchangeable Redeemable Preferred Stock due 2007. (Contained in Exhibit 3.01 to Registrant's Current Report on Form 8-K for the event dated October 9, 1997 which is incorporated herein by reference.) (File No. 0-21605) |
| 4.11 | Form of Certificate for 12 7/8% Senior Exchangeable Redeemable Preferred Stock due 2007. (Incorporated herein by reference is Exhibit 4.02 to the Registrant's Current Report on Form 8-K the event dated October 9, 1997.) (File No. 0-21605) |

| | |
|---|---|
| 4.12 | Form of Indenture, with respect to the Registrant's 12 7/8% Senior Subordinated Exchange Debentures due 2007. (Contained as Annex A in Exhibit 3.01 to Registrant's Current Report on Form 8-K for the event dated October 9, 1997 which is incorporated herein by reference.) (File No. 0-21605) |
| 4.13 | Indenture dated as of March 2, 1999, with respect to Hyperion Telecommunications, Inc. 12% Senior Subordinated Notes due 2007, between Hyperion and the Bank of Montreal Trust Company (Incorporated by reference herein is Exhibit 4.01 to the Current Report on Form 8-K for Adelphia Communications Corporation filed on March 10, 1999.) (File No. 0-16014). |
| 4.14 | Form of 12% Senior Subordinated Notes due 2007 (Contained in Exhibit 4.13). |
| 10.1* | Employment Agreement between the Registrant and Charles R. Drenning. (Incorporated herein by reference is Exhibit 10.1 to Registration Statement No. 333-06957 on Form S-4.) |
| 10.2* | Employment Agreement between the Registrant and Paul D. Fajerski. (Incorporated herein by reference is Exhibit 10.2 to Registration Statement No. 333-06957 on Form S-4.) |
| 10.3* | Employment Agreement between the Registrant and Randolph S. Fowler. (Incorporated herein by reference is Exhibit 10.3 to Registration Statement No. 333-06957 on Form S-4.) |
| 10.4 | Pre-Incorporation and Shareholder Restrictive Agreement between Adelphia, Paul D. Fajerski, Charles R. Drenning and Randolph S. Fowler. (Incorporated herein by reference is Exhibit 10.5 to Registration Statement No. 333-06957 on Form S-4.) |
| 10.5 | Letter Agreement dated March 19, 1996 between the Registrant, Charles R. Drenning, Paul D. Fajerski, Randolph S. Fowler and Adelphia. (Incorporated herein by reference is Exhibit 10.12 to Registration Statement No. 333-06957 on Form S-4.) |
| 10.6 | Warrant Agreement dated as of April 15, 1996, by and among Hyperion Telecommunications, Inc. and Bank of Montreal Trust Company. (Incorporated herein by reference is Exhibit 10.13 to Registration Statement No. 333-06957 on Form S-4.) |
| 10.7 | Warrant Registration Rights Agreement dated as of April 15, 1996, by and among Hyperion Telecommunications, Inc. and the Initial Purchasers. (Incorporated herein by reference is Exhibit 10.14 to Registration Statement No. 333-06957 on Form S-4.) |
| 10.8 | Form of Management Agreement. (Incorporated herein by reference is Exhibit 10.15 to Registration Statement No. 333-06957 on Form S-4.) |
| 10.9* | Employment Agreement between Hyperion Telecommunications, Inc. and Daniel R. Milliard dated as of March 4, 1997. (Incorporated herein by reference is Exhibit 10.03 to Current Report on Form 8-K of Adelphia Communications Corporation dated May 1, 1997.) (File Number 0-16014) |
| 10.10* | 1996 Long-Term Incentive Compensation Plan. (Incorporated herein by reference is Exhibit 10.17 to Registration Statement No. 333-13663 on Form S-1.) |
| 10.11 | Registration Rights Agreement among Charles R. Drenning, Paul D. Fajerski, Randolph S. Fowler, Adelphia Communications Corporation and the Company. (Incorporated herein by reference is Exhibit 10.18 to Registration Statement No. 333-13663 on Form S-1.) |
| 10.12 | Registration Rights Agreement between Adelphia Communications Corporation and the Company. (Incorporated herein by reference is Exhibit 10.19 to Registration Statement No. 333-13663 on Form S-1.) |

| | |
|---|---|
| 10.13 | Extension Agreement dated as of January 8, 1997, among Hyperion Telecommunications, Inc., Adelphia Communications Corporation, Charles R. Drenning, Paul D. Fajerski, Randolph S. Fowler, and six Trusts named therein. (Incorporated herein by reference is Exhibit 10.04 to Current Report on Form 8-K of Adelphia Communications Corporation dated May 1, 1997.) (File Number 0-16014) |
| 10.14 | Purchase Agreement among the Registrant, Bear Stearns & Co. Inc., Chase Securities Inc., TD Securities (USA) Inc., CIBC Wood Gundy Securities Corp., and Scotia Capital Markets (the "Initial Purchasers") dated August 21, 1997. (Incorporated herein by reference is Exhibit 10.01 to Form 8-K dated August 27, 1997.) (File No. 0-21605) |
| 10.15 | Purchase Agreement among the Registrant and Bear Stearns & Co. Inc. (the "Initial Purchaser") dated October 1, 1997 regarding the 12 7/8% Senior Exchangeable Redeemable Preferred Stock due 2007. (Incorporated by reference is Exhibit 10.01 to the Registrant's Current Report on Form 8-K for the event dated October 9, 1997.) (File No. 0-21605) |
| 10.16* | Management Services Agreement dated as of April 10, 1998, between Adelphia Communications Corporation and the Registrant (Incorporated herein by reference is Exhibit 10.23 to Registration Statement No. 333-48209 on Form S-1). |
| 10.17 | Letter Agreement dated April 10, 1998, among the Registrant, Adelphia Communications Corporation and MCImetro Access Transmission Services, Inc. (Incorporated herein by reference is Exhibit 10.24 to Registration Statement No. 333-48209 on Form S-1). |
| 10.18 | Amendment to Registration Rights Agreement dated as of April 15, 1998, between the Registrant and Adelphia Communications Corporation (Incorporated herein by reference is Exhibit 10.25 to Registration Statement No. 333-48209 on Form S-1). |
| 10.19 | Letter Agreement dated as of April 9, 1998, between the Registrant and Adelphia Communications Corporation regarding the purchase of Class A Common Stock (Incorporated herein by reference is Exhibit 10.26 to Registration Statement No. 333-48209 on Form S-1). |
| 10.20 | U.S. Underwriting Agreement dated May 4, 1998 among the Company and the Representatives named therein (Incorporated herein by reference is Exhibit 10.01 to the Registrant's Current Report on Form 8-K dated June 24, 1998.) (File No. 0-21605) |
| 10.21 | International Underwriting Agreement dated May 4, 1998 among the Company and the Representatives named therein (Incorporated herein by reference is Exhibit 10.02 to the Registrant's Current Report on Form 8-K dated June 24, 1998.) (File No. 0-21605) |
| 10.22 | Warrant issued to MCI dated May 8, 1998 (Incorporated herein by reference is Exhibit 10.03 to the Registrant's Current Report on Form 8-K dated June 24, 1998.) (File No. 0-21605) |
| 10.23 | Warrant issued in favor of Adelphia Communications Corporation dated June 5, 1998 (Incorporated herein by reference is Exhibit 10.04 to the Registrant's Current Report on Form 8-K dated June 24, 1998.) (File No. 0-21605) |
| 10.24 | Registration Rights Agreement between the Registrant and the Initial Purchasers, dated August 27, 1997, regarding the 12 1/4%Senior Secured Notes due 2004. (Incorporated herein by reference is Exhibit 4.04 to Form 8-K dated August 27, 1997.) (File No. 0-21605) |
| 10.25 | Registration Rights Agreement between the Registrant and the Initial Purchaser dated October 9, 1997, regarding the 12 7/8% Senior Exchangeable Redeemable Preferred Stock due 2007. (Incorporated herein by reference is Exhibit 4.04 to the Registrant's Current Report on Form 8-K for the event dated October 9, 1997.) (File No. 0-21605) |

10.26 Purchase Agreement between Hyperion Telecommunications, Inc. and the Initial Purchasers named therein, dated as of February 25, 1999, regarding Hyperion's 12% Senior Subordinated Notes due 2007 (Incorporated herein by reference is Exhibit 10.03 to Adelphia's Current Report on Form 8-K for the event dated February 22, 1999.) (File No. 0-16104).

10.27 Purchase Agreement between Hyperion Telecommunications, Inc. and Highland Holdings, dated as of February 25, 1999, regarding Hyperion's 12% Senior Subordinated Notes due 2007 (Incorporated herein by reference is Exhibit 10.05 to Adelphia's Current Report on Form 8-K for the event dated February 22, 1999.) (File No. 0-16104).

21.1 Subsidiaries of the Registrant

23.1 Consent of Deloitte & Touche LLP

27.1 Financial Data Schedule

99.1 "Schedule E – Form of Financial Information and Operating Data of the Subsidiaries and the Joint Ventures Presented by Cluster".

99.2 "Schedule F – Form of Financial Information and Operating Data of the Pledged Subsidiaries and the Joint Ventures.

99.3 Press Release Dated June 24, 1998

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* Denotes management contracts and compensatory plans and arrangements required to be identified by Item 14(a)(3).

The Registrant will furnish to the Commission upon request copies of instruments not filed herewith which authorize the issuance of long-term obligations of Registrant not in excess of 10% of the Registrant's total assets on a consolidated basis.

(b) The Registrant did not file any Form 8-K reports during the three months ended March 31, 1998.

(c) The Company hereby files as exhibits to this Form 10-K the exhibits set forth in Item 14(a)(3) hereof which are not incorporated by reference.

(d) The Company hereby files as financial statement schedules to this Form 10-K the financial statement schedules set forth in Item 14(a)(2) hereof.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

HYPERION TELECOMMUNICATIONS, INC.

| | |
|---|---|
| May 27, 1999 | By: /s/ Daniel R. Milliard<br>Daniel R. Milliard,<br>President. |

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| | |
|---|---|
| May 27, 1999 | /s/ John J. Rigas<br>John J. Rigas,<br>Chairman and Director |
| May 27, 1999 | /s/ Timothy J. Rigas<br>Timothy J. Rigas,<br>Vice Chairman, Treasurer, Chief Financial Officer and Director |
| May 27, 1999 | /s/ Michael J. Rigas<br>Michael J. Rigas,<br>Vice Chairman and Director |
| May 27, 1999 | /s/ James P. Rigas<br>James P. Rigas,<br>Vice Chairman, Chief Executive Officer and Director |
| May 27, 1999 | /s/ Daniel R. Milliard<br>Daniel R. Milliard,<br>Vice Chairman, President, Secretary and Director |
| May 27, 1999 | /s/ Peter J. Metros<br>Pete J. Metros,<br>Director |
| May 27, 1999 | /s/ James L. Gray<br>James L. Gray,<br>Director |
| May 27, 1999 | /s Randolph F. Fowler<br>Randolph F. Fowler<br>Director |
| May 27, 1999 | /s/ Edward E. Babcock Jr.<br>Edward E. Babcock, Jr.<br>Chief Accounting Officer |

EXHIBIT 21.1

SUBSIDIARIES OF REGISTRANT

Hyperion Telecommunications, Inc. (Delaware corporation)

Hyperion Telecommunications, LLC (Delaware limited liability company)

Hyperion Communications General Holdings, Inc. (Delaware corporation)

Hyperion Communications Capital, Inc. (Delaware corporation)

Hyperion Communications Long Haul, L.P. (Delaware limited partnership)

Hyperion International, LLC (Delaware limited liability company)

Hyperion Communications of Alabama, LLC (Delaware limited liability company)

Hyperion Communications of Arkansas, LLC (Delaware limited liability company)

Entergy Hyperion Telecommunications of Arkansas, L.L.C. (50% owned) (an Arkansas limited liability company)

Hyperion Communications of Connecticut, Inc. (Delaware corporation)

Hyperion Communications of Delaware, LLC (Delaware limited liability company)

Hyperion Communications of District of Columbia, LLC (Delaware limited liability company)

Hyperion Communications of Florida, LLC (Florida limited liability company)

Hyperion Telecommunications of Florida, Inc. (Florida corporation)

Hyperion Communications of Jacksonville, Inc. (Florida corporation)

Hyperion Communications of Georgia, LLC (Delaware limited liability company)

Hyperion Communications of Illinois, Inc. (Delaware corporation)

Hyperion Communications of Indiana, L.P. (Delaware limited liability company)

Hyperion Communications of Kansas, LLC (Delaware limited liability company)

Hyperion Communications of Kentucky, Inc. (Delaware corporation)

Hyperion Telecommunications of Louisiana, Inc. (Delaware corporation)

Entergy Hyperion Telecommunications of Louisiana, L.L.C. (50% owned) (an Arkansas limited liability company)

Hyperion Communications of Maine, Inc. (Delaware corporation)

Hyperion Communications of Maryland, LLC (Delaware limited liability company)

Hyperion Communications of Massachusetts, Inc. (Delaware corporation)

Hyperion Communications of Michigan, Inc. (Delaware corporation)

Hyperion Communications of Mississippi, L.P. (Delaware limited partnership)

Hyperion Telecommunications of Mississippi, Inc. (Delaware corporation)

Entergy Hyperion Telecommunications of Mississippi, L.L.C. (50% owned) (an Arkansas limited liability company)

Hyperion Communications of New Hampshire, Inc. (Delaware corporation)

Hyperion Communications of New Jersey, LLC (Delaware limited liability company)

Hyperion Telecommunications of New York, Inc. (Delaware corporation)

Hyperion Communications of Eastern New York, Inc. (Delaware corporation)

Hyperion Communications of North Carolina, Inc. (Delaware corporation)

Hyperion Communications of North Carolina, L.P. (Delaware limited partnership)

Hyperion Communications of Ohio, Inc. (Delaware corporation)

Hyperion Telecommunications of Pennsylvania, Inc. (Delaware corporation)

PECO Hyperion Telecommunications (50% owned) (Pennsylvania general partnership)

Hyperion Susquehanna Telecommunications (50% owned) (Pennsylvania general partnership)

Allegheny Hyperion Telecommunications, L.L.C. (50% owned) (Pennsylvania limited liability company)

Hyperion Telecommunications of Harrisburg, Inc. (Delaware corporation)

Hyperion Communications of Pennsylvania, LLC (Delaware limited liability company)

Hyperion Communications of Rhode Island, Inc. (Delaware corporation)

Hyperion Communications of South Carolina, Inc. (Delaware corporation)

Hyperion Telecommunications of Tennessee, Inc. (Delaware corporation)

AVR, L.P. d/b/a Hyperion of Tennessee, L.P. (95% owned) (California limited partnership)

Hyperion Communications of Tennessee, L.P. (Delaware limited partnership)

Hyperion Communications of Texas, L.P. (Delaware limited partnership)

Hyperion Communications of Vermont, Inc. (Delaware corporation)

Hyperion Communications of Virginia, LLC (Virginia limited liability company)

Hyperion Communications of West Virginia, LLC (Delaware limited liability company)

Exhibit 23.1

## INDEPENDENT AUDITORS' CONSENT

We consent to the incorporation by reference in Post-Effective Amendment No. 2 to Registration Statement No. 333-12619 on Form S-3 (formerly Form S-1), and Registration Statement No. 333-62539 of Hyperion Telecommunications, Inc. on Form S-8 of our report dated May 17, 1999, appearing in this Transition Report on Form 10-K of Hyperion Telecommunications, Inc. for the nine months ended December 31, 1998.

/s/ DELOITTE & TOUCHE LLP
Pittsburgh, Pennsylvania

May 25, 1999

Exhibit 99.1

SCHEDULE E

## Hyperion Telecommunications, Inc.

### Form of Financial Information and Operating Data of the Subsidiaries and the Joint Ventures Presented by Cluster

Data presented for the quarter ended: **12/31/98**

*Unaudited*

| | North East | Mid-Atlantic | Mid-South | *** Other | Total |
|---|---|---|---|---|---|
| **FINANCIAL DATA (dollars in thousands):** | | | | | |
| Total Revenue | $ 7,017.5 | $ 8,700.5 | $ 5,331.5 | $ 3,469.2 | $ 24,518.7 |
| Total Capital Expenditures | $ 7,192.2 | $ 24,221.0 | $ 12,392.8 | $ 10,373.2 | $ 54,179.2 |
| Total EBITDA | $ 2,713.1 | $ (2,536.0) | $ (3,774.0) | $ 365.5 | $ (3,231.4) |
| Gross PP&E | $ 103,486.1 | $ 299,901.1 | $ 117,674.8 | $ 120,407.7 | $ 641,469.7 |
| Proportional Revenue * | $ 6,866.9 | $ 5,655.6 | $ 4,616.8 | $ 950.8 | $ 18,090.1 |
| Proportional Capital Expenditures* | $ 7,192.2 | $ 17,989.8 | $ 10,290.5 | $ 9,040.0 | $ 44,512.5 |
| Proportional EBITDA * | $ 2,791.7 | $ (2,437.3) | $ (3,060.1) | $ (210.8) | $ (2,916.5) |
| Proportional Gross PP&E * | $ 103,486.1 | $ 230,921.6 | $ 96,501.8 | $ 77,785.3 | $ 508,694.8 |
| **STATISTICAL DATA** | | | | | |
| **Increase for December 31, 1998** | | | | | |
| Networks in Operation | -- | -- | -- | -- | -- |
| Route Miles | 1,634 | 1,943 | 2,399 | 3,318 | 9,294 |
| Fiber Miles | 25,984 | 44,923 | 10,696 | 21,794 | 103,397 |
| Buildings connected | 6 | 1 | 40 | 8 | 55 |
| Total Buildings with Customers | 374 | 14 | 93 | 62 | 640 |
| LEC-COs collocated ** | -- | -- | -- | -- | -- |
| Voice Grade Equivalent Circuits | 38,808 | (26,304) | (9,096) | (71,520) | (68,112) |
| **As of September 30, 1998:** | | | | | |
| Networks in Operation | 3 | 9 | 6 | 2 | 20 |
| Route Miles | 1,564 | 2,210 | 1,158 | 779 | 5,711 |
| Fiber Miles | 67,325 | 106,079 | 55,584 | 37,392 | 266,380 |
| Buildings connected (adjusted) | 341 | 680 | 310 | 362 | 1,693 |
| Total Buildings with Customers | 1,649 | 811 | 2,825 | 535 | 5,820 |
| LEC-COs collocated ** | 16 | 64 | 25 | 18 | 123 |
| Voice Grade Equivalent Circuits | 173,544 | 496,032 | 209,352 | 267,072 | 1,146,000 |
| **As of December 31, 1998:** | | | | | |
| Networks in Operation | 3 | 9 | 6 | 2 | 20 |
| Route Miles | 3,198 | 4,153 | 3,557 | 4,097 | 15,005 |
| Fiber Miles | 93,309 | 151,002 | 66,280 | 59,186 | 369,777 |
| Buildings connected with fiber | 347 | 681 | 350 | 370 | 1,748 |
| Total Buildings with Customers | 2,023 | 922 | 2,918 | 597 | 6,460 |
| LEC-COs collocated ** | 16 | 64 | 25 | 18 | 123 |
| Voice Grade Equivalent Circuits | 212,352 | 469,728 | 200,256 | 195,552 | 1,077,888 |
| Access Lines Sold | 20,711 | 63,231 | 39,341 | 10,403 | 133,686 |
| Access Lines Installed | 17,578 | 53,061 | 31,379 | 7,987 | 110,005 |

* Represents portion attributable to the Company.

** Local Exchange Carrier's central office

*** Other Network amounts includes Network Control Centers and Corporate Capital Expenditures and Gross Property, Plant and Equipment

Exhibit 99.2

## SCHEDULE F

## Hyperion Telecommunications, Inc.

### Form of Financial Information and Operating Data of the Pledged Subsidiaries and the Joint Ventures

| Data presented for the quarter ended: | | **12/31/98** |
|---|---|---|
| | | *Unaudited* |
| | | **Total** |
| **FINANCIAL DATA (dollars in thousands)(a):** | | |
| Total Revenue | $ | 11,388.0 |
| Total Capital Expenditures | $ | 13,616.1 |
| Total EBITDA | $ | 1,312.9 |
| Gross Property, Plant & Equipment | $ | 183,786.0 |
| **STATISTICAL DATA(b):** | | |
| **As of December 31, 1998:** | | |
| Networks in Operation: | | |
| Route Miles | | 3,149 |
| Fiber Miles | | 143,433 |
| Buildings connected | | 838 |
| LEC-COs collocated | | 54 |
| Voice Grade Equivalent Circuits | | 528,864 |
| Access Lines Sold | | 60,873 |
| Access Lines Installed | | 48,363 |

(a) Financial Data represents 100% of the operations of all entities except Hyperion of Florida, which is at Hyperion's ownership in the Jacksonville network, which is 20%.
(b) Statistical Data represents 100% of operating data for all entities