McLeodUSA INC
Form S-1/A
May 25, 2007

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As filed with the Securities and Exchange Commission on May 25, 2007

Registration No. 333-141490

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

AMENDMENT NO. 2

TO

FORM S-1

REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

McLeodUSA Incorporated

(Exact name of registrant as specified in its charter)

Delaware	**4813**	**42-1407240**
(State or other jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification Number)

One Martha's Way
Hiawatha, Iowa 52233
(319) 790-7800

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Royce J. Holland
President and Chief Executive Officer
McLeodUSA Incorporated
One Martha's Way
Hiawatha, Iowa 52233
(319) 790-7800

(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

David A. Westenberg, Esq. **Wilmer Cutler Pickering** **Hale and Dorr LLP** **60 State Street** **Boston, Massachusetts 02109** **Telephone: (617) 526-6000** **Telecopy: (617) 526-5000**	**Bernard L. Zuroff, Esq.** **Group Vice President General Counsel** **McLeodUSA Incorporated** **One Martha's Way** **Hiawatha, Iowa 52233** **Telephone: (319) 790-7800** **Telecopy: (319) 790-7008**	**Nazim Zilkha, Esq.** **White & Case LLP** **1155 Avenue of the Americas** **New York, New York 10036** **Telephone: (212) 819-8200** **Telecopy: (212) 354-8113**

Approximate date of commencement of proposed sale to the public: As soon as practicable after this registration statement becomes effective.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered(1)	Proposed Maximum Aggregate Offering Price Per Share(2)	Proposed Maximum Aggregate Offering Price(3)	Amount of Registration Fee(4)
Common Stock, par value $0.01 per share	12,333,750	$15.00	$185,006,250	$5,680

(1) Includes 1,608,750 shares of common stock that may be purchased by the underwriters to cover over-allotments, if any.

(2) Estimated solely for the purpose of computing the registration fee in accordance with Rule 457(a) under the Securities Act of 1933, as amended.

(3) Calculated pursuant to Rule 457(a) based on an estimate of the proposed maximum aggregate offering price.

(4) A registration fee of $5,296 was paid previously in connection with this Registration Statement. Accordingly, the Registrant has paid the difference of $384 with this filing.

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

Subject to Completion, Dated May 25, 2007

10,725,000 Shares

Common Stock

This is the initial public offering of common stock of McLeodUSA Incorporated. We are offering 7,150,000 shares of our common stock. Selling stockholders are offering an additional 3,575,000 shares of our common stock. We anticipate that the initial public offering price will be between $13.00 and $15.00 per share. We will not receive any proceeds from the sale of shares by the selling stockholders. We have applied to list our common stock on The Nasdaq Global Market under the symbol "MUSA."

Investing in our common stock involves a high degree of risk. See "Risk Factors" beginning on page 9.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

	Per Share	Total
Public offering price	$	$
Underwriting discounts and commissions	$	$
Proceeds, before expenses, to us	$	$
Proceeds, before expenses, to the selling stockholders	$	$

Certain selling stockholders have granted the underwriters the right to purchase up to 1,608,750 additional shares of common stock to cover over-allotments.

Deutsche Bank Securities Jefferies & Company

CIBC World Markets **Raymond James** **Thomas Weisel Partners LLC**

The date of this prospectus is , 2007.

PROSPECTUS SUMMARY

This summary highlights selected information contained in greater detail elsewhere in this prospectus. This summary may not contain all of the information that you should consider before investing in our common stock. You should carefully read the entire prospectus, including "Risk Factors," our audited consolidated financial statements and the other financial information appearing elsewhere in this prospectus, before making an investment decision.

Company Overview

We provide internet protocol-based, or IP-based, communications services to small- and medium-sized enterprises, and traditional telephone services to commercial and residential customers. Our IP-based communications services are delivered over a high-speed broadband connection and consist of a wide variety of voice and data services, including local and long distance voice, internet access, email, virtual private networking, network security, conference calling, and high capacity private line services. We believe we provide a level of service and network and call reliability comparable to that of traditional phone networks, with significantly lower capital expenditures and operating costs. We also provide wholesale communications services to other communications services providers through our extensive network facilities, in which we have invested over $2.5 billion since our inception.

Since January 2006, we have primarily targeted small- and medium-sized enterprise and multi-location customers within our geographic footprint with average monthly telecommunications bills of $500 to $5,000 per location. According to IDC, a leading provider of global information technology research and advice, approximately eight million small- and medium-sized enterprises, defined as businesses with less than 500 employees, will spend an aggregate of approximately $76.8 billion in 2007 for communications services in the United States. To address our target customers, we have shifted most of our sales resources from telemarketing to field and agent sales and have focused on geographic areas with potential enterprise customers who will use our services in multiple locations. As part of our strategy, we manage all aspects of our service offerings for our customers, including installation, provisioning, monitoring, proactive fault management and billing.

We serve 67 metropolitan statistical areas, including 19 of the largest 50 MSAs, across 20 states in the Midwest, Rocky Mountain, Southwest and Northwest regions, representing 40% of the U.S. population. We deliver our services primarily over our private secure network using T-1 and higher connectivity. We have one of the largest facilities-based networks maintained by a competitive carrier in the United States, spanning approximately 13,000 intercity and 4,000 metropolitan local route miles and encompassing over one million intercity fiber miles and 500,000 fiber miles of metropolitan local fiber optic cable. In addition, we lease capacity from other carriers and space in approximately 650 regional Bell operating company central offices, known as collocations, where we place our network transmission equipment to access most of our customers' locations.

Our team of senior executives has substantial experience in the telecommunications industry and extensive knowledge of our markets. Our management team is led by our Chief Executive Officer, Royce Holland, who has over 30 years of managerial experience, including over 18 years of experience in the telecommunications industry. Our executive management team includes key personnel who have held positions at leading major communications companies. Combined, our executive management team has over 150 years of telecommunications industry experience.

As of March 31, 2007, we had approximately 1,550 employees serving approximately 91,000 residential telephone lines, 264,900 business lines and 14,900 T-1 circuits. For the year ended December 31, 2006, we had revenue of $544.7 million, an operating loss of $15.3 million and a net loss of $28.3 million. For the quarter ended March 31, 2007, we had revenue of $126.4 million, an operating loss of $7.1 million and a net loss of $11.1 million. At March 31, 2007, we had stockholders' equity of $209.0 million and an accumulated deficit of $39.4 million.

Our Strategy

In January 2006, we emerged from Chapter 11 bankruptcy with a new chief executive officer, board of directors and equity ownership. At the same time, we shifted our business strategy to focus on providing services based on high-speed digital transmission connections, known as T-1 circuits, which we believe offer greater value to customers, increase customer retention and provide revenue growth opportunities for us.

Elements of our new strategy include:

Focusing on Small- and Medium-Sized Enterprise Customers. We plan to continue to target enterprise customers with our IP-based integrated packages of voice and data services that we believe will generate greater revenue and profits per customer location than the residential and very small business customers which were our historic focus.

Leveraging Our Network and Operational Infrastructure. Our IP-based intercity fiber network enables us to provide our services with minimal incremental investment and maintain one of the lowest ratios of capital expenditures as a percentage of revenues within our industry. As of March 31, 2007, our average network utilization was approximately 50%, as measured by unused capacity in our switches and intercity fiber network.

Improving Network Efficiency and Reducing Network Expenses. We believe that our disciplined approach to sales, installation and service, together with our automated business processes, will allow us to further streamline our operations and maintain low operating costs. As part of our ongoing effort to evaluate and rationalize our network, we have reduced monthly recurring costs for electric power and cross-connects for our collocations, decommissioned collocations in areas with limited potential to capture target business customers, and eliminated excess leased network capacity.

Expanding Our Field Sales Force and Agency Distribution Channels. In early 2006, we shifted most of our sales resources from telemarketing to field and agent sales, which we believe are more effective in selling higher value services to our larger target customers. We have also expanded our field sales force to target small-and medium-sized enterprise and multi-location customers in geographies where we have network facilities.

Providing Services that Meet the Needs of Our Customers. Our goal is to provide services that improve our customers' daily productivity, simplify their networks and provide them with control of their networks. Since January 2006, our retail T-1 products are typically purchased under two or three year contracts, which we believe increases customer retention and provides revenue growth opportunities.

Considering Potential Strategic Transactions. We may supplement our organic growth by acquiring network assets and customers that overlay our existing network and allow us to realize cost synergies, gain market share or improve profitability. Alternatively, we may divest certain assets or markets that are no longer core to our business strategy.

For a discussion of the industry in which we operate, please see "Business Industry Overview."

Company History

We were founded in 1993 with a strategy to serve residential and small business customers in the Midwest by reselling the local and long distance voice services of other carriers. Through August 2001, we grew rapidly, acquired numerous businesses, and focused on the construction of local and long distance voice networks and a national data network. As a result of the subsequent slowdown in the telecommunications industry and the national economy, and the burden of approximately $4.0 billion in debt we had incurred to finance our growth, we filed for Chapter 11 bankruptcy in January 2002. As part of our first plan of reorganization, pre-Chapter 11 noteholders received $670 million in cash and new preferred stock, and all other outstanding equity securities were exchanged for new common stock. We emerged from Chapter 11 in April 2002 with approximately $950 million in debt and a revised strategic plan that attempted to focus on profitable revenue growth but still within the residential and small business markets.

Following our first bankruptcy, our revenues continued to decline because of continuing weakness in segments of the telecommunications industry; the fact that our target residential and small business customers generally sought commoditized services from the lowest cost provider and exhibited high turnover; reduction in demand for long distance services among our retail customer base; and increased competition from the regional Bell operating companies and reductions in access rates and intercarrier compensation due to regulatory changes. In light of our inability to achieve new revenue growth in excess of existing customer turnover and ultimately to generate enough operating cash flow to service our remaining debt, we filed for Chapter 11 bankruptcy again in October 2005. Upon emergence on January 6, 2006, all outstanding equity securities were cancelled without consideration, and our creditors received all of our new common stock. Since that time, our common stock has not been publicly traded.

As a result of our two bankruptcies, equity securities (including securities issued in acquisitions) with an aggregate issuance price of approximately $5.0 billion were cancelled, and an aggregate of approximately $3.1 billion in indebtedness was cancelled.

We believe our new business strategy and capital structure address many of the past difficulties which resulted in our Chapter 11 filings:

We have significantly deleveraged our balance sheet, reducing our total debt from $777.3 million at December 31, 2005 to $120.1 million at March 31, 2007. In May 2007, we further reduced our indebtedness to $104.1 million by redeeming $16 million in principal amount of our outstanding $10^1/_2$% notes.

We generated positive cash flow during 2006, and had $64.8 million of cash on hand at December 31, 2006. During the first quarter of 2007, our cash on hand increased to $71.1 million primarily due to the sale of our ATS business on March 9, 2007 for $16 million.

Operationally, we reduced sales, general and administrative expenses by 16% from 2005 to 2006, and successfully shifted our sales focus to higher value enterprise customers. From the fourth quarter of 2005 to the first quarter of 2007, sales of T-1 based services grew from 30% of new sales to 66% of new sales, and monthly churn for T-1 based services decreased from 1.50% to 1.25%.

Risks Associated with Our Business

Our business is subject to numerous risks and uncertainties, as more fully described under "Risk Factors" beginning on page 9, which you should carefully consider before purchasing our common stock. For example:

- We have never been profitable and we may not be profitable in the future.
- We face intense and growing competition from other providers of communications services that have significantly greater resources than we do.
- We may not be successful in implementing our new business strategy, including the consummation of future acquisitions or divestitures or the integration of acquired businesses.
- Our historic financial difficulties, including our two bankruptcies, have adversely affected our image, ability to compete, liquidity and financial results.
- Government regulation may increase our costs, decrease our revenues, adversely impact our ability to provide services and/or subject our services to additional competitive pressures.
- We are dependent on the regional Bell operating companies from whom we lease collocations, portions of our local transport networks and the vast majority of the wires, known as "last mile" circuits, connecting our network transmission equipment to our customers' locations.

In addition, the ability of new investors to influence corporate matters may be limited because a small number of stockholders will beneficially own a substantial amount of our common stock following this offering. After giving effect to this offering, assuming no exercise by the underwriters of their over-allotment option, affiliates of Fidelity Investments will beneficially own 21.3% of our common stock, affiliates of Wayzata Investment Partners LLC will beneficially own 20.1% of our common stock, and an affiliate of Jefferies & Company, Inc., one of the managing underwriters of this offering, will beneficially own 5.9% of our common stock.

Recent Developments

On March 9, 2007, we completed the sale of our ATS business for a purchase price of approximately $16 million. ATS provides cable television services in and around Cedar Rapids and Marion, Iowa, and was not core to our continuing telecommunications business.

On May 16, 2007, we completed the acquisition of the Chicago-area customer base and related assets of Mpower Communications Corp. for approximately $17.3 million in cash.

On March 26, 2007, we filed a Registration Statement on Form S-4 pursuant to which we plan to offer to exchange all of our outstanding $10^1/_2$% notes, which we originally issued in a private placement transaction in October 2006, for new $10^1/_2$% notes that are identical to the old notes except that the new notes will be freely transferable. On May 8, 2007, we used the ATS proceeds to redeem $16 million in principal amount of $10^1/_2$% notes at a redemption price equal to 100% of the aggregate principal amount thereof, plus accrued and unpaid interest thereon and we intend to use a portion of the net proceeds of this offering to redeem up to an additional $26 million in aggregate principal amount of $10^1/_2$% notes, as more fully described under "Use of Proceeds" beginning on page 30. As of the date of this prospectus, affiliates of Jefferies & Company, Inc. own approximately $3.5 million in principal amount of our $10^1/_2$% notes and will benefit from these redemptions.

Our Corporate Information

We were incorporated in Delaware as McLeod, Inc. in 1993 and changed our name to McLeodUSA Incorporated in 1997. Our principal executive offices are located at One Martha's Way, Hiawatha, Iowa 52233, and our telephone number is (319) 790-7800. Our website address is www.mcleodusa.com. We have included our website address as an inactive textual reference only. The information contained on, or that can be accessed through, our website is not a part of this prospectus.

In this prospectus, unless otherwise stated or the context otherwise requires, references to "McLeodUSA," "we," "us," "our" and similar references refer to McLeodUSA Incorporated.

The Offering

Common stock outstanding before this offering	30,750,000 shares
Common stock offered by McLeodUSA	7,150,000 shares
Common stock offered by the selling stockholders	3,575,000 shares
Common stock to be outstanding after this offering	37,900,000 shares
Over-allotment option	1,608,750 shares
Use of proceeds	We intend to use a portion of the net proceeds of this offering to redeem up to \$26 million in principal amount of our outstanding $10^1/_2$% notes and the balance of our net proceeds for working capital and other general corporate purposes, which may include funding capital expenditures, acquisitions and investments. See "Use of Proceeds" for additional information. We will not receive any proceeds from the sale of shares by the selling stockholders.
Dividend Policy	We intend to retain all future earnings, if any, to fund the development and growth of our business. We do not anticipate paying cash dividends on our common stock.
Proposed Nasdaq Global Market symbol	"MUSA"

The number of shares of our common stock that will be outstanding immediately after the offering is based on shares outstanding as of March 31, 2007, but does not include:

- 838,925 shares of common stock issuable upon the exercise of options outstanding and exercisable as of March 31, 2007 under our 2006 Omnibus Equity Plan, which we refer to as our 2006 plan, at a weighted average exercise price of $8.60 per share;
- 1,387,175 shares of common stock issuable upon the exercise of options outstanding, but not exercisable, as of March 31, 2007 under our 2006 plan, at a weighted average exercise price of $8.65 per share; and
- 123,900 shares of common stock available for future issuance under our 2006 plan as of March 31, 2007.

The 10,725,000 shares sold in this offering will represent 28.3% of our outstanding common stock upon completion of this offering.

Unless otherwise indicated, the information contained in this prospectus assumes:

- *no exercise by the underwriters of their over-allotment option;*
- *the filing of an amendment to our restated certificate of incorporation to increase the number of authorized shares of our common stock; and*
- *the issuance and sale by us of 7,150,000 shares of common stock in this offering.*

McLeodUSA® and StarQuality® are our registered trademarks. Other trademarks, trade names or service marks appearing in this prospectus are the property of their respective owners.

SUMMARY CONSOLIDATED FINANCIAL DATA

The following tables set forth our selected consolidated financial data for the periods ended and dates indicated. The selected consolidated financial data for January 1, 2006 and the years ended December 31, 2004, 2005 and 2006 and as of December 31, 2005 and 2006 have been derived from, and should be read together with, our audited consolidated financial statements beginning on page F-1 of this prospectus. The summary financial data for the three months ended March 31, 2006 and 2007 has been derived from our unaudited consolidated financial statements beginning on page F-1 of this prospectus.

The summary historical financial information set forth below is not necessarily indicative of the results of future operations and should be read in conjunction with, and is qualified in its entirety by, the discussion under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our financial statements and notes thereto included elsewhere in this prospectus.

	Predecessor McLeodUSA			Reorganized McLeodUSA		
	Years Ended December 31,				Three Months Ended March 31,	
	2004	2005	One Day January 1, 2006(1)	Year Ended December 31, 2006	2006	2007
			(dollars in millions)		(unaudited)	
Income Statement Data:						
Revenue	$ 716.2	$ 635.0	$	$ 544.7	$ 145.7	$ 126.4
Operating Expenses:						
Cost of service(2)	393.8	362.1		315.8	86.8	67.8
Selling, general and administrative(2)	268.4	217.4		181.7	44.2	49.3
Depreciation and amortization	356.8	212.9		60.1	14.5	16.4
Reorganization charges, net		20.2	(18.5)			
Restructuring, asset impairment and other charges (adjustments)	262.9	301.7		2.4	1.8	
Total operating expenses (income)	1,281.9	1,114.3	(18.5)	560.0	147.3	133.5
Operating (loss) income	(565.7)	(479.3)	18.5	(15.3)	(1.6)	(7.1)
Interest expense, net	(48.2)	(65.3)		(12.7)	(3.2)	(3.1)
Other (expense) income	(10.6)	9.8		(0.3)		(0.9)
Gain on cancellation of debt			728.1			
Net (loss) income	(624.5)	(534.8)	746.6	(28.3)	(4.8)	(11.1)
Preferred stock dividend	(2.9)	(1.3)				
(Loss) income applicable to common shares	$ (627.4)	$ (536.1)	$ 746.6	$ (28.3)	$ (4.8)	$ (11.1)

(1) On October 28, 2005, we filed a voluntary petition for bankruptcy relief under Chapter 11. On January 6, 2006 we emerged from bankruptcy pursuant to the terms of a plan of reorganization. Upon emergence, we adopted the fresh start accounting provisions of SOP 90-7. The adoption of fresh start accounting had a material effect on our financial statements. As a result, our financial statements for periods after January 1, 2006 are not comparable to our financial statements for earlier periods. Specifically, interest expense, due to the substantial cancellation of debt, and depreciation and amortization expense, due to the adjustment of the carrying values of property, equipment and intangibles to their estimated fair market values, have significantly changed after the application of SOP 90-7.

(2) Exclusive of depreciation and amortization.

Unaudited pro forma information in the consolidated balance sheet data table set forth below reflects our sale of 7,150,000 shares of common stock in this offering at an assumed initial public offering price of $14.00 per share, after deducting estimated underwriting discounts and commissions and estimated offering expenses, as well as our use of proceeds from the ATS sale to redeem a portion of our outstanding $10^1/_2$% notes. Pro forma as adjusted information in the consolidated balance sheet data table set forth below further reflects our use of a portion of the proceeds of this offering to redeem a portion of our outstanding $10^1/_2$% notes.

	March 31, 2007		
	Actual	Pro Forma	Pro Forma As Adjusted
	(in millions)		
Balance Sheet and Other Data:			
Cash and cash equivalents	$ 71.1	$ 146.7	$ 118.0
Property and equipment, net	298.6	298.6	298.6
Working capital (deficiency) (excluding assets held for sale)	27.2	102.8	74.1
Total assets	464.1	539.7	511.0
Total debt	120.1	104.1	78.1
Stockholders' equity (deficiency)	209.0	300.6	297.9
Weighted average common shares outstanding:			
Basic	30.0	37.9	37.9
Diluted	30.0	37.9	37.9

	Year Ended December 31, 2006	Quarter Ended March 31, 2007
Selected Operating Data:		
Capital expenditures	$ 31.9	$ 6.9
Deferred line installation costs(1)	17.0	4.8
Retail residential traditional telephone service line churn	3.54%	3.83%
Retail business traditional telephone service line churn	3.17%	3.23%
Retail T-1 circuit churn	1.32%	1.25%
Retail unit churn for our Dynamic Integrated Access service	0.59%	0.55%

	As of March 31, 2007
Retail residential traditional telephone service lines in service	91,000
Retail business traditional telephone service lines in service	264,900
Retail T-1 circuits in service	14,900
Quota bearing field sales representatives	214
Quota bearing inside sales representatives	48
Total employees	1,564

(1) Deferred line installation costs represent costs that are driven by new sales and include equipment, internal labor for installation and provisioning of equipment and service and non-recurring costs paid to the regional Bell operating companies for provisioning traditional telephone service or T-1 circuits.

RISK FACTORS

Investing in our common stock involves a high degree of risk. You should carefully consider the following risk factors and all other information contained in this prospectus before purchasing our common stock. The risks and uncertainties described below are not the only ones facing us. Additional risks and uncertainties that we are unaware of, or that we currently deem immaterial, also may become important factors that affect us.

If any of the following risks occur, our business, financial condition or results of operations could be materially and adversely affected. In that case, the trading price of our common stock could decline, and you may lose some or all of your investment.

Risks Relating to Our Industry and Business

We have never been profitable and we may not be profitable in the future. Our revenues have declined for five consecutive years and we expect will decline further in 2007.

We have experienced significant net and operating losses in the past. For the years ended December 31, 2004, 2005 and 2006, we recorded net losses of $624.5 million, $534.8 million and $28.3 million, respectively, and operating losses of $565.7 million, $479.3 million and $15.3 million. For the quarter ended March 31, 2007, we had an operating loss of $7.1 million and a net loss of $11.1 million. We have only recently generated sufficient cash flow from operations to fund our expenses and may not continue to do so in the future. We have never been profitable on an operating basis and may not be in the future. Our revenues have declined for five consecutive years, from a high of $1,810.8 million (including discontinued operations) in 2001 to $544.7 million in 2006, and we expect that our revenues will decline further in 2007. Our revenue declined from $145.7 million in the quarter ended March 31, 2006 to $126.4 million in the quarter ended March 31, 2007.

We face intense and growing competition from other providers of communications services that have significantly greater resources than we do. Several of these competitors are better positioned to engage in competitive pricing, which may make it difficult for us to attract new customers.

The market for communications services is highly competitive and we expect the competition to intensify. We compete with many types of communications providers, including traditional local telephone companies, cable companies, new IP-based service providers and other managed service providers with similar business models to our own. Our current or future competitors may provide services that are comparable or superior to those that we provide, or at lower prices, or adapt more quickly to evolving industry trends or changing market requirements.

Our target customers are small- and medium-sized enterprises and multi-location customers within our geographic footprint. The success of our business depends in part on our ability to attract these potential customers to leave their current providers. Many of these providers have competitive advantages over us, including substantially greater financial, personnel and other resources, better access to capital, brand name recognition and long-standing relationships with customers. These resources may place us at a competitive disadvantage in our current markets and limit our ability to expand into new markets. Because of their greater financial resources, some of our competitors can also afford to reduce prices for their services, offer sales inducements, such as low-cost or free telecommunications equipment, and engage in aggressive promotional activities, which could have an adverse effect on our business. If we are required to reduce our prices to remain competitive, or if we lose customers as a result of these factors, our revenue will decrease.

We may not be successful in implementing our new business strategy or in realizing its anticipated benefits, which could adversely affect our business.

In the past, we focused on delivering a broad portfolio of products to a wide spectrum of customer segments including residential, small- and medium-sized enterprises, other carriers and internet service providers, and, to a lesser extent, large corporate enterprises. This strategy resulted in a large base of small and lower margin customers with monthly billings of up to $200 per month per location. Upon our January 2006 emergence from our second bankruptcy, we shifted our business strategy to focus on providing higher value bundles of integrated voice, broadband internet access and other data services to enterprise customers with average monthly telecommunications bills of $500 to $5,000 per location. In order to better target these enterprise customers, we also changed our sales and marketing strategy to emphasize direct sales and agent channels with less reliance on telemarketing and yellow pages advertising.

Our new business strategy represents a significant change from our historic practices. We may not be able to implement our new strategy successfully, and its success is dependent on a number of factors, including our ability to:

- sell bundled products and services to voice- and data-intensive small- to medium-sized enterprise customers;
- scale our operations;
- maximize network utilization;
- evaluate our network and monitor technological developments;
- retain our existing customer base by reducing churn;
- allocate greater sales and marketing and company resources to offering a broad set of value-added services;
- expand, train and incentivize our sales force to sell more complex services; and
- retain access to the last mile access loops and other necessary network elements and collocations leased from the regional Bell operating companies at rates that enable us to competitively price our products.

In order for us to become profitable, we must achieve objectives in a timely and cost-effective manner. In our effort to become profitable, our revenues have decreased and may continue to do so, which could adversely affect our financial condition, results of operations and cash flows. We may not achieve our objectives, and if we fail to achieve one or more of our objectives, we may not become profitable on an operating basis, our results of operations and cash flows could be negatively impacted and we could be forced to seek alternatives for our business.

Failure to raise necessary capital could restrict our ability to support our network infrastructure, develop or enhance our products, take advantage of future opportunities, operate and expand our business or respond to competitive pressures.

Our capital resources may not be sufficient to enable us to fund the capital expenditures required to:

- deploy network assets currently not in service;
- construct, purchase, develop and improve communications assets in target markets; and

improve our business infrastructure and systems to support a more efficient telecommunications company.

We also require substantial funds for general corporate and other expenses and may require additional funds for working capital fluctuations. Failure to generate or raise sufficient funds may require us to delay or abandon some of our plans or expenditures, which could harm our business and competitive position.

We expect to meet our funding needs through various sources, including existing cash balances, cash flow from future operations, and proceeds from sales of excess fiber or other excess inventory. While the indenture governing our $10^1/_2$% notes allows us to enter into a senior secured credit facility and, subject to the satisfaction of a leveraged based ratio test, incur additional indebtedness to fund future liquidity needs, our ability to raise additional capital may be adversely affected by our past financial difficulties and prior bankruptcies. The significant losses incurred by the prior holders of our shares and debt in connection with our bankruptcies may make it more difficult for us to access these sources of additional funds on satisfactory terms, or at all.

Our historic financial difficulties, including our two bankruptcies, have adversely affected our image, ability to compete, liquidity and financial results.

In August 2001, we initiated a broad financial and operational restructuring, and in April 2002, we emerged from Chapter 11. We filed another voluntary petition for relief under Chapter 11 in October 2005, and on January 6, 2006, we again emerged from bankruptcy. Our past financial difficulties and two bankruptcies have harmed our image with investors, customer and suppliers. They have also adversely affected our liquidity position, because we have been required to provide letters of credit as deposits to certain of our vendors. As of March 31, 2007, we had $8.3 million in outstanding letters of credit. Of this amount, $7.3 million in letters of credit were issued to provide additional security to our vendors, including $4.1 million issued to Qwest related to disputed items and amounts that we have withheld as a result, and $3.2 million required by an insurance company that has issued bonds to various third parties. Generally, these bonds are performance-type bonds required in the ordinary course of our business to allow us access to rights-of-way in order to construct and maintain our network facilities. In connection with our September 2006 issuance of our $10^1/_2$% notes, we repaid the credit facility under which these letters of credit were originally issued. Accordingly, the outstanding letters of credit are now required to be cash collateralized at 105% of their face value, resulting in a significant amount of restricted cash.

Additionally, our past financial difficulties and two bankruptcies have adversely affected the willingness of potential customers, particularly the larger, more sophisticated business customers that we are now targeting, to purchase telecommunications services from us. In numerous instances, potential customers have decided not to purchase services from us because of their concerns regarding our financial stability, and in other instances, have required discussions with our sales and executive management regarding our financial condition before purchasing our services. Our financial position may continue to adversely affect the willingness of potential customers to purchase their communications services from us.

We may also lose revenues to the extent other carriers reduce the amount of business they transact with us as a result of their perception of our financial condition. Some of our critical suppliers of network services, such as the regional Bell operating companies and their affiliated long distance carriers, have sought in the past and may seek in the future to impose burdensome security deposits or require letters of credit that may adversely affect our liquidity position. These vendors may be successful in imposing these requirements on us which could have a material adverse effect on our liquidity and financial condition.

Prices for some of our services are expected to continue to decrease.

The prices that we charge for some of our communications services have been decreasing, and we expect to continue to experience decreasing prices for certain of our communications services:

- as we and our competitors increase transmission capacity on existing and new networks;
- as a result of the continuing convergence of various technological means to provide similar services to customers in our markets;
- as a result of our current agreements with customers which often contain volume based pricing or other contractually agreed upon decreases in prices during the term of the agreement;
- through technological advances or otherwise; and
- as a result of changes in regulatory policy.

We may be unable to compensate for declining revenues and, accordingly, our historical revenue may not be indicative of future revenue based on comparable customer count or traffic volumes. If the prices for our communications services decrease, and if we are unable to offer additional services from which we can derive additional revenue or otherwise reduce our operating expenses, our operating results will decline and our business and financial results will suffer.

The success of our communications services will depend on our ability to keep pace with rapid technological changes affecting our industry.

The communications industry has experienced, and we believe will continue to experience, rapid and significant changes in technology. Technological changes, such as the use of wireless network access, could render aspects of our technology suboptimal or obsolete and provide a competitive advantage to new or larger competitors who might more easily be able to take advantage of these opportunities. Some of our competitors, including the local telephone companies, have much longer operating histories, more experience in making upgrades to their networks and greater financial resources than we do. We may not be able to obtain access to new technologies as quickly or on the same terms as our competitors, and we may not be able to apply new technologies to our existing networks without incurring significant costs or at all. In addition, responding to demand for new technologies would require us to increase our capital expenditures, which may require additional financing. If we are unable to keep pace with these technological changes, we could face difficulties in attracting and retaining customers.

Government regulation may increase our costs, decrease our revenues, adversely affect our ability to provide services and/or subject our services to additional competitive pressures.

Our facilities and services are subject to federal, state and local regulations. The time and expense of complying with these regulations could increase our costs of providing services and subject us to additional competitive pressures. One of the primary purposes of the Telecommunications Act of 1996 was to open the local telephone services market to competition. While this has presented us with opportunities to enter local telephone markets, it also provided important competitive and other benefits to the regional Bell operating companies, such as the ability to provide long distance service to customers in their respective regions. In addition, we need to obtain and maintain licenses, permits and other regulatory approvals in connection with some of our services. Any of the following could adversely affect our business:

- failure to comply with federal and state tariff requirements;
- failure to maintain proper federal, state and municipal certifications or authorizations;
- failure to comply with federal, state or local laws and regulations;
- failure to obtain and maintain required licenses and permits;
- failure to properly classify revenues and any misclassification's impact on surcharge collection and remittance;
- burdensome license or permit requirements to operate in public rights-of-way; and
- burdensome or adverse regulatory requirements.

State and federal regulations to which we are subject require prior approval for a range of different corporate activities, such as transfers of direct and indirect control of authorized telecommunications carriers, certain corporate reorganizations, acquisitions of telecommunications operations, assignment of carrier assets, certain stock offerings and incurrence by carriers of significant debt obligations. The failure to obtain such required approvals could adversely affect us and our operations.

Certificates of authority can generally be conditioned, modified, canceled, terminated or revoked by state regulatory authorities for failure to comply with state law or the rules, regulations and policies of state regulatory authorities. State utility commissions generally have authority to supervise telecommunications service providers in their states and to enforce state utility laws and regulations. Fines or other penalties also may be imposed for violations. We have been fined for violations in the past. State utility commissions or third parties could challenge our compliance with applicable laws or regulations, which could have a material adverse effect on our business, results of operations and financial condition.

The legislative and regulatory environment in which we operate continues to undergo significant changes. Many of the developments discussed in this prospectus are subject to further legislative and regulatory actions as well as litigation and court review. Our business may be adversely affected by future legislation, regulatory change or court decisions.

Additional liabilities may arise in connection with the federal universal service program

The Federal Communications Commission, or FCC, has established a "universal service" program that is intended to ensure that affordable, quality basic telecommunications services are available to all residents of the United States. Like other telecommunications providers, we are required to make contributions to support federal and state universal service goals. Our contribution to federal universal service support programs is assessed against our interstate and international end-user telecommunications gross revenue. Our contribution was 10.9% of such revenue in both 2005 and 2006. We paid approximately $6.6 million to the federal program in 2005 and approximately $6.3 million in 2006.

On March 8, 2007, the Universal Service Administration Company, which administers the federal universal service program on behalf of the FCC, completed an audit of our contributions to the federal universal service program based upon our 2005 revenues. The audit report, which is not yet final, tentatively concludes that we underreported or misclassified certain telecommunications service revenues, resulting in a contribution shortfall of approximately $4.4 million. We have filed a response to identify what we believe are errors in the audit report, and we intend to seek modification of the audit findings before the report is finalized. For example, we assert that the audit did not recognize that a significant portion of allegedly underreported interstate revenues are from services sold to other carriers for incorporation into their own telecommunications services. Additionally, a significant portion of the allegedly underreported interstate revenues are associated with high capacity digital T-1 and primary rate interface services that are local in nature and, therefore, not interstate services. In each of these examples, we believe that the services are not end-user interstate services subject to universal service fee contributions. We expect the audit report to be finalized during the first half of 2007. We have reserved what we believe to be an adequate amount related to this audit based on our assessment of the likely outcome. If our efforts are unsuccessful, we have the right to appeal the audit findings to the FCC. In the event that the tentative audit findings are upheld, however, we may be required to pay the contribution shortfall with respect to 2005 revenues, and we also may have additional unanticipated liabilities with respect to our 2006 and 2007 revenues. To satisfy any such additional contribution obligations, we would either need to impose billing surcharges on our customers, thereby increasing our prices, or to absorb these obligations as additional costs.

Consolidation among the RBOCs and advancing deregulation make it more difficult for us to compete with the RBOCs and increase revenues.

It has become increasingly difficult to compete against large, financially strong competitors with well known brands, particularly the regional Bell operating companies, which currently consist of AT&T, Qwest and Verizon, and are known in the telecommunications industry as RBOCs. These companies are now allowed to provide long distance services to customers in all states. The RBOCs have generally been successful in gaining significant market share for such services, and in the case of AT&T and Verizon, have now acquired the most significant long distance providers. In addition, the ability of the RBOCs to expand their service offerings enhances their competitive position for local and other services.

Consolidation in the communications industry has accelerated in the wake of these new policies and other changes in market conditions. The RBOCs have also successfully achieved broader deregulation of their retail offerings in many states. With the recent merger and deregulatory activity in the telecommunications industry, we believe that the RBOCs will likely become even stronger competitors.

Our dependence on the RBOCs to provide many of our communications services could make it harder for us to offer our services at a profit.

Under the Telecommunications Act, the RBOCs are required to provide us with access to certain individual elements of their telecommunications networks on an unbundled basis and at regulated prices based on their costs. These individual elements are known in the telecommunications industry as unbundled network elements. In addition, under the Telecommunications Act, the RBOCs are required to provide us with other network elements that may not qualify as unbundled network elements, such as circuit switching, directory assistance and operator services, at just and reasonable prices.

We depend on the RBOCs to provide us with many of these elements, including the "last mile" connections to most of our customers. At the same time, the RBOCs are our largest competitors. Today, without using the network elements and communications services provided by these companies, we could not economically provide services to most of our customers. Because of this dependence, our communications services are highly susceptible to changes in the conditions for access to RBOC facilities and to possible inadequate service quality provided by the RBOCs. Therefore, we may have difficulty offering our services on a profitable and competitive basis. Qwest and AT&T, including its wholly-owned subsidiaries AT&T Midwest Corporation and Southwestern Bell Telephone Company, are the primary suppliers of these network elements and communications services that allow us to initiate and complete calls and transmit data. Our suppliers' communications facilities allow us to provide local, long distance and internet services and private lines dedicated to our customers' uses. If the RBOCs or other companies are legally entitled to deny or limit our access to their network elements or communications services, or if regulatory decisions allow them to charge higher rates for these elements or services, we may not be able to offer communications services at profitable rates.

Our loss of access to unbundled network elements has occurred on three occasions to date. In September 2005 the FCC granted forbearance relief to Qwest that has resulted in our loss of access to unbundle network elements at cost-based rates in nine central offices in the Omaha MSA where we have collocated equipment and customers. Qwest has since proposed substantially increasing the prices for all network elements that we use to provide services in the nine affected central offices. Based on the prices demanded by Qwest for replacement facilities, we estimate that our average cost of accessing our customers with T-1 circuits in the Omaha metropolitan area has increased from $76 to $200 as a result of this FCC ruling. Although AT&T has committed not to seek forbearance from the unbundled network element loop and transport obligations before mid-2010, Qwest has made no such commitment. In fact, on April 27, 2007, Qwest petitioned the FCC for forbearance of its obligation to offer unbundled network elements in the Denver, Minneapolis, Seattle and Phoenix metropolitan areas. If Qwest's petition is successful, we would no longer be able to obtain access to our customers in these metropolitan areas at regulated prices, and Qwest might be able to increase the costs of serving our customers by raising the prices of its deregulated transmission services.

Effective March 11, 2006, the FCC eliminated access to the unbundled network element platform, which was a combination of unbundled network elements purchased from the RBOCs at state-regulated prices using the FCC's pricing methodology. This combination of unbundled network elements enabled us to offer local service in markets where we did not have our own local network facilities, and was used to serve residential and very small business customers with four or fewer local lines. To continue serving our customers in those markets, we were forced to replace our lost access to the unbundled network element platform by entering into commercial agreements with Qwest and AT&T.

In place of the unbundled network element platform, Qwest now offers a commercial product called Qwest Platform Plus, which is priced from 8% to 25% more than the former unbundled network element platform prices for each access line, depending on the state. Under our agreement with Qwest for this product, prices for this product annually increase an average of $1 per access line. The AT&T commercial replacement product, called Local Wholesale Complete, is priced 25 to 300% more than the former unbundled network element platform prices for each access line, depending on the market. Our agreement with AT&T for this product provides for annual price increases based on the rate of inflation. We are annually increasing our retail prices to end users to offset these cost increases. Our 2006 statement of operations reflects both the cost and revenue effects related to these agreements.

Also effective March 11, 2006, the FCC modified its unbundling rules to eliminate access to high capacity digital loops in certain central offices, and high capacity transport facilities that are used to carry traffic between certain central offices. Seventeen wire centers in our 20-state local network footprint are affected by the rule modification that eliminates our access to high-capacity digital loops. As a result of these rule modifications, we are required to purchase these facilities from the RBOCs through their special access tariffs or through commercial agreements, or, if available, from third-party vendors. Depending on the market and facilities, prices for high capacity facilities affected by the rule modification are on average approximately 80% higher than prices paid for these same facilities when they were classified as unbundled network elements. The total cost impact to us of these price increases is approximately $139,000 per month. To date, the RBOCs have not billed us at the higher prices, but may have a right to do so retroactive to the March 2006 effective date. Our 2006 statement of operations reflects the cost increase resulting from this regulatory change, and we believe we have fully reserved the amounts that may be due if we are billed for each of the affected facilities at the deregulated price.

Similarly, FCC rules currently permit the RBOCs to unilaterally retire copper loop facilities that we use as the last mile connection to our customer without any regulatory oversight. As RBOCs deploy more fiber loop facilities that the FCC has declared are not subject to unbundling obligations, the RBOCs may be able to eliminate our access to last mile facilities that we require to serve our customers. Verizon has filed more than 80 notifications of copper plant retirement affecting several of its exchanges. AT&T and Qwest have not yet filed a notification of copper plant retirement in any exchange in which we use their last mile facilities. Several competitive local exchange carriers, including us, petitioned the FCC in January 2007, to change the rules governing copper plant retirement to protect our access to these last mile copper facilities. The FCC has solicited public comments on this petition but has not yet made any decision.

In order to interconnect our network equipment and other communications facilities to unbundled network elements controlled by the RBOCs, we must enter into, maintain and renew interconnection agreements with them. Interconnection obligations imposed on the RBOCs by the Telecommunications Act have been and continue to be subject to a variety of legal proceedings. In addition, the mergers of SBC and AT&T, Verizon and MCI and AT&T and BellSouth could significantly impact the availability of acceptable interconnection agreements without incurring the expense of lengthy negotiations and arbitrations with an RBOC in each state. Former standalone long distance carriers AT&T and MCI dedicated significant internal and external resources to negotiate and arbitrate interconnection agreements that many competitive local exchange carriers used as model agreements, and these resources are no longer available as a result of consolidation among RBOCs. On March 2, 2007, Qwest provided notice that it was terminating all current interconnection agreements with us. The termination notice begins a 160-day period for negotiation of new interconnection agreements for each of the states. If we cannot successfully negotiate new agreements with Qwest for each state, or find existing interconnection agreements that Qwest has with other competitive local exchange carriers that meet our network and operating requirements and that we can opt into, then we will be required to arbitrate all unresolved issues before each state commission. We may not be able to obtain interconnection agreements on terms that would continue to permit us to offer services using our own communications network facilities in combination with the local network elements of the RBOCs at profitable and competitive rates.

When FCC decisions eliminate our access to elements of RBOC networks at cost-based prices, the RBOCs may choose or be required to offer those elements on a commercial rather than a regulated basis, and these commercial terms may make these elements uneconomical for us to use. For example, we have been unable to reach an agreement with Qwest for replacement of high capacity facilities in the Omaha central offices affected by the FCC forbearance decision. In these central offices, we have the option of purchasing RBOC special access services in lieu of unbundled network elements, but the FCC has granted the RBOCs substantial pricing flexibility for these services and in many cases they are much more costly than the unbundled network elements they would replace. We may not be able to obtain commercial agreements or special access services on terms that would continue to permit us to offer local services using the RBOC's network facilities at profitable and competitive rates, which may lead us to exit such markets and decrease our customer base and revenues.

Actions by the RBOCs may make it more difficult for us to offer our communications services.

We anticipate that the RBOCs will continue to pursue litigation, forbearance, retirement of copper loop facilities, changes in regulations and legislation to reduce regulatory oversight over their networks, rates and operations. If they are successful, these initiatives will make it more difficult for us to challenge RBOC actions in the future, which will adversely affect our business. For example, on April 27, 2007, Qwest petitioned the FCC for forbearance of its obligation to offer unbundled network elements in the Denver, Minneapolis, Seattle and Phoenix metropolitan areas. If Qwest's petition is successful, we would no longer be able to obtain access to our customers in these metropolitan areas at regulated prices, and Qwest would potentially be able to increase our cost to serve our customers by raising the prices of its deregulated transmission services.

The RBOCs are also pursuing actions to make it more difficult for us to act as a wholesale provider of communications services. For example, AT&T and Qwest are attempting to limit competitive local exchange carriers to using unbundled network elements to serve only their own end-user customers, which would eliminate our ability to provide local wholesale services to other competitive local exchange carriers. Both AT&T and Qwest are also trying to impose new network configuration requirements that prohibit use of local interconnection service trunks for terminating anything but local traffic from a competitive local exchange carrier's end-user customers, which would impact our Dynamic Integrated Access services. If successful, the RBOCs will make it more costly for us to serve customers and act as a wholesale provider of communications services.

The RBOCs are also actively pursuing federal legislative and regulatory initiatives and litigation that could have the effect of decreasing the benefits to us of certain provisions in the Telecommunications Act and various state laws, and increasing the competition that we face from the RBOCs in data services, including by limiting their obligations to provide access to their unbundled network elements, including elements necessary to support our Dynamic Integrated Access services. If successful, these initiatives could make it more difficult for us to compete with the RBOCs and to offer services on a profitable and competitive basis. Please see "Regulatory Environment."

Developments in the wireless telecommunications industry could make it more difficult for us to compete.

The wireless telecommunications industry is experiencing increasing competition, consolidation, significant technological change and rapid growth. Wireless internet services, high-speed data services and other more advanced wireless services are also gaining in popularity. These developments may make it more difficult for us to gain and maintain our share of the communications market, which may facilitate the migration of wireline usage to wireless services. We could also face additional competition from users of new wireless technologies including, but not limited to, currently unlicensed spectrum. In addition, some governmental entities are contracting with individual companies to construct and operate government subsidized wireless networks using WiMax technology to offer high-speed internet connectivity throughout a city or county.

Many of the wireless carriers and governmental entities have financial and other resources far greater than we have and have more experience testing and deploying new or improved products and services. The largest wireless carriers, AT&T and Verizon Wireless, both have common ownership interests with RBOCs. As a result, RBOCs are better positioned to offer both wireless and landline telecommunications services and can offer bundled services that may be more attractive to our customers than landline offerings alone. Mobile wireless is also reducing demand for our long distance services local landline installations. In addition, several wireless competitors operate or plan to operate wireless telecommunications systems that encompass most of the United States, which could give them a significant competitive advantage.

Changes in FCC unbundling requirements and compensation rules will continue to affect our business.

Several times in recent years, the FCC has revised its rules defining the unbundled network elements that the RBOCs are required to sell to competitive local exchange carriers, such as us, at total element long run incremental cost, or TELRIC, rates, which reflect efficient costs plus a reasonable profit. We depend on access to these unbundled network elements in order to provide services to our customers.

These FCC decisions, among other things, eliminated access to the unbundled network element platform, and eliminated unbundled access to high capacity loops in certain central offices depending on the amount of business access lines and number of fiber collocators in a wire center. To date, 17 wire centers in our 20-state network footprint are affected by the revised loop unbundling rules. We have been required to replace unbundled high capacity loops and transport facilities in the affected wire centers with services provided by a third-party supplier, or with higher priced special access services or other commercially priced offerings from a RBOC. Our business could be adversely affected by the FCC's revised unbundling rules, future changes to those rules, new legislation passed in response to the new unbundling rules or any court decisions relating to the unbundling rules.

The FCC also has an open docket proposing to reform all forms of intercarrier compensation, including both reciprocal compensation payments for local calls and access charges for in-state and inter-state toll calls. We receive these types of payments on calls that other carriers terminate to our customers, and make payments to other carriers for calls that our customers place. An industry task force produced a proposal named the "Missoula plan" that was filed with the FCC on July 24, 2006. The Missoula Plan would impose a uniform compensation rate applicable to all types of traffic that a carrier terminates, change the rules of interconnection and transiting and partially preempt state authority over intrastate access rates. If the Missoula plan is adopted as proposed, we would experience a significant reduction in access revenues and increased costs of interconnection after the plan is fully implemented over a proposed three-year period, which would have a material adverse effect on us.

The mergers of AT&T and MCI with RBOCs may impact our ability to challenge the RBOCs in federal and state proceedings that will determine our ability to offer services and our cost of services.

In late 2005, SBC and AT&T and Verizon and MCI completed their respective mergers, and in December 2006, AT&T and BellSouth completed their merger. Since enactment of the Telecommunications Act, MCI and AT&T had been the primary opponents of the RBOCs in federal and state legislative and regulatory forums that related to the Telecommunications Act, FCC rules implementing the Telecommunications Act, and state laws fostering competition in local exchange markets, and served as the primary source of funding for a variety of competitive local exchange carrier coalitions that fought the actions of the RBOCs before state and federal legislators, and in state and federal regulatory and judicial proceedings. AT&T and MCI also dedicated significant internal resources to federal and state regulatory and court proceedings such as interconnection arbitrations and TELRIC dockets in which the costs of unbundled network elements were set by state agencies. As a result of the merger of SBC and AT&T and the merger of Verizon and MCI, the primary source of opposition to RBOC regulatory and legislative actions affecting the ability of competitive local exchange carriers to compete in virtually every key regulatory and legislative forum has been eliminated. We and the remainder of the independent competitive local exchange carrier industry may not have the resources to replace the loss of internal and external resources provided by AT&T and MCI, and as a result our business could be harmed.

The loss of key personnel could weaken our technical and operational expertise, hinder the development of our markets, lower the quality of our service and harm our ability to implement our new business strategy.

We believe that our ability to implement our new business strategy depends, in part, on our experienced management team, including Royce J. Holland, who has served as our President and Chief Executive Officer since January 2006. For various reasons, including our recent emergence from Chapter 11, we may not be able to retain experienced and innovative management, technology and sales personnel. The loss of the services of key personnel, or the inability to attract additional qualified personnel, could cause us to make less successful strategic decisions, which could hinder the development of our markets. We could also be less prepared for technological or marketing problems, which could reduce our ability to serve our customers and lower the quality of our services. As a result, our financial condition could be adversely affected and we may not be able to implement our new business strategy.

Failure to obtain and maintain necessary permits and rights-of-way could interfere with our network infrastructure and operations.

To obtain and maintain rights-of-way and similar rights and easements needed to install, operate and maintain our fiber optic cable and other network elements, we must negotiate and manage agreements with state highway authorities, local governments, transit authorities, local telephone companies and other utilities, railroads, long distance carriers and other parties. The failure to obtain or maintain any rights-of-way could interfere with our operations, interfere with our network infrastructure and our use of that infrastructure and adversely affect the business. For example, if we lose access to a right-of-way, we may need to spend significant sums to remove and relocate our facilities.

The success of our Dynamic Integrated Access services is dependent on the growth and public acceptance of IP telephony and public policy that enables us to offer IP-based services using network elements and commercial services purchased from the RBOCs.

The success of our Dynamic Integrated Access services is dependent upon future demand for IP-based telephony and data services. The growth of the internet telephony market is dependent on several factors. We must continue to have access to the last mile digital circuits at economical prices that enable us to offer IP-based services using these leased facilities. We also must continue to have the ability to terminate voice over IP, or VoIP, calls using existing local interconnection facilities. In addition, IP providers must continue to improve quality of service for real-time communications so that toll-quality service can be provided. IP telephony equipment and services must achieve a similar level of reliability that users of the public switched telephone network have come to expect from their telephone service, including emergency calling features and capabilities. IP telephony service providers must offer cost and feature benefits to their customers that are sufficient to cause the customers to switch away from traditional telephony service providers. If any or all of these factors fail to occur, our IP-based services business may not grow. In addition, IP telephony service is a relatively new technology and we may encounter difficulties, including regulatory hurdles and other problems that we may not anticipate, that may adversely affect the success of our IP-based services.

The effects of increased regulation of IP-based service providers are unknown.

The FCC has to date generally treated internet service providers as enhanced service providers subject to less stringent regulatory oversight than traditional common carriers. Recently, the FCC has begun imposing regulatory burdens on voice services offered over the internet that connect with the conventional telephone network. In 2005, the FCC imposed emergency 911 obligations on VoIP providers and required them, along with providers of facilities-based internet access services, to upgrade certain network capabilities required by the Communications Assistance for Law Enforcement Act, or CALEA, at potentially significant costs. In June 2006 the FCC required such providers to contribute to the Universal Service Fund. Some states have imposed taxes, fees or surcharges applicable to VoIP telephony services. Congress has to date not sought to heavily regulate, or exempt from regulation, the provision of IP-based services. The FCC, Congress and the states are considering proposals that involve greater regulation of IP-based service providers. The imposition of such regulation could have a material adverse effect on us.

For example, a Federal District Court in Missouri ruled in January 2007 that the Missouri Public Service Commission is not preempted from regulating IP-based voice services offered by a cable company. Under this ruling, we may be required to follow state regulations concerning tariff requirements and service quality to offer Dynamic Integrated Access services. Other state utility commissions may begin to require providers of IP-based voice services to comply with state regulations that affect the cost of providing Dynamic Integrated Access services.

In March 2004, the FCC issued a Notice of Proposed Rulemaking, or NPRM, regarding IP-enabled services that could result in the loss of access to last mile access loops on an unbundled basis at TELRIC prices. If the FCC classifies all IP-based services as information services, this could eliminate the RBOCs' obligations to provide unbundled network element T-1 circuits to competitive local exchange carriers for the provisioning of IP-based services. Such an interpretation could have a material adverse effect on us.

Our business requires the implementation and continued development of effective business support systems to implement customer orders and to provide and bill for services.

Our business depends on our ability to continue to implement effective business support systems. This is a complicated undertaking requiring significant resources and expertise and support from third-party vendors. Business support systems are needed for:

- implementing customer orders for services;
- provisioning, installing and delivering these services; and
- monthly billing for these services.

Because we plan to increase the number and volume of services we offer, there is a need to continue to develop these business support systems. The failure to continue to develop effective business support systems could materially adversely affect our relationships with customers and our ability to maintain and expand our business.

We may lose customers if we experience system failures that significantly disrupt the availability and quality of the services that we provide.

Our customers depend on our ability to provide services on a 24 hours a day, seven days a week, 365 days a year schedule, and to avoid and mitigate any interruptions in service or reduced capacity. Interruptions in service or performance problems, for whatever reason, could undermine confidence in our services and cause us to lose customers or make it more difficult to attract new ones. In addition, because many of our services are critical to the businesses of many of our customers, any significant interruption in service could result in lost profits or other loss to customers. Although we attempt to disclaim liability in our service agreements and in our tariffs, certain state laws prohibit such limitations and courts might not enforce a limitation on liability, which could expose us to financial loss. In addition, we often provide our customers with service level commitments. If we are unable to meet these service level commitments as a result of service interruptions, we may be obligated to provide credits, generally in the form of free service for a short period of time, to our customers, which could negatively affect our operating results, or permit customers to terminate their service agreements with us.

The failure of any equipment or facility on our network, including the network management center and network data storage locations, could result in the interruption of customer service until necessary repairs are effected or replacement equipment is installed. Network failures, delays and errors could also result from natural disasters, terrorist acts, power losses, security breaches and computer viruses. These failures, faults or errors could cause delays, service interruptions, expose us to customer liability or require expensive modifications that could significantly hurt our business.

Network costs may significantly increase over time, which could significantly affect our ability to become profitable.

We use a variety of wholesale providers to route our long haul and interoffice traffic primarily to and from locations where we do not have our own fiber. These wholesale providers are known in the telecommunications industry as least cost router entities, or LCRs, and they typically provide this service at a rate that is lower than the rate offered by other carriers. Some LCRs in the industry have been accused of converting traditional long distance traffic to IP format and terminating such traffic as local traffic to avoid access charges that would otherwise apply to long distance traffic. If the FCC or a court determines that all traffic carried by LCRs is subject to terminating access charges, then LCRs may exit the market or the prices charged to us by the remaining carriers for transport and transiting services could significantly increase.

Adverse rulings on disputes with AT&T and Qwest would have a significant adverse effect on our cash reserves and we face other litigation risk that could materially adversely affect our business, financial condition and results of operations.

We are involved in certain disputes with AT&T and Qwest and are subject to other litigation risks which, if they resulted in adverse outcomes for us, could materially adversely affect our business, financial condition and results of operations.

As a result of a settlement we reached with Qwest prior to our emergence from Chapter 11, we filed complaints against Qwest with several state utility commissions related to a collocation billing dispute. We had withheld payments to Qwest due to the fact that we believed Qwest had not properly implemented our amended interconnection agreement with Qwest. Also as a result of the settlement with Qwest, we filed a civil complaint against Qwest in the U.S. District Court for the Northern District of Iowa seeking recovery of damages related to numerous other billing disputes. Our business and cash reserves could be materially adversely affected by adverse state agency and court rulings in these pending matters.

We are subject to a litigation risk as a provider of local termination services to LCRs because our LCR customers may misrepresent the nature of traffic that they contract with us to terminate on their behalf. Identifying the originating nature of traffic that has been converted to a digital signal is challenging, and thus it is difficult for us to know the nature of all traffic passed to us by an LCR with absolute certainty. We are currently one of several defendants in a lawsuit brought by AT&T and its affiliates alleging that we conspired with other carriers to avoid payment of AT&T's state or federal access charges. In the event an LCR improperly terminates long distance traffic through us we could be subject to litigation that would be costly to defend and would distract our management from the operation of our business.

For further discussion of these and other matters regarding disputes or legal proceedings in which we are involved, please see "Legal Proceedings."

We may not be able to successfully consummate future acquisitions or divestitures or integrate acquired businesses.

From time to time, we evaluate acquiring companies or assets that would allow us to gain market share and expand into markets that complement our existing network footprint, or divesting assets that we no longer consider core to our business strategy. For example, on March 9, 2007, we completed the ATS sale for cash proceeds of approximately $16 million, and on May 16, 2007, we completed the acquisition of certain assets from Mpower Communications Corp. for approximately $17.3 million in cash. We can give no assurances that we will proceed with any future acquisitions or divestitures. Acquisitions and divestitures present financial, managerial and operational challenges, including diversion of management attention, difficulty with integrating personnel and financial and other systems, increased expenses, assumption of unknown liabilities and potential disputes with the buyers or sellers. In addition, if we are unable to consummate and successfully integrate future acquisitions and realize contemplated revenue synergies and cost savings, our financial results could be adversely affected.

We have adopted fresh start accounting and, as a result, you will not be able to compare our future financial statements with our historical financial statements.

On January 6, 2006, our plan of reorganization became effective, and we emerged from Chapter 11 with a new chief executive officer, board of directors and equity ownership. In addition, in connection with our emergence from bankruptcy, we implemented fresh start accounting under the provisions of SOP 90-7 on January 1, 2006, which had a material effect on our financial statements. Accordingly, our financial statements for periods after January 1, 2006 are not comparable to our financial statements for earlier periods.

Risks Related to Our Common Stock and This Offering

There is no existing public market for our common stock, and an active trading market may not develop.

Since we terminated our public reporting obligations on January 9, 2006 in connection with our January 2006 reorganization, there has been no public market for shares of our common stock. The initial public offering price for our common stock will be determined through negotiations with the underwriters. Although we have applied to have our common stock listed on The Nasdaq Global Market, an active trading market for our shares may never develop or be sustained following this offering. If an active market for our common stock does not develop, it may be difficult to sell shares you purchase in this offering without depressing the market price for the shares or at all.

If our stock price fluctuates after this offering, you could lose a significant part of your investment.

Our common stock price is likely to be volatile. The stock market in general has experienced extreme volatility that has often been unrelated to the operating performance of particular companies. As a result of this volatility, investors may not be able to sell their common stock at or above the initial public offering price. The market price for our common stock may be influenced by many factors, including:

- the failure of securities analysts to publish research about us after this offering or to make changes in their financial estimates;
- announcements by us or our competitors of significant contracts, productions, acquisitions or capital commitments;
- variations in quarterly operating results;
- general economic conditions;
- terrorist acts;
- future sales of our common stock; and
- investor perception of us and the telecommunications industry.

We have broad discretion in the use of our net proceeds from this offering and may not use them effectively.

Our management will have broad discretion in the application of our net proceeds from this offering and could spend the proceeds in ways that do not improve our operating results or enhance the value of our common stock. The failure by our management to apply these funds effectively could result in financial losses that could have a material adverse effect on our business and cause the price of our common stock to decline. Pending their use, we may invest our net proceeds from this offering in a manner that does not produce income or that loses value.

A significant portion of our total outstanding shares are restricted from immediate resale but may be sold into the market in the near future. This could cause the market price of our common stock to drop significantly, even if our business is doing well.

Sales of a substantial number of shares of our common stock in the public market could occur at any time after the expiration of the lock-up agreements described in "Underwriting."

After the completion of this offering, we will have 37,900,000 shares of common stock outstanding based on the number of shares outstanding as of April 30, 2007. This includes the 10,725,000 shares that we and the selling stockholders are selling in this offering, which may be resold in the public market immediately. The remaining 27,175,000 shares, or 71.7% of our outstanding shares after this offering, will be eligible for resale, subject to any applicable volume limitations under federal securities laws, in the near future as set forth below.

Days After Prospectus	Shares Eligible for Resale	Comment
Date of prospectus	none	Freely tradable shares resaleable under Rule 144(k) that are not subject to lock-up
90 days	none	Shares resaleable under Rules 144 and 701 that are not subject to lock-up
180 days and thereafter	27,175,000	Lock-up released; shares resaleable under Rules 144, 144(k) and 701 or under Section 1145 of the Bankruptcy Code

Of the shares of common stock to be outstanding after this offering, 30,000,000 were issued under Section 1145 of the Bankruptcy Code in connection with our plan of reorganization. All of these shares will be subject to lock-up agreements and, except for such shares held by holders that are deemed to be underwriters under Section 1145, will be freely transferable after the expiration of the lock-up period. For further discussion of Section 1145, please see "Shares Eligible for Future Sale."

In addition, as of March 31, 2007, there were 2,226,100 shares of our common stock issuable upon the exercise of options under our 2006 plan, 750,000 shares of common stock had been issued under our 2006 plan, and an additional 123,900 shares of common stock were available for future issuance under our 2006 plan that will become eligible for sale in the public market to the extent permitted by any applicable vesting requirements, the lock-up agreements and Rules 144, 144(k) and 701 under the Securities Act. Upon completion of this offering, the number of available shares under our 2006 plan will be increased by 2,563,218 shares.

We also intend to register all shares of our common stock that we may issue under our employee benefit plans. Once we register these shares, they can be freely sold in the public market upon issuance, subject to lock-up agreements.

These sales, or the perception in the market that the holders of a large number of shares intend to sell shares, could reduce the market price of our common stock.

The issuance of additional shares of common stock in connection with acquisitions, our employee benefit plans or otherwise will dilute your investment.

After this offering, we will have an aggregate of 207,186,782 shares of common stock authorized but unissued and not reserved for issuance under our 2006 plan or otherwise. We may issue all of these shares without any action or approval by our stockholders. We intend to pursue strategic acquisitions, and may pay for such acquisitions, partly or in full, through the issuance of additional equity. Any issuance of shares in connection with our acquisitions, the exercise of stock options or otherwise would dilute the percentage ownership held by the investors who purchase our shares in this offering.

Your ability to influence corporate matters may be limited because a small number of stockholders beneficially own a substantial amount of our common stock.

After giving effect to this offering, assuming no exercise by the underwriters of their over-allotment option, affiliates of Fidelity Investments will beneficially own 21.3% of our common stock, affiliates of Wayzata Investment Partners LLC will beneficially own 20.1% of our common stock and an affiliate of Jefferies & Company, Inc., one of the managing underwriters of this offering, will beneficially own 5.9% of our common stock. One of our directors, John D. McEvoy, is associated with Wayzata Investment Partners LLC. As a result, these investors could exert significant influence over our management and policies, may have interests that are different from yours and may vote in a way with which you disagree and which may be adverse to your interests. In addition, this concentration of ownership may have the effect of preventing, discouraging or deferring a change of control, which could depress the market price of our common stock. See "Principal and Selling Stockholders."

We have never paid cash dividends on our capital stock and we do not anticipate paying any cash dividends in the foreseeable future.

We have never declared or paid cash dividends on our capital stock. We currently intend to retain all of our future earnings, if any, to finance the growth and development of our business. The indenture governing our $10^1/_2$% notes prohibits us from paying dividends on our common stock. In addition, the terms of existing or any future debt agreements may preclude us from paying dividends. As a result, capital appreciation, if any, of our common stock will be your sole source of gain for the foreseeable future.

We will incur significant increased costs as a result of operating as a public company and our management will be required to devote substantial time to new compliance initiatives.

As a public company, we will incur significant legal, accounting and other expenses that we did not incur as a private company. In addition, the Sarbanes-Oxley Act of 2002, and rules subsequently implemented by the Securities and Exchange Commission, or the SEC, and The Nasdaq Global Market, impose additional requirements on public companies, including requiring changes in corporate governance practices. Our management and other personnel will need to devote a substantial amount of time to these compliance initiatives. Moreover, these rules and regulations will increase our legal and financial compliance costs and will make some activities more time-consuming and costly. For example, we expect these rules and regulations to make it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced policy limits and coverage or incur substantial additional costs to maintain the same or similar coverage. These rules and regulations could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors, on our board committees or as executive officers.

In addition, the Sarbanes-Oxley Act requires, among other things, that we maintain effective internal control over financial reporting and disclosure controls and procedures. In particular, for the year ending December 31, 2008, we must perform system and process evaluation and testing of our internal control over financial reporting to allow management and our independent registered public accounting firm to report on the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. Our testing, or the subsequent testing by our independent registered public accounting firm, may reveal deficiencies in our internal control over financial reporting that are deemed to be material weaknesses. Our compliance with Section 404 will require that we incur substantial expense and expend significant management time on compliance-related issues. We may need to hire additional accounting and financial staff with appropriate public company experience and technical accounting knowledge. Moreover, if we are not able to comply with the requirements of Section 404 in a timely manner, or if we or our independent registered public accounting firm identify deficiencies in our internal control over financial reporting that are deemed to be material weaknesses, the market price of our common stock could decline and we could be subject to sanctions or investigations by The Nasdaq Global Market, the SEC or other regulatory authorities, which would require additional financial and management resources.

Risks Relating to Our Substantial Indebtedness

Our substantial level of indebtedness could materially adversely affect our financial condition and prevent us from fulfilling our obligations under our $10^1/_2$% notes and our other indebtedness.

We have a substantial amount of debt. As of March 31, 2007, we had $120.1 million of total indebtedness. In May 2007, we reduced our indebtedness to $104.1 million by redeeming $16 million in principal amount of our $10^1/_2$% notes with the proceeds from the sale of our ATS business. The indenture governing our $10^1/_2$% notes allows us to enter into a senior secured credit facility and incur additional indebtedness thereunder.

Our substantial indebtedness could have important consequences to investors and significant effects on our business, including the following:

- it may make it difficult for us to satisfy our obligations under our $10^1/_2$% notes and our other indebtedness and contractual and commercial commitments and, if we fail to comply with these requirements, an event of default could result;
- we must use a substantial portion of our cash flow from operations to pay interest on our $10^1/_2$% notes and our other indebtedness, which will reduce the funds available to us for other purposes;
- our ability to obtain additional debt financing in the future for working capital, capital expenditures, acquisitions or general corporate purposes will be limited;
- our flexibility in reacting to changes in our industry may be limited and we could be more vulnerable to adverse changes in our business or economic conditions in general; and
- we may be at a competitive disadvantage compared to those of our competitors that are not as highly leveraged.

The occurrence of any one of these events could have a material adverse effect on our business, financial condition, results of operations, prospects and ability to satisfy our obligations under our $10^1/_2$% notes.

McLeodUSA Incorporated, the issuer of our $10^1/_2$% notes, is a holding company, and therefore our ability to make any required payment on our $10^1/_2$% notes depends upon the ability of its subsidiaries to pay it dividends or to advance it funds.

McLeodUSA Incorporated, the issuer of our $10^1/_2$% notes, has no direct operations and no significant assets other than the stock of its subsidiaries. Because it conducts its operations through its operating subsidiaries, McLeodUSA Incorporated depends on those entities for dividends and other payments to generate the funds necessary to meet its financial obligations, including its required obligations under our $10^1/_2$% notes. However, each of its subsidiaries is a legally distinct entity, and while its domestic subsidiaries guarantee the notes, such guarantees are subject to risks. The ability of our subsidiaries to pay dividends and make distributions will be subject to, among other things, the terms of any debt instruments of its subsidiaries then in effect and applicable law. If distributions from our subsidiaries to it were eliminated, delayed, reduced or otherwise impaired, our ability to make payments on our $10^1/_2$% notes would be substantially impaired.

To service our indebtedness, including our $10^1/_2$% notes, we will require a significant amount of cash. Our ability to generate cash depends on many factors beyond our control.

We expect to obtain the necessary funds to pay our expenses and the amounts due under our $10^1/_2$% notes primarily from our operations. Our ability to pay our expenses and make these payments therefore depends on our future performance, which will be affected by financial, business, economic, legislative and other factors, many of which are beyond our control. Our business may not generate sufficient cash flow from operations in the future, which could result in our being unable to repay indebtedness, including our $10^1/_2$% notes, or to fund other liquidity needs. If we do not have sufficient funds, we may be required to sell assets or incur additional debt. We may need to refinance all or a portion of our indebtedness, including our $10^1/_2$% notes, at or before maturity. We may not be able to accomplish any of these alternatives on terms acceptable to us, or at all. In addition, the terms of existing or future debt agreements may restrict us from adopting any of these alternatives. The failure to generate sufficient cash flow or to achieve any of these alternatives could materially adversely affect the value of our $10^1/_2$% notes and our ability to pay the amounts due under the notes.

Despite our substantial level of indebtedness, we may still incur significantly more debt, which could exacerbate any or all of the risks described above.

We may be able to incur substantial additional indebtedness in the future. Although the indenture governing our $10^1/_2$% notes limits our ability and the ability of our subsidiaries to incur additional indebtedness, these restrictions are subject to a number of qualifications and exceptions and, under certain circumstances, debt incurred in compliance with these restrictions could be substantial. In addition, the indenture governing our $10^1/_2$% notes does not prevent us from incurring obligations that do not constitute indebtedness. To the extent that we incur additional indebtedness or such other obligations, the risks associated with our substantial leverage described above, including our possible inability to service our debt, would increase.

Our $10^1/_2$% notes contain restrictive covenants that limit our operational flexibility.

Our $10^1/_2$% notes contain covenants that, among other things, restrict our ability to take specific actions, even if we believe them to be in our best interest. These covenants may include restrictions on our ability to:

- incur or guarantee additional indebtedness or issue certain preferred stock;
- pay dividends or make other distributions;
- issue capital stock of our restricted subsidiaries;
- transfer or sell assets, including capital stock of our restricted subsidiaries;
- make certain investments or acquisitions;
- grant liens on our assets;
- incur dividend or other payment restrictions affecting our restricted subsidiaries;
- enter into certain transactions with affiliates; and
- merge, consolidate or transfer all or substantially all of our assets.

Our failure to comply with these restrictions could lead to a default under the notes. The actual covenants are contained in the indenture governing our $10^1/_2$% notes.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus includes statements that are, or may be deemed to be, "forward-looking statements" that can be identified by the use of forward-looking terminology, including the terms "believes," "estimates," "anticipates," "expects," "intends," "may," "plan," "predict," "project," "likely," "continue," "will," "should," "could" or, in each case, their negative or other variations or comparable terminology. These forward-looking statements include all matters that are not historical facts. They appear in a number of places throughout this prospectus and include statements regarding our intentions, beliefs or current expectations concerning, among other things, our results of operations, financial condition, liquidity, prospects, growth and strategies and the industry in which we operate.

By their nature, forward-looking statements involve risks and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future. We caution you that forward-looking statements are not guarantees of future performance and that our actual results of operations, financial condition and liquidity, and the development of the industry in which we operate may differ materially from those made in or suggested by the forward-looking statements contained in this prospectus. In addition, even if our results of operations, financial condition and liquidity, and the development of the industry in which we operate, are consistent with the forward-looking statements contained in this prospectus, those results or developments may not be indicative of results or developments in subsequent periods.

The following listing represents some, but not necessarily all, of the factors that may cause actual results to differ from those anticipated or predicted:

- our ability to implement our business strategy and realize its expected benefits;
- our risk of inadequate liquidity;
- our ability to raise necessary capital;
- decreasing prices for our communications services due to changing market conditions;
- our ability to attract new customers, retain existing customers and increase revenues;
- potential adverse affects of our financial difficulties and other competitive communications providers on our image;
- our ability to keep pace with rapid technological changes;
- our dependence on RBOCs;
- the impact of the pursuit of certain litigation, regulations and legislation by RBOCs on our ability to conduct our business;
- RBOCs' success in requiring us to provide them significant deposits or other financial security to maintain our ability to purchase services from the RBOCs;
- RBOCs' ability to offer bundled local and long distance services;
- RBOCs' ability to offer internet access services free of common carrier obligations;
- increased competition in the communications services markets;

developments in the wireless telecommunications industry;

government regulation;

the impact of the Triennial Review Order and the Triennial Review Remand Order;

- the impact of mergers of certain of our competitors with RBOCs;
- the impact of intercarrier compensation reform when adopted by regulators;
- our ability to retain experienced and innovative personnel;
- our ability to obtain and maintain rights-of-way and similar rights and easements;
- the growth and public acceptance of VoIP telephony;
- regulatory risks associated with VoIP telephony;
- additional grants of forbearance to RBOCs by the FCC that negatively impact our ability to interconnect and access bottleneck wireline network elements required to serve customers;
- our ability to implement, develop and maintain effective business support systems;
- our ability to right-size our network and remove excess network costs from our cost of service;
- our ability to develop new products and services that meet customer demands and generate acceptable margins;
- our ability to avoid and mitigate system failures;
- the impact of increases in network costs;
- adverse outcomes in pending disputes between us and AT&T, Qwest and the FCC;
- our ability to consummate strategic transactions; and
- general economic and business conditions.

You should also carefully read the factors described in the "Risk Factors" section of this prospectus to better understand the risks and uncertainties inherent in our business and underlying any forward-looking statements.

Any forward-looking statements that we make in this prospectus speak only as of the date of such statement, and we undertake no obligation to update such statements. Comparisons of results for current and any prior periods are not intended to express any future trends or indications of future performance, unless expressed as such, and should only be viewed as historical data.

USE OF PROCEEDS

We estimate that we will receive approximately $91.6 million in net proceeds from the 7,150,000 shares of common stock that we are offering based upon an assumed initial public offering price of $14.00 per share, the midpoint of the estimated price range shown on the cover of this prospectus, and after deducting underwriting discounts and commissions and estimated offering expenses payable by us. A $1.00 increase (decrease) in the assumed initial public offering price of $14.00 would increase (decrease) the net proceeds to us from this offering by $6.6 million, assuming the number of shares offered by us, as set forth on the cover of this prospectus, remains the same. We will not receive any proceeds from the sale of shares of common stock offered by the selling stockholders.

We intend to use:

- a portion of our net proceeds from this offering to redeem up to $26.0 million in principal amount of our outstanding $10^1/_2$% notes, at a redemption price of 110.5%, plus accrued and unpaid cash interest; and
- the balance of our net proceeds from this offering for working capital and other general corporate purposes, which may include funding capital expenditures, acquisitions and investments.

We may use a portion of the net proceeds of this offering to acquire businesses or assets that are complementary to our operations. However, we have no present understandings, commitments or agreements to enter into any acquisitions or make any investments.

In addition, the other principal purposes for this offering are to:

- create a public market for our common stock;
- facilitate our future access to the public capital markets;
- provide liquidity for our existing stockholders;
- increase our visibility in our markets;
- mitigate concerns among potential customers about our financial condition and viability;
- improve the effectiveness of our equity compensation plans in attracting and retaining key employees; and
- enhance our ability to acquire complementary businesses or assets.

Our $10^1/_2$% notes, which we issued on September 28, 2006, bear interest at 10.5% per annum, payable semi-annually in arrears, and mature on October 1, 2011. We used the net proceeds from the issuance of the $10^1/_2$% notes to repay $82.7 million of existing indebtedness under our then-outstanding term loans and to cash collateralize $8.8 million related to outstanding trade and performance bond letters of credit, and the remainder for general corporate purposes. Under the terms of the indenture governing our $10^1/_2$% notes, we are permitted to use the net proceeds from the ATS sale to redeem outstanding $10^1/_2$% notes at par, plus accrued and unpaid interest, and to use our net proceeds from this offering to redeem additional outstanding $10^1/_2$% notes at a redemption price of 110.5%, plus accrued and unpaid interest, subject to an overall requirement that we may not redeem more than 35% of the aggregate principal amount of $10^1/_2$% notes originally issued. On May 8, 2007, we used the ATS proceeds to redeem $16.0 million in principal amount of $10^1/_2$% notes at a redemption price equal to 100% of the aggregate principal amount thereof, plus accrued and unpaid interest thereon. As a result, we are permitted to redeem up to $26 million in principal

amount of $10^{1}/_{2}\%$ notes with a portion of our net proceeds from this offering. We have not yet determined the amount of $10^{1}/_{2}\%$ notes we will redeem with a portion of our net proceeds from this offering. The amount we redeem will depend on the amount of our proceeds from this offering, our anticipated cash resources and needs and other factors we consider relevant. If we redeem the maximum amount, we will redeem $26 million in principal amount of $10^{1}/_{2}\%$ notes for $28.73 million in cash, plus accrued and unpaid interest. For each $1.0 million decrease in the principal amount redeemed, we will pay $1.105 million less in cash.

We have not yet determined with any certainty the manner in which we will allocate our net proceeds from this offering, and as a result management will retain broad discretion in the allocation and use of the net proceeds. The amounts and timing of our expenditures will vary depending on a number of factors, including the amount of cash generated by our operations, potential acquisitions, competitive developments and the rate of growth, if any, of our business. For example, if we were to expand our operations more rapidly than anticipated by our current plans, a greater portion of the proceeds would likely be used for working capital and capital expenditures. Alternatively, if we were to engage in an acquisition that contained a significant cash component, some or all of the proceeds might be used for that purpose.

Pending use of our net proceeds from this offering, we intend to invest the proceeds in a variety of capital preservation investments, including short-term, investment grade, interest-bearing instruments.

DIVIDEND POLICY

We have never declared or paid cash dividends on our capital stock. We currently intend to retain all of our future earnings, if any, to finance the growth and development of our business. We do not anticipate paying cash dividends to our stockholders in the foreseeable future. The indenture governing our $10^{1}/_{2}\%$ notes prohibits us from paying dividends on our common stock.

CAPITALIZATION

The following table presents our capitalization as of March 31, 2007 on:

an actual basis;

a pro forma basis to reflect (i) our sale of 7,150,000 shares of common stock in this offering at an assumed public offering price of $14.00 per share, after deducting estimated underwriting discounts and commissions and estimated offering expenses and (ii) our use of proceeds from the sale of our ATS assets to redeem $16 million in principal amount of our outstanding $10^1/_2$% notes at a redemption price equal to 100% of the aggregate principal amount thereof, plus accrued and unpaid interest thereon, and to pay related fees and expenses; and

a pro forma as adjusted basis to further reflect our use of a portion of the proceeds of this offering to redeem $26.0 million in principal amount of our outstanding $10^1/_2$% notes (plus approximately $2.7 million in redemption premium).

This table should be read with our financial statements and the related notes and Management's Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this prospectus.

	March 31, 2007		
	Actual	**Pro Forma**	**Pro Forma As Adjusted**
$10^1/_2$% Senior Second Secured Notes due 2011	$ 120.0	$ 104.0	$ 78.0
Capital lease obligations	0.1	0.1	0.1
Stockholders' equity:			
Common stock, par value $0.01 per share: 37,500,000 shares authorized, 30,750,000 shares issued and outstanding, actual; 250,000,000 shares authorized and 37,900,000 shares issued and outstanding, pro forma and pro forma as adjusted	0.3	0.4	0.4
Additional paid-in capital	247.9	339.4	339.4
Accumulated deficit	(39.4)	(39.4)	(42.1)
Accumulated other comprehensive income	0.2	0.2	0.2
Total stockholders' equity (deficit)	209.0	300.6	297.9
Total capitalization	$ 329.1	$ 404.7	$ 376.0

Although the above table assumes we will redeem $26.0 million in principal amount of our $10^1/_2$% notes with a portion of our net proceeds from this offering, we have not yet determined the actual amount we will redeem. For each $1.0 million decrease in the principal amount redeemed, we will pay $1.105 million less in cash.

The preceding table excludes:

838,925 shares of common stock issuable upon the exercise of options outstanding and exercisable as of March 31, 2007 under our 2006 plan at a weighted average exercise price of $8.60 per share;

1,387,175 shares of common stock issuable upon the exercise of options outstanding, but not exercisable, as of March 31, 2007 under our 2006 plan, at a weighted average exercise price of $8.65 per share; and

123,900 shares of common stock available for future issuance under our 2006 plan as of March 31, 2007.

DILUTION

If you invest in our common stock, your ownership interest will be diluted to the extent of the difference between the initial public offering price per share of common stock and the net tangible book value per share of common stock immediately after this offering.

Our net tangible book value as of March 31, 2007 was $174.8 million, or $5.68 per share of common stock. Net tangible book value per share represents the amount of our total tangible assets less total liabilities, divided by the number of shares of our common stock outstanding.

After giving effect to our sale of 7,150,000 shares of common stock at an assumed initial public offering price of $14.00 per share and after deducting estimated underwriting discounts and commissions and estimated offering expenses payable by us, our net tangible book value as of March 31, 2007 would have been $266.3 million, or $7.03 per share. This amount represents an immediate increase in net tangible book value to our existing stockholders of $1.35 per share and an immediate dilution to new investors of $6.97 per share. Dilution per share to new investors is determined by subtracting the net tangible book value per share after this offering from the initial public offering price per share paid by a new investor. The following table illustrates the per share dilution without giving effect to the over-allotment option granted to the underwriters:

Assumed initial public offering price per share		$ 14.00
Net tangible book value per share as of March 31, 2007	$ 5.68	
Increase per share attributable to new investors	1.35	
Net tangible book value per share after this offering		7.03
Dilution per share to new investors		$ 6.97

The following table summarizes as of March 31, 2007, the number of shares of common stock purchased from us, the total consideration paid to us and the average price per share paid by our existing stockholders and by new investors, based upon an assumed initial public offering price of $14.00 per share and before deducting estimated underwriting discounts and commissions and estimated offering expenses payable by us.

	Shares Purchased		Total Consideration		Average Price per Share
	Number	Percent	Amount	Percent	
Existing stockholders(1)	30,750,000	81.1%	$ 728,100,000	87.9%	$ 23.68
New investors	7,150,000	18.9	100,100,000	12.1	14.00
Total	37,900,000	100.0%	$ 828,200,000	100.0%	

(1) Pursuant to our January 2006 plan of reorganization, 30,000,000 shares of our common stock were issued in full satisfaction of $728,100,000 of aggregate claims.

The sale of 3,575,000 shares of common stock to be sold by the selling stockholders in this offering will reduce the number of shares held by existing stockholders to 27,175,000, or 71.7% of the total shares outstanding, and will increase the number of shares held by new investors to 10,725,000, or 28.3% of the total shares outstanding. If the underwriters exercise their over-allotment option in full, the shares held by existing stockholders will further decrease to 25,566,250, or 67.5% of the total shares outstanding, and the number of shares held by new investors will further increase to 12,333,750, or 32.5% of the total shares outstanding.

The preceding discussion and tables assume no exercise of any stock options outstanding as of March 31, 2007. As of March 31, 2007, there were options outstanding to purchase a total of 2,226,100 shares of common stock under our 2006 plan. Those options had a weighted average exercise price of $8.65 per share. To the extent any of those options are exercised, there will be further dilution to new investors.

SELECTED CONSOLIDATED FINANCIAL DATA

You should read the selected financial data with Management's Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and related notes included elsewhere in this prospectus. The selected consolidated financial data for the years ended December 31, 2004, 2005 and 2006 and as of December 31, 2005 and 2006 have been derived from our audited consolidated financial statements included elsewhere in this prospectus. The selected consolidated historical financial data for the years ended December 31, 2002 and 2003 and as of December 31, 2002, 2003 and 2004 have been derived from our audited consolidated financial statements which are not included in this prospectus. The selected consolidated financial data for the three months ended March 31, 2006 and 2007 have been derived from our unaudited consolidated financial statements and related notes included elsewhere in this prospectus. In the opinion of management, the unaudited consolidated financial statements have been prepared on the same basis as our audited financial statements and include all adjustments, consisting of normal recurring adjustments and accruals, necessary for the fair statement of the financial information set forth in those statements. Our historical results for any prior period are not necessarily indicative of results to be expected for any future period.

The selected historical financial information set forth below is not necessarily indicative of the results of future operations and should be read in conjunction with, and is qualified in its entirety by, the discussion under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our financial statements and notes thereto included elsewhere in this prospectus.

	Predecessor McLeodUSA						Reorganized McLeodUSA		
			Year Ended December 31,					Three Months Ended March 31,	
	(January 1-April 16)(1) 2002	(April 17-December 31)(1) 2002	2003	2004	2005	One Day January 1, 2006(2)	Year Ended December 31, 2006(2)	2006	2007
			(dollars in millions)					(unaudited)	
Statement of Operations Data:									
Revenue	$ 311.4	$ 680.7	$ 869.0	$ 716.2	$ 635.0	$	$ 544.7	$ 145.7	$ 126.4
Operating Expenses:									
Cost of service(3)	211.2	410.3	498.9	393.8	362.1		315.8	86.8	67.8
Selling, general and administrative(3)	108.9	240.4	312.2	268.4	217.4		181.7	44.2	49.3
Depreciation and amortization	126.3	217.9	340.5	356.8	212.9		60.1	14.5	16.4
Reorganization charges, net	1,596.8				20.2	(18.5)			
Restructuring, asset impairment and other charges (adjustments)	(6.8)	(0.1)	(0.2)	262.9	301.7		2.4	1.8	
Total operating expenses	2,036.4	868.5	1,151.4	1,281.9	1,114.3	(18.5)	560.0	147.3	133.5
Operating (loss) income	(1,725.0)	(187.8)	(282.4)	(565.7)	(479.3)	18.5	(15.3)	(1.6)	(7.1)
Interest expense, net	(33.2)	(30.8)	(35.8)	(48.2)	(65.3)		(12.7)	(3.2)	(3.1)
Other (expense) income	2.0	(0.5)	22.5	(10.6)	9.8		(0.3)		(0.9)
Gain on cancellation of debt	2,372.8					728.1			
(Loss) income from continuing operations	616.6	(219.1)	(295.7)	(624.5)	(534.8)	746.6	(28.3)	(4.8)	(11.1)
Income from discontinued operations	167.1	17.7							
Net (loss) income	783.7	(201.4)	(295.7)	(624.5)	(534.8)	746.6	(28.3)	(4.8)	(11.1)
Preferred stock dividend	(4.8)	(3.5)	(4.6)	(2.9)	(1.3)				
(Loss) income applicable to common shares	$ 778.9	$ (204.9)	$ (300.3)	$ (627.4)	$ (536.1)	$ 746.6	$ (28.3)	$ (4.8)	$ (11.1)
Basic and diluted net income (loss) per common share:									
(Loss) income from continuing operations	$ 0.97	$ (0.80)	$ (1.07)	$ (2.12)	$ (1.71)	$ 2.36	$ (0.94)	$ (0.16)	$ (0.37)
Discontinued operations	$ 0.27	$ 0.06	$	$	$	$	$	$	$
(Loss) income per common share	$ 1.24	$ (0.74)	$ (1.07)	$ (2.12)	$ (1.71)	$ 2.36	$ (0.94)	$ (0.16)	$ (0.37)
Weighted average common shares outstanding:									

	Predecessor McLeodUSA						Reorganized McLeodUSA		
Basic	627.7	276.3	280.4	296.2	313.2	315.7	30.0	30.0	30.0
Diluted	627.7	276.3	280.4	296.2	313.2	315.7	30.0	30.0	30.0
Investing Activities									
Capital Expenditures	$ 37.2	$ 88.0	$ 78.4	$ 49.4	$ 35.9	$	$ 31.9	$ 6.8	$ 6.9
Deferred line installation costs	$ 16.5	$ 39.2	$ 41.4	$ 28.8	$ 26.3	$	$ 17.0	$ 3.9	$ 4.8

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Unaudited pro forma information in the consolidated balance sheet data table set forth below reflects our sale of 7,150,000 shares of common stock in this offering at an assumed initial public offering price of $14.00 per share, after deducting estimated underwriting discounts and commissions and estimated offering expenses, as well as our use of proceeds from the ATS sale to redeem $16 million in principal amount of our outstanding $10^{1}/_{2}$% notes. Pro forma as adjusted information in the consolidated balance sheet data table set forth below further reflects our use of a portion of the proceeds of this offering to redeem a portion of our outstanding $10^{1}/_{2}$% notes.

	Predecessor McLeodUSA				Reorganized McLeodUSA			
	December 31,					March 31, 2007 (unaudited)		
	2002	2003	2004	2005	December 31, 2006	Actual	Pro Forma	Pro Forma As Adjusted
Balance Sheet Data:								
Cash and cash equivalents	$ 170.6	$ 56.5	$ 50.0	$ 20.0	$ 64.8	$ 71.1	$ 146.7	$ 118.0
Property and equipment, net	1,203.1	1,007.7	728.7	346.4	306.3	298.6	298.6	298.6
Working capital (deficiency) (excluding assets held for sale)	11.3	(42.6)	(62.5)	(824.6)	10.4	27.2	102.8	74.1
Total assets	2,000.3	1,630.6	1,025.8	486.2	479.0	464.1	539.7	511.0
Total debt	719.9	744.4	777.3	777.3	120.0	120.1	104.1	78.1
Stockholders' equity (deficiency)	775.8	521.7	(46.8)	(548.6)	217.1	209.0	300.6	297.9

(1) On January 31, 2002, we filed a voluntary petition for bankruptcy relief under Chapter 11. On April 16, 2002, we emerged from bankruptcy pursuant to the terms of an amended plan of reorganization, which became effective on that date. Upon emergence, we adopted the fresh start accounting provisions of SOP 90-7. The adoption of fresh start accounting had a material effect on our financial statements. As a result, our financial statements for periods after April 16, 2002 are not comparable to our financial statements for earlier periods. Specifically, interest expense, due to the substantial cancellation of debt, and depreciation and amortization expense, due to the adjustment of the carrying values of property, equipment and intangibles to their estimated fair market values, have significantly changed after the application of SOP 90-7.

(2) On October 28, 2005, we filed a voluntary petition for bankruptcy relief under Chapter 11. On January 6, 2006 we emerged from those bankruptcy proceedings pursuant to the terms of a plan of reorganization. Upon emergence, we adopted the fresh start accounting provisions of SOP 90-7. The adoption of fresh start accounting had a material effect on our financial statements. As a result, our financial statements for periods after January 1, 2006 are not comparable to our financial statements for earlier periods. Specifically, interest expense, due to the substantial cancellation of debt, and depreciation and amortization expense, due to the adjustment of the carrying values of property, equipment and intangibles to their estimated fair market values, have significantly changed after the application of SOP 90-7.

(3) Exclusive of depreciation and amortization.

	Three Months Ended March 31, 2007
Selected Operating Data:	
Retail residential traditional telephone service line churn	3.83%
Retail business traditional telephone service line churn	3.23%
Retail T-1 circuit churn	1.25%
Retail unit churn for our Dynamic Integrated Access service	0.55%

	As of March 31, 2007
Retail residential traditional telephone service lines in service	91,000
Retail business traditional telephone service lines in service	264,900
Retail T-1 circuits in service	14,900
Quota bearing field sales representatives	214
Quota bearing inside sales representatives	48
Total employees	1,564

	Predecessor McLeodUSA						Reorganized McLeodUSA		
			Year Ended December 31,					Three Months Ended March 31,	
	(January 1-April 16)(1) 2002	(April 17-December 31)(1) 2002	2003	2004	2005	One Day January 1, 2006(2)	Year Ended December 31, 2006(2)	2006	2007
	(dollars in millions)								
								(unaudited)	
Non-GAAP Financial Data(1):									
Adjusted EBITDA	(8.7)	30.0	57.9	54.0	55.5		52.1	14.7	12.2

(1) This prospectus contains financials measures that are not prepared in accordance with generally accepted accounting principles, or GAAP. We generally refer to these financial measures as non-GAAP financial measures.

EBITDA is a non-GAAP financial measure. EBITDA is an acronym for earnings before interest, taxes, depreciation and amortization. EBITDA allows analysts, investors and other interested parties in the telecommunications industry to facilitate company-to-company comparisons by eliminating variation in company's capital structure and embedded network investment. Facilities-based telecommunications services providers face high initial capital investments in order to gain entry to the industry, and, accordingly we believe that omitting depreciation and amortization provides a relevant and useful measure of our core operating performance and enhances comparability between periods. EBITDA is reconciled to net loss, the most comparable GAAP financial measure in the table below.

Adjusted EBITDA is a non-GAAP financial measure used by our management to evaluate the effectiveness of our operating performance and to enhance comparability between periods. Adjusted EBITDA, as used by our management, further removes the effects of other income and expense, restructuring and impairment charges, gain on cancellation of debt, income from discontinued operations, reorganization charges and non-cash compensation expense. We exclude the effects of other income and expense, restructuring and impairment charges, gain on cancellation of debt, income from discontinued operations, reorganization charges and non-cash compensation expense because we do not believe that such items are representative of the core operating results of our ongoing competitive telecommunications activities. Our management believes that non-GAAP financial measures such as Adjusted EBITDA are also commonly reported and used by analysts, investors and other interested parties in the telecommunications industry. Adjusted EBITDA is also reconciled to net loss, the most comparable GAAP financial measure, in the table below. Our use of Adjusted EBITDA may not be comparable to similarly-titled measures used by other companies in the telecommunications industry. Our use of Adjusted EBITDA is not intended to replace measures of financial performance reported in accordance with GAAP.

Our management uses Adjusted EBITDA in its decision-making processes relating to the operation of our business together with GAAP financial measures such as revenue and income from operations.

Our calculation of Adjusted EBITDA excludes:

- restructuring charges and adjustments, reorganization items and impairment charges and income from discontinued operations which are non-recurring items; and

- non-cash stock option compensation, gain on cancellation of debt and other non-operating income or expense, each of which our management views as non-operating and non-cash expenses that are not related to management's assessment of the operating results and performance of our consolidated operations.

Our management believes that Adjusted EBITDA permits a comparative assessment of our operating performance, relative to our performance based on our GAAP results, while isolating the effects of depreciation and amortization, which may vary from period to period without any correlation to underlying operating performance, and of non-cash stock option compensation, which is a non-cash expense that varies widely among similar companies. We provide information relating to our Adjusted EBITDA so that investors have the same data that we employ in assessing our overall operations. We believe that trends in our Adjusted EBITDA are a valuable indicator of our operating performance on a consolidated basis and of our ability to produce operating cash flow to fund working capital needs, to service debt obligations and to fund capital expenditures.

In addition, Adjusted EBITDA is a useful comparative measure within the communications industry because the industry has experienced recent trends of increased merger and acquisition activity and financial restructurings, which have led to significant variations among companies with respect to capital structures and cost of capital (which affect interest expense) and differences in taxation and book depreciation of facilities and equipment (which affect relative depreciation expense), including significant differences in the depreciable lives of similar assets among various companies, as well as non-operating and one-time charges to earnings, such as the effect of debt restructurings.

Accordingly, Adjusted EBITDA allows analysts, investors and other interested parties in the telecommunications industry to facilitate company-to-company comparisons by eliminating some of the foregoing variations. Adjusted EBITDA as used in this prospectus may not, however, be directly comparable to similarly titled measures reported by other companies due to differences in accounting policies and items excluded or included in the adjustments, which limits its usefulness as a comparative measure.

Our calculation of Adjusted EBITDA is not directly comparable to EBIT, which is an acronym for earnings before interest and taxes, or EBITDA. In addition, Adjusted EBITDA does not reflect:

- our cash expenditures, or future requirements, for capital expenditures or contractual commitments;
- changes in, or cash requirements for, our working capital needs;
- our interest expense, or the cash requirements necessary to service interest or principal payments on our debts; and
- any cash requirements for the replacement of assets being depreciated and amortized, which will often have to be replaced in the future, even though depreciation and amortization are non-cash charges.

Adjusted EBITDA is not intended to replace operating income, net income and other measures of financial performance reported in accordance with GAAP. Rather, Adjusted EBITDA is a measure of operating performance that you may consider in addition to those measures. Because of these limitations, Adjusted EBITDA should not be considered as a measure of discretionary cash available to us to invest in the growth of our business. We compensate for these limitations by relying primarily on our GAAP results and using Adjusted EBITDA as a supplemental financial measure.

	Predecessor McLeodUSA						Reorganized McLeodUSA		
			Year ended December 31,					Three Months Ended March 31,	
Reconciliation of EBITDA and Adjusted EBITDA:	**(January 1-April 16) 2002**	**(April 17-December 31) 2002**	**2003**	**2004**	**2005**	**One Day January 1 2006**	**Year Ended December 31, 2006**	**2006**	**2007**
					(dollars in millions)			(unaudited)	
Net Income (Loss)	783.7	(201.4)	(295.7)	(624.5)	(534.8)	746.6	(28.3)	(4.8)	(11.1)
Interest expense	33.2	30.8	35.8	48.2	65.3		12.7	3.2	3.1
Depreciation and amortization	126.3	217.9	340.5	356.8	212.9		60.1	14.5	16.4
EBITDA	943.2	47.3	80.6	(219.5)	(256.6)	746.6	44.5	12.9	8.4
Income from discontinued operations	(167.1)	(17.7)							
Gain on cancellation of debt	(2,372.8)					(728.1)			
Other (income) expense	(2.0)	0.5	(22.5)	10.6	(9.8)		0.3		0.9
Restructuring charges (adjustments)	(6.8)	(0.1)	(0.2)	(0.2)	23.9		2.4	1.8	

	Predecessor McLeodUSA						**Reorganized McLeodUSA**		
Reorganization items	1,596.8				20.2	(18.5)			
Impairment charge				263.1	277.8				
Non-cash compensation							4.9		2.9
Adjusted EBITDA	(8.7)	30.0	57.9	54.0	55.5		52.1	14.7	12.2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the financial statements and related notes and the other financial information appearing elsewhere in this prospectus. This discussion and analysis contains forward-looking statements that involve risk, uncertainties and assumptions. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of many factors, including those discussed in "Risk Factors" and elsewhere in this prospectus.

Overview

We provide internet protocol-based, or IP-based, communications services to small- and medium-sized enterprises, and traditional telephone services to commercial and residential customers. We have one of the largest facilities-based networks maintained by a competitive carrier in the United States, which allows us to offer integrated communications services across 20 states in the Midwest, Rocky Mountain, Southwest and Northwest regions, representing 40% of the U.S. population. We serve 67 MSAs with our network facilities, including 19 of the top 50 MSAs. We provide our customers with a comprehensive suite of networking and telecommunications services, including IP-based integrated data and voice services, internet services, private data networking, virtual private networks, or VPNs, hosting services and local and long distance voice services.

We were founded in 1993 with a strategy to serve residential and small business customers in the Midwest by reselling the local and long distance voice services of other carriers. Through August 2001, we grew rapidly, acquired numerous businesses, and focused on the construction of local and long distance voice networks and a national data network. As a result of the subsequent slowdown in the telecommunications industry and the national economy and the burden of approximately $4.0 billion in debt we had incurred to finance our growth, we filed for Chapter 11 bankruptcy in January 2002. As part of our first plan of reorganization, pre-Chapter 11 noteholders received $670 million in cash and new preferred stock, and all other outstanding equity securities were exchanged for new common stock. We emerged from Chapter 11 in April 2002 with approximately $950 million in debt and a revised strategic plan that attempted to focus on profitable revenue growth but still within the residential and small business markets.

Following our first bankruptcy, our revenues continued to decline because of continuing weakness in the telecommunications industry; the fact that our target residential and small business customers generally sought commoditized services from the lowest cost provider and exhibited high turnover turnover; reduction in demand for long distance services among our retail customer base; and increased competition from the RBOCs and reductions in access rates and intercarrier compensation due to regulatory changes. In light of our inability to achieve new revenue growth in excess of existing customer turnover and ultimately to generate enough operating cash flow to service our remaining debt, we filed for Chapter 11 bankruptcy again in October 2005. We emerged from Chapter 11 on January 6, 2006. All equity securities outstanding at the time of our second bankruptcy were cancelled without consideration, and our creditors received all of our new common stock in exchange for the cancellation of approximately $728.1 million in debt and accrued interest. Since that time, our common stock has not been publicly traded.

We emerged from Chapter 11 on January 6, 2006 with a new chief executive officer, board of directors and equity ownership. At the same time, we shifted our business strategy to focus on providing services based on high-speed digital transmission connections, known as T-1 circuits, which we believe offer greater value to customers, increase customer retention and provide revenue growth opportunities for us. Our goal is to provide services that improve our customer's daily productivity, simplify their networks and provide them with control of their network. Our new strategy focuses on sales to small- and medium-sized enterprise customers who seek high-capacity services. These enterprises generate greater revenue and profit margins than the services sought by residential and very small business customers, which were our historic focus. In order to serve this market, we have shifted our sales resources from telemarketing to direct field and agent channel sales, which we believe are more effective in selling higher value services to our larger target customers. We have revised our sales commission plans and revamped the field sales organization to incent and mandate the targeting and capture of small- and medium-sized enterprise customers. New sales of T-1 based services represented approximately 30% of total new sales during the fourth quarter of 2005, 45% during the first quarter of 2006, 53% during the second quarter of 2006, 62% during the third quarter of 2006, 73% during the fourth quarter of 2006 and 66% during the first quarter of 2007. In addition, we may supplement our organic growth plans by selectively acquiring assets that operate in our markets or adjacent markets, serve similar customers and offer complementary products and services. This will allow us to gain market share and expand into markets that complement our existing network.

While RBOCs remain the market leaders in their service territories, competitive communications providers continue to gain market share among small- and medium-sized enterprises. We believe that the RBOCs have neglected small- and medium-size enterprises due to their increased focus on the global enterprise business market, increased competitive pressures in the residential markets, continued integration of recent mergers and acquisitions and investment in "triple-play" product offerings. We believe this has created an increased demand for alternatives in the small- and medium-sized enterprise communications market, which we believe provides sustainable growth opportunity for us.

As of March 31, 2007, our broadband network and facilities, in which we have invested over $2.5 billion since our inception, spanned approximately 13,000 intercity and 4,000 metropolitan local route miles and encompassed approximately one million intercity backbone fiber miles and 500,000 fiber miles of metropolitan local fiber optic cable. We operate and maintain an intercity multiprotocol label switching internet backbone with a nationally distributed IP voice switching architecture to provide a broad set of managed voice and data services cost-effectively. We also operate a circuit-switched based telephony network to provide voice services to our commercial, wholesale and residential customers. We believe owning our own facilities-based network allows us to ensure our network's service quality and reliability, have greater control over customer care and reduce our exposure to regulatory uncertainty associated with leasing network connectivity and facilities from the RBOCs. We expect to continue to improve the efficiency of our network and reduce our network expenses while maintaining our ability to serve the majority of our addressable market with our existing network facilities. As of March 31, 2007, our average network utilization was approximately 50%, as measured by unused capacity in our switches and network backbone. We expect to increase the total number of customers we serve with minimal incremental investments, thereby improving capacity utilization and resulting in increased cash flow and profitability.

Since emerging from Chapter 11 on January 6, 2006, we believe that we have made progress towards execution of our plan and achieving profitability. We have been successful in increasing the mix of new sales to include a significantly higher percentage of T-1 products, we have experienced a quarter over quarter decline in the costs of sales as a percentage of revenues and have increased the number of field salespeople from 116 at the end of 2005 to 214 at March 31, 2007. As a result of the bankruptcy, we have significantly deleveraged our balance sheet. Our total debt was $777.3 million at December 31, 2005 compared to $120.1 million at March 31, 2007. We have since reduced our outstanding debt to $104.1 million after the redemption of $16.0 million in principal amount of our $10^{1}/_{2}$% notes on May 8, 2007 with the proceeds from the ATS sale. In addition, we generated positive cash flow during 2006 and had $64.8 million of cash on hand at December 31, 2006.

As of March 31, 2007, we had approximately 1,550 employees serving approximately 91,000 residential traditional telephone service lines, 264,900 business traditional telephone service lines and 14,900 T-1 circuits in service. As of March 31, 2007, approximately 88% of our revenue was attributable to service using our own network facilities, and approximately 12% was attributable to reselling the services of other carriers, primarily RBOCs. For the quarter ended March 31, 2007, we generated revenue of $126.4 million and a net loss of $11.1 million. During the quarter ended March 31, 2007, we generated approximately 9% of our revenue from retail residential traditional telephone service, approximately 29% from retail business traditional telephone service, approximately 21% from retail T-1s, approximately 14% from other retail products and approximately 27% from wholesale services.

We use several primary metrics to analyze our revenues and measure our performance. These metrics include: number of residential and business traditional telephone service lines in service, number of T-1 circuits in service, average monthly unit churn for residential traditional telephone service, business traditional telephone service and T-1 circuits and number of field sales people.

	As of				
	March 31, 2006	**June 30, 2006**	**September 30, 2006**	**December 31, 2006**	**March 31, 2007**
Retail T-1 circuits in service	11,900	12,400	13,200	14,300	14,900
Retail T-1 circuit churn	1.50%	1.50%	1.04%	1.23%	1.25%
Retail Dynamic Integrated Access units in service	1,300	1,900	2,600	3,500	4,400
Retail Dynamic Integrated Access unit churn	0.95%	0.60%	0.31%	0.51%	0.55%
Retail business traditional telephone service lines in service	350,400	325,700	302,300	283,500	264,900
Retail business traditional telephone service line churn	3.28%	2.99%	3.13%	3.28%	3.23%
Retail residential traditional telephone service lines in service	134,200	123,200	111,200	101,900	91,000
Retail residential traditional telephone service line churn	3.75%	3.28%	3.80%	3.32%	3.83%
Quota bearing field sales representatives	118	177	200	210	214
Quota bearing inside sales representatives	46	49	41	42	48
Total employees	1,591	1,545	1,556	1,588	1,564

Results of Operations

The following table summarizes our historical operations as a percentage of revenues for the years ended December 31, 2004, 2005 and 2006 and quarters ended March 31, 2006 and 2007.

	Predecessor McLeodUSA		Reorganized McLeodUSA		
	Year Ended December 31,		Year Ended December 31,	Quarter Ended March 31,	
	2004	2005	2006(2)	2006	2007
				(unaudited)	
Statements of Operating Data:					
Revenue	100.0%	100.0%	100.0%	100.0%	100.0%
Operating expenses:					
Cost of service(1)	55.0%	57.0%	58.0%	59.6%	53.6%
Selling, general and administrative(1)	37.5%	34.2%	33.4%	30.3%	39.0%
Depreciation and amortization	49.8%	33.5%	11.0%	10.0%	13.0%
Restructuring and asset impairment charge	36.7%	47.5%	0.4%	1.2%	0.0%
Reorganization charges, net	0.0%	3.2%	0.0%	0.0%	0.0%
Total operating expenses	179.0%	175.4%	102.8%	101.1%	105.6%
Operating (loss) income	(79.0)%	(75.4)%	(2.8)%	(1.1)%	(5.6)%
Net (loss) income	(87.2)%	(84.2)%	(5.2)%	(3.3)%	(8.8)%
Net (loss) income applicable to common stockholders	(87.6)%	(84.4)%	(5.2)%	(3.3)%	(8.8)%

(1) Exclusive of depreciation and amortization.

(2) Does not include the results of Predecessor McLeodUSA for January 1, 2006.

Comparison of the Quarters Ended March 31, 2006 and 2007

Revenue

Total revenue for the three months ended March 31, 2007 decreased $19.3 million, or 13%, to $126.4 million from $145.7 million for the three months ended March 31, 2006. The following table compares our revenue for the quarters ended March 31, 2006 and 2007:

	Three Months Ended March 31,		
	2006	2007	Change
	(dollars in millions)		
Local	$ 76.3	$ 66.0	(10.3)
Long distance	30.2	22.5	(7.7)
Data services and other	26.1	22.7	(3.4)

	Three Months Ended March 31,		
Carrier access	10.9	11.0	0.1
Indefeasible rights of use agreements including those that qualify as sales type leases	2.2	4.2	2.0
Total revenue	$ 145.7	$ 126.4	(19.3)

Revenue is derived primarily from business telephony services, including local dial tone, switched access lines, long distance, data services and access charges. Revenue from local telephone service consists of charges for basic local service, including dedicated T-1 access and Dynamic Integrated Access services, and local wholesale services utilizing our network to provide local voice services to the carrier's local customer. Revenue from long distance service consists of per-minute-of-use charges or bundled flat rates for traditional switched and dedicated long distance, toll-free calling, calling card and international calls. Data services and other revenue is primarily derived from charges for private line, dedicated internet access services, network maintenance and DSL service. Carrier access revenue consists primarily of usage charges that we bill long distance carriers to originate and terminate calls to and from our customers. Revenue from indefeasible rights to use fiber optic telecommunications network facilities includes revenue recognized over the term of the related lease unless it qualifies as a sales type lease, for which revenue is recognized at the time of sale.

Total revenues declined by $19.3 million from the quarter ended March 31, 2006 due primarily to a decline in total customers and lower long distance volume. The $10.3 million decrease in local revenues is attributable to a combination of factors, including a decrease of approximately $15.6 million due to a reduction in the number of access lines in service as a result of customer turnover in excess of new lines sold. This decrease was partially offset by an increase of $1.7 million in revenue related to increases in our local rates and an increase of $3.7 million in revenue related to our Dynamic Integrated Access services. Consistent with our revised strategy, our sales force does not actively sell traditional telephone service lines, except as part of larger, bundled service packages, and as a result we expect our local traditional telephone service revenues will continue to decline. Additional traditional telephone service lines and features are sold to our larger existing business customers by the field sales force, and our inside sales force sells traditional telephone service and other services to new business customers who do not require T-1 services. Our wholesale sales force sells traditional telephone services to other carriers who seek to move their resale residential and very small business customers from the RBOCs as a result of significant recent price increases. Sales of traditional telephone services to new retail business customers and to carrier customers is limited to markets and collocations where we have significant unused capacity where traditional telephone service lines can be added at minimal cost. Monthly customer turnover on residential traditional telephone service lines averaged approximately 3.8% per month during the first quarter of 2007, and we expect that trend will continue throughout 2007. We anticipate that this reduction in the number of lines and revenues generated from traditional telephone service customers will be somewhat offset by increases in higher margin services provided over T-1 circuits, although we expect that total local revenues and revenue in total will continue to decline in 2007. While we expect that overall 2007 revenues will be lower than in 2006, we believe that continued growth in T-1 based services will ultimately result in revenue growth and profitability. T-1 customer account turnover averaged approximately 1.3% per month during the first quarter of 2007, including 0.6% per month for Dynamic Integrated Access services.

The $7.7 million decrease in long distance revenue is primarily attributable to a 43% decline in the volume of minutes from the quarter ended March 31, 2006. The volume of retail minutes declined primarily as a result of the reduction in the number of access lines in service and increased price competition. Wholesale long distance minutes have declined primarily as a result of strategic wholesale price increases that we implemented during 2006. We expect that long distance revenues will continue to decline during 2007 because average rates for long distance services continue to decline and many T-1-based products, on which we have focused our business and sales strategy, include bundled long distance as part of the base monthly service. Although we expect that long distance revenues will continue to decline during 2007, we believe that our revenue attributable to T-1-based services will ultimately result in overall revenue growth. Data and other services declined as a result of customer turnover in excess of new sales. We expect that our revenue from data and other services will decrease during 2007 as a result of the ATS sale that occurred March 9, 2007. ATS has historically generated approximately $10 million of revenue per year. Included in revenues from indefeasible rights of use in the above table is $1.6 million and $1.5 million for the quarters ended March 31, 2007 and 2006, respectively, related to ongoing revenues from operating leases.

Cost of service

Cost of service includes expenses directly associated with providing communication services to our customers. Costs classified as cost of service include, among other items, the cost of connecting customers to our network via leased facilities, the costs paid to third-party providers for interconnection access and transport services, the costs of leasing components of our network facilities and the cost of fiber related to sales and leases of network facilities.

Cost of service was $67.8 million for the three months ended March 31, 2007, a decrease of $19.0 million, or 22%, from the three months ended March 31, 2006. The decrease in cost of service is principally attributable to the decline in revenues resulting from our decrease in customers. The reduction in the number of access lines in service from the quarter ended March 31, 2006 to the quarter ended March 31, 2007 resulted in a reduction in the cost of leased local loops of approximately $6.8 million, and the corresponding reduction in long distance minutes resulted in lower variable long distance costs of approximately $8.8 million. Costs savings of $1.5 million were achieved as a result of cost reduction efforts that we began in the third quarter of 2006. These efforts primarily consist of our initiative to reduce monthly recurring costs for electric power and cross-connects for our collocations, decommission collocations in areas with limited potential to capture target business customers and eliminate excess leased network capacity. For the month ended March 31, 2007, our monthly recurring savings were $0.6 million, and we expect this monthly savings amount to increase during 2007. We expect to have implemented 90% of this network optimization project by June 2007, and to complete the implementation during the third quarter of 2007. This initiative is intended to reduce power and capacity in excess of our projected growth requirements, and we do not expect that it will affect the quality of our products and services or materially limit our future growth potential.

The cost of fiber related to sales and leases of network facilities was $1.6 million and $0.6 million for the quarters ended March 31, 2007 and 2006, respectively. In connection with the application of fresh start accounting upon our emergence from bankruptcy in January 2006, the book value of our fiber network was adjusted to fair value. As a result, the cost of fiber related to sales and leases of network facilities during the three months ended March 31, 2006 was representative of the selling price less selling costs, principally sales commissions.

Selling, general and administrative expenses

Selling, general and administrative expenses include expenses related to sales and marketing, customer service, internal network operations and engineering, information systems and other administrative functions. Selling, general and administrative expenses were $49.3 million for the three months ended March 31, 2007, an increase of $5.1 million, or 12%, from the same period in 2006. Included in selling, general and administrative expense for the three months ended March 31, 2007 is $2.9 million of stock compensation expense. The quarter ended March 31, 2006 does not contain any stock compensation expense because no grants were made until the second quarter of 2006. Salaries and commission expense increased by $3.3 million primarily related to the increase in headcount in the sales organization. These increases were partially offset by lower costs for operating leases, bad debt expense and insurance costs. We expect selling, general and administrative costs to continue to increase, primarily attributable to the planned increase in the number of our field sales personnel. We also expect to incur approximately $2.0 million to $2.5 million in additional recurring annual costs as a result of becoming a public company.

Depreciation and amortization

Depreciation and amortization includes the depreciation of our communications network and equipment, amortization of other intangibles determined to have finite lives, and amortization over the life of the customer contract of one-time direct installation costs associated with transferring customers' local line services from the RBOCs to our local telecommunications services. Depreciation and amortization expenses were $16.4 million for the three months ended March 31, 2007, an increase of $1.9 million from the same period of 2006.

Reorganization items

On January 1, 2006 we recorded reorganization income of $18.5 million to adjust the carrying value of the asset retirement obligation based on the current discount rates in effect upon our adoption of fresh start accounting.

Restructuring charges

During the first quarter of 2006 we incurred restructuring costs of $1.8 million, primarily related to severance costs due to our revised strategic plan and professional fees related to our recapitalization. No restructuring costs were incurred in the first quarter of 2007.

Interest expense

Gross interest expense was $3.4 million for the three months ended March 31, 2007, an increase of $0.1 million from $3.3 million during the first quarter of 2006.

Other nonoperating income (expense)

Other nonoperating expense totaling $0.9 million for the quarter ended March 31, 2007 is primarily due to loss on the sale of our ATS operations.

Gain on cancellation of debt

On January 1, 2006, we recognized a gain of $728.1 million upon our emergence from bankruptcy related to the cancellation of debt of $677.3 million and accrued interest of $50.8 million.

Comparison of the Years Ended December 31, 2005 and 2006

Our adoption of fresh start accounting on January 1, 2006 had a material effect on our financial statements. As a result, our historical financial statements are not comparable to our financial statements published for periods following the implementation of fresh start accounting.

Revenue

Total revenue for the year ended December 31, 2006 decreased $90.3 million, or 14% to $544.7 million from $635.0 million for the year ended December 31, 2005. The following table compares our revenue for the years ended December 31, 2005 and 2006:

	Year Ended December 31, 2005	Year Ended December 31, 2006	Change
	(in millions)		
Local	$ 324.0	$ 286.7	$ (37.3)
Long distance	130.4	104.9	(25.5)
Data services and other	112.0	97.5	(14.5)
Carrier access	51.4	43.3	(8.1)
Indefeasible rights of use agreements including those that qualify as sales type leases	17.2	12.3	(4.9)
Total revenue	$ 635.0	$ 544.7	$ (90.3)

Total revenues declined by $90.3 million compared to the year ended December 31, 2005 due primarily to a decline in total customers and both lower long distance volume and rates. The $37.3 million decrease in local revenues is attributable to a combination of factors, including a decrease of approximately $81.0 million due to a reduction in the number of access lines in service as a result of customer turnover in excess of new lines sold. This decrease was partially offset by an increase of $18.3 million in revenue related to increases in our local rates, an increase of $10.0 million in revenue related to our Dynamic Integrated Access services and an increase of $15.4 million related to local wholesale volume increases. Monthly customer turnover on residential traditional telephone service lines averaged approximately 3.5% per month during 2006. T-1 customer account turnover averaged approximately 1.3% per month in 2006, including 0.6% per month for Dynamic Integrated Access services.

The $25.5 million decrease in long distance revenue is primarily attributable to an 11% decline in the average rate per minute and 13% decline in the volume of minutes during the year ended December 31, 2006. The volume of retail minutes declined primarily as a result of the reduction in the number of access lines in service and increased price competition. Wholesale long distance minutes have declined primarily as a result of strategic wholesale price increases that we implemented during 2006. Data and other services declined as a result of customer turnover in excess of new sales. Carrier access revenue in 2006 decreased by $8.1 million from the year ended December 31, 2005 due primarily to the reduction in the volume of long distance minutes and the continuing reduction in carrier access charge rates mandated by regulators. Included in revenues from indefeasible rights of use in the above table is $6.2 million and $5.5 million for the years ended December 31, 2006 and 2005, respectively, related to ongoing revenues from operating leases.

Cost of service

Cost of service was $315.8 million for the year ended December 31, 2006, a decrease of $46.3 million, or 13%, from the year ended December 31, 2005. The decrease in cost of service is principally attributable to the decline in revenues resulting from our decrease in customers. The reduction in the number of access lines in service during 2006 resulted in a reduction in the costs of leased local loops of approximately $16.1 million, and the corresponding reduction in long distance minutes resulted in lower variable long distance costs of approximately $9.9 million. In addition, our continued least cost routing efforts during 2006 yielded a lower average cost per long distance minute, which further reduced cost of service by approximately $7.9 million. During 2006, we recorded cost reductions totaling approximately $3.9 million related to the resolution of a number of disputes with various wireless carriers in connection with costs associated with access services. Additional costs savings of $0.9 million were achieved as a result of the cost reduction efforts that we began in the third quarter of 2006.

The cost of fiber related to sales and leases of network facilities was $5.8 million and $2.1 million for the years ended December 31, 2006 and 2005, respectively. In connection with the application of fresh start accounting upon our emergence from bankruptcy in January 2006, the book value of our fiber network was adjusted to fair value. As a result, the cost of fiber related to sales and leases of network facilities during 2006 was representative of the selling price less selling costs, principally sales commissions.

Selling, general and administrative expenses

Selling, general and administrative expenses were $181.7 million for the year ended December 31, 2006, representing a decrease of $35.7 million, or 16%, from 2005. Of this decrease, $15.7 million was attributable to additional bad debt expense incurred during 2005 in connection with settlements and allowances for interstate and intrastate access charge billing disputes with other carriers related to wireless originated 800 toll-free calls. In 2006, we realized substantial selling, general and administrative expense reductions as a result of lower headcount, lower costs for operating leases, insurance and professional fees. Partially offsetting the selling, general and administrative expense reductions for 2006 is $4.9 million of stock compensation expense relating to stock option grants in 2006. Overall selling, general and administrative expense has declined as a percentage of revenues from 34% in 2005 to 33% in 2006.

Depreciation and amortization

Depreciation and amortization expenses were $60.1 million for the year ended December 31, 2006, a decrease of $152.8 million from the same period of 2005. This decrease was due to the adoption of fresh start accounting effective January 1, 2006 that resulted in a significant reduction in the basis of our long-lived assets.

Impairment charge

In accordance with SFAS 144, during the second quarter of 2005, we performed an evaluation of the recoverability of property and equipment, which indicated that certain of our long-lived assets were impaired. We used a probability-weighted discounted cash flow analysis to estimate the fair value of our property and equipment and recorded a non-cash impairment charge of $174.8 million to reduce the carrying amount to estimated fair value.

In accordance with SFAS 142, during the second quarter of 2005, we performed an evaluation of the McLeodUSA trade name utilizing a "relief from royalty" method of valuation. The evaluation indicated an impairment of $27.7 million on the McLeodUSA trade name to reduce its carrying value to estimated fair value of $37.2 million.

In connection with our bankruptcy filing in October 2005 and the results of our valuations performed to estimate the fair value of our noncurrent tangible and intangible assets in connection with fresh start accounting, we recorded an incremental impairment charge of $75.3 million in the fourth quarter of 2005. This incremental impairment charge consisted primarily of revisions to the valuation assumptions related to the McLeodUSA trade name, the value of our customer lists as well as adjustments to the carrying value of deferred line installation costs.

Consequently, we recorded non-cash impairment charges totaling $277.8 million in 2005 to include the impairment on both the property and equipment as well as the intangible assets discussed above. We did not record any impairment charges during 2006.

Reorganization items

On January 1, 2006, we recorded reorganization income of $18.5 million to adjust the carrying value of the asset retirement obligation based on the current discount rates in effect upon our adoption of fresh start accounting. During 2005, we recorded net reorganization items of $20.2 million primarily related to the write off of the deferred financing fees on our credit agreement, the write off of director and officer insurance that was in effect prior to our plan of reorganization and professional fees.

Restructuring charges

During the year ended December 31, 2006, we incurred restructuring costs of $2.4 million, primarily related to increased severance costs due to our revised strategic plan and professional fees related to our recapitalization. During the year ended December 31, 2005, we incurred $23.9 million in restructuring charges related to financial and legal advisors and severance costs in connection with our pursuit of our financial restructuring.

Interest expense

Gross interest expense was $13.4 million for the year ended December 31, 2006, a decrease of $52.7 million from $66.1 million during the year ended December 31, 2005 primarily due to the cancellation of $677.3 million of debt upon our emergence from bankruptcy on January 6, 2006. The decrease related to the lower outstanding debt balance was partially offset by a significant increase in interest rates. Interest expense of approximately $0.7 million and $0.8 million was capitalized as part of the construction of our network during the years ended December 31, 2006 and 2005, respectively.

Other nonoperating income (expense)

Nonoperating expense of $0.3 million for the year ended December 31, 2006, primarily relates to the write off of the deferred financing fees related to our credit facility offset by gains on asset sales. The nonoperating income of $9.8 million in the prior year primarily relates to gains on asset sales.

Gain on cancellation of debt

On January 1, 2006, we recognized a gain of $728.1 million upon our emergence from bankruptcy related to the cancellation of debt of $677.3 and accrued interest of $50.8 million.

Comparison of Years Ended December 31, 2004 and 2005

Revenue

Total revenue for the year ended December 31, 2005 decreased $81.2 million or 11% to $635.0 million from $716.2 million for the year ended December 31, 2004. The following table compares our revenue for the years ended December 31, 2004 and 2005:

	Year Ended December 31,		
	2004	**2005**	**Change**
	(in millions)		
Local	$ 365.1	$ 324.0	$ (41.1)
Long distance	133.8	130.4	(3.4)
Data services and other	131.7	112.0	(19.7)
Carrier access	76.9	51.4	(25.5)
Indefeasible rights of use agreements including those that qualify as sales type leases	8.7	17.2	8.5
Total revenue	$ 716.2	$ 635.0	$ (81.2)

Total revenues declined for the year ended December 31, 2005 by $81.2 million from the year ended December 31, 2004 due to a continued decline in total customers, FCC mandated reduction in access rates and lower long distance rates. The $41.1 million decrease in local revenues was attributable to a reduction in the number of access lines in service due to customer turnover in excess of new lines sold of approximately $52.5 million, partially offset by an increase in local revenues of approximately $21.4 million resulting from increased sales of our Dynamic Integrated Access services and our local wholesale contract with MCI to provide local services to its residential customers. The remainder of the decrease in local revenues was due to a reduction in rates. The overall decrease in long distance revenue was attributable to a 36% drop in average rates from 2004. This decrease in rates occurred primarily as a result of the significant change in our mix of wholesale versus retail minutes. During 2005, wholesale minutes increased 200% as compared to 2004. Data and other services declined by $19.7 million, primarily as a result of customer turnover in excess of new sales. Access revenues in 2005 decreased by $25.5 million from 2004, primarily due to the FCC-mandated access rate reduction. Indefeasible rights of use revenue during 2005 includes $7.3 million of revenue from a single sale of fiber. Revenues from indefeasible rights of use of $5.5 million for the year ended December 31, 2005 and $5.6 million for the year ended December 31, 2004 were related to ongoing revenues from operating leases.

Cost of service

Cost of service was $362.1 million for the year ended December 31, 2005, a decrease of $31.7 million or 8% from the year ended December 31, 2004. Approximately $22 million of the decrease reflects the results of our ongoing network cost reduction efforts, including least cost routing, network optimization and grooming and migration of customers to our network. The balance of the decrease was attributable to our reduction in revenues. The cost of fiber related to sales and leases of network facilities was $2.1 million for the year ended December 31, 2005 and $0.4 million for the year ended December 31, 2004.

Selling, general and administrative expenses

Selling, general and administrative expenses were $217.4 million for the year ended December 31, 2005, representing a decrease of $51.0 million or 19% from 2004. This decrease in selling, general and administrative expenses was primarily attributable to our actions to reduce headcount and reductions in advertising and marketing expenses, as well as to lower maintenance and repair costs. We reduced our headcount from approximately 2,400 employees at December 31, 2004 to approximately 1,700 at December 31, 2005.

Depreciation and amortization

Depreciation and amortization expenses were $212.9 million for the year ended December 31, 2005, representing a decrease of $143.9 million from 2004. This decrease was due to our fully depreciating a significant amount of our depreciable assets during 2005, as well as to a lower depreciable asset base as a result of impairment charges we recorded to property and equipment during 2005.

Impairment charge

In accordance with SFAS 142, we performed our 2004 annual impairment test of goodwill and other indefinite lived intangible assets. The evaluations indicated that our goodwill was fully impaired and the McLeodUSA trade name was partially impaired. As a result, during 2004, we recorded a $245.1 million impairment charge to eliminate goodwill and an $18.0 million impairment charge to reduce the carrying value of the McLeodUSA trade name to $64.9 million.

In accordance with SFAS 144, during the second quarter of 2005, we performed an evaluation of the recoverability of property and equipment which indicated that certain of our long-lived assets were impaired. We used a probability-weighted discounted cash flow analysis to estimate the fair value of our property and equipment and recorded a non-cash impairment charge of $174.8 million to reduce the carrying amount to estimated fair value.

In accordance with SFAS 142, during the second quarter of 2005, we performed an evaluation of the McLeodUSA trade name using a "relief from royalty" method of valuation. As a result of this evaluation, we recorded a $27.7 million impairment on the McLeodUSA trade name to reduce its carrying value to estimated fair value of $37.2 million.

In connection with our October 2005 bankruptcy filing and the results of valuations performed to estimate the fair value of our noncurrent tangible and intangible assets in connection with fresh start accounting, we recorded a $75.3 million incremental impairment charge in the fourth quarter of 2005. This incremental impairment charge consisted primarily of revisions to the valuation assumptions related to the McLeodUSA trade name and the value of our customer lists, as well as adjustments to the carrying value of deferred line installation costs.

Consequently, we recorded non-cash impairment charges totaling $277.8 million during the year ended December 31, 2005.

Interest expense

Gross interest expense was $66.1 million for the year ended December 31, 2005, representing an increase of $16.2 million from $49.9 million during 2004. The increase was primarily due to an increase in average interest rates during the period. In addition to a general market rate increase, we were required to accrue two additional percentage points of interest on our outstanding debt balance as a result of an event of default, which contributed an additional $9.7 million of interest. This increase was partially offset as we ceased to record $11.7 million of interest expense on the impaired debt for the period October 29, 2005 to December 31, 2005 upon commencement of our Chapter 11 proceedings. We capitalized interest expense of approximately $0.8 million during 2005, and $1.7 million during 2004, as part of the construction of our fiber optic network.

Other nonoperating income (expense)

Other nonoperating income was $9.8 million during 2005 compared to other nonoperating expense of $10.6 million during 2004. The income during 2005 related to gains on sales of certain of our assets, primarily aircraft. The loss during 2004 primarily related to the loss recorded on a sale of fiber to Level 3 and certain other parties totaling $12.1 million, partially offset by a $1.9 million gain related to the final true up of the dissolution of an equity partnership following our mandatory withdrawal in 2003 from the partnership under the terms of the partnership agreement.

Unaudited Quarterly Financial Data

The following table summarizes our unaudited condensed financial data for the quarters ended March 31, 2006, June 30, 2006, September 30, 2006, December 31, 2006 and March 31, 2007.

	Quarter Ended				
	March 31, 2006	**June 30, 2006**	**September 30, 2006**	**December 31, 2006**	**March 31, 2007**
	(in millions)				
Revenue	$ 145.7	$ 139.7	$ 132.5	$ 126.8	$ 126.4
Cost of service(1)	86.8	82.6	75.9	70.5	67.8
Selling, general and administrative(1)	44.2	45.4	45.8	46.3	49.3
Depreciation and amortization	14.5	14.7	15.0	15.9	16.4
Restructuring charges	1.8	0.7		(0.1)	
Total operating expenses	147.3	143.4	136.7	132.6	133.5
Operating loss	(1.6)	(3.7)	(4.2)	(5.8)	(7.1)
Interest expense, net	(3.2)	(3.1)	(2.9)	(3.5)	(3.1)
Other income (expense)		0.3	(0.8)	0.2	(0.9)
Net loss	$ (4.8)	$ (6.5)	$ (7.9)	$ (9.1)	$ (11.1)
Reconciliation of EBITDA and Adjusted EBITDA:(2)					
Net loss	$ (4.8)	$ (6.5)	$ (7.9)	$ (9.1)	$ (11.1)
Interest expense, net	3.2	3.1	2.9	3.5	3.1
Depreciation and amortization	14.5	14.7	15.0	15.9	16.4
EBITDA	12.9	11.3	10.0	10.3	8.4
Other expense (income)		(0.3)	0.8	(0.2)	0.9
Restructuring charges	1.8	0.7		(0.1)	
Non-cash compensation		1.8	1.4	1.7	2.9
Adjusted EBITDA	$ 14.7	$ 13.5	$ 12.2	$ 11.7	$ 12.2

(1) Exclusive of depreciation and amortization.

(2)

Please see footnote 1 on page 38 of this prospectus for a discussion of the uses and limitations of non-GAAP financial measures.

Capital expenditures	$ 6.8	$ 6.7	$ 8.6	$ 9.8	$ 6.9
Deferred line installation costs	$ 3.9	$ 3.9	$ 4.9	$ 4.3	$ 4.8
Revenue from fiber sales	$ 0.7	$ 2.2	$ 0.7	$ 2.5	$ 2.6
Cost of fiber sold	$ 0.6	$ 2.1	$ 0.7	$ 2.4	$ 1.6

Liquidity and Capital Resources

On January 6, 2006, we emerged from bankruptcy. Key elements of our plan of reorganization included:

Cancellation of $677.3 million of outstanding debt and accrued interest of $50.8 million;

In exchange for the cancellation of $677.3 million of debt and the unpaid interest thereon, our lenders received their pro rata share of 100% of our equity;

Use of $27.3 million of proceeds from the sale of our headquarters facility to pay down the remaining debt outstanding to $72.7 million;

A new credit facility consisting of $10.0 million of funded debt and a $40.0 million revolving credit facility, under which no amounts were outstanding as of December 31, 2006; and

Hiring Royce Holland as our new Chief Executive Officer and appointing a new board of directors.

As of March 31, 2007, we had cash and cash equivalents of $71.1 million compared with $20.0 million and $64.8 million at December 31, 2005 and 2006, respectively.

The changes in cash for the years ended December 31, 2005 and 2006, and three months ended March 31, 2006 and 2007, were as follows:

	Year Ended		Three Months Ended March 31,	
	2005	**2006**	**2006**	**2007**
Provided by operating activities	$ 14.4	$ 45.7	$ 0.8	$ 1.9
(Used in) provided by investing activities	(44.4)	(14.5)	33.3	4.4
Provided by (used in) financing activities		13.6	(18.7)	
Net increase in cash and cash equivalents	$ (30.0)	$ 44.8	$ 15.4	$ 6.3

Operating activities in three months ended March 31, 2006 compared to three months ended March 31, 2007. Cash provided by operating activities was $1.9 million for the first quarter of 2007 compared to $0.8 million during the first quarter of 2006. During the first quarter of 2007, our net loss was greater than the net loss for the quarter ended March 31, 2006, primarily due to stock compensation expense of $2.9 million in 2007, an increase in depreciation and amortization of $1.9 million in 2007, and a loss on the sale of assets during the first quarter of 2007 of $0.9 million. During the first quarter of 2007, we had unfavorable working capital fluctuations of $7.9 million, primarily due to lower cash receipts and the timing of certain payments, including payroll liabilities and property taxes. This compares to an unfavorable working capital fluctuation during the first quarter of 2006 of $9.3 million.

Operating activities in year ended December 31, 2006 compared to year ended December 31, 2005. Cash provided by operating activities was $45.7 million during 2006, compared to cash provided by operating activities during 2005 of $14.4 million. The increase in the cash provided by operating activities is primarily due to the substantial amount of restructuring costs incurred during 2005. Cash expended for restructuring activities decreased from $49.4 million during 2005 to $10.2 million for 2006. Cash paid for restructuring activities were principally for professional fees incurred related to the bankruptcy proceedings, severance, and lease rejection claims pursuant to our plan of reorganization. The increase in cash provided by operating activities was partially offset by the timing of payments for accounts payable and accrued liabilities.

Investing activities in three months ended March 31, 2007 compared to three months ended March 31, 2006. Our principal investing activities consist of purchases of property and equipment, as well as cash paid for customer installation costs. Our capital expenditures for the first quarter of 2007 of $6.9 million were in line with 2006 capital expenditures of $6.8 million. Our deferred installation costs for the first quarter of 2007, consisting principally of non-recurring charges to the RBOCs for provisioning unbundled loops or T-1s, and labor and materials for installations and provisioning of equipment and service, totaled $4.8 million, an increase of $0.9 million over the first quarter of 2006. The increase was due to the addition of new customers at a higher rate during the quarter ended March 31, 2007 compared to the quarter ended March 31, 2006. Proceeds from the sale of assets during the first quarter of 2007 included $16.0 million from the sale of our ATS operations.

Investing activities in year ended December 31, 2006 compared to year ended December 31, 2005. Our 2006 capital expenditures of $31.9 million were in line with 2005 expenditures of $35.9 million, and consisted primarily of purchases of equipment in connection with the growth and maintenance of our network, facilities expenditures in connection with the enhancement of our physical locations and costs associated with licenses and implementation of operational support systems and financial and administrative systems. Our deferred line installation costs for 2006 totaled $17.0 million, a decrease of $9.3 million from 2005. This reduction is primarily related to a substantial volume of non-recurring charges paid to RBOCs during 2005 in connection with the ramp-up of a large local wholesale contract with another carrier to provide local service to its residential customers, as well as continued reductions in the amount of internal labor and materials required to add new customers.

During 2005, we received $61.2 million in proceeds from the sale of assets, as compared to $2.7 million received during 2006. Proceeds from the sale of assets during 2005 primarily included the sale of our headquarters in Cedar Rapids, Iowa, three aircraft, certain real estate and excess inventory. Proceeds during 2006 were primarily from the sale of excess inventory.

As of December 31, 2005, we had $43.4 million of restricted cash that was used during 2006 primarily to repay $27.3 million outstanding under our term loans, pay $5.6 million of lease rejection claims, prepay $4.5 million of outstanding invoices due to SBC in accordance with a settlement agreement and pay deferred financing fees of $1.4 million. The remaining $4.6 million balance was returned to us for general corporate purposes. At December 31, 2006 we had $11.7 million classified as restricted cash, comprised of $9.3 million cash collateral, supporting outstanding letters of credit, and $2.4 million held in escrow related to our dispute of certain charges billed to us by AT&T. In accordance with various interconnection agreements between AT&T and us, we are required to deposit amounts in dispute into an interest bearing escrow account with a third-party escrow agent. Of this restricted cash, $1.1 million is classified as noncurrent.

Financing activities in three months ended March 31, 2007 compared to three months ended March 31, 2006. As noted above, we used $27.3 million of restricted cash to pay down debt upon our emergence from bankruptcy and pay the financing fees related to a new facility. The new credit facility also funded $10.0 million immediately upon our emergence from bankruptcy on January 6, 2006.

Financing activities in year ended December 31, 2006 compared to year ended December 31, 2005. On September 28, 2006, we refinanced our outstanding debt obligations with the issuance of $120.0 million aggregate principal amount of our 10½% notes. The proceeds from long-term debt of $130.0 million illustrated in the table above include $10.0 million of borrowings under our credit facility that were immediately funded upon our emergence from bankruptcy on January 6, 2006, as well as the $120.0 million of proceeds received upon the issuances of the 10½% notes. We used the proceeds from issuance of the 10½% notes to repay $82.7 million outstanding under our term loans. As a result of our refinancing of our term loans, our outstanding letters of credit are required to be cash collateralized at 105% of face value. A portion of the proceeds from the issuance of the 10½% notes was used to cash collateralize our outstanding letters of credit. The remaining proceeds from the issuance of the 10½% notes have been and will continue to be used for general corporate purposes.

The 10½% notes bear interest at 10.5% per annum, payable semi-annually in arrears, and mature on October 1, 2011. No principal payments are due until maturity. In connection with the issuance of the 10½% notes, we entered into a registration rights agreement in which we agreed to, among other things, file a registration statement with the SEC within 180 days of the issuance of the 10½% notes and use our best efforts to cause the registration statement to be declared effective within 270 days after the issuance of the 10½% notes. If there is a registration default, the annual interest rate on the 10½% notes will increase by 0.25%. The annual interest rate will increase by 0.25% for any subsequent 90-day period during which the registration default continues, up to a maximum additional interest rate of 1.00% per year. The 10½% notes are collateralized by substantially all of our tangible and intangible assets. On May 8, 2007, we redeemed $16 million in principal amount of the 10½% notes out of the proceeds from the ATS sale. In addition, under the terms of the indenture governing our 10½% notes, we may use the net proceeds from certain equity offerings, including this offering to redeem additional principal amount of our outstanding 10½% notes, up to a maximum of 35% of the aggregate principal amount originally issued, at a redemption price of 110.5%, plus accrued and unpaid cash interest. We plan to use the net proceeds of this offering to redeem a portion of our outstanding 10½% notes.

The 10½% notes do not contain financial covenants but do include limitations and restrictions as to, among other things, additional indebtedness, payment of cash dividends, the redemption or repurchase of equity securities, our ability to incur liens and security interests and our ability to enter into any business other than certain permitted businesses. Upon the occurrence of a change of control as defined in the indenture related to the 10½% notes, the holders of the 10½% notes will have the right to require us to redeem the 10½% notes at 101% of the principal amount outstanding plus accrued and unpaid interest.

In addition, the 10½% notes include limitations and restrictions on our ability to make investments or stock acquisitions if at the time of such investment:

- a default under the 10½% notes has occurred and is continuing,
- we are not able to incur additional indebtedness in compliance with the 10½% notes, or
- the aggregate amount of investments (including the proposed investment) exceeds certain thresholds determined by reference to, among other things, our consolidated adjusted cash flow, net cash proceeds received by us from the issuance of certain capital stock or certain equity contributions, and net cash proceeds received by us from the issuance of certain indebtedness.

The 10½% notes do not, however, prohibit:

investments in any person that is or will become a guarantor of the 10 1/2% notes or that will merge or consolidate with or into us, or that transfers or conveys all or substantially all of its assets to us or

an investment either (i) solely in exchange for shares of our specified capital stock or (ii) with the proceeds of sales for cash of our specified capital stock within 60 days after such sale. These restrictions could affect our ability to expand our business by limiting the ways in which we can structure acquisitions of companies or assets that would otherwise enable us to gain market share and enter new markets.

The 10 1/2% notes also limit our ability to sell or transfer any property or assets other than in the ordinary course of business (except for asset sales for which we receive aggregate consideration of less than $1.0 million), unless:

we receive consideration at least equal to the fair market value of the assets sold,

at least 75% of the consideration is in the form of cash or cash equivalents, and

we apply the net cash proceeds within 360 days to make (i) investments in certain replacement assets or other assets used or useful in a permitted business, (ii) repayments of certain indebtedness, or (iii) an acquisition of a majority of the capital stock of a person engaged in a permitted business that becomes a restricted subsidiary under the indenture related to the 10 1/2% notes.

These limitations on asset sales could hinder our ability to execute our strategy of divesting assets that are no longer essential to our core business.

The 10 1/2% notes contain customary events of default, including, among other things, payment default, covenant default, cross-default, bankruptcy, material money judgments, failure to maintain perfected and first priority security interests and failure to maintain subsidiary guarantees. If an event of default occurs and is continuing, all obligations under the 10 1/2% notes could be accelerated by the trustee or the holders of at least 25% in aggregate principal amount of outstanding 10 1/2% notes, causing the outstanding principal amount of, and premium, if any, and accrued interest on, the 10 1/2% notes to be declared immediately due and payable. In the case of the occurrence and continuance of a bankruptcy event of default, all unpaid principal of, and premium, if any, and accrued and unpaid interest on all of the outstanding 10 1/2% notes will become immediately due and payable without any act on the part of the trustee or any holder.

Capital requirements

Our past financial difficulties and two bankruptcies have harmed our image with investors, customer and suppliers. They have also adversely affected our liquidity position, because we have been required to provide letters of credit as deposits to certain of our vendors. As of March 31, 2007, we had $8.3 million in outstanding letters of credit. Of this amount, $7.3 million in letters of credit were issued to provide additional security to our vendors, including $4.1 million issued to Qwest related to disputed items and amounts that we have withheld as a result, and $3.2 million required by an insurance company that has issued bonds to various third parties. Generally, these bonds are performance-type bonds required in the ordinary course of our business to allow us access to rights-of-way in order to construct and maintain our network facilities. In connection with our September 2006 issuance of our 10 1/2% notes, we repaid the credit facility under which these letters of credit were originally issued. Accordingly, the outstanding letters of credit are now required to be cash collateralized at 105% of their face value, resulting in a significant amount of restricted cash.

We have filed a civil complaint against Qwest in the U.S. District Court for the Northern District of Iowa seeking recovery of damages related to numerous billing disputes. Qwest has filed a counterclaim for amounts it believes that we owe to it. Qwest has claimed damages exceeding $14 million and we have claimed damages of approximately $12 million. While we continue to negotiate with Qwest and believe that a settlement will be reached that will not result in a significant cash outlay, if a settlement is not reached, an adverse ruling by a state agency or court could materially reduce our cash reserves.

In connection with our plan of reorganization, certain of our assets, including ATS, were identified for sale to raise cash. On March 9, 2007, we completed the ATS sale for a purchase price of approximately $16 million. On May 8, 2007, we redeemed $16 million in principal amount of the $10^1/_2$% notes at a redemption price equal to 100% of the aggregate principal amount thereof, plus accrued and unpaid interest thereon, out of the proceeds from the ATS sale. We continue to evaluate other opportunities to divest assets or markets that are no longer core to our business strategy.

We believe that our cash flow from operating activities during 2007 will be similar to our cash flow from operating activities during 2006, and sufficient, when combined with cash on hand, to enable us to meet our debt service obligations, meet our liquidity needs, provide for our planned capital expenditures and expand our field sales force and business for at least the next 12 months without additional financing or the proceeds from this offering. We expect to spend approximately $53 million for capital expenditures and deferred line installation costs during 2007. Approximately 55% of this amount is attributable to new sales and installations for new customers. These expenditures include customer premise equipment, other network equipment, labor and materials for installation and provisioning of equipment and service and up-front non-recurring charges paid to the RBOCs for provisioning. We expect these expenditures to increase if we exceed our sales plan, and to decrease if we do not achieve our sales plan. The remainder of our estimated aggregate capital expenditure requirements includes the projected costs of:

- deploying network assets currently not in service;
- constructing, purchasing, developing or improving communications assets in target markets; and
- improving the business infrastructure and systems, including software, to support new product development.

On May 16, 2007, we completed the acquisition of certain assets from Mpower Communications Corp. for approximately $17.3 million in cash. The assets consist primarily of Mpower's Chicago-area customer base and related assets. Until closing, we assisted Mpower in managing its Chicago-area assets in exchange for a management fee that was calculated based on monthly cash flow from Mpower's operations. We funded this acquisition with cash on hand.

We may supplement our organic growth by opportunistically acquiring or exchanging additional assets that would allow us to gain market share and expand into markets that complement our existing network footprint. Growth opportunities could include acquisitions of companies, as well as the acquisition or exchange of customers, network assets and customers in select markets. In pursuing strategic transactions, we focus on those assets that operate in our markets or adjacent markets, serve similar customers and offer complementary products and services. Alternatively, we may divest certain assets or markets that are no longer core to our business strategy. Although we are currently evaluating several opportunities to acquire or divest assets or markets, we can give no assurances that we will proceed with such acquisitions or divestitures or that any such transactions will be successful. If we sell any non-strategic assets or markets, we may use the proceeds for general corporate purposes or to acquire or invest in businesses, technologies and products that are complementary to our operations. We currently have no agreements or commitments to complete any such transactions.

We believe that cash on hand and cash generated from operating activities will be sufficient to finance the expansion of our business, enhance our products, fund anticipated capital expenditures and meet our debt service requirements through at least 2009. If we choose to pursue additional acquisitions, we may use the proceeds from this offering to do so, and we may also require additional funding. We anticipate that we would, but may not, be able to obtain such additional funding through the incurrence of additional indebtedness on commercially reasonable terms. Failure to generate or raise sufficient funds may require us to delay or abandon some of our plans or expenditures, which could harm our business and competitive position.

Off-Balance-Sheet Arrangements

We have indemnification obligations to our current and former directors and officers. The terms of the indemnification obligations provide for no limitation to the maximum potential future payments under such indemnification. We maintain insurance, subject to limitations set forth in the policies, which is intended to cover the costs of claims made against our directors and officers.

Contractual Obligations

The following table sets forth our contractual obligations to make further payments at December 31, 2006:

	Payment Due by Period				
Contractual Obligations	**Less Than 1 Year**	**1-3 Years**	**4-5 Years**	**After 5 Years**	**Total**
$10^1/_2$% notes(1)	$ 12.6	$ 25.2	$ 145.2	$	$ 183.0
Operating leases	28.9	33.8	9.0	4.3	76.0
Purchase obligations (based on contract expiration)	2.6	0.4			3.0
Other long-term liabilities				14.2	14.2
Total obligations	$ 44.1	$ 59.4	$ 154.2	$ 18.5	$ 276.2

(1) Includes interest due on our $10^1/_2$% notes.

The following shows our other contingent obligations at December 31, 2006 based on the expiration date of the commitment:

	Payment Due by Period				
Contractual Obligations	**Less Than 1 Year**	**1-3 Years**	**4-5 Years**	**After 5 Years**	**Total**
	(in millions)				
Standby letters of credit	$ 7.4	$ 0.4	$	$ 0.5	$ 8.3

Critical Accounting Policies and Estimates

We believe the following critical accounting policies reflect management's more significant judgments and estimates used in the preparation of our consolidated financial statements.

We have substantial investments in long-lived assets. In accordance with SFAS 144, whenever events or changes in circumstances indicate that the carrying amount of any asset may not be recoverable, we assess long-lived assets to be held and used for impairment. We recognize an impairment loss if the estimated undiscounted future cash flows expected to result from the use of the asset and its eventual disposition are less than the carrying amount of the asset. Changes in our estimates of undiscounted future cash could have an impact on our assessment as to whether an asset is impaired under SFAS 144. In addition, impairment losses are measured as the amount by which the carrying amount of the asset exceeds the fair value of the asset. For those assets that are considered impaired, the charge taken to write down the asset is determined by our estimate of the assets' fair value.

We have a substantial investment in property and equipment and deferred line installation costs. Our property and equipment consists of buildings, communications networks, furniture, fixtures and equipment, and networks in progress. Networks in progress includes construction costs, internal labor, overhead, and interest capitalized during the construction and installation of fiber optic networks as well as new and reusable parts to maintain those fiber optic networks. These costs are considered in progress until the networks become operational at which time the costs are reclassified as communications network assets. Our communications networks are subject to technological risks and rapid market changes due to new products and services and changing customer demand. These changes may result in changes in the estimated useful lives of these assets. Deferred line installation costs represent success-based costs that are driven by new sales and include equipment, internal labor for installation and provisioning of equipment and service and non-recurring costs paid to the RBOCs for provisioning unbundled loops or T-1s.

In connection with our substantial investment in property and equipment, we are required to record a liability for asset retirement obligations in accordance with SFAS 143, Accounting for Asset Retirement Obligations, which we refer to as SFAS 143. SFAS 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which the legal or contractual removal obligation is incurred. SFAS 143 requires significant estimates regarding the timing and amounts to be paid for asset retirement obligations. For each asset class, we have estimated a range of possible retirement dates and have assigned probabilities to each of these dates based on the expected life of each class. We have estimated the possible range of retirement dates to be between 15 and 25 years. We have additionally assigned probabilities to the likelihood of removal of buried fiber optic network assets. A 20% unfavorable change in the estimates of either the expected date of retirement or the probability of removal would result in an increase in the asset retirement obligations of approximately $3 million as of March 31, 2007.

We derive our revenue primarily from commercial-grade telecommunications services, including dedicated transport, local, switched, long distance, data and high-speed internet access services. Our customers are principally small- and medium-sized enterprises, wholesale and residential customers in our 20-state network footprint. Revenue for dedicated transport, data, internet, and the majority of switched services exclusive of switched access is generally billed in advance on a fixed rate basis and recognized over the period the services are provided. Revenue for the majority of switched access and long distance is generally billed on a transactional basis determined by customer usage with some fixed rate elements. The transactional elements of switched services are billed in arrears and estimates are used to recognize revenue in the period earned. The fixed rate elements are billed in advance and recognized over the period the services are provided. Revenue derived from customer installation fees are deferred and recognized over the expected customer service period.

The revenue from indefeasible rights to use fiber optic telecommunications network facilities is recognized over the term of the related lease unless it qualifies as a sales type lease, on which revenue is recognized at the time the sale criteria in SFAS 66, Accounting for Sales of Real Estate, are met. Base annual revenue for telecommunications network maintenance is recognized on a straight-line basis over the term of the contract. Additional services provided under these contracts are recognized as the services are performed.

In evaluating the collectibility of our trade receivables, we assess a number of factors including a specific customer's ability to meet its financial obligations to us, as well as general factors, such as the length of time the receivables are past due, historical collection experience and the general economic environment. Based on these assessments, we have recorded both specific and general reserves for bad debt to reduce the related receivables to the amount we ultimately expect to collect from customers. If circumstances related to specific customers change or economic conditions worsen such that our past collection experience is no longer relevant, our estimate of the recoverability of our trade receivables could be further reduced from the levels provided for in our consolidated financial statements.

We grant options to purchase our common stock to employees and directors under our 2006 plan. We have also granted restricted stock to our chief executive officer. The benefits provided under this plan are share-based payments subject to the provisions of Statement of Financial Accounting Standards No. 123(R), Accounting for Stock Issued to Employees, which we refer to as SFAS 123(R). Effective January 1, 2006, we used the fair value method to apply the provision of SFAS 123(R) with a modified prospective application which provides for certain changes to the method for valuing share-based compensation. Under the modified prospective approach, the valuation provisions of SFAS 123(R) apply to new awards and to awards that are outstanding on the effective date and subsequently modified or cancelled. Under the modified prospective application, prior periods are not revised for comparative purposes.

Upon adoption of SFAS 123(R), we began recording, as expense, the fair value of share-based payment awards on the date of grant. The determination of the fair value of share-based payment awards on the date of grant is affected by our stock price as well as assumptions regarding a number of complex and subjective variables. These variables include, but are not limited to, our expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behaviors, risk-free interest rate and expected dividends.

We have generally granted stock options at exercise prices at least equal to the fair value of our common stock on the date of grant. Our compensation committee has responsibility for setting the exercise price for our stock option grants. Given the lack of a public market for our common stock, our compensation committee granted stock options with exercise prices equal to its determination of the fair value of our common stock on the date of grant. Determining the fair value of our common stock requires making complex and subjective judgments. At the date of each grant, our compensation committee reviewed and considered the following primary factors:

- significant business milestones that may have affected the value of our business;

- the continued risks associated with our business;

our level of outstanding indebtedness and working capital;

current liquidity and capital needs;

economic and market factors; and

contemporaneous valuation analyses utilizing the guidance set forth in the AICPA Practice Aid Valuation of Privately-Held-Company Equity Securities Issued as Compensation.

A weighted average of three generally accepted valuation procedures, including the income approach, the market approach publicly-traded guideline company method and the market approach transaction method, was used to determine the fair value of our common stock. The income approach is a method used to value business interests that involves estimating the future cash flows of the business, discounted to their present value. The publicly-traded guideline company method estimates fair value using earnings or book value multiples derived from the stock price of publicly-traded companies engaged in a similar line of business. The market approach transaction method estimates fair value using transactions involving the actual sale or purchase of similar companies. Thirty-two transactions involving telecommunications companies were analyzed.

The results of the various valuation methods and other factors were then correlated to calculate the enterprise value attributable to common stockholders and the fair value of each share. We believe that several factors account for the difference in the fair value of our common stock used in establishing the initial public offering price as compared to the fair value used in connection with the issuance of the options and grants of restricted stock during the past 12 months, including the following:

the fair value of our common stock has increased as a result of market considerations, as represented in the increased market values of public companies engaged in the competitive telecom sector;

the changes that will result in our capital structure as a result of this offering, including the anticipated reduction in outstanding debt resulting from the redemption of $26 million in principal amount of our $10^1/_2$% notes, in addition to $16 million in principal amount that was redeemed on May 8, 2007 with the proceeds from the ATS sale;

we believe the value of our common stock will increase as a result of our listing on a public securities exchange, thereby eliminating the discount for lack of marketability due to the illiquid nature of private company equity securities; and

the expected integration of the operations of Mpower-Chicago into our business and the synergies associated therewith.

If factors change and we employ different assumptions in the application of SFAS 123(R) in future periods, the compensation expense that we record under SFAS 123(R) may differ significantly from what we have recorded in the current period. In addition, there is a risk that our estimates of the fair values of our share-based compensation awards on the grant dates may bear little resemblance to the actual values realized upon the exercise, expiration, early termination or forfeiture of those share-based payments in the future. Certain share-based payments, such as employee stock options, may expire worthless or otherwise result in zero intrinsic value as compared to the fair values originally estimated on the grant date and reported in our financial statements. Alternatively, value may be realized from these instruments that are significantly in excess of the fair values originally estimated on the grant date and reported in our financial statements.

We recognize deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Net deferred tax assets are reduced by a valuation allowance when appropriate. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

The telecommunications industry is subject to significant government regulation that materially affects our ability to offer services. Some of the laws underpinning these regulations and the regulations themselves are subject to ongoing efforts to have such regulations rewritten or modified. There also continues to be legal challenges to the existing laws and regulations because the laws are complex and, therefore, subject to varying interpretations and inconsistent applications between jurisdictions. Accordingly, regulatory uncertainty commonly gives rise to disputes with other carriers and municipalities regarding the payments owed or due for the leasing of network elements or finished services, classification of traffic, rights-of-way, rates and minutes of use.

We estimate and reserve for the risk associated with regulatory and other carrier contingencies. These estimates are based on assumptions and other considerations including historical experience, expectations regarding changes in public policies, expectations regarding regulatory rulings, studies of traffic patterns and ongoing negotiations with other carriers. We evaluate these reserves on an ongoing basis and makes adjustments as necessary.

Effects of New Accounting Standards

The Financial Accounting Standards Board, or FASB, has issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, or FIN 48. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in our financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. FIN 48 provides guidance for recognizing and measuring tax positions taken or expected to be taken in a tax return that directly or indirectly affect amounts reported in the financial statement. FIN 48 also provides accounting guidance for related income tax effects of tax positions that do not meet the recognition threshold specified in this interpretation. FIN 48 is effective for fiscal years beginning after December 15, 2006. Our adoption of FIN 48 in the first quarter of 2007 did not have a material impact on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, or SFAS 157, which is intended to provide guidance for using fair value to measure assets and liabilities. In general, this pronouncement is intended to establish a framework for determining fair value and to expand the disclosures regarding the determination of fair value. The provisions of SFAS 157 are effective for fiscal years beginning after November 15, 2007.

During 2006, the FASB Emerging Issues Task Force, or EITF, issued EITF No. 06-3, How Taxes Collected from Customers and Remitted to Government Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation). This consensus concludes that the presentation on either a gross or net basis of any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer is an accounting policy decision that should be disclosed. For any such taxes that are reported on a gross basis, a company should disclose the amount of those taxes in interim and annual financial statements for each period for which an income statement is presented if those amounts are significant. The consensus should be applied to financial reports for interim and annual periods beginning after December 15, 2006. Our adoption of EITF No. 06-3 in the first quarter of 2007 did not have a material effect on our consolidated financial statements.

In December 2006, the FASB issued FASB Staff Position on EITF No. 00-19, Accounting for Registration Payment Arrangements. This FASB Staff Position, or FSP, addresses an issuer's accounting for registration payment arrangements, specifying that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement, whether issued as a separate agreement or included as a provision of a financial instrument or other agreement, should be separately recognized and measured in accordance with FASB Statement No. 5, Accounting for Contingencies. This FSP further clarifies that a financial instrument subject to a registration payment arrangement should be accounted for in accordance with other applicable generally accepted accounting principles without regard to the contingent obligation to transfer consideration pursuant to the registration payment arrangement. This FSP is effective for new and modified registration payment arrangements. Registration payment arrangements that were entered into before the FSP was issued would become subject to its guidance for fiscal years beginning after December 15, 2006 by recognizing a cumulative-effect adjustment in retained earnings as of the year of adoption. Our adoption of this FSP during the first quarter of 2007 did not have a material effect on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115, ("SFAS 159"), which permits entities to choose to measure many financial instruments and certain other items at fair value. The objective of SFAS 159 is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We will be required to adopt SFAS 159 on January 1, 2008. We have not completed our evaluation of the effect of SFAS 159.

Quantitative and Qualitative Disclosures about Market Risk

We do not have indebtedness subject to variable interest rates.

BUSINESS

Company Overview

We provide managed IP-based communications services to small- and medium-sized enterprises, and traditional circuit-switched telephony services to commercial and residential customers. As part of our competitive communications solutions, we provide a wide variety of broadband IP-based voice and data solutions, including local and long distance voice, dedicated broadband internet access, email, virtual private networking, managed network security, conference calling, high capacity private line services and other integrated voice and data services. We deliver integrated IP-based communications solutions to customers over a single high-speed broadband connection on our private managed secure network. We believe our IP-based communications technology provides a level of service and network and call reliability comparable to that of traditional phone networks, with significantly lower capital expenditures and operating costs. We also provide wholesale communications services to other communications services providers through our extensive network facilities, in which we have invested over $2.5 billion since our inception.

Our Target Market and Value Proposition. Since January 2006, we have primarily targeted small- and medium-sized enterprise and multi-location customers within our geographic footprint with an average monthly telecommunications spend of $500 to $5,000 per location. According to IDC, a leading provider of global information technology research and advice, approximately eight million small- and medium-sized enterprises, defined as businesses with less than 500 employees, will spend an aggregate of approximately $76.8 billion in 2007 for communications services in the United States. To address our target customers, we have shifted most of our sales resources from telemarketing to field and agent sales and have focused on geographic areas with potential enterprise customers who will use our services in multiple locations within our extensive network footprint. As part of our strategy, we manage all aspects of our service offerings for our customers, including installation, provisioning, monitoring, proactive fault management and billing.

We have also made significant technological improvements to our network, which allows us to deliver a wide range of cost-effective, enhanced communications solutions, including bundled integrated voice and data services, as well as more sophisticated managed services, which can be layered onto these integrated bundled offerings.

We seek to increase the number of services our customers purchase from us, which we believe improves our customer retention as customers increasingly rely on us for a greater portion of their communications needs. In addition, these customers typically enter into multi-year contracts, which we believe allows us to increase customer retention and provides revenue growth opportunities. For example, nearly all of our Dynamic Integrated Access services are provided under contracts with two- or three-year terms. For our traditional telephony customers, we continue to offer services and pricing that are competitive with those offered by RBOCs.

Our Extensive IP and Fiber Optic Network. We deliver our services primarily over our private managed secure network using T-1 and higher connectivity. In addition, we have one of the largest facilities-based networks maintained by a competitive carrier in the United States, which allows us to offer integrated communications services across 20 states in the Midwest, Rocky Mountain, Southwest and Northwest regions, representing 40% of the U.S. population. We serve 67 MSAs with our network facilities, including 19 of the top 50 MSAs. Our network includes approximately 650 collocations, enabling us to access unbundled loops and T-1s from the RBOCs to connect to customer locations in local serving areas. In addition, we can serve approximately 350 additional outlying areas of our markets where we do not have collocations by using enhanced extended loops or special access T-1 lines to connect more remote customer locations to our network. This allows us to extend our network to offer metro-wide solutions to multi-location customers. We operate and maintain an intercity multiprotocol label switching internet backbone with a nationally distributed IP voice switching architecture to provide a broad set of managed voice and data services cost-effectively. We also operate a circuit-switched based telephony network to provide voice services to our commercial, wholesale and residential customers. As of March 31, 2007, our broadband network and facilities spanned approximately 13,000 intercity and 4,000 metropolitan local route miles and encompassed approximately one million intercity backbone fiber miles and 500,000 fiber miles of metropolitan local fiber optic cable. We believe owning our own facilities-based network allows us to ensure our network's service quality and reliability, have greater control over customer care and reduce our exposure to regulatory uncertainty associated with leasing network connectivity and facilities from the RBOCs.

As of March 31, 2007, we had approximately 1,550 employees serving approximately 91,000 residential traditional telephone service lines, 264,900 business traditional telephone service lines and 14,900 T-1 circuits in service.

Company Strategy

In January 2006, we emerged from Chapter 11 with a new chief executive officer, board of directors and equity ownership, and we shifted our business strategy to focus on providing higher value and lower churn T-1-based solutions of integrated voice, broadband internet access and other data services to voice- and data-intensive business customers. In order to implement this strategy, we reorganized our sales staff to become more customer solutions oriented, which has allowed us to sell effectively to the underserved small- and medium-sized enterprise segment, as well as to strategic multi-location customers. Key elements of our strategy include:

Focusing on Small- and Medium-Sized Enterprise Customers. We focus our sales efforts on small- and medium-sized enterprise and multi-location customers with average monthly telecommunications bills of $500 to $5,000 per location. We believe these customers seek services that generate greater revenue than those sought by residential and very small business customers, which were our historic focus. We have revised our sales commission plans and revamped our field sales organization to incent and mandate the targeting and capture of small- and medium-sized enterprise customers. We believe that this strategy will further increase the quality of our revenue streams.

We plan to continue to aggressively sell into our existing markets and target enterprise customers with our IP-based solutions that we believe result in increased revenue to us. These services include integrated managed network services, dedicated broadband internet access, T-1-based services such as digital voice calling with primary rate interfaces, as well as traditional voice and data services and VoIP telephony solutions, among others. Our T-1-based services offer significant value to our customers, are supported with strong customer service and are typically purchased under contracts with two- or three-year terms. The higher revenue associated with these T-1-based services results in shorter payback periods than traditional lines. For example, our T-1 based services over the past year have generated average monthly billings of $600 per circuit compared to our traditional lines, which have generated average monthly billings of $40 per line.

Leveraging Our Managed Network Services and Operational Infrastructure. We have introduced a number of IP-based bundled solutions for our customers which leverages our extensive infrastructure. We seek to expand our small- and medium-sized enterprise customer base within our existing network infrastructure and to sell additional services to our existing customers. As of March 31, 2007, our average network utilization was approximately 50%, as measured by unused capacity in our switches and network backbone. We believe we can increase the total number of customers we serve with minimal incremental investments, thereby improving capacity utilization and resulting in increased cash flow and profitability.

Continuing to Improve the Efficiency of our Network and Reduce Network Expenses. We believe that our disciplined approach to sales, installation, and service, together with our automated business processes, will allow us to further streamline our operations and maintain low operating costs. In March 2006, we established a cross-functional task force to evaluate and rationalize our network, and particularly the 690 collocations that we operated at that time, to improve market penetration, reduce network expenses and improve operating margins, while maintaining our ability to serve the significant majority of our addressable market with our network facilities. The primary initiatives undertaken include reducing monthly recurring costs for electric power and cross-connects for our collocations, decommissioning collocations in areas with limited potential to capture target business customers and eliminating excess leased network capacity. In the approximately 40 local serving areas where we are decommissioning collocations, we expect to continue to serve our T-1 customers using virtual collocations, enhanced extended