ORIGINAL

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September 3, 1999

VIA OVERNIGHT DELIVERY

Florida Public Service Commission
Division of Communications
Certification & Compliance Section
2540 Shumard Oak Blvd.
Gunter Bldg.
Tallahassee, Florida 32399-0850

991388-TX

Re: Convergent Communications Services, Inc.

Dear Sir/Madam:

Enclosed please find one original and six (6) copies of Convergent communications Services, Inc.'s Application for Authority to Provide Alternate Local Exchange Service Within the State of Florida. Applicant was granted a Certificate to Provide Interexchange Services in Docket No. 980985-TI on October 26, 1998.

Convergent Communications Services, Inc. has sufficient financial capability to provide the requested service in the State of Florida and has sufficient financial capability to maintain the requested service and to meet its lease or ownership obligations. In support of Convergent Communications Services, Inc.'s stated financial capability, copies of Convergent Communications, Inc.'s audited financial statements for the years ended December 31, 1997, 1997 & 1998 respectively are included in the Form 10K attached to its application, along with a 10Q for the period ended March 31, 1999. As a switchless reseller, Convergent Communications Services, Inc. does not intend to make a capital investment to provide service in the State of Florida, however, Convergent Communications Services, Inc. intends to fund the provision of service through internally generated cash flow or its parent company. Convergent Communications Services, Inc. also has the ability to borrow funds, if required, based upon its financial capabilities. Furthermore, in July of 1999, the Convergent Communications, Inc. completed its initial public stock offering and raised over $100,000,000.

Check received with filing and forwarded to Fiscal for deposit. Fiscal to forward a copy of check to RAR with proof of deposit.

Initials of person who forwarded check:

RECEIVED & FILED

FPSC-BUREAU OF RECORDS

DOCUMENT NUMBER-DATE
11039 SEP 14 99

FPSC-RECORDS/REPORTING

I also have enclosed a check in the amount of $250.00 payable to the Florida Public Service Commission to cover the cost of filing these documents.

Please return a stamped copy of the extra copy of this letter in the enclosed preaddressed prepaid envelope.

If you have any questions regarding the application, please do not hesitate to call me. Thank you for your attention to this matter.

Sincerely,

Lance J.M. Steinhart, Esq.
Attorney for Convergent Communications Services, Inc.

Enclosures
cc: Mr. Martin Freidel (w/enc)

FLORIDA PUBLIC SERVICE COMMISSION
CAPITAL CIRCLE OFFICE CENTER - 2540 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA 32399-0850

APPLICATION FORM
for
AUTHORITY TO PROVIDE ALTERNATIVE LOCAL EXCHANGE SERVICE WITHIN THE STATE OF FLORIDA

INSTRUCTIONS

1. This form is used for an original application for a certificate and for approval of sale, assignment or transfer of an existing alternative local exchange certificate. In case of a sale, assignment or transfer, the information provided shall be for the purchaser, assignee or transferee.

2. Respond to each item requested in the application and appendices. If an item is not applicable, please explain why.

3. Use a separate sheet for each answer which will not fit the allotted space.

4. If you have questions about completing the form, contact:

   Florida Public Service Commission
   Division of Communications
   Certification & Compliance Section
   2540 Shumard Oak Blvd.
   Tallahassee, Florida 32399-0866
   (904) 413-6600

5. Once completed, submit the original and six (6) copies of this form along with a non-refundable application fee of $250 made payable to the Florida Public Service Commission at the above address.

FORM PSC/CMU (11/95)
Required by Chapter 364.337 F.S.

1. This is an application for (check one):

(X) **Original authority** (new company)

( ) **Approval of transfer** (to another certificated company)
Example, a certificated company purchases an existing company and desires to retain the original certificate of authority.

( ) **Approval of assignment of existing certificate** (to a non-certificated company)
Example, a non-certificated company purchases an existing company and desires to retain the certificate of authority rather than apply for a new certificate.

( ) **Approval for transfer of control** (to another certificated company)
Example, a company purchases 51% of a certificated company. The Commission must approve the new controlling entity.

2. Name of applicant:

Convergent Communications Services, Inc.

3. Name under which the applicant will do business (d/b/a):

d/b/a Not Applicable

4. If applicable, please provide proof of fictitious name (d/b/a) registration. **N/A**

Fictitious name registration number: Not Applicable

5. A. National mailing address including street name, number, post office box, city, state, zip code and phone number.

400 Inverness Drive South, Suite 400
Englewood, Colorado 80112
303-749-3000

B. Florida mailing address including street name, number, post office box, city, state, zip code and phone number.

None

6. Structure of organization:

( ) Individual	(**X**) Corporation
(**X**) Foreign Corporation	( ) Foreign Partnership
( ) General Partnership	( ) Limited Partnership
( ) Joint Venture	( ) Other, Please explain ______________

7. If applicant is an individual, partnership, or joint venture, please give name, title and address of each legal entity.

N/A

8. State whether any of the officers, directors, or any of the ten largest stockholders have previously been adjudged bankrupt, mentally incompetent, or found guilty of any felony or of any crime, or whether such actions may result from pending proceedings. If so, please explain.

No.

9. If incorporated, please provide proof from the Florida Secretary of State that the applicant has authority to operate in Florida.

Corporate charter number: P98000001039

10. Please provide the name, title, address, telephone number, internet address, and facsimile number for the person serving as ongoing liaison with the Commission, and if different, the liaison responsible for this application.

Karen Bedell -
Ongoing Liaison
Sr. Director, External Affairs
Convergent Communications Services, Inc.
400 Inverness Drive South, Suite 400
Englewood, Colorado 80112
303-749-3000/Phone
303-749-3113/Fax
kbedell@converg.com

Lance J.M. Steinhart -
Application
Regulatory Counsel
6455 E. Johns Crossing, Suite 285
Duluth, GA 30097
770-232-9200/Phone
770-232-9208/Fax
steinhart@mindspring.com

11. Please list other states in which the applicant is currently providing or has applied to provide local exchange or alternative local exchange service.

The company is currently providing local service colorado, Iowa and California. The company intends to apply to provide local exchange service in the 48 contiguous states. The company is currently authorized to provide resold local exchange service in California, Colorado, Iowa, Montana, New York, Oregon, Utah and Wisconsin.

12. Has the applicant been denied certification in any other state? If so, please list the state and reason for denial.

No.

13. Have penalties been imposed against the applicant in any other state? If so, please list the state and reason for penalty.

No.

14. Please indicate how a customer can file a service complaint with your company.

Customer service will be available at the same times as the incumbent local exchange carriers which will provide the underlying facilities for applicant's proposed service.

15. Please complete and file a price list in accordance with Commission Rule 25-24.825.

Applicant will provide prior to the commencement of the provision of basic service.

16. Please provide all available documentation demonstrating that the applicant has the following capabilities to provide alternative local exchange service in Florida.

A. Financial capability.

Regarding the showing of financial capability, the following applies:

The application should contain the applicant's financial statements for the most recent 3 years, including:

1. the balance sheet

2. income statement

3. statement of retained earnings.

Further, a written explanation, which can include supporting documentation, regarding the following should be provided to show financial capability.

1. Please provide documentation that the applicant has sufficient financial capability to provide the requested service in the geographic area proposed to be served.

2. Please provide documentation that the applicant has sufficient financial capability to maintain the requested service.

3. Please provide documentation that the applicant has sufficient financial capability to meet its lease or ownership obligations.

NOTE: This documentation may include, but is not limited to, financial statements, a projected profit and loss statement, credit references, credit bureau reports, and descriptions of business relationships with financial institutions.

If available, the financial statements should be audited financial statements.

If the applicant does not have audited financial statements, it shall be so stated. The unaudited financial statements should then be signed by the applicant's chief executive officer and chief financial officer. The signatures should attest that the financial statements are true and correct.

See Attached

B. Managerial capability.

See Attached.

C. Technical capability.

(If you will be providing local intra-exchange switched telecommunications service, then state how you will provide access to 911 emergency service. If the nature of the emergency 911 service access and funding mechanism is not equivalent to that provided by the local exchange companies in the areas to be served, describe in detail the difference.)

Since applicant intends to provide only resold local exchange service utilizing the facilities of incumbent local exchange carriers, access to 911 emergency service will be provided by the LECs.

AFFIDAVIT

By my signature below, I, the undersigned officer, attest to the accuracy of the information contained in this application and attached documents and that the applicant has the technical expertise, managerial ability, and financial capability to provide alternative local exchange service in the State of Florida. I have read the foregoing and declare that to the best of my knowledge and belief, the information is true and correct. I attest that I have the authority to sign on behalf of my company and agree to comply, now and in the future, with all applicable Commission rules and orders.

Further, I am aware that pursuant to Chapter 837.06, Florida Statutes, "Whoever knowingly makes a false statement in writing with the intent to mislead a public servant in the performance of his official duty shall be guilty of a misdemeanor of the second degree, punishable as provided in s. 775.082 and s. 775.083".

Official: Martin Freidel 8/31/99
Date

Title: Exec. VP & General Counsel 303-749-3000
Telephone Number

Address: 400 Inverness Drive South, Suite 400

Englewood, CO 80112

FORM PSC/CMU (11/95)
Required by Chapter 364.337 F.S.

LIST OF ATTACHMENTS

FINANCIAL INFORMATION

MANAGEMENT INFORMATION

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 1999

OR

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

For the transition period from to

Commission file number 333-53953

CONVERGENT COMMUNICATIONS, INC.
(Exact name of registrant as specified in its charter)

Colorado	**84-1337265**
(State or other jurisdiction of incorporation)	(I.R.S. Employer Identification No.)

400 Inverness Drive South, Suite 400
Englewood, Colorado 80112
(303) 749-3000
(Address and telephone number of principal executive offices)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

(1) Yes X No ___

(2) Yes X No ___

On April 30 1999, 28,334,662 shares of the registrant's Common Stock were outstanding.

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PART I: FINANCIAL INFORMATION

PART II: OTHER INFORMATION

When used in this Report, the words "intend," "expects," "plans," "estimates," "anticipates," "projects," "believes," and similar expressions are intended to identify forward-looking statements. Specifically, statements included in this Report that are not historical facts, including statements about our beliefs and expectations about our business and our industry are forward-looking statements. These statements are subject to risks and uncertainties that could cause actual results or outcomes to differ materially. These risks and uncertainties include, but are not limited to, the degree to which we are leveraged and the restrictions imposed on us under our existing debt instruments that may adversely affect our ability to finance our future operations, to compete effectively against better capitalized competitors, to withstand downturns in our business or the economy generally and other factors discussed in our filings with the Securities and Exchange Commission. Forward—looking statements included in this Report speak only as of the date of this report and we will not revise or update these statements to reflect events or circumstances after the date of this report or to reflect the occurrence of unanticipated events.

CONVERGENT COMMUNICATIONS, INC.

CONSOLIDATED BALANCE SHEETS

	December 31, 1998	March 31, 1999 (unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 25,597,461	$ 10,392,752
Short-term investments	—	15,884,601
Restricted cash	20,800,000	20,800,000
Trade accounts receivable, net of allowance for doubtful accounts of $1,908,811 and $2,932,559, respectively	17,661,220	20,750,560
Inventory	6,826,732	9,026,881
Prepaid expenses, deposits and other current assets	2,134,210	2,995,457
Total current assets	73,019,623	79,850,251
Property, network and equipment	28,139,460	31,882,773
Less accumulated depreciation	(4,882,832)	(6,353,628)
Total property, network and equipment	23,256,628	25,529,145
Restricted cash, non-current	30,549,658	32,024,750
Goodwill, net of amortization of $2,967,283 and $4,174,400, respectively	46,526,288	49,035,071
Other intangible assets, net of amortization of $1,470,363 and $1,880,211, respectively	10,281,016	10,365,858
Investments and other assets	1,225,626	1,231,792
Leases receivable, less current portion	796,790	1,288,573
Total assets	$185,655,629	$199,325,440
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Trade accounts payable	$ 15,061,514	$ 15,795,372
Accrued compensation	4,583,140	6,564,699
Accrued interest	5,214,133	10,414,133
Other accrued liabilities	8,666,182	7,728,239
Deferred revenue and customer deposits	5,211,748	5,824,101
Current portion of long-term debt	603,919	5,358,614
Current portion of capital lease obligations	5,179,251	5,798,921
Total current liabilities	44,519,887	57,484,079
Long term debt, less discount and current portion	153,730,573	154,594,138
Long term capital lease obligations, less current portion	8,754,054	9,185,791
Total liabilities	207,004,514	221,264,008
Commitments		
Convertible preferred stock	—	19,300,000
Shareholders' equity (deficit):		
Common stock, no par value, 100 million shares authorized, 27,848,270 and 27,920,704 issued and outstanding, respectively	27,486,554	27,806,290
Warrants	11,719,399	12,171,879
Treasury stock	(501,674)	(501,674)
Deferred compensation obligation	501,674	501,674
Accumulated other comprehensive income	—	11,700
Unearned compensation	(150,150)	(136,500)
Accumulated deficit	(60,404,688)	(81,091,937)
Total shareholders' equity (deficit)	(21,348,885)	(41,238,568)
Total liabilities and shareholders' equity (deficit)	$185,655,629	$199,325,440

The accompanying notes are an integral part of these consolidated financial statements

CONVERGENT COMMUNICATIONS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

	Three months ended March 31,	
	1998	1999
	(unaudited)	
Data and voice service revenue	$ 1,807,073	$ 15,310,576
Data and voice product revenue	4,715,792	15,170,290
Total revenue	6,522,865	30,480,866
Cost of sales excluding depreciation	4,798,024	20,073,569
Selling, general and administrative	6,061,845	23,337,581
Depreciation and amortization	762,439	2,862,892
Total operating expenses	11,622,308	46,274,042
Operating loss	(5,099,443)	(15,793,176)
Interest expense	(52,568)	(5,936,665)
Interest income	31,478	950,646
Other income, net	9,867	91,946
Net loss	(5,110,666)	(20,687,249)
Other comprehensive income, Unrealized holding gains on securities	57,690	11,700
Comprehensive loss	$(5,052,976)	$(20,675,549)
Net loss per share:		
Net loss per share (basic and diluted)	$ (0.19)	$ (0.74)
Weighted average number of shares outstanding (basic and diluted)	26,958,467	27,885,235

The accompanying notes are an integral part of these consolidated financial statements

CONVERGENT COMMUNICATIONS, INC.

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY (DEFICIT)
(unaudited)

	Common Shares	Common Stock	Warrants	Treasury Stock	Deferred Compensation Obligation	Unearned Compensation	Accumulated Other Comprehensive Income	Accumulated Deficit	Total
Balance, December 31, 1998	27,848,270	$27,486,554	$11,719,399	$(501,674)	$501,674	$(150,150)	$ —	$(60,404,688)	$(21,348,885)
Common stock issued for:									
401(k) match	42,434	169,736	—	—	—	—	—	—	169,736
Business combinations	30,000	150,000	—	—	—	—	—	—	150,000
Compensation expense	—	—	—	—	—	13,650	—	—	13,650
Warrants issued in connection with financing	—	—	452,480	—	—	—	—	—	452,480
Other comprehensive income:									
Unrealized gain on securities	—	—	—	—	—	—	11,700	—	11,700
Net loss	—	—	—	—	—	—	—	(20,687,249)	(20,687,249)
Balance, March 31, 1999	27,920,704	$27,806,290	$12,171,879	$(501,674)	$501,674	$(136,500)	$11,700	(81,091,937)	(41,238,568)

The accompanying notes are an integral part of these consolidated financial statements

CONVERGENT COMMUNICATIONS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the three months ended March 31, 1998	For the three months ended March 31, 1999
	(unaudited)	
Cash flows from operating activities		
Net loss	$(5,110,666)	$(20,687,249)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	762,439	2,862,892
Amortization of deferred financing costs and accretion of debt discount	—	400,927
Provision for uncollectible accounts	—	902,468
Stock compensation expense	27,300	13,650
401(k) contributions through the issuance of common stock	—	169,736
Change in working capital (net of acquisitions):		
Trade accounts receivable	(2,333,283)	(2,275,973)
Inventory	21,106	439,135
Prepaid expenses and other current assets	(299,099)	(565,651)
Trade accounts payable	1,906,273	(421,975)
Accrued compensation	799,600	1,630,229
Accrued interest	—	5,200,000
Deferred revenue and customer deposits	33,956	(205,321)
Other accrued liabilities	1,752,207	(979,918)
Net cash used in operating activities	(2,440,167)	(13,517,050)
Cash flows from investing activities		
Additions of property and equipment	(1,711,759)	(1,074,597)
Acquisitions, net of cash acquired	(424,302)	(1,500,000)
Short-term investments	4,926,509	(15,872,901)
Restricted cash	(3,482)	(1,475,092)
Leases receivable	—	(700,262)
Other assets	(217,245)	(22,865)
Net cash provided by (used in) investing activities	2,569,721	(20,645,717)
Cash flows from financing activities		
Proceeds from private placement, net of offering costs	—	19,300,000
Proceeds from new borrowings	—	985,843
Payments on notes payable	(166,805)	(29,743)
Payments on capital leases	(231,776)	(1,298,042)
Proceeds from exercise of stock options	14,500	—
Net cash provided by (used in) financing activities	(384,081)	18,958,058
Net decrease in cash and cash equivalents	(254,527)	(15,204,709)
Cash and cash equivalents at beginning of period	667,344	25,597,461
Cash and cash equivalents at end of period	$ 412,817	$ 10,392,752
Supplemental disclosure of other cash and non-cash investing and financing activities:		
Acquisition of property and equipment through the issuance of capital leases	$ 537,500	$ 2,281,484
Cash paid for interest	97,958	335,738

The accompanying notes are an integral part of these consolidated financial statements

CONVERGENT COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND BASIS OF PRESENTATION:

References in these footnotes to ''Convergent Communications,'' ''us,'' ''we,'' ''our'' refer to Convergent Communications, Inc. and its subsidiaries.

Convergent Communications is a single-source provider of data and voice communications systems, services and solutions to small and medium sized businesses. We design, build, install, manage and monitor data and voice networks inside enterprises and provide external network services such as data transport, long distance, local service and Internet access. We offer these products and services on a stand-alone basis or as part of a bundled offering that can include owning an enterprise's internal data and voice networks. We are also installing a next generation, converged data and voice switching platform in each of the markets in which we operate to efficiently handle our customers' traffic. We provide the following products and services:

- Data Services
- Voice Services
- Enterprise Network Services
- Data Products
- Voice Products

Our ultimate success depends upon, among other factors, establishing our nationwide network, funding the development of our enterprise networks, continuing to develop our customer care and sales organizations, integrating acquired businesses, attracting and retaining customers, continuing to develop and integrate our operational support system and other back office systems, responding to competitive developments, continuing to attract, retain and motivate qualified personnel, and continuing to upgrade our technologies and commercialize our services incorporating these technologies. There is no assurance that we will be successful in addressing these matters and our failure to do so could have a material adverse effect on our business prospects, operating results and financial condition. Our business plan will continue to require a substantial amount of capital to fund our expansion of our existing and acquired markets. As we continue to expand our business, we will seek additional sources of financing to fund our development. If we are unsuccessful in obtaining financing, we would be compelled to alter our business strategy or delay or abandon some of our future plans.

2. INTERIM FINANCIAL DATA:

The consolidated balance sheet as of March 31, 1999, statement of shareholders' equity (deficit) for the three months ended March 31, 1999 and the consolidated statements of operations and comprehensive loss, and cash flows for the three months ended March 31, 1998 and 1999 have been prepared by us without audit. In our opinion, all adjustments, consisting of only normal recurring adjustments, necessary to present fairly the consolidated financial position, results of operations and cash flows have been made. The results of operations for these interim periods are not necessarily indicative of the results for the full year.

The accompanying financial statements should be read with our consolidated financial statements included in our 1998 form 10-K filed with the Securities and Exchange Commission on March 16, 1999.

Certain prior period amounts have been reclassified to conform to the current period's presentation.

3. ACQUISITIONS:

Kansas Communications, Inc. In February 1999, we acquired the assets and assumed certain liabilities of Kansas Communications, Inc. (''KCI''). KCI was a telecommunications equipment provider and integrator. The purchase price consisted of $1.5 million in cash, $4.5 million in notes payable and 30,000 shares of our common stock (additional shares of our common stock may be issued after certain financial adjustments are completed), which, for purchase accounting purposes, were assigned a value of $5.00, and assumed liabilities of $2.4 million resulting in total consideration of $8.7 million. After March 31, 1999, $1.5 million of the notes payable were paid with the proceeds from the sale of our Series A Convertible Preferred Stock. An additional $2.0 million will be due upon the completion of a debt or equity financing in excess of $25.0 million.

We accounted for this acquisition as a business combination using the purchase method of accounting. In connection with the acquisition, the excess of consideration given over the fair market value of the net assets acquired is being amortized on a straight line basis over the estimated life of the intangible asset acquired which is ten years. The accompanying financial statements include the accounts of KCI from the effective date of the acquisition.

The allocation of consideration given during the three months ended March 31, 1999 to the acquired assets is as follows:

Purchase price:	
Cash paid	$ 1,500,000
Notes payable issued to former owner	4,490,000
Common stock issued to the former owners	150,000
Total purchase price	$ 6,140,000
Allocation of the purchase price to acquired assets and assumed liabilities:	
Accounts receivable	$ 1,715,835
Inventory	2,639,284
Prepaid expenses, deposits and other current assets	87,117
Equipment	391,129
Goodwill	3,741,412
Liabilities and debt assumed	(2,434,777)
Amounts allocated	$ 6,140,000

4. SERIES A PREFERRED STOCK:

In March 1999, we sold 800,000 shares of Series A Convertible Preferred Stock and warrants to purchase 1,500,000 shares of our common stock to various affiliates of the Sandler/21st Century Group for total consideration of $20.0 million. Each share of Series A Convertible Preferred Stock will automatically convert into a minimum of 5 and maximum of 7.14 shares of common stock upon a public offering that provides gross proceeds to us in excess of $50.0 million. Each warrant entitles the holder to purchase one share of our common stock at an exercise price of $7.50 per share for a period of five years. The number of shares issuable upon the exercise of the warrants is subject to adjustment based upon our initial public offering price, up to a maximum of 2,000,000 shares. If there is not a public offering providing gross proceeds to us in excess of $50.0 million within five years of the sale of the Series A Convertible Preferred Stock, the holders of the Series A Convertible Preferred Stock have the option to require us to repurchase their shares plus accrued interest. The proceeds from the sale, net of related offering costs were $19.3 million. One of our directors, Michael Marocco, is a principal of several of the entities in the Sandler/21st Century Group. Mr. Roland Casati, another director, also purchased shares of Series A Convertible Preferred Stock.

We have 1,000,000 shares of preferred stock authorized none of which were outstanding as of December 31, 1998 and 800,000 of which were outstanding as of March 31, 1999.

5. BUSINESS SEGMENTS:

We classify our business into five fundamental areas: data services, voice services, Enterprise Network Services, data products and voice products. Senior management evaluates and makes operating decisions about each of these operating segments based on a number of factors. We do not account for assets by business segment and, therefore, depreciation and amortization are not factors used in evaluating operating performance. Two of the more significant factors used in evaluating our operating performance are: *revenue* and *gross margin before depreciation* as presented below:

	Three Months Ended March 31,	
	1998	1999
Revenue:		
Data services	$ 808,015	$ 2,118,940
Voice services	882,667	12,458,199
Enterprise Network Services	116,391	733,437
Data products	4,462,299	7,161,752
Voice products	253,493	8,008,538
Total revenue	6,522,865	30,480,866
Gross margin before depreciation:		
Data services	446,732	987,008
Voice services	383,400	5,250,256
Enterprise Network Services	61,374	591,455
Data products	740,389	794,861
Voice products	92,946	2,783,717
Total gross margin before depreciation	1,724,841	10,407,297
Reconciliation to net loss:		
Selling, general and administrative	(6,061,845)	(23,337,581)
Depreciation and amortization	(762,439)	(2,862,892)
Operating loss	(5,099,443)	(15,793,176)
Interest expense	(52,568)	(5,936,665)
Interest income	31,478	950,646
Other income, net	9,867	91,946
Net loss	$(5,110,666)	$(20,687,249)

6. NET LOSS PER SHARE:

The net loss available to common shareholders and weighted average shares consists of the following:

	Three Months Ended March 31,	
	1998	1999
Net loss	$(5,110,666)	$(20,687,249)
Weighted average common shares used for basic earnings per share	26,958,467	27,885,235
Warrants	—	—
Stock options	—	—
Weighted average number of shares outstanding (basic and diluted)	26,958,467	27,885,235
Anti-dilutive weighted average options and warrants not included	12,935,125	17,732,957

7. SUBSEQUENT EVENTS:

In April 1999, we acquired BSSi Innovations, Inc. (''BSSi''). BSSi was a data network integration services provider based in Chicago, Illinois. The purchase price consisted of $455,000 in cash, 74,000 shares of our common stock, which for purchase accounting purposes were assigned a value of $5.00 per share, and assumed debt of approximately $525,000, resulting in total consideration of $1.3 million. An additional 20,000 shares may be issued if certain financial conditions are met.

In April 1999, we executed a memorandum of understanding with Cisco Systems, Inc. for the purchase of approximately $103.5 million of Cisco equipment, including Cisco's IP + ATM switches to be installed in our multi-service switching platforms (which we call our ePOP).

In addition, in conjunction with our memorandum of understanding with Cisco Systems, Inc., we executed a non-binding proposal letter with Cisco Systems Capital Corporation for the financing of the Cisco equipment to be purchased from Cisco Systems, Inc.

We are in the process of filing a registration statement with the Securities and Exchange Commission in connection with a proposed initial public offering of our common stock.

CONVERGENT COMMUNICATIONS, INC.

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

The following discussion should be read in conjunction with the Consolidated Financial Statements and the accompanying footnotes included in this Form 10-Q. This discussion includes forward-looking statements and is based on current expectations which involve risks and uncertainties. Because of the uncertainty of many factors, what actually occurs in the future may be very different from what we project in our forward-looking statements.

Overview

We are a rapidly growing national provider of single-source data and voice communications systems, services and solutions primarily to businesses with 25 to 500 employees. *Inside* our customers' premises we own communications networks and provide professional services, such as the design, installation, management and monitoring of those networks to our customers. *Outside* our customer' premises, we provide a full range of data and voice transport services. By operating networks, both inside and outside our customers' premises, and by offering a broad range of data and voice products and services, we enable small and medium sized businesses to use state-of-the-art communications solutions, including data and voice networks based on Internet Protocol, electronic commerce, the Internet and sophisticated communications systems. We offer each of our products and services on a stand-alone basis and are now offering a bundled communications solution, which we call Enterprise Network Services, in which we design, install, own, manage and monitor the data and voice networks inside our customers' premises and provide communications services outside our customers' premises.

We were first capitalized on March 1, 1996, Since that time, we have successfully raised $204.5 million in capital, including $450,000 in founder's capital, $24.0 million in two private placements of common stock in 1996 and 1997 (including an additional $450,000 from the founders), $160.0 million through the 1998 sale of our 13% Senior Notes and related warrants and $20.0 million in a 1999 sale of our convertible preferred stock and warrants to affiliates of Sandler Capital/21st Century Group. As a result of that investment in our preferred stock, we also have increased the borrowing capacity under our existing Comdisco equipment lease facility by $20.0 million to a total of $30.0 million.

In the last three years, we completed 14 strategic acquisitions, the most significant of which was the 1998 acquisition of substantially all of the assets of Tie Communications, Inc. at a cost of approximately $51.4 million. With the acquisition of these assets, we accelerated our growth by adding 24 new markets and 452 employees with experience in voice products and services. This acquisition also gave us the opportunity to cross-market our data products and services, including Enterprise Network Services, to the approximately 77,000 customers that purchased products or services from Tie in the past.

We began offering Enterprise Network Services in December 1997 and have now entered into long-term Enterprise Network Service contracts with 21 customers with an aggregate of approximately 1,670 computers and telephones. We expect these contracts will provide us with approximately $2.6 million in annual contract revenue, and over their terms we expect they will produce total revenue of approximately $15.4 million. Although these contracts may be canceled by the customer, exposing us to risks related to remarketing, cancellation requires payment of a fee designed to reimburse us for all or substantially all of our costs incurred in entering into the contract.

Description of Financial Components

We classify our business into five segments: data services, voice services, Enterprise Network Services, data products and voice products.

Revenue and cost of sales. The following chart outlines the components of revenue and the related cost of sales excluding depreciation, by segment.

Revenue	Cost of Sales (excluding depreciation)
Data Services	
Professional Services	
web design and hosting and network planning, design, maintenance, and monitoring	• engineer and technician compensation and benefits
Network Services	
frame relay (ATM and IP switching), Internet access and web hosting	• leased line costs of connecting a customer to a long distance or local network • capacity charges that long distance and local carriers, Internet providers and others impose to use their equipment and network
Voice Services	
Professional Services	
network planning, design, maintenance and monitoring	• engineer and technician compensation and benefits
Network Services	
long distance service, local telephone service and public phone service	• leased line facilities' costs of connecting a customer to a long distance or local network • capacity charges that long distance and local carriers, Internet service providers and others impose to use their equipment and network
Enterprise Network Services	
long-term contracts (typically three to five years) under which we own, manage and are responsible for all or a portion of the network inside our customers' premises	• all the costs associated with all the data and voice products and services described in this table
Data Products	
sale and installation of network equipment	• cost of data network equipment • costs of installation, including technician compensation and benefits.
Voice Products	
sale and installation of network equipment	• cost of voice network equipment • costs of installation, including technician compensation and benefits.

Selling, general and administrative expenses have increased significantly and will continue to increase as we recruit additional management and support personnel necessary for continued growth. The Tie acquisition contributed substantially to this increase. However, we expect these expenses to decline as a percentage of our revenue as we expand our customer base and begin selling additional products and services in each of our markets.

- *Sales and marketing expenses* include commissions paid in connection with our sales programs, marketing salaries and benefits, travel expenses, trade show expenses, consulting fees and promotional costs. Also included are the costs of soliciting potential customers such as telemarketing, brochures, targeted advertising and promotional campaigns. We expect these expenses to increase as we add additional sales and marketing personnel and further implement our business plan.
- *General and administrative expenses* primarily consist of salaries and related expenses of management and support services personnel, occupancy fees, professional fees and general corporate and administrative expenses. We also include costs associated with the development, support and expected enhancements of our operational support software platform, to the extent these costs are not capitalized.

Depreciation and amortization expense includes depreciation of property, network and equipment (over two to five years), including our assets located inside our customers' premises provided under Enterprise Network Services contracts. Amortization expense includes the amortization of intangible assets (over three to ten years), primarily goodwill (over ten years), that result from business acquisitions. We had $49.0 million of goodwill, net of amortization, on March 31, 1999. Depreciation and amortization will increase as we install additional ePOP switching platforms and expand our Enterprise Network Services business and as a result of increased amortization of intangibles expected to result from future acquisitions.

Interest expense includes interest expense on our short-term and long-term debt, including capital leases. The majority of the interest expense is related to our 13% Senior Notes which mature in 2008. Interest expense will increase as we continue to finance a significant portion of our capital expenditures, including our purchase of Cisco Systems Inc.'s multi-service, data and voice switches and additional Cisco equipment under the proposed $103.5 million equipment facility with Cisco Systems Capital Corporation.

Results of Operations

Management evaluates and makes operating decisions about each of our operating segments based on a number of factors. Two of the more significant factors we use in evaluating operating performance are: *revenue* and *gross margin before depreciation.* We do not account for assets by business segment and, therefore, depreciation and amortization are not factors used by management in evaluating operating performance.

The percentages shown in the following table with respect to revenue represent revenue for each business segment as a percentage of total revenue. Percentages with respect to cost of sales excluding depreciation and gross margin before depreciation are of the revenue for the related segment.

	Three Months March 31,			
	1998		1999	
	(dollars in thousands)			
Revenue:				
Data services	$ 808	12%	$ 2,119	7%
Voice services	883	14	12,458	41
Enterprise Network Services	116	2	733	2
Data products	4,462	68	7,162	24
Voice products	254	4	8,009	26
Total revenue	$6,523	100%	$30,481	100%
Cost of sales excluding depreciation:				
Data services	$ 361	45%	$ 1,132	54%
Voice services	499	57	7,208	58
Enterprise Network Services	55	48	142	19
Data products	3,722	84	6,367	89
Voice products	161	46	5,225	65
Total cost of sales excluding depreciation	$4,798	74%	$20,074	66%
Gross margin before depreciation:				
Data services	$ 447	55%	$ 987	46%
Voice services	384	43	5,250	42
Enterprise Network Services	61	52	591	81
Data products	740	16	795	11
Voice products	93	54	2,784	35
Total gross margin before depreciation	$1,725	26%	$10,407	34%

Summary Quarterly Financial Data

The table below presents unaudited quarterly statement of operations data for each of the nine quarters through March 31, 1999. This information has been derived from unaudited financial statements that have been prepared on the same basis as the audited financial statements contained in our 1998 Form 10-K and, in our opinion, includes all adjustments, consisting only of normal recurring adjustments, that we consider necessary for a fair presentation of the information. The operating results for any quarter are not necessarily indicative of results for any future periods.

	1997				1998				1999
	1st	2nd	3rd	4th	1st	2nd	3rd	4th	1st
					(in thousands)				
Operating Statement Data:									
Revenue	$ 598	$ 2,020	$ 3,144	$ 4,448	$ 6,523	$ 7,982	$ 22,316	$ 24,779	$ 30,481
Cost of sales excluding depreciation	378	1,359	2,209	3,423	4,798	5,772	14,717	18,416	20,074
Selling, general and administrative	1,188	1,974	3,052	4,769	6,062	7,710	15,507	18,583	23,337
Depreciation and amortization	223	233	296	701	762	1,191	2,646	2,894	2,863
Operating loss	(1,191)	(1,546)	(2,413)	(4,445)	(5,099)	(6,691)	(10,554)	(15,114)	(15,793)
Net loss	$(1,086)	$(1,586)	$(2,817)	$(4,166)	$(5,111)	$(11,169)	$(15,355)	$(18,941)	$(20,687)
EBITDA (1)	$ (968)	$(1,313)	$(2,117)	$(3,744)	$(4,337)	$ (5,500)	$ (7,908)	$(12,220)	$(12,930)

(1) EBITDA consists of earnings before interest (net), income taxes, depreciation and amortization and other income (expense). EBITDA is a measure commonly used to analyze companies on the basis of operating performance. It is not a measure of financial performance under GAAP and should not be considered as an alternative to net income (loss) as a measure of performance or as an alternative to cash flow as a measure of liquidity. Our measure of EBITDA may not be comparable to similarly titled measures used by other companies.

We have generated greater revenue in each successive quarter since our inception, reflecting increases in the number of customers, mainly due to acquisitions, and in sales to existing customers. Cost of sales excluding depreciation has increased in every quarter, reflecting product and service costs directly associated with revenue. Our selling, general and administrative expenses have increased in every quarter and reflect sales and marketing costs such as sales commissions, and the development and growth of regional and corporate support staff. Depreciation and amortization has increased in each quarter through December 31, 1998. The increases in depreciation are due to the purchase of property, network and equipment both inside and outside our customers' premises associated with our expansion from one to 35 markets since inception, and due to the deployment of our multi-service data and voice switching platform in three markets. The increases in amortization are due to the increase in goodwill and other intangible assets resulting from the completion of 13 acquisitions through March 31, 1999. We have also experienced increasing operating and net losses every quarter. However, net loss has declined as a percentage of revenue from 182% for the first quarter of 1997 to 68% of revenue for the first quarter of 1999.

Three Months Ended March 31, 1998 Compared to Three Months Ended March 31, 1999

Revenue for the first quarter of 1999 was $24.0 million greater than revenue for the first quarter of 1998. The increase in revenue was primarily due to the addition of 27 new markets from 1998 to 1999. The increase in markets resulted from acquisitions made between the end of the first quarter of 1998 and the first quarter of 1999. The increase in revenue was also due to internal growth of our operations and sales staff. Our most significant acquisition was the acquisition of the assets of Tie Communications, which occurred in the third quarter of 1998. The Tie acquisition contributed to the sizable increase in voice product revenue and voice services revenue. The increase in data products was primarily a result of the development and growth of existing markets and a result of the expansion of data services markets from eight at March 31, 1998 to 12 at March 31, 1999. As a result of the Tie acquisition, and our continued strategy to increase our service offerings, our overall revenue mix shifted from approximately 28% in services for the first three months of 1998, to 50% in services for the first three months of 1999.

Cost of sales excluding depreciation increased $15.3 million from the first quarter of 1998 to the first quarter of 1999 and declined as a percentage of total revenue from 74% for the first quarter of 1998 to 66% for the first quarter of 1999. This decline as a percentage of total revenue is a reflection of the decline in cost of product sales excluding depreciation, as a percentage of product revenue, from 82% for the first quarter of 1998 to 76% for the first quarter of 1999. This decrease as a percentage of product revenue is due to an increase in sales of voice products which have a lower related cost of sales excluding depreciation than data products. Cost of service sales excluding depreciation as a percentage of service revenue, increased from 51% for the first quarter of 1998 to 55% for the first quarter of 1999. The increase in cost of service sales excluding depreciation as a percentage of service revenue was primarily due to an increase in voice services, primarily long-distance services which have a higher related cost of sales excluding depreciation.

Selling, general and administrative expenses increased $17.2 million from the first quarter of 1998 to the first quarter of 1999, but decreased as a percentage of revenue from 93% to 77%. We expect selling, general and administrative expenses to continue to decrease as a percentage of revenue as we expand our customer base and begin selling additional products and services in each of our markets.

The $17.2 million increase was primarily a result of:

- the expansion from eight to 35 markets;
- the completion of five acquisitions (four in the last nine months of 1998 and one in the first three months of 1999);
- an increase from 209 employees at March 31, 1998 to 1,080 at March 31, 1999 (452 of which were hired as a result of the Tie acquisition); and
- continued growth of the support services organization required to support expanding field operations, which accounted for approximately $11.2 million or 48% of total selling, general and administrative expenses for the three months ended March 31, 1999.

Depreciation and amortization expense increased approximately $2.1 million from the first quarter of 1998 to the first quarter of 1999. This increase is a direct result of increases of $23.7 million in property, network and equipment. In addition, goodwill increased $44.5 million and other intangible assets increased $1.7 million as a result of the five acquisitions completed between March 31, 1998 and March 31, 1999. As of March 31, 1999 we had $49.0 million in goodwill, net of amortization, which is being amortized over ten years. The increase in property, network and equipment is largely due to:

- the expansion from eight to 35 markets;
- the development and deployment of our multi-functional converged data and voice switching platform in three markets;
- continued development of our operational support system;
- the increase in assets managed under Enterprise Network Services contracts; and
- office equipment and furniture related to the growth of our support services organization.

Interest expense increased by approximately $5.9 million as a result of the April 1998 issuance of $160.0 million in principal amount of our 13% Senior Notes promissory notes and warrants to purchase 1,728,000 shares of common stock. Approximately $400,000 of this increase relates to accretion of the debt discount resulting from the value assigned to the warrants and amortization of debt issuance costs, neither of which are cash expenses. Interest expense also increased as a result of assumed indebtedness from acquisitions, as well as increased indebtedness under our equipment financing facilities with Comdisco and Sun Financial Group, Inc. due to property, network and equipment purchased for our networks both inside and outside our customers' premises.

Interest expense will increase as we continue to finance a significant portion of our capital expenditures, including equipment purchased for installation at our customers' offices in connection with the provision of Enterprise Network Services.

Interest income increased approximately $919,000 as a result of the temporary investment of the remaining proceeds of the offering of the 13% Senior Notes and proceeds from the sales of convertible preferred stock in March 1999, prior to using the proceeds in our business.

Other income (net), which consists of miscellaneous other non-operating types of expenses, increased by approximately $82,000.

Net loss increased approximately $15.6 million as a result of the factors discussed above.

Liquidity and Capital Resources

Since inception, in addition to borrowing under our credit facilities we have funded our net losses and capital expenditures through financing activities as outlined in the following table. In the table below, net proceeds equals the gross proceeds of the offering less advisors' fees, underwriting discounts and other expenses associated with the offering.

Securities Sold	Gross Proceeds	Net Proceeds
Initial sale of 7,500,000 shares of common stock to founders (April through October 1996)	$ 450,000	$ 450,000
7,000,000 shares of common stock and 3,500,000 warrants (December 1996 through February 1997)	7,000,000	6,295,794
6,820,000 shares of common stock and 3,410,000 warrants (October through November 1997)	17,050,000	15,339,787
13% Senior Notes and 1,728,000 warrants (April 1998)	160,000,000	152,377,955
Sale of 800,000 shares of Series A Convertible Preferred Stock and 1,500,000 warrants (March 1999)	20,000,000	19,300,000
Total funds raised	$204,500,000	$193,763,536

Our principal uses of cash are to fund working capital requirements, capital expenditures, business acquisitions and operating losses. We expect that our expansion will require additional capital expenditures and direct operating costs and expenses. As a result, we expect to incur net losses for at least the next 36 months. However, if our customer base grows and we are successful in offering all of our data services and products, we believe revenue will increase in larger proportion than operating expenses.

As of March 31, 1999, we had current assets of $79.9 million, including cash and cash equivalents of $10.4 million, short-term investments of $15.9 million and restricted cash of $20.8 million, and working capital of $22.4 million. In addition, we also had $32.0 million in non-current restricted cash. The majority of our restricted cash, along with the interest we earn on this cash, will be used to make the interest payments through April 2001 on our 13% Senior Notes. We invest excess funds in short-term investments until these funds are needed for capital investments, acquisitions and operations of the business.

Cash Flows From Operating Activities: Operating activities used cash of approximately $13.5 million during the first quarter of 1999 and $2.4 million during the first quarter of 1998. The majority of this increase was due to an increase in net loss of $15.6 million and an increase in trade accounts receivable of approximately $2.3 million, which were partially offset by an increase in accrued interest expense of $5.2 million, depreciation and amortization of $2.9 million, an increase of $1.6 million in accrued compensation, non-cash expenses and other changes in working capital. Cash used in operating activities for the first quarter of 1998 was primarily due to our net loss of $5.1 million, partially offset by non-cash expenses such as depreciation and amortization and changes in working capital.

Cash Flows From Investing Activities: Investing activities used cash of $20.6 million during the first quarter of 1999 and provided cash of $2.6 million during the first quarter of 1998. Cash used in investing activities during the first quarter of 1999 primarily consisted of short-term investments and restricted cash of $17.3 million, business combinations of $1.5 million and capital expenditures of $1.1 million. An additional $2.3 of capital expenditures were financed under our financing facilities. Cash provided by investing activities during the first quarter of 1998 consisted of $4.9 million resulting from maturing short-term investments, partially offset by $1.7 million in capital expenditures and approximately $424,000 for business combinations.

In April 1999, we completed the acquisition of BSSi Innovations, Inc. (BSSi). BSSi was a provider of data network integration services based in Chicago, Illinois. The purchase price consisted of $455,000 in cash, 74,000 shares of our common stock and assumed debt of approximately $525,000. An additional 20,000 shares may be issued if certain financial conditions are met.

Cash Flows From Financing Activities: Financing activities provided cash of approximately $19.0 million during the first quarter of 1999 and used cash of approximately $384,000 during the first quarter of 1998. Cash provided by financing activities during 1999 consisted of approximately $19.3 million in net proceeds from the sale of our convertible preferred stock and $1.0 million in new borrowings, which was partially offset by approximately $1.3 million in payments on long-term borrowings. Cash used in financing activities during the first quarter of 1998 consisted of payments on long-term notes payable and capital leases.

In November 1997, we entered into an agreement with Comdisco, Inc. through which we can receive up to $50.0 million of equipment lease financing. At March 31, 1999, $30.0 million was available to us under this facility. As of March 31, 1999, a total of approximately $10.2 million had been utilized and $19.8 million was available. This facility will expire on June 30, 2000. The remaining $20.0 million will become available upon the satisfaction of additional conditions.

On April 2, 1998, we completed the offering of our 13% Senior Notes, in the aggregate principal amount of $160.0 million and warrants to purchase 1,728,000 shares of common stock. At the closing, we deposited $56.8 million of the proceeds from that offering in a collateral account. The amount in the collateral account along with the interest earned will be sufficient to pay the first six interest payments on the 13% Senior Notes, of which two have been made as of April 1, 1999. We received approximately $95.6 million after deducting offering costs of approximately $7.6 million and funding the collateral account. The 13% Senior Notes contain certain covenants that restrict our ability to incur additional debt and make certain payments, including dividends.

In March 1999, we sold to affiliates of the Sandler/21st Century Group 800,000 shares of Series A Convertible Preferred Stock and warrants to purchase 1,500,000 shares of our common stock, for total consideration of $20.0 million. The proceeds from the sale, net of related offering costs, were approximately $19.3 million.

In April 1999, we executed a non-binding proposal letter with Cisco Systems Capital Corporation for a six-year $103.5 million credit facility. This credit facility will provide the financing for the purchase and installation of our Cisco Systems, Inc. powered multi-service data and voice switching platform and for other Cisco System's equipment. Under the terms of this proposal, Cisco Systems Capital would also receive a warrant to purchase 1,150,000 shares of our common stock. The warrant would have an exercise price of $10.00 per share and be exercisable for three years from the date of issuance. The facility would be available in three tranches over a three year period with quarterly payments due over the three years beginning one year from the availability of each tranche.

We have an agreement with Sun Financial Group, Inc., a subsidiary of GATX Capital Corporation, that was used to finance our internal capital needs under which $4.8 million was outstanding on March 31, 1999. We also have a $1.8 million agreement with GE Capital Fleet Services for financing purchases of company vehicles, none of which was outstanding as of March 31, 1999.

Future Capital Requirements. We have significant debt in relation to our equity. At March 31, 1999, we had $174.9 million in debt and $41.2 million in shareholders' deficit, which includes paid-in capital of $40.0 million, but excluded $19.3 million in convertible preferred stock classified outside of shareholders' equity. Our business plan will continue to require a substantial amount of capital to fund our expansion of existing and acquired markets. Our business plan includes the following:

- deploying our multi-functional converged data and voice switching platform in all of our markets and leasing of our IP/ATM network connecting our switches;
- funding the purchase, installation and ownership of enterprise networks of our Enterprise Network Services customers (which includes providing our customers with all necessary hardware, software, transmission facilities and management maintenance and monitoring);
- continuing to develop customer care and sales organizations;
- continuing to develop our operational support system; and
- funding operating losses and debt service requirements.

In addition, we will continue to evaluate acquisitions and investments. Completing additional acquisitions and investments could require us to spend a portion of our cash, and compel us to raise additional capital sooner. We are currently in the process of filing a registration statement with the Securities and Exchange Commission for a proposed initial public offering of our common stock.

We estimate that our existing funds, the proceeds from our proposed initial public offering, our available borrowing and lease financing capacity and the proceeds from the exercise of our warrants expiring in July 1999 will be sufficient to meet our capital requirements for the foreseeable future. We could, however, require additional capital sooner due to material shortfalls in our operating and financial performance or if we are more aggressive in our expansion than currently contemplated. We cannot be certain that we would be successful in raising sufficient debt or equity capital to fund our operations on a timely basis or on acceptable terms. If needed financing were not available on acceptable terms, we could be compelled to alter our business strategy, or delay or abandon some of our future plans or expenditures or fail to make interest payments on our debt. Any of these events would have a material adverse effect on our financial condition, results of operations and liquidity.

Impact of the Year 2000 Issue

The year 2000 issue generally describes the various problems that may result from the improper processing of dates and date-sensitive calculations by computers and other equipment as a result of computer hardware and software using two digits to identify the year in a date. Those computers and software will need to be upgraded or replaced to accept four digit dates to distinguish dates in the 21st century from dates in the 20th century. The problem could result in system failures or miscalculations and cause disruptions in operations including, among other things, the inability to process transactions, send invoices, provide data and voice communications services or engage in similar normal business activities.

State of Readiness. We have created a task force (consisting of representatives from our information technology, product management, sales and marketing, finance and legal departments) that evaluates our internal and external systems as they relate to year 2000 issues. We have reviewed our critical internal systems, including our systems for customer billing, customer service and financial reporting. We have obtained year 2000 readiness certifications from most manufacturers and suppliers of our internal systems. Any internal systems which were identified as having a potential problem have already been replaced or are in the process of being replaced or modified. Except for portions of two systems relating to order entry procedures which we acquired in our two most recent acquisitions (Tie and KCI), we believe that our internal systems are year 2000 ready. We are in the process of upgrading the two systems based upon the manufacturer's recommendation, which should be completed by the third quarter of 1999.

We continue to assess internal non-information technology systems and external systems, including systems used by manufacturers and suppliers of computer equipment, software programs, telephone systems, data systems, systems comprising our enterprise networks and equipment used to provide services to our customers.

To date, we have not identified any year 2000 issues with third-parties which could have a material adverse effect on our business. We may identify a significant internal or external year 2000 issue in the future which, if not remediated in a timely manner, could have a material adverse effect on our business, financial condition and results of operations.

Costs. We have not incurred any significant costs in identifying year 2000 issues other than the opportunity cost of the time spent by our personnel. We do not anticipate any significant further costs in identifying year 2000 issues. Programming costs associated with conforming the two non-ready systems are estimated to be approximately $500,000. We have prepared contingency plans, including manual order entry procedures and identification of potential software modifications, in the event that there are delays in moving the information from the non-ready systems to our year 2000 systems. Costs associated with our contingency plans could include the hiring of additional personnel to process orders and implement software modifications. The exact amount of the costs associated with our contingency plans cannot be determined at this time as a result of not knowing the number of additional personnel that may need to be hired.

Risks of Year 2000 Issues. Based on our assessments to date, we believe that we will not experience any material disruption in internal systems or information processing as a result of year 2000 issues. However, almost all of our systems and products relating to our internal and external systems and products are manufactured or supplied by third parties which are outside of our control. Although we have taken steps that we believe should have identiied potential year 2000 issues, if some or all of our internal or external systems and products fail, or if any critical systems are overlooked or are not year 2000 ready in a timely manner, there could be a material adverse effect on our business, financial condition or results of operations. In addition, if a critical provider of services, such as those providers supplying electricity, water or other services, or a vendor or manufacturer supplying products sold to our customers, experiences difficulties resulting in disruption of services to us or th sale of malfunctioning products to our customers, there could be a material adverse effect on our business. Potential risks include

- the disruption of utility services resulting in a closure of the affected facility for the duration of the disruption;
- the disruption of data or vice services we provide to our customers;
- the inability to process customer billing accurately or in a timely manner;
- the inability to provide accurate financial reporting to management, auditors, investors and others;
- litigation costs associated with potential suits from customers and investors; and
- delays in implementing other projects as a result of work by internal personnel on year 2000 issues.

Part II

Item 1. Legal Proceedings

The Company is involved in legal proceedings from time to time, none of which management believes, if d adversely to the Company, would have a material adverse effect on the business, financial condition or res operations of the Company.

Item 2. Changes in Securities

Date	Underwriters or Class of Purchasers	Number of Shares of Common Stock	Common Stock Warrants/ Options	Other Securities	Consideration	Ex C
Feb. 12, 1999	Sellers in an acquisition	30,000			Substantially all of the assets of the target company	Sec
Mar. 17, 1999 and Mar. 31, 1999	Accredited investors and one investor who retained Company director Michael Marocco as Investor Representative		1,500,000	800,000 shares of Class A Convertible Preferred Stock	$20,000,000	Sec
Mar. 21, 1999	Credit facility provider		400,000		Extension of $20.0 million of credit	Sec

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

None

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Articles of Incorporation

†3.3 Articles of Amendment to the Amended and Restated Articles of Incorporation of Convergent Communications, Inc.

††3.4 Articles of Amendment to the Amended and Restated Articles of Incorporation of Convergent Communications, Inc.

10 Material Contracts

†10.23 Securities Purchase Agreement dated March 17, 1999 between Convergent Communications, Inc. a Initial Purchaser

27 Financial Data Schedule

(b) Reports on Form 8-K

None

† Previously filed and incorporated by reference to the exhibit of the same number in the Form 10-K (SEC F 333-53953)

†† Previously filed and incorporated by reference to the exhibit of the same number in the Form S-1 filed on t hereof.

SIGNATURE

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Convergent Communications, Inc.

Date: May 14, 1999	By: /s/ JOHN R. EVANS John R. Evans Chairman and Chief Executive Officer
Date: May 14, 1999	By: /s/ KEITH V. BURGE Keith V. Burge President and Chief Operating Officer
Date: May 14, 1999	By: /s/ JOHN J. PHIBBS John J. Phibbs Jr. Chief Financial Officer and Treasurer

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

(Mark One)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 1998

OR

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

Commission file number 333-53953

CONVERGENT COMMUNICATIONS, INC.
(Exact name of registrant as specified in its charter)

Colorado	**84-1337265**
(State or other jurisdiction of incorporation)	**(I.R.S. Employer Identification No.)**

400 Inverness Drive South, Suite 400
Englewood, Colorado 80112
(303) 749-3000
(Address and telephone number of principal executive offices)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Not Applicable	Not Applicable

Securities registered pursuant to section 12(g) of the Act:
Not Applicable

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☑ No ☐

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

On March 16, 1999, the aggregate market value of Convergent Communications, Inc. common stock held by non-affiliates was approximately $95.6 million, based on a price per share of common stock of $5.00.

On March 16, 1999, 27,920,704 shares of the registrant's Common Stock were outstanding.

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Note Concerning Forward-Looking Information

Some of the information in this report contains forward-looking statements that involve substantial risks and uncertainties. You can identify these statements by forward-looking words such as "may," "will," "expect," "anticipate," "believe," "estimate" and "continue" or similar words. You should read statements that contain these words carefully because they: (1) discuss our future expectations; (2) contain projections of our future results of operations or of our financial condition; or (3) state other "forward-looking" information. We believe that it is important to communicate our future expectations to our investors. However, there may be events in the future that we have not accurately predicted or over which we have no control. These events may include future operating results, our efforts to address Year 2000 issues and potential competition, among other things. Cautionary language in this report provides examples of risks, uncertainties and events that may cause our actual results to differ materially from the expectations we describe in our forward-looking statements. You should be aware that the occurrence of the events described in this report could have a material adverse effect on our business, operating results and financial condition.

PART I

Item 1. *Business*

Introduction

Convergent Communications, Inc. is a single-source provider of data and voice communications systems, services and solutions to small and medium-sized businesses. We design, build, install, monitor and manage data and telephony networks inside enterprises and provide external network services such as data transport, long distance service, local service and Internet access. We offer these products and services on a stand-alone basis or as part of a bundled offering that can include owning an enterprise's internal data and voice networks. We are also installing next-generation, converged data and voice switching platforms in each of the markets in which we operate to efficiently handle our customers' traffic.

We operate in 35 markets in the United States and, either directly or through businesses we have acquired, have provided products or services to more than 60,000 customers in the last 18 months. We had revenue for 1998 of $61.6 million. During the year ended December 31, 1998, we sold in a private placement $160 million principal amount of 13% senior notes due 2008 and warrants to purchase 1,728,000 shares of common stock. Since year end, affiliates of Sandler Capital have agreed to invest $20 million in our preferred stock, of which $16 million has been received. As a result of the investment in our preferred stock we also have met the requirements to increase the borrowing capacity under our existing Comdisco equipment lease facility by an additional $20 million.

In the last three years we have:

- increased sales from $98,000 in 1996, to $10.2 million in 1997, and to $61.6 million in 1998;
- acquired and have integrated or are in the process of integrating 13 companies, adding sales and technical personnel and new products, services and markets;
- developed and deployed our next-generation converged data and voice switching architecture, the Enterprise Point-of-Presence (or "E-POP™") switch, in three markets and positioned ourselves to deploy our E-POP™ switch in all our existing markets over the next 24 to 36 months;
- assembled an experienced support-services management team of communications experts;
- devoted significant resources to the development, testing and implementation of our operational and customer support software platform, the Computer-Telephony Integrated Support System™ ("CTISS"); and
- developed, tested and implemented our national, around-the-clock customer care center.

Industry Overview

According to published reports, the revenue from data communications in the United States last year (including personal computers, data communications, Internet usage and electronic commerce) grew 35 percent. Total data products and services revenue was $97.6 billion, with data and network services accounting for $22.1 billion. Sophisticated data technology solutions such as wide area networks, dedicated Internet access and virtual private networking are becoming not only increasingly commonplace at small and medium-sized businesses, but also a competitive necessity. Increasingly complex service options are offered by a number of traditional and emerging carriers. In addition, telephony products are substantially more complex than they have been in the past because computer functionality has been designed into traditional business telephone products. Because of this complexity, we believe small and medium-sized businesses are seeking single-source solutions providers for their communications needs. We believe other factors that are leading these businesses to seek comprehensive solutions include:

- the large number of manufacturers of data and telephony equipment and the variety of options and features available on these products;
- the need to focus on their core operations rather than network and communications issues;
- rapid changes in technology;
- the proliferation of carriers and diverse emerging carrier options

- the cost and difficulty of maintaining in-house technical expertise;
- the potential savings associated with outsourcing communications requirements; and
- the desire to deploy capital resources in their core business rather than on the purchase and continual upgrade of communications systems.

Small and medium-sized businesses today generally purchase their communications equipment and services from several, usually local or regional, suppliers. In this fragmented market, there are few providers of complete data and voice communications solutions. In general, the small, regional providers that supply most small and medium-sized businesses are not as sophisticated as the national systems integrators, outsourcers, data technology companies and telecommunications providers that have focused on selling products and services to large enterprises. In addition, few providers offer a complete package of data and voice systems, services and solutions in the small and medium-sized market.

The Convergent Communications™ Solution

We are a single-source provider of technologically advanced data and telephony systems, services and solutions to small and medium-sized businesses. Many of the advanced solutions we offer have traditionally only been available to large companies. We are able to design sophisticated systems and solutions targeted for our customer base and offer those systems, services and solutions in each of our markets. We have a highly trained technical staff of 195 individuals.

In addition, our Enterprise Network Solutions (or "ENS") offering provides our customers with a communications networking solution that reduces the capital expenditure, technical staffing requirements and risks associated with quickly evolving communications, data and Internet technologies. With ENS, we purchase all or a portion of the existing communications system inside our customer's enterprise, and then become the outsourced service provider for the customer over a long-term period (typically three to five years). ENS may include network design, monitoring, maintenance and upgrading during the term of the contract in addition to providing data and voice transport services. These contracts typically provide the customer with a fixed monthly expense for all or most of their communications needs and reduce the customer's total cost of communications equipment and services.

We believe our expertise in both data and voice systems, services and solutions, and our willingness to finance the purchase of new systems and/or own the networks inside of an enterprise (as part of our ENS offering), make us an attractive single-source provider of communications systems, services and solutions to small and medium-sized businesses.

Our Strategy

Our strategy is designed to achieve rapid market penetration, strong growth and recurring revenue. The key elements of this strategy include:

- **Providing Single-Source, Comprehensive Solutions.** We design, build, install, monitor and manage data and voice networks. We are able to provide virtually all of our customers' communications systems, services and solutions and offer equipment financing and maintenance contracts. This comprehensive approach is designed to reduce the complexity and expense of communications networks and operations for our customers and allow us to capture a substantial portion of our customers' communications expenditures.

- **Targeting Small and Medium-Sized Businesses.** Small and medium-sized businesses have historically been underserved by large systems integrators, outsourcers, data technology companies and telecommunications providers. Because we are focused on this market, we have developed solutions that are best suited for the financial resources, growth characteristics, technological sophistication and other needs of small and medium-sized businesses.

- **Providing Sophisticated Data and Internet Solutions.** Most small and medium-sized businesses do not have the internal capability or capital required to deploy and manage the latest data and Internet technology, such as intranets and extranets, even though that technology could be critical to their success. We are able to provide these businesses with the type of data and Internet solutions that have previously been available only to much larger organizations with dedicated information technology staffs and large information services budgets.

- **Upselling Existing Customer Base.** We have, either directly or through businesses we have acquired, done business with more than 60,000 customers in the last 18 months. Most of these customers have purchased telephone systems and services from us or one of the companies we acquired. We are now beginning to leverage our relationships with these businesses and offer advanced data and Internet products and services to them, including network design and installation, virtual private networks (a shared dedicated network), web hosting, extranets and intranets. In addition, as we expand our data capabilities in each of our markets, we will begin offering ENS to these customers We currently offer ENS in eight of our 35 markets.

- **Improving Margins Through the Rapid Deployment of Our Lower-Cost Converged Switching Architecture.** We have designed a multi-functional switch (our E-POP™) from commercially available components. This switch provides greater functionality at a lower capital cost than traditional switches. The lower capital cost of our converged switching architecture allows us to deploy switches in all of our markets quickly and economically. These switches should also improve our operating margins on our transport services as we switch more of our customers' traffic ourselves.

- **Increasing Higher-Margin Revenue and Reducing Customer Turnover With our ENS Offering.** Our ENS offering allows our customers to focus on their core business and outsource their entire communications networks, including the design, ownership, upgrading and maintenance of those networks. These long-term contracts:
    - increase the portion of our customers' communications spending that we can capture;
    - reduce customer turnover and provide a stable, recurring source of higher-margin revenue; and
    - enhance our opportunities to sell systems and service upgrades to existing customers.

- **Leveraging our Operational Support System.** We are developing and implementing a proprietary multifunctional operational support system we call the Computer Telephony Integrated Support System™. CTISS is an Oracle-based system that integrates all internal support services on a single platform, permitting customer care, sales engineering, service management, service delivery, accounting and inventory management personnel to provide input and work from a single customer record. This system is intended to provide better customer service and to help identify opportunities to sell additional products and services.

- **Making Selective Acquisitions to Expand Data Expertise and Geographic Coverage.** We have made and will continue to make acquisitions of companies that have experience in providing data, voice and Internet systems, services and solutions and companies that will help us expand geographically.

Sales and Marketing

In the last 18 months, we have provided products or services to approximately 60,000 customers, either directly or through businesses we have acquired, and are currently offering our products and services in 35 markets in the United States. We are selling all our systems, services and solutions, including ENS, in eight of our markets, and voice systems and services in all of our markets. We are developing additional data, Internet and ENS expertise in the markets in which we do not currently offer those products and services. We anticipate being able to provide all of our products and services in an additional six to eight of our markets by the end of 1999, and in all of our existing markets over the next 24 to 36 months.

Our Sales Team. We market and sell our systems, services and solutions through our staff of 144 sales representatives in 49 offices in our 35 markets. Our sales force is supervised by area and general managers, each of whom has responsibility for all sales functions in one of our geographic regions. A significant portion of the compensation of the sales force is tied to annual goal and quota programs with incentive bonuses paid based on gross margin (rather than revenue) targets.

Products and Services. We provide a broad range of products and services on a stand-alone or integrated solutions basis. Our products and services include:

- *Data Services.* We provide professional data services including network design, maintenance and management and World Wide Web site development and hosting. We also offer data transport services such as Internet access and frame relay transmission for computer data and digitized voice.
- *Voice Services.* We provide professional telephony services, including network design, maintenance and management and assist our customers with adding and moving phone lines. We also sell conventional long distance and local services.
- *Enterprise Network Services.* We offer our customers a comprehensive communications solution that we call Enterprise Network Services, or ENS. ENS customers sign a long-term contract with us (typically three to five years) under which we own, manage and are responsible for all or a portion of the network inside the customer's premises.
- *Data Products.* We market products, from a large variety of suppliers, needed to create data networks including routers, hubs, bridges, multiplexers, switches, servers, personal computers, and other equipment.
- *Voice Products.* We are a provider of voice network products such as private branch exchanges (PBX), key systems (smaller versions of PBX's), handsets, voice messaging, call management software, facsimile services and other voice services.

While we provide each of our products and services on a stand alone-basis, we believe the ENS offering to be particularly attractive to small and medium-sized businesses because it:

- lowers the total cost of network ownership for our customer;
- reduces our customers' risks and burdens associated with owning, operating and maintaining their data and telephony networks;
- conserves our customers' capital in exchange for a stable, monthly expense; and
- reduces the need for our customers to employ costly and difficult-to-recruit information technology personnel.

We intend to market ENS both to our existing customer base as well as to new customers through direct marketing programs.

Financing. We provide financing options to our customers for their data and voice products. We believe that these services enhance our ability to attract customers and to act as their single-source provider. As of February 28, 1999, Convergent Capital Corporation, our financing subsidiary, had provided $2.7 million in financing in connection with our sales of data and voice products.

Customer Care

Our Customer Care Staff. We maintain highly integrated sales and customer care support functions. Our customer care specialists are trained in all aspects of the systems, products and services offered in their market. Our customer care staff currently consists of 83 employees.

Integrated Care Approach. We provide extensive customer care training to each of our employees who has customer contact, allowing us to provide high quality service in every aspect of our operations. This integrated approach allows us to pursue our goal of providing best-in-care service starting with the initial customer contact and continuing throughout the life of the account.

Commitment to Superior Service. We strive to provide superior service through our well-trained staff and our commitment to:

- ***Acting Immediately.*** Our employees are specialists who will begin troubleshooting immediately to resolve any problem and seek to reach a conclusion and fix a problem during the initial contact. The regional customer care centers are staffed nine hours a day, five days a week to handle the anticipated workload, and our national customer care center provides additional around-the-clock support.
- ***Providing a Single Point of Contact.*** Our customers can call a single toll-free trouble-reporting number for assistance in solving most communications problems. Because our customer care teams are trained in a variety of communication systems and services, they are able to assist customers in solving problems that may involve more than one product or service.

Network Architecture

Switching Platform. We have designed a switching platform we call an Enterprise Point-of-Presence (or E-POP™), that we use to carry voice and data traffic on a single digital connection. Unlike traditional switches, which are designed to transport only specific types of data or voice services, our switching platform acts as both a single converged voice and data service aggregation point for our customers and a dissemination point to facilities-based providers of data transport, Internet services and long distance and local services. Our architecture requires substantially less capital to deploy than the combination of traditional switches necessary to carry the same types of traffic. We have already installed and are carrying customer traffic over our E-POPs™ in three markets and intend to deploy them in each of our existing markets within the next two years.

National IP/ATM Network. Our national network, which we will lease to connect our E-POPs™ and carry our customers' data, voice and Internet traffic will be based on asynchronous transfer mode (or ATM), technology. We will lease fiber capacity from other carriers and install our equipment at the connection points. Our national network will also use Internet Protocol (IP) to identify the packets of information that we transport. Our IP/ATM national network is designed to transport all data, voice, video and Internet information at high speed from our E-POPs™ to their destinations. We expect to have seven of our E-POPs™ connected via our IP/ATM network by June 1999.

Acquisitions

Since our inception, we have completed 13 acquisitions which have aided in establishing our operations in 28 of our 35 markets and have added to our skills and areas of expertise. We are expanding the product and service offerings available to the acquired sales and field personnel, and are thereby creating new sales opportunities. We expect to continue to make selective acquisitions to expand our data and Internet expertise and broaden our geographic coverage.

The key factors we have and will continue to use in evaluating potential acquisitions are:

- historical and projected financial performance;
- complementary skills and strengths;
- cross-selling and up-selling opportunities;
- acceleration of our geographic growth or expansion of current markets;
- additions to our sales force and technical personnel; and
- existing customer base.

The Tie Acquisition. On August 1, 1998, we completed our largest acquisition to date when we acquired substantially all the assets of Tie Communications, Inc. for $51.4 million, including $40.0 million in cash consideration plus other costs and assumed liabilities. Tie was a debtor-in-possession under the U.S. Bankruptcy Code at the time. We acquired these assets to accelerate our growth, expand our service offerings and add to our skill base. The Tie acquisition provided us with 24 new markets and 436 employees with extensive experience in telephony products and services. The strong consultative sales organization we acquired from Tie, which remains largely intact, used a marketing approach similar to our own. The organization's expertise in the sales and service of complex telephony products complements our strength in data networking products and services. The acquisition was also attractive because of the opportunity to market our data, Internet and telephony systems, services and solutions to Tie's 55,000 telephony customers.

Regulatory Environment

Certain components of our data and telephony products and services are regulated as telecommunications services and are subject to federal, state, and local regulation.

Federal Regulation. Convergent Communications™, like all carriers providing interstate or international service, must comply with the Communications Act of 1934, and the regulations of the Federal Communications Commission. The Communications Act of 1934 was comprehensively amended by the Telecommunications Act of 1996, which eliminated many barriers to competition in the telecommunications market, particularly in the sale of local telephone service.

The FCC classifies competitive carriers like us as non-dominant, which means that we are not subject to the onerous regulations imposed on dominant carriers possessing market power. As a non-dominant carrier, we are subject to only minimal FCC regulation of our sale of data products. Likewise, we are subject to only minimal FCC regulation over our sale of enhanced services or information services. However, the FCC regulates what products may be connected to the public switched telephone network, and those products we install must meet the FCC's standards.

Frame relay services are considered a "basic" transmission service subject to tariffing and other requirements which apply to common carriers. Under the current regulatory structure, our national IP/ATM network, in contrast, is exempt from such regulations. However, the regulatory classification of voice communications using IP or ATM technology is in a state of flux, and there is a possibility that voice communications using IP or ATM technology will be subject to considerable regulation in the near future.

Our voice services are more extensively regulated. Although we presently only provide local and long-distance telecommunications services through resale of services purchased from, or as an agent on behalf of, other carriers, we are still subject to various regulations. We must file tariffs with the FCC where we resell regulated interstate phone service such as operator services, and, in most cases, must file tariffs with state public utility commissions where we resell intrastate phone service.

While we are not required to file tariffs for our interstate long distance services as a result of an FCC order, that order has been challenged, and the U.S. Court of Appeals of the D.C. Circuit has stayed the order while it considers the merits of the challenge. As a result, we have filed tariffs with the FCC for our interstate long distance services. If we are required to continue filing tariffs for these services, we will incur various costs and delays in bringing new services to the market.

Operator Services. We provide some operator services which are regulated at the federal and state level. We are required to disclose our operator service prices to callers and must file informational tariffs with the FCC containing detailed and specific information about our rates.

Website Hosting. We provide website hosting for our customers. The FCC does not regulate website hosting, although the transmission of data through the Internet is within the jurisdiction of the FCC. We cannot predict what effect any new regulations would have on this portion of our business. Potential negative impacts could include the increased costs to comply with any regulations which are imposed and delays in getting new products and services to market.

State Regulation. Some of our resold local and long-distance services are classified as intrastate and therefore subject to state regulation. In most states in which we do business, we are required to obtain a certificate of public convenience and necessity and operating authority for the sale of local phone services. In addition, we are often required to file tariffs setting forth the terms, conditions, and prices for services which are classified as intrastate, particularly local exchange services.

Our Regulatory Status. We are authorized by the FCC to provide resold international services. We also have tariffs on file with the FCC for interstate interexchange services, frame relay services and operator services. In addition to these federal authorizations, we are authorized to provide intrastate interexchange services in 30 states and are certified to provide local exchange services in seven states.

Competition

Although several larger data and telephony companies have entered or will enter our market, we believe that we can compete successfully because:

- we have expertise in providing integrated data and telephony systems, services and solutions specifically tailored to the needs of small and medium-sized business;
- our product and service offerings are broad and provide a suitable solution and price point for our target market;
- we are focused on providing extremely high quality customer service and technical support;
- we are willing to help the customer finance our network solutions; and
- we intend to continue to offer new systems, services and solutions to enable small and medium-sized businesses to take advantage of leading technology.

The telecommunications industry is highly competitive. We expect that we will face substantial and growing competition from a number of providers of data networking, data transport, and telephony services. Although we do not believe that a significant number of other companies are providing Enterprise Network Services solutions or a comparable range of integrated data networking, data transport, and telephony outsourcing services to small and medium-sized businesses, we do face intense competition in each of our individual product and service offerings. Our competitors include incumbent local exchange carriers (including the regional bell operating companies (''RBOCs'' and GTE), traditional and wireless competitive local exchange carriers, long distance carriers (such as AT&T and MCI WorldCom), and data integrators and providers of network services and customer premises equipment (such as Williams Telecommunications, Inter-Tel and Claricom).

With respect to any individual product or service we offer, we do not necessarily enjoy any particular competitive advantage over other industry participants. Indeed, some of these competitors or potential competitors are or will be able to bundle the same types of product and service components offered by us. In particular, any telecommunications carrier that offers both local and long-distance telecommunications services, including any incumbent local exchange carrier permitted to offer in-region long-distance services, will be able to offer these services as a single-source provider to customers. Because we have no present intention of owning fiber optic cable or last mile connections, some of our competitors will have a lower cost than we do for long distance or local services.

The RBOCs are also moving more aggressively into data transport. They have filed petitions seeking to have the FCC deregulate immediately the provision of packet-switched transport services. Although the FCC denied these petitions, the FCC has proposed permitting incumbent local exchange carriers to offer interLATA (local access and transport area) data services through a separate affiliate. Moreover, Bell Atlantic has petitioned to be allowed to provide interLATA data transport services in West Virginia; SBC Communications and Bell Atlantic have announced that they intend to provide more data networking services to commercial customers; and a number of RBOCs have begun offering digital subscriber line services.

A continuing trend toward business combinations and alliances in the telecommunications industry may create significant new competitors with resources far greater than ours. These business combinations include the merger of AT&T and Tele-Communications, Inc. ("TCI"), which will allow the resulting entity to bundle products from each of these companies. The AT&T-TCI merger follows AT&T's successful acquisition of Teleport Communications Group, a large competitive local exchange carrier. In addition, several of the largest local phone companies have proposed to merge, including Bell Atlantic with GTE and SBC Communications with Ameritech.

Technological developments may allow other companies to provide a single-source solution in competition with our product offerings. For example, Sprint has announced its development of an "Integrated-On-Demand Network" which if viable will allow customers to simultaneously use the Internet, telephone, and fax machine through use of the same phone line. Hardware manufacturers are also designing multi-function switching platforms similar to our E-POP™, possibly allowing other start up providers to use a similar lower-cost architecture. We would also, however, intend to take advantage of these developments in technology.

To the extent that competitors begin bundling components of the Enterprise Network Services (including data networking and the provision of customer premises equipment) into their own product offerings, we will face additional competition as a single-source provider of services. Most of our existing and potential competitors have financial and other resources far greater than ours, have long-standing relationships with their customers, and have greater name recognition than we do.

Employees

As of February 28, 1999, we had 1,032 full-time employees, of which 436 were added as a result of the Tie Acquisition. A total of 53 of the 436 former Tie employees we hired were represented by the Communications Workers of America labor union while employed by Tie at locations in California, Minnesota and New York. The local chapters of the Communications Workers of America have asked us to enter into collective bargaining negotiations as a result of the hiring of these employees at these locations.

Item 2. *Properties*

We lease sales and support facilities in each of our markets. Our principal corporate and support facilities are also leased, and are located as follows:

Location	Size (sq. ft)	Lease Expiration
Englewood, Colorado	28,488	April 30, 2003
Englewood, Colorado	23,256	November 30, 2000
Englewood, Colorado	16,700	February 28, 2002
Overland Park, Kansas	32,044	November 30, 1999*

* The employees located at this facility will be relocated to our offices which were acquired through the Kansas Communications, Inc. acquisition.

Item 3. *Legal Proceedings*

We are involved in legal proceedings from time to time, none of which we believe, if decided adversely to us, would have a material adverse effect on our business, financial condition or results of operations.

Item 4. *Submission of Matters to a Vote of Security Holders*

This item is inapplicable.

PART II

Item 5. ***Market for Registrant's Common Equity and Related Stockholder Matters.***

There is no established public trading market for our equity securities. As of March 16, there were 446 record holders of common stock.

We have never paid cash dividends on our common stock. We currently intend to retain future earnings, if any, to fund the development and growth of our business. Therefore, we do not currently anticipate paying any cash dividends in the foreseeable future. In addition, the terms of the indenture governing our 13% Series B Senior Notes due 2008 contain restrictions on our ability to pay dividends or other distributions.

The following tables summarize all equity securities issued or sold by us during the fiscal year ended December 31, 1998 that were not sold pursuant to registered offerings:

Common Stock

Date	Underwriters or Class of Purchasers	Number of Shares	Consideration ($)	Exemption Claimed
Jan 15, 1998	Investment Banker Fee	12,000	Services performed	Section 4(2)
Jan 15, 1998	Investment Banker Fee	8,333	Services performed	Section 4(2)
Feb. 19, 1998	Employee options	10,000	$10,000	Rule 701
Feb. 20, 1998	Sellers in an acquisition	10,000	100% equity interest in the target company	Section 4(2)
Mar 10, 1998	Consultants	75,000	$4,500 plus services	Rule 701
Apr. 9, 1998	Private placement agent warrant exercise	56,250	$67,500	Section 4(2)
Apr. 9, 1998	Private placement agent warrant exercise	13,700	$41,100	Section 4(2)
Apr. 28, 1998	Sellers in an acquisition	100,000	Substantially all of the assets of the target company	Section 4(2)
May 4, 1998	Employees	168,993	deferred compensation plan payment	Section 4(2)
May 22, 1998	Sellers in an acquisition	30,000	100% equity interest in the target company	Section 4(2)
Jul. 16, 1998	Sellers in an acquisition	340,000	Substantially all of the assets of the target company	Section 4(2)
Sep 10, 1998	Sellers in an acquisition	5,000	Additional consideration for purchase pursuant to earn-out provisions	Section 4(2)
Sep 11, 1998	Employee options	2,000	$2,000	Rule 701

Warrants

Apr. 2, 1998	Accredited investors – Merrill Lynch & Co.; Bear, Stearns & Co; and BT Alex. Brown (underwriters)	1,728,000	$6,886,400	Rule 144(A) and Regulation S
Aug. 1, 1998	Strategic marketing services provider	262,500 (subject to reduction based on performance) (65,625 canceled)	Services performed	Section 4(2)
Aug. 3, 1998	Consultant	210,000 (60,000 canceled)	Services performed	Section 4(2)

Item 6. ***Selected Financial Data***

The following selected financial data should be read in conjunction with our Consolidated Financial Statements and Notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" which appear elsewhere in this 10-K. The selected financial data are derived from our audited financial statements and the financial statements of our predecessor. Effective December 17, 1996, we acquired

Integrated Communication Networks, L.C., which is referred to as the "predecessor" for the period prior to the acquisition. Convergent Communications™, since inception, and Integrated Communication Networks, L.C., since December 17, 1996, are referred to as the "successor." Share and per share information is not presented for the predecessor as they are not relevant due to the predecessor's different capital structure.

	For the Year Ended December 31, 1994 (predecessor)	For the Year Ended December 31, 1995 (predecessor)	For the Period January 1, 1996 through December 16, 1996 (predecessor)	For the Period from Inception through December 31, 1996 (successor)	For the Year Ended December 31, 1997 (successor)	For the Year Ended December 31, 1998 (successor)
	(in thousands, except per share amounts)					
Operating Statement Data:						
Revenue	$ 988	$1,434	$1,496	$ 98	$10,210	$ 61,600
Cost of sales before depreciation	729	964	1,018	79	7,368	43,703
Selling, general and administrative	477	405	554	552	10,983	47,862
Depreciation and amortization	106	127	124	41	1,453	7,493
Total operating expenses	1,312	1,496	1,696	672	19,804	99,058
Interest expense	(15)	(17)	(21)	(1)	(155)	(17,502)
Interest income	—	—	—	—	251	4,632
Other expense, net	(49)	—	—	—	(156)	(248)
Net loss	$(388)	$ (79)	$ (221)	$ (575)	$ (9,655)	$(50,576)
Net loss per share (basic and diluted)				$ (0.07)	$ (0.46)	$ (1.84)
Weighted average shares outstanding (basic and diluted)				7,775	20,922	27,463

	As of December 31, 1994 (predecessor)	As of December 31, 1995 (predecessor)	As of December 31, 1996 (successor)	As of December 31, 1997 (successor)	As of December 31, 1998 (successor)
	(in thousands)				
Balance Sheet:					
Cash and cash equivalents	$ 23	$ 13	$3,161	$ 667	$ 25,597
Working capital	219	(10)	1,890	5,334	28,500
Total assets	1,012	797	9,887	24,922	185,656
Long-term debt, less current portion	440	431	423	966	162,485
Total liabilities	529	580	1,902	6,194	207,005
Shareholders' equity (deficit)	483	217	7,985	18,728	(21,349)

	For the Year Ended December 31, 1994 (predecessor)	For the Year Ended December 31, 1995 (predecessor)	For the Period January 1, 1996 through December 16, 1996 (predecessor)	For the Period from Inception through December 31, 1996 (successor)	For the Year Ended December 31, 1997 (successor)	For the Year Ended December 31, 1998 (successor)
	(in thousands)					
Other Operating Data:						
Net cash provided by (used in) operating activities	$(217)	$ 60	$ (31)	$ (242)	$ (6,698)	(28,698)
Net cash used in investing activities	(200)	(8)	(36)	(1,446)	(11,648)	(94,647)
Net cash provided by (used in) financing activities	427	(61)	91	4,849	15,852	148,274
EBITDA(1)	(218)	65	(76)	(534)	(8,141)	(29,965)
Capital expenditures	140	23	36	29	2,042	19,916

(1) EBITDA consists of earnings before interest (net), income taxes, depreciation, amortization and other income (expense). EBITDA is a measure commonly used in the telecommunications industry to analyze companies on the basis of operating performance. It is not a measure of financial performance under generally accepted accounting principles and should not be considered as an alternative to net income as a measure of performance or as an alternative to cash flow as a measure of liquidity. Our measure of EBITDA may not be comparable to similarly titled measures by other companies.

Item 7. ***Management's Discussion and Analysis of Financial Condition and Results of Operations***

The following discussion should be read along with the Consolidated Financial Statements and the accompanying footnotes included later in this Form 10-K. This discussion includes what are called "forward-looking statements" and are based on current expectations which involve risks and uncertainties. There is a risk that what we currently expect will not happen in the future. Because of the uncertainty of many factors, what actually occurs in the future may be very different from what we project in our forward-looking statements.

Overview

Convergent Communications, Inc. is a single-source provider of data and voice communications systems, services and solutions to small and medium-sized businesses. We design, build, install, monitor and manage data and telephony networks inside enterprises and provide external network services such as data transport long distance service, local service and Internet access. We offer these products and services on a stand-alone basis or as part of a bundled offering that can include owning an enterprise's internal data and voice networks. We are also installing a next-generation, converged data and voice switching platform in each of the markets in which we operate to efficiently handle our customers' traffic.

We operate in 35 markets in the United States and, either directly or through businesses we have acquired, have provided products or services to more than 60,000 customers in the last 18 months. We had revenue for 1998, of $61.6 million. During the year ended December 31, 1998 we completed the sale of $160 million in 13% senior notes and warrants. Since year end, affiliates of Sandler Capital have agreed to invest $20 million in our preferred stock, of which $16 million has been received. As a result of the investment in our preferred stock, we also have met the requirements to increase the borrowing capacity under our existing Comdisco equipment lease facility by an additional $20 million.

We began offering Enterprise Network Services in December 1997 and as of December 31, 1998, had entered into long-term Enterprise Network Service contracts with 18 customers with an aggregate of approximately 1,537 computers and handsets. We expect these contracts will provide us with approximately $2.4 million in annual contract revenues, and over their terms we expect they will produce total revenues of approximately $14.6 million. Although these contracts may be canceled by the customer, cancellation requires payment of a fee designed to reimburse us for all or substantially all of our costs incurred in entering into the contract.

During 1998 we made several strategic acquisitions, the latest and most significant of which was the acquisition of substantially all of the assets of Tie. With the acquisition of these assets we have accelerated our growth by adding 24 new markets and 436 employees with extensive experience in telephony products and services and by gaining the opportunity to cross-market our data products and services, including Enterprise Network Services, to Tie's 55,000 telephony customers.

We expect that this expansion will require additional capital expenditures and direct operating costs and expenses. As a result, we expect our net losses to increase. However, as our customer base grows and we are successful in offering all of our data services and products, we believe revenue will increase faster than operating expenses and will generate positive cash flow.

Description of Financial Components

We classify our business into five business segments: data services, voice services, Enterprise Network Services, data products and voice products. The following table outlines the components of revenue and the related cost of sales, excluding depreciation, by business segment:

Revenue	Cost of Sales (excluding depreciation)
Data Services	
• *Professional* web design, data network monitoring and support and data network planning and design	• engineer and technician compensation and benefits
• *Network* provision of frame relay (ATM and IP switching), Internet access and web hosting	• leased line facilities charges connecting a customer to a long distance or local network • capacity charges that long distance and local carriers, Internet providers and others impose to use their switches, ports, servers and other equipment
Voice Services	
• *Professional* voice network monitoring and support, and voice network planning and design	• engineer and technician compensation and benefits
• *Network* long distance service, local telephone service and public phone service	• leased line facilities charges connecting a customer to a long distance or local network • capacity charges that long distance and local carriers, Internet providers and others impose to use their switches, ports, servers and other equipment
Enterprise Network Services	
• long-term contracts (typically three to five years) under which we own, manage and are responsible for all or a portion of the network inside the customer's premises	• costs associated with all of the data and voice products and services we offer
Data Products	
• sale and installation of data network equipment	• cost of data network equipment • installation of data network equipment
Voice Products	
• sale and installation of voice network equipment	• cost of voice network equipment • installation of voice network equipment

Selling, general and administrative expenses have increased significantly and will continue to increase as we recruit additional management and support personnel necessary for continued growth. The Tie acquisition contributed substantially to this increase.

- *Sales and marketing expenses* include commissions paid in connection with our sales programs, marketing salaries and benefits, travel expenses, trade show expenses, consulting fees and promotional costs. Also included are the costs of acquiring a customer such as telemarketing, brochures and targeted advertising and promotional campaigns. We expect these expenses to increase as we add additional sales and marketing personnel and further implement our business plan.

- *General and administrative expenses* primarily consist of salaries and related expenses of management and support services personnel, occupancy fees, professional fees and general corporate and administrative expenses. We also include non-capitalizable costs associated with the development, support and expected growth of our operational support software platform.

Depreciation and amortization expense includes depreciation of property, network and equipment, including assets used for our internal use and assets being used by our customers under Enterprise Network Services contracts. Amortization expense includes the amortization of intangible assets, primarily goodwill, that resulted from business acquisitions. Depreciation and amortization will increase in connection with our capital deployment strategies and as a result of increased amortization of intangibles resulting from future acquisitions.

Results of Operations

Management evaluates and makes operating decisions about each of our operating segments based on a number of factors. Two of the more significant factors we use in evaluating operating performance are: *revenue* and *gross margin before depreciation.* We do not account for assets by business segment and, therefore, depreciation and amortization are not factors used by management in evaluating operating performance.

	For the period from Inception through December 31, 1996		Year ended December 31,			
	1996		1997		1998	
	(in thousands)		(in thousands)		(in thousands)	
Revenue:						
Data services	$ —	—%	$ 585	6%	$ 3,620	6%
Voice services	58	59	2,203	22	22,299	36
Enterprise Network Services	—	—	6	—	2,003	3
Data products	40	41	6,658	65	20,892	34
Voice products	—	—	758	7	12,786	21
Total revenue	$ 98	100%	$10,210	100%	$61,600	100%
Cost of sales (excluding depreciation):						
Data services	$ —		$ 51		$ 1,509	
Voice services	40		1,224		13,383	
Enterprise Network Services	—		3		695	
Data products	39		5,601		18,642	
Voice products	—		490		9,474	
Total cost of sales excluding depreciation	$ 79		$ 7,369		$43,703	
Gross margin before depreciation:						
Data services	$ -		$ 534		$ 2,111	
Voice services	17		979		8,916	
Enterprise Network Services	—		3		1,308	
Data products	1		1,057		2,250	
Voice products	—		268		3,312	
Total gross margin before depreciation	$ 18		$ 2,841		$17,897	

Year Ended December 31, 1997 Compared to the Year Ended December 31, 1998

Revenue increased by $51.4 million in 1998 to almost six times 1997 revenue. The increase in revenue was due to our expansion from eight markets at December 31, 1997 to 32 markets at December 31, 1998. This expansion was primarily due to the six acquisitions we completed during the year and internal growth of our operations and sales staff. The most significant acquisition was the acquisition of substantially all of the assets of Tie Communications, which occurred in the third quarter of 1998. The Tie acquisition resulted in most of the significant increase in voice product revenue and an even greater increase in voice services revenue. The increase in data products is primarily a result of the development and growth of existing markets and a full year of operations in 1998 compared to a partial year of operations in 1997 for those markets we entered in late 1997. As a result of the Tie acquisition, and our strategy to increase our services offering, our overall revenue mix shifted from 27% in services in 1997, to 45% in services in 1998.

Cost of sales excluding depreciation increased $36.3 million from 1997 to 1998. Cost of sales (excluding depreciation) as a percentage of total revenue declined slightly from 72% in 1997 to 71% in 1998. Cost of sales (excluding depreciation) related to sales of services, as a percentage of service revenue, increased from 46% in 1997 to 56% in 1998 while cost of sales (excluding depreciation) related to product sales, as a percentage of product revenue, remained relatively constant, increasing from 82% to 83%. The increase in cost of sales (excluding depreciation) as a percentage of service revenue was primarily due to a shift in product mix to services such as long-distance which have a higher related cost of sales (excluding depreciation).

Selling, general, and administrative expenses increased $36.9 million from 1997 to 1998, but decreased as a percentage of revenue from 108% in 1997 to 78% in 1998. As with most companies in their early stages of formation, our selling, general and administrative expenses have been disproportionately high, compared to revenue. We expect selling, general and administrative expenses to continue to decrease as a percentage of revenue as we expand our customer base and begin selling additional products and services in each of our markets.

The $36.9 million increase was primarily a result of:

- the expansion from 8 to 32 markets;
- the completion of six acquisitions;
- an increase from 165 employees at December 31, 1997 to 877 at December 31, 1998 (436 of which were hired as a result of the Tie acquisition); and
- continued growth of the support services organization required to support expanding field operations, which accounted for approximately $20.2 million or 42% of the total.

Depreciation and amortization expense increased approximately $6.0 million from 1997 to 1998. This increase is a direct result of an increase of $22.7 million in property, network and equipment from the end of 1997 to the end of 1998. In addition, goodwill increased $42.6 million and other intangible assets increased $1.7 million as a result of the six acquisitions completed in 1998. The increase in property, network and equipment is largely due to:

- the expansion from 8 to 32 markets (mainly through acquisitions);
- the development and deployment of our next generation convergent data and voice switching architecture, the E-POP™, in three markets;
- continued development of our operational support system;
- the increase in assets managed under Enterprise Network Services contracts; and
- office equipment and furniture related to the growth of our support services organization

Interest expense increased by approximately $17.3 million as a result of the April 1998 issuance of the $160 million principal amount of 13% Senior Notes and warrants. Approximately $1.2 million of this increase relates to accretion of the debt discount resulting from the value assigned to the warrants and amortization of debt issuance costs neither of which are cash expenses. Interest expense also increased as a result of assumed indebtedness from acquisitions, as well as capital purchases through our equipment leasing facilities with Comdisco and Sun Financial, Inc.

Interest income increased approximately $4.4 million as a result of the temporary investment of the proceeds of the offering of the 13% Senior Notes, prior to use in our business.

Other expense (net) increased by approximately $92,000 and primarily consisted of losses on disposal of assets and miscellaneous other non-operating types of expenses.

Period Ended December 31, 1996 Compared to the Year Ended December 31, 1997

Revenue increased $10.1 million from 1996 to 1997. The 1997 revenue includes a full year of operations. In comparison, there were only 15 days of revenue generating operations in 1996. Also, we completed five acquisitions in 1997, which added $2.9 million in revenue and expanded our operations from one to eight markets.

Cost of sales (excluding depreciation) increased $7.3 million from 1996 to 1997. Cost of sales (excluding depreciation) as a percentage of revenue declined from 81% in 1996 to 72% in 1997 because of a change in our service offering from public telephone services in 1996 to sales of other data and voice products and services in 1997.

Selling, general and administrative expenses increased $10.4 million from 1996 to 1997. The increase was primarily a result of:

- the expansion from one to eight markets.
- the completion of five acquisitions.
- an increase of 143 employees from 22 at December 31, 1996 to 165 at December 31, 1997.
- building our support services organization to support anticipated growth in field operations which accounted for approximately $7.3 million or 67% of the total selling, general and administrative expenses for 1997.

Depreciation and amortization expense increased approximately $1.4 million from 1996 to 1997. This increase is because of the increase in assets purchased and developed in our expansion from one to eight markets and capitalized costs associated with the development of our operational support system. Also, an increase in goodwill as a result of the five acquisitions we completed in 1997 caused an increase in the amortization of goodwill.

Interest expense increased by approximately $155,000 as a result of assumed indebtedness from acquisitions and capital purchases through our equipment leasing facility with Sun Financial Group, Inc.

Interest income increased approximately $251,000 as a result of the temporary investment of funds received in our private equity offerings in February and October of 1997.

Other expense (net) increased by approximately $156,000 and primarily consists of losses on disposal of assets and miscellaneous other non-operating types of expenses.

Liquidity and Capital Resources

Since inception, we have funded a significant portion of our operations through financing activities. Our private placements of debt and equity securities generated net proceeds of $152.4 million in 1998, $17.3 million in 1997 and $4.4 million in 1996. Our principal uses of cash are to fund working capital requirements, capital expenditures, business acquisitions, and the operating losses incurred during the start up phase in each new market we establish or acquire.

As of December 31, 1998, we had current assets of $73.0 million, including cash and cash equivalents of $25.6 million, restricted cash of $20.8 million, and working capital of $28.5 million. In addition, we also had $30.5 million in non-current restricted cash. The majority of our restricted cash, along with the interest we earn on this cash, will be used to make the interest payments through April 2001 on our 13% Senior Notes. We invest excess funds in short-term investments until these funds are needed for capital investments, acquisitions and operations of the business.

Cash Flows From Operating Activities:

Operating activities used cash of approximately $28.7 million for the year ended December 31, 1998 and $6.7 million for the year ended December 31, 1997. While this represents an increase of $22.0 million from 1997 to 1998, the percentage increase in cash used in operating activities is significantly less than the percentage increase in net loss. In addition, cash used in operating activities was 65% of revenue in 1997 compared to 46% of revenue in 1998. The majority of the increase from 1997 to 1998 was due to an increase in trade accounts receivable of approximately $11.0 million and a $40.9 million increase in the operating loss which were partially offset by an increase in trade accounts payable of approximately $12.4 million, an increase of $5.2 million of accrued interest expense, and non-cash expenses such as depreciation and amortization and other changes in working capital. Cash used in operating activities during the year ended December 31, 1997 was primarily due to our net loss of $9.7 million partially offset by non-cash expenses such as depreciation and amortization and changes in working capital.

Cash Flows From Investing Activities:

Investing activities used cash of $94.6 million during the year ended December 31, 1998 and $11.6 million during the year ended December 31, 1997. Cash used in investing activities during 1998 consisted of restricted cash investments in U.S. government securities of $50.9 million, business combinations of $42.4 million and capital expenditures of $6.9 million. These cash uses were partially offset by maturing short-term investments of $7.4 million. Cash used for investing activities during the year ended December 31, 1997 consisted of $7.4 million used for short term investments, $2.0 million in capital expenditures and $1.5 million for business combinations.

In August 1998, we completed the acquisition of substantially all the assets of Tie Communications, Inc. The purchase price consisted of $40.0 million in cash and the assumption of certain liabilities, which, with legal and professional and other costs resulted in a total purchase price of approximately $51.4 million. We have also incurred substantial integration costs and will incur additional integration costs in 1999.

Cash Flows From Financing Activities:

Financing activities provided cash of $148.3 million for the year ended December 31, 1998 and $15.9 million for the year ended December 31, 1997. Cash provided by financing activities during 1998 consisted of approximately $152.4 million in net proceeds from the sale of the 13% Senior Notes and outflows of approximately $4.3 million in payments on long-term borrowings. In 1997 cash flows from financing activities consisted of $17.3 million in net proceeds from the sale of shares of our common stock and warrants which was partially offset by approximately $1.4 million in debt repayments.

On March 17, 1999, we executed an agreement pursuant to which various affiliates of the Sandler/21st Century Group agreed to purchase 800,000 shares of Convertible Preferred A Stock and warrants to purchase 1,000,000 shares of our common stock. We sold 640,000 shares of Convertible Preferred A Stock and warrants to purchase 800,000 shares of our common stock on March 17, 1999 for total consideration of $16.0 million. The balance of the shares and warrants are required to be purchased for $4.0 million no later than March 31, 1999. Each share of Convertible Preferred A Stock is currently convertible into five shares of our common stock. The Convertible Preferred A Stock will automatically convert into common stock upon a public offering which provides gross proceeds to us in excess of $50.0 million. At the public offering, each share of Convertible Preferred A Stock will convert into a minimum of 5 and a maximum of 7.14 shares of common stock, depending on the price of common stock in the public offering. Each warrant entitles the holder to purchase one share of our common stock at an exercise price of $10.00 per share for a period of five years. The proceeds from the first closing, net of related offering costs, were approximately $15.3 million. One of our directors, Michael Marocco, is a principal of several of the entities in the Sandler/21st Century Group.

On April 2, 1998, we completed the offering of our 13% Senior Notes, which consisted of $160.0 million of promissory notes and warrants to purchase 1,728,000 shares of common stock. At the closing, we deposited $56.8 million of the proceeds in a collateral account. The amount in the collateral account along with the interest earned, will be sufficient to pay the first six interest payments on the 13% Senior Notes, the first of which was made on October 1, 1998. We received approximately $95.6 million after deducting offering costs of approximately $7.6 million and funding the collateral account. The 13% Senior Notes contain certain covenants that restrict our ability to incur additional debt and to make certain payments, including dividends.

In November 1997, we entered into a three year Program Agreement with Comdisco, Inc. through which we can receive up to $50 million of equipment lease financing. At December 31, 1998, $10 million of financing was available to us under this facility of which approximately $7.6 million was being utilized. As a result of the sale of our Convertible Preferred A Stock, we have met all of the requirements for an additional $20 million to become available under this Program Agreement. The Program Agreement expires on June 30, 2000.

We have an agreement with Sun Financial Group, Inc., a subsidiary of GATX Capital Corporation, which was used to finance our internal capital needs under which $4.4 million was outstanding on December 31, 1998. We also have a $1.8 million fleet agreement with GE Capital Fleet Services for financing purchases of company vehicles which had not been utilized as of December 31, 1998.

Subsequent acquisition: In February 1999, we acquired the assets and assumed certain liabilities of Kansas Communications, Inc. ("KCI"). KCI was a telecommunications equipment provider and integrator. The purchase price consisted of $1.5 million in cash, $4.5 million in notes payable due between July 1999 and February 2000, 30,000 shares of our common stock and assumed liabilities of $2.5 million. Upon the completion of an equity or debt financing with net proceeds in excess of $25.0 million, $3.5 million of the notes payable will become due.

General:

We have significant debt in relation to our equity. At December 31, 1998, we had $168 million in debt and $21.0 million in shareholders' deficit. Our relatively high leverage could negatively affect our operations in a number of ways, including:

- reducing our ability to obtain additional financing when desired for acquisitions and expansions;
- reducing our funds available for other corporate purposes, because of the significant interest payments required by our indebtedness; and
- reducing our flexibility to respond to downturns in the economy or in our business.

Our business plan will continue to require a substantial amount of capital to fund our expansion of existing and acquired markets. Our business plan includes the following:

- establishment of our nationwide IP/ATM network connecting our E-POPs™
- funding the development of our enterprise networks (which includes providing our customers with all necessary hardware, software, transmission facilities and management services)
- deploying E-POPs™ in all of our markets
- *continuing to develop customer care and sales organizations*
- continuing development of CTISS
- funding operating losses and debt service requirements

We will also continue to evaluate acquisitions and investments in light of our long-range plans. Completing additional acquisitions and investments could require us to spend our cash and we would need to raise additional capital sooner.

We estimate that our existing funds, the proceeds of our March 1999 sale of preferred stock, our available borrowing and lease financing capacity and the proceeds from the exercise of our warrants which will expire in July 1999 will be sufficient to meet our capital requirements for approximately the next 12 to 18 months.

Following the exhaustion of such funds, we will need to raise additional funds from other sources. In addition, we could require additional capital sooner due to material shortfalls in our operating and financial performance or if we are more aggressive in our expansion than currently contemplated. We cannot be certain that we will be successful in raising sufficient debt or equity capital to fund our operations on a timely basis on acceptable terms. If needed financing were not available on acceptable terms, we could be compelled to alter our business strategy or delay or abandon some of our future plans or expenditures or miss an interest payment on our debt. Any of these events would have a material adverse effect on our financial condition and results of operations.

Recently Adopted Accounting Standards

Effective January 1, 1998 we adopted Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income." This statement established standards for reporting and display of comprehensive income and its components. Comprehensive income generally includes changes in separately reported components of equity along with net income.

We have adopted Statement of Financial Accounting Standards No. 131, "Disclosure about Segments of an Enterprise and Related Information" for the year ended December 31, 1998. We have disclosed the business segments that we operate in along with the financial information that management uses in measuring the operating performance of those segments and for allocating resources to each segment as required by this statement. The adoption of this statement had no affect our results of operations, financial position or cash flows.

The American Institute of Certified Public Accountants issued Statement of Position 98-5, "Reporting on the Costs of Start-Up Activities" ("SOP 98-5"). SOP 98-5 provides guidance on the financial reporting of start-up costs and organization costs. It requires cost of start-up activities and organization costs to be expensed as incurred and is effective for financial statements for fiscal years beginning after December 15, 1998, though early adoption is encouraged. We have adopted SOP 98-5 for fiscal year ended December 31, 1998. The amount of start-up costs written off as a result of the adoption of this SOP was not material.

Effects of Inflation and Interest Rates

Management does not believe that its business is impacted by inflation or interest rates to a significantly different extent than businesses in general. However, there can be no assurances that inflation or interest rate changes will not have a material effect on the our operations in the future.

Impact of the Year 2000

The "year 2000 issue" generally describes the various problems that may result from the improper processing of dates and date-sensitive calculations by computers and other equipment as a result of computer hardware and software using two digits to identify the year in a date. Those computers and software will need to be upgraded or replaced to accept four digit dates to distinguish dates in the 21st century from dates in the 20th century. The problem could result in system failures or miscalculations and cause disruptions in operations including, among other things, a temporary inability to process transactions, send invoices or engage in similar normal business activities.

State of Readiness. We have created a task force (consisting of representatives from our information technology, product management, sales and marketing, finance and legal departments) that evaluates our internal and external systems as they relate to year 2000 issues. We have reviewed our critical internal systems, including our systems for customer billing, customer service and financial reporting. We have obtained year 2000 readiness certifications from most manufacturers and suppliers of our internal systems. Any internal systems which were identified as having a potential problem have already been replaced or are in the process of being replaced. Except for portions of two systems relating to order entry procedures which we acquired in our last two acquisitions (Tie Communications and KCI), we believe that our internal systems are year 2000 ready. We are in the process of moving all of the information from the acquired systems to our year 2000 ready system, which should be completed by the third quarter of 1999.

We continue to assess internal non-information technology systems and external systems, including systems used by manufacturers and suppliers of computer equipment, software programs, telephone systems, data systems, systems comprising our enterprise networks and equipment used to provide services to our customers.

To date, we have not identified any year 2000 issues with third-parties which could have a material adverse effect on our business. We may identify a significant internal or external year 2000 issue in the future which, if not remediated in a timely manner, could have a material adverse effect on our business, financial condition and results of operations.

Costs. Other than time spent by our personnel which could be spent on other matters, we have not incurred any significant costs in identifying year 2000 issues. We do not anticipate any significant further costs in identifying year 2000 issues. Programming costs associated with conforming the two non-ready systems are estimated to be approximately $300,000. We are currently evaluating an upgrade to a third party off-the-shelf product, that would replace the two non-ready systems as well as providing order entry, logistics, call center, sales force automation and contract management functionality. The estimated costs of the upgrades are estimated to be between $4 million and $6 million. We have prepared contingency plans, including manual order entry procedures, and identification of potential software modifications, in the event that there are delays in moving the information from the non-ready systems to our year 2000 systems. Costs associated with our contingency plans could include the hiring of additional personnel to process orders and implement software modifications. The exact amount of the costs associated with our contingency plans cannot be determined at this time as a result of not knowing the number of additional personnel that may need to be hired.

Risks of Year 2000 Issues. Based on our assessments to date, we believe that we will not experience any material disruption as a result of year 2000 issues in internal systems or information processing. However, almost all of our systems and products relating to our internal and external systems and products are manufactured or supplied by third parties which are outside of our control of those third party systems and products will be year 2000 ready. If some or all of our internal or external systems and products fail, or if any critical systems are overlooked or are not year 2000 ready in a timely manner, there could be a material adverse effect on our business, financial condition or results of operations. In addition, if a critical provider of services, such as those providers supplying electricity, water or other services, or a vendor or manufacturer supplying products sold to our customers, experiences difficulties resulting in disruption of services to us or the sale of malfunctioning products to our customers, there could be a material adverse effect on our business. Potential risks include (i) the disruption of utility services resulting in a closure of the affected facility for the duration of the disruption, (ii) the inability to process customer billing accurately or in a timely manner, (iii) the inability to provide accurate financial reporting to management, auditors, investors and others, (iv) litigation costs associated with potential suits from customers and investors and (v) delays in implementing other projects as a result of work by internal personnel on year 2000 issues.

Item 7A. ***Quantitative and Qualitative Disclosures About Market Risk***

This item is inapplicable.

Item 8. ***Financial Statements and Supplementary Data***

Report of Independent Accountants

To the Board of Directors of Convergent Communications, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of shareholders' equity (deficit) and of cash flows present fairly, in all material respects, the financial position of Convergent Communications, Inc. at December 31, 1997 and 1998, and the results of their operations and their cash flows for the period January 1, 1996 to December 16, 1996, the period from inception (March 1, 1996) to December 31, 1996 and the years ended December 31, 1997 and 1998, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

As explained in Note 1 to the financial statements, the Successor Company purchased all of the net assets of the Predecessor Company as of December 17, 1996. The transaction was accounted for as a purchase whereby the purchase price was allocated to the assets and liabilities of the Predecessor based on their estimated fair values as of December 17, 1996. Accordingly, the financial statements of the Successor Company are not comparable to those of the Predecessor.

PricewaterhouseCoopers LLP

Denver, Colorado
March 5, 1999, except for
Note 16, as to which the date is March 17, 1999

CONVERGENT COMMUNICATIONS, INC.
CONSOLIDATED BALANCE SHEETS

	December 31, 1997	December 31, 1998
ASSETS		
Current assets:		
Cash and cash equivalents	$ 667,344	$ 25,597,461
Short-term investments	7,371,303	—
Restricted cash	—	20,800,000
Trade accounts receivable, net of allowance for doubtful accounts of $21,389 and $1,908,811, respectively	2,075,150	17,661,220
Inventory	230,809	6,826,732
Prepaid expenses, deposits and other current assets	218,349	2,134,210
Total current assets	10,562,955	73,019,623
Property, network and equipment	5,448,183	28,139,460
Less accumulated depreciation	(610,386)	(4,882,832)
Total property, network and equipment	4,837,797	23,256,628
Restricted cash	405,816	30,549,658
Goodwill, net of amortization of $475,052 and $2,967,283, respectively	6,392,600	46,526,288
Other intangible assets, net of amortization of $358,486 and $1,470,363, respectively	1,728,575	10,281,016
Investments and other assets	994,426	1,225,626
Leases receivable, net of current portion	—	796,790
Total assets	$24,922,169	$185,655,629
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Trade accounts payable	$ 2,040,457	$ 15,061,514
Accrued compensation	1,467,587	4,583,140
Accrued interest	—	5,214,133
Other accrued liabilities	691,781	8,666,182
Deferred revenue and customer deposits	61,545	5,211,748
Current portion of notes payable	163,220	603,919
Current portion of capital leases	804,138	5,179,251
Total current liabilities	5,228,728	44,519,887
Long-term notes payable, less current portion	378,761	153,730,573
Long-term capital leases, less current portion	586,950	8,754,054
Total liabilities	6,194,439	207,004,514
Commitments (Note 8)		
Shareholders' equity (deficit):		
Preferred stock, 1 million shares authorized, none issued	—	—
Common stock, no par value, 100 million shares authorized, 26,859,000 and 27,848,270 issued and outstanding, respectively	24,004,297	27,486,554
Warrants	4,773,751	11,719,399
Treasury stock	—	(501,674)
Deferred compensation obligation	—	501,674
Accumulated other comprehensive income	(16,864)	—
Unearned compensation	(204,750)	(150,150)
Accumulated deficit	(9,828,704)	(60,404,688)
Total shareholders' equity (deficit)	18,727,730	(21,348,885)
Total liabilities and shareholders' equity (deficit)	$24,922,169	$185,655,629

The accompanying notes are an integral part of these consolidated financial statements.

CONVERGENT COMMUNICATIONS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	For the period from January 1, 1996 through December 16, 1996	For the period from Inception through December 31, 1996	For the year ended December 31, 1997	For the year ended December 31, 1998
	(Predecessor)	(Successor)	(Successor)	(Successor)
Data and voice service revenue	$1,495,977	$ 57,754	$ 2,794,777	$ 27,922,022
Data and voice product revenue	—	39,387	7,415,247	33,678,089
Total revenue	1,495,977	97,741	10,210,024	61,600,111
Cost of sales, excluding depreciation	1,018,494	79,459	7,368,509	43,703,183
Selling, general and administrative	554,109	552,092	10,982,769	47,861,785
Depreciation and amortization	124,086	40,698	1,453,019	7,493,613
Total operating expenses	1,696,689	672,249	19,804,297	99,058,581
Operating loss	(200,712)	(574,508)	(9,594,273)	(37,458,470)
Interest expense	(20,588)	(884)	(155,450)	(17,501,512)
Interest income	—	—	251,290	4,632,420
Other income (expense)	—	—	(156,346)	(248,422)
Net loss	$ (221,300)	$ (575,392)	$ (9,654,779)	$(50,575,984)
Net loss per share (basic)		$ (0.07)	$ (0.46)	$ (1.84)
Weighted average shares outstanding (basic)		7,774,651	20,921,569	27,463,469
Net loss per share (diluted)		$ (0.07)	$ (0.46)	$ (1.84)
Weighted average shares outstanding (diluted)		7,774,651	20,921,569	27,463,469

The accompanying notes are an integral part of these consolidated financial statements.

CONVERGENT COMMUNICATIONS, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (DEFICIT)

Predecessor

Balance, December 31, 1995	$ 216,833
Net loss allocated to members	(221,300)
Contributions from members	214,128
Balance December 16, 1996	$ 209,661

Successor

	Common Shares	Common Stock	Warrants	Treasury Stock	Deferred Compensation Obligation	Unearned Compensation	Accumulated Other Comprehensive Income	Accumulated Deficit	Total
Balance, March 1, 1996	—	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Conversion from Subchapter S corporation	—	(401,467)	—	—	—	—	—	—	(401,467)
Initial sale of stock to founders	7,500,000	450,000	—	—	—	—	—	—	450,000
Sale of stock in private placement	4,739,525	4,587,525	152,000	—	—	—	—	—	4,739,525
Offering costs	—	(411,310)	—	—	—	—	—	—	(411,310)
Stock issued in acquisition of ICN	3,500,000	3,500,000	—	—	—	—	—	—	3,500,000
Compensation	—	282,267	—	—	—	—	—	—	282,267
Net loss	—	—	—	—	—	—	—	(173,925)	(173,925)
Balance, December 31, 1996	15,739,525	8,007,015	152,000	—	—	—	—	(173,925)	7,985,090
Sale of stock in private placement	9,060,475	15,845,915	3,414,560	—	—	—	—	—	19,260,475
Offering costs	—	(2,780,400)	777,291	—	—	—	—	—	(2,003,109)
Stock issued to SONeTech	375,000	375,000	—	—	—	—	—	—	375,000
Stock issued in acquisitions	875,000	2,112,500	—	—	—	—	—	—	2,112,500
Exercise of stock options	950,000	261,750	—	—	—	(204,750)	—	—	57,000
Stock purchases	(200,000)	(12,000)	—	—	—	—	—	—	(12,000)
Compensation	59,000	194,517	—	—	—	—	—	—	194,517
Warrants	—	—	429,900	—	—	—	—	—	429,900
Other comprehensive income:									
Unrealized loss on securities	—	—	—	—	—	—	(16,864)	—	(16,864)
Net loss	—	—	—	—	—	—	—	(9,654,779)	(9,654,779)
Balance, December 31, 1997	26,859,000	24,004,297	4,773,751	—	—	(204,750)	(16,864)	(9,828,704)	18,727,730
Common stock issued for:									
401(k) match	137,994	435,894	—	—	—	—	—	—	435,894
Payments to consultants	20,333	55,000	—	—	—	—	—	—	55,000
Correction of private placement	20,000	—	—	—	—	—	—	—	—
Business combinations	480,000	2,266,400	—	—	—	—	—	—	2,266,400
Exercise of stock options	87,000	16,500	—	—	—	—	—	—	16,500
Exercise of warrants	69,950	129,235	(20,635)	—	—	—	—	—	108,600
Compensation	173,993	579,228	—	—	—	54,600	—	—	633,828
Deferred stock compensation	—	—	—	(501,674)	501,674	—	—	—	—
Warrants issued in private placement	—	—	6,886,400	—	—	—	—	—	6,886,400
Warrants issued to consultants	—	—	79,883	—	—	—	—	—	79,883
Other comprehensive income:									
Reclassification adjustment for loss included in net loss	—	—	—	—	—	—	16,864	—	16,864
Net loss	—	—	—	—	—	—	—	(50,575,984)	(50,575,984)
Balance, December 31, 1998	27,848,270	$27,486,554	$11,719,399	$(501,674)	$501,674	$(150,150)	$ —	$(60,404,688)	$(21,348,885)

The accompanying notes are an integral part of these consolidated financial statements.

CONVERGENT COMMUNICATIONS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the period from January 1, 1996 through December 16, 1996	For the period from Inception through December 31, 1996	For the year ended December 31, 1997	For the year ended December 31, 1998
	(Predecessor)	(Successor)	(Successor)	(Successor)
Cash flows from operating activities				
Net loss	$(221,300)	$ (575,392)	$(9,654,779)	$(50,575,984)
Adjustments to reconcile net loss to net cash used in operating activities:				
Depreciation and amortization	124,076	40,698	1,453,019	7,493,613
Amortization of deferred financing costs and accretion of debt discount	—	—	—	1,162,465
Provision for uncollectible accounts	3,802	—	—	196,532
Stock compensation expense	—	282,267	194,517	633,828
401k contributions through the issuance of stock	—	—	—	435,894
Warrants issued for the payment of consulting fees	—	—	—	79,883
Loss from sale of equipment	312	—	50,751	—
Other	—	—	40,000	—
Change in working capital (net of acquisitions):				
Trade accounts receivable	61,535	(97,741)	(1,527,544)	(10,969,753)
Inventory	—	—	(230,809)	(2,068,102)
Prepaid expenses, deposits and other current assets	1,107	(51,697)	(43,420)	(870,269)
Trade accounts payable	10,341	56,278	1,326,723	12,357,189
Accrued compensation	—	—	1,467,587	2,591,776
Accrued interest	—	—	—	5,214,133
Deferred revenue and customer deposits	—	—	61,545	3,299,802
Other accrued liabilities	(10,544)	103,731	161,127	2,321,332
Net cash used in operating activities	(30,671)	(241,856)	(6,698,283)	(28,697,661)
Cash flows from investing activities				
Additions of property and equipment	(35,742)	(28,713)	(2,042,203)	(6,877,095)
Acquisitions, net of cash acquired	—	(1,157,304)	(1,542,208)	(42,364,328)
Short-term investments	—	—	(7,388,167)	7,388,167
Restricted cash	—	—	(405,816)	(50,943,842)
Leases receivable	—	—	—	(1,174,302)
Intangible and other assets	(115)	(259,637)	(269,425)	(675,206)
Net cash used in investing activities	(35,857)	(1,445,654)	(11,647,819)	(94,646,606)
Cash flows from financing activities				
Proceeds from senior notes and warrants, net	—	—	—	152,377,955
Payments on notes payable	(9,214)	—	(317,927)	(1,397,043)
Payments on capital leases	—	—	—	(2,940,834)
Proceeds from borrowings	100,000	—	—	109,206
Proceeds from initial capital contributions	—	450,000	—	—
Proceeds from sale of common stock, net	—	4,398,897	17,257,366	—
Payment of note to former owner of ICN	—	—	(1,000,000)	—
Cash paid to retire indebtedness of predecessor company	—	—	(132,380)	—
Proceeds from exercise of stock options and warrants	—	—	57,000	125,100
Repurchase of common shares	—	—	(12,000)	—
Net cash provided by financing activities	90,786	4,848,897	15,852,059	148,274,384
Net increase (decrease) in cash and cash equivalents	24,258	3,161,387	(2,494,043)	24,930,117
Cash and cash equivalents at beginning of period	13,438	—	3,161,387	667,344
Cash and cash equivalents at end of period	$ 37,696	$3,161,387	$ 667,344	$ 25,597,461

The accompanying notes are an integral part of these consolidated financial statements.

CONVERGENT COMMUNICATIONS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS, (Continued)

	For the period from January 1, 1996 through December 16, 1996	For the period from Inception through December 31, 1996	For the year ended December 31, 1997	For the year ended December 31, 1998
	(Predecessor)	(Successor)	(Successor)	(Successor)
Supplemental disclosure of other cash and non-cash investing and financing activities:				
Acquisition of equipment through the assumption of capital lease obligations	$ —	$ —	$1,674,596	$13,038,529
Interest paid	$18,190	$ —	$ 144,782	$11,124,914

The accompanying notes are an integral part of these consolidated financial statements.

CONVERGENT COMMUNICATIONS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND BASIS OF PRESENTATION:

References in these footnotes to "Convergent Communications™," "us," "we," and "our" refer to Convergent Communications, Inc. and its subsidiaries.

Convergent Communications, Inc. is a single-source provider of data and voice communications systems, services and solutions to small and medium-sized businesses. We design, build, install, monitor and manage data and telephony networks inside enterprises and provide external network services such as data transport long distance, and local service and Internet access. We offer these products and services on a stand-alone basis or as part of a bundled offering that can include owning an enterprise's internal data and voice networks. We are also installing a next-generation, converged data and voice switching platform in each of the markets in which we operate to efficiently handle our customers' traffic. We provide the following products and services:

- Data Services
- Voice Services
- Enterprise Network Services
- Data Products
- Voice Products

In November 1996, we consummated a private placement offering (the "Private Placement") and on December 17, 1996 we acquired all of the assets of Integrated Communication Networks, L.C. ("ICN") in exchange for cash, notes and shares of common stock. This acquisition has been treated as a business combination accounted for by the purchase method of accounting. The accompanying consolidated financial statements include the accounts of ICN from December 17, 1996, the effective date of the acquisition. For purposes of identification and description, ICN is referred to as the "Predecessor" for the period prior to the acquisition. In these financial statements the term "Successor" is used to refer to us since our inception and to ICN since December 17, 1996 (see Note 3).

Our ultimate success depends upon, among other factors, establishment of our nationwide network, funding the development of our enterprise networks, continuing to develop our customer care and sales organizations, integrating acquired businesses, attracting and retaining customers, continuing to develop and integrate our operational support system and other back office systems, responding to competitive developments, continuing to attract, retain and motivate qualified personnel, and continuing to upgrade our technologies and commercialize our services incorporating such technologies. There is no assurance that we will be successful in addressing these matters and failure to do so could have a material adverse effect on our business prospects, operating results and financial condition. Our business plan will continue to require a substantial amount of capital to fund our expansion of our existing and acquired markets. As we continue to expand our business, we will seek additional sources of financing to fund our development. If we are unsuccessful in obtaining such financing, we would be compelled to alter our business strategy or delay or abandon some of our future plans.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Principles of Consolidation:

The accompanying consolidated financial statements include our accounts and the accounts of our wholly owned subsidiaries. All intercompany amounts and transactions have been eliminated.

Use of Estimates:

Our management is required to make estimates and assumptions in order to prepare the financial statements in conformity with generally accepted accounting principles. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents:

We consider all highly liquid investments with an original maturity of three months or less to be cash equivalents.

Short-term Investments:

Short-term investments are classified as available-for-sale securities at December 31, 1997. Gains or losses on the sale of short-term investments are recognized on the specific identification method. Unrealized gains or losses are treated as a separate component of shareholders' equity until the security that the unrealized gain or loss was recorded on is sold. Other than in restricted cash, we had no short-term investments at December 31, 1998, as none of our investments had original maturities greater than three months.

Restricted Cash:

Restricted cash primarily represents funds held in collateral accounts for paying semi-annual interest payments on the 13% Senior Notes through April 1, 2001. The cash is invested in U.S. Government Securities, which mature semi-annually on October 1 and April 1 through April 1, 2001 (see Note 7). Restricted cash also represents cash used to collateralize letters of credit, which are held as collateral for certain of our office leases, capital lease obligations and performance bonds. The amounts invested are classified as held to maturity and carried at amortized cost which approximates fair value.

Fair Value of Financial Instruments:

The carrying amounts reported in the balance sheets for cash and cash equivalents, short-term investments, accounts receivable, accounts payable and short-term borrowings approximate fair value because of the immediate or short-term maturity of these financial instruments. The carrying amounts reported for long-term debt other than the 13% Senior Notes approximate fair value based upon management's best estimates of what interest rates would be available for the same or similar instruments. The 13% Senior Notes are publicly traded securities. The quoted fair market value and the carrying amount of the 13% Senior Notes at December 31, 1998 are as follows:

	Carrying Amount	Fair Market Value
13% Senior Notes	$160,000,000	$76,800,000

Property, Network and Equipment:

Property, network and equipment are recorded at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets or the lease term if shorter, which range from two to five years. Expenditures which significantly increase asset values or extend useful lives are capitalized. Maintenance and repairs are expensed as incurred. When property, network and equipment is retired, sold or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and resulting gains and losses are reflected in operations.

Inventory:

Inventory primarily consists of new and refurbished equipment for resale and is valued at the lower of cost or market using the first-in, first-out method. We evaluate the need for reserves associated with obsolete and excess inventory.

Intangible Assets:

Intangible assets consist of the following:

- *Goodwill* represents the excess purchase price over the net assets acquired in acquisitions and is being amortized over ten years.
- *Customer lists* were obtained through business combinations and are being amortized over five years.
- *Debt offering costs* represent costs incurred in connection with an offering of 13% senior notes (see Note 7) and are being amortized over the term of the notes, ten years.
- *Deferred finance costs* are costs associated with obtaining certain financing arrangements and are amortized over the life of the financing arrangement, three years.
- *Site location contracts* are exclusive rights to operate public telephones at various locations we acquired through business combinations. The site location contracts are being amortized over the average lives of the contracts, primarily three years.
- *Software license fees* represent proprietary rights to software associated with our public telephones which are being amortized over five years, the estimated life of the related equipment.

We periodically evaluate the carrying amount of our intangible assets based on undiscounted cash flows, or other indicators of fair value, to determine whether adjustments to these amounts are required.

Long-Lived Assets:

We evaluate the recoverability of long-lived assets in accordance with Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" ("SFAS 121"). SFAS 121 requires an evaluation of indicators of impairment and future undiscounted cash flows to be generated by those assets. Impairment is measured as the amount by which the asset's carrying amounts exceed the future discounted cash flows estimated to be generated by those assets. We do not believe an impairment exists as of December 31, 1998.

Investments:

Investments consist of ownership interests of less than 20% in unrelated entities and are accounted for using the cost method.

Software:

We capitalize certain costs of developing software for internal use. Such costs are amortized on a straight line basis over three years, which is the estimated useful life of the software. In March 1998, the AICPA issued Statement of Position No. 98-1, "Accounting for the Cost of Computer Software Developed or Obtained for Internal Use" ("SOP 98-1"). SOP 98-1 provides guidance regarding the conditions under which the costs of internal-use software should be capitalized, and is effective for financial statements for years beginning after December 15, 1998. We do not expect the adoption of SOP 98-1 to have a material effect on our financial statements.

Revenue Recognition:

Revenue is recognized for product sales when the product is shipped. Revenues from non-recurring services are recognized when the services are provided. Revenue for long-term service and maintenance contracts is recognized over the term of the contract as the services are provided. Revenue from reselling of long distance service is recognized at the time of performance based on customer usage.

Deferred Revenue:

Deferred revenue represents the unearned portion of revenue related to our long-term service and maintenance contracts, which is recognized over the term of the contract, generally one year.

Income Taxes:

Deferred tax assets and liabilities are recognized for future tax consequences attributable to the differences between the financial statement carrying value of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured by using enacted tax rates that are applicable to the future years in which deferred tax assets or liabilities are expected to be realized or settled. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in net earnings in the period in which the tax rate change is enacted. We establish a valuation allowance when it is more likely than not that a deferred tax asset will not be recovered.

Stock-Based Compensation:

We use the intrinsic value method under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," to account for our employee stock-based compensation plans. We account for options and warrants granted to non-employees in accordance with Statement of Financial Accounting Standards No. 123 "Accounting for Stock-Based Compensation" ("SFAS 123"), which requires that we recognize an expense based on the fair value of the option or warrant at the time of grant.

Concentrations of Credit Risk:

We sell products and services to small to medium sized businesses on open account and do not obtain collateral for our receivables. We believe our reserves for potential credit losses are adequate and we perform on-going credit evaluations. To date, we have not experienced any significant credit losses.

All of our cash, cash equivalents and investments are maintained at a single financial institution, certain accounts are over insurable limits. The investments consist of high-quality commercial paper.

Reclassifications:

Certain reclassifications have been made to the prior year data to make it consistent with the 1998 presentation. These reclassifications had no impact on net loss.

Recently Adopted Accounting Standards:

Effective January 1, 1998 we adopted Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income." This statement established standards for reporting and display of comprehensive income and its components. Comprehensive income generally includes changes in separately reported components of equity along with net income.

We have adopted Statement of Financial Accounting Standards No. 131, "Disclosure about Segments of an Enterprise and Related Information" for the year ended December 31, 1998. We have disclosed the business segments that we operate in along with the financial information that management uses in measuring the operating performance of those segments and for allocating resources to each segment as required by this statement (Note 10). The adoption of this statement had no effect on our results of operations, financial position or cash flows.

The American Institute of Certified Public Accountants issued Statement of Position 98-5, "Reporting on the Costs of Start-Up Activities"("SOP 98-5"). SOP 98-5 provides guidance on the financial reporting of start-up costs and organization costs. It requires cost of start-up activities and organization costs to be expensed as incurred and is effective for financial statements for fiscal years beginning after December 15, 1998, early adoption is encouraged. We have adopted SOP 98-5 for fiscal year ended December 31, 1998. The amount of start-up costs written off as a result of the adoption of this SOP was not material.

3. Acquisitions:

Integrated Communication Networks, L.C. In December 1996, we acquired Integrated Communication Networks, L.C. (ICN), a public telephone service provider. We paid $1,232,300 in cash, issued a $1,000,000 promissory note and issued 3,500,000 shares of our common stock valued at $3,500,000 for total consideration of $5,732,300. The note was paid in January 1997.

Communication Services of Iowa, Inc. In April 1997, we acquired Communication Services of Iowa, Inc. (CSI), an Iowa reseller of telephony keyboard PBX telephone equipment to businesses. We paid $100,000 cash, issued a $100,000 one-year promissory note at 8% and issued 50,000 shares of our common stock valued at $50,000 for total consideration of $250,000. The note was paid in March 1998.

A.T.T.ex Corporation. In September 1997, we acquired A.T.T.ex Corporation (A.T.T.ex) of Des Moines, Iowa, a telecommunications service company that provided direct telephony service support to corporate customers. The purchase price consisted of $450,000 in cash and the issuance of 75,000 shares of our common stock valued at $187,500 for total consideration of $537,500.

Vital Integration Solutions, Inc. In September 1997, we acquired Vital Integration Solutions, Inc. (Vital) of Des Moines, Iowa and Omaha, Nebraska, a full service integration solutions provider which specialized in comprehensive information management and networking solutions. Vital provided its clients with the hardware, software and integration services necessary to build information systems and networks. We paid $500,000 in cash and issued 750,000 shares of our common stock valued at $1,875,000 for total consideration of $2,375,000.

Telephone Communications Corporation. In February 1998, we acquired the assets and assumed certain liabilities of Telephone Communications Corporation ("TCC") of Vail, Colorado. TCC was a long distance switchless reseller providing 1+, 0+, 800, and Calling Card services to cities such as Dillon, Frisco and the Vail Valley. We paid $400,000 in cash, issued a $200,000 one-year note at 8% and issued 10,000 shares of our common stock which for purchase accounting purposes were assigned a value of $4.00 per share. We also assumed a note with National Network Corporation of approximately $287,000, which was paid in April 1998. Total consideration for the purchase was $927,000. We negotiated an early discounted payoff of the $200,000 note in the total amount of $180,000 (including accrued interest of $2,250) in May 1998.

Network Computer Solutions, LLC. In February 1998, we acquired the assets and assumed certain liabilities of Network Computer Solutions ("NCS") of Greenwood Village, Colorado. NCS provided network integration services. We paid $500,000 in cash, issued 100,000 shares of our common stock which for purchase accounting purposes were assigned a value of $4.00, assumed liabilities of $438,372 and paid a finders fee of $150,000 for total consideration of $1,488,372.

Communication Services of Colorado. In May 1998, we completed a merger with Communication Services of Colorado ("CSC") of Englewood, Colorado. CSC was a long distance switchless reseller providing 1+, 0+, 800, and Calling Card services. The purchase price consisted of $475,000 in cash, the issuance of a $530,000 one-year note at 8% and assumed liabilities of $341,054 for total consideration of $1,346,054.

HH&H Communications Technologies, Inc. In May 1998, we completed the acquisition of the assets and certain liabilities of HH&H Communications Technologies, Inc. ("CTI"), a voice equipment provider in Texas.

We paid $200,000 in cash, issued 30,000 shares of our common stock, which for accounting purposes were assigned a value of $4.25 per share, and assumed liabilities of $151,383 for total consideration of $478,883.

CMB Holdings, Inc. d/b/a Independent Equipment Company. In June 1998, we completed the acquisition of substantially all of the assets of CMB Holdings, Inc. d/b/a Independent Equipment Company ("IEC"), an equipment remarketer in Florida. The purchase price consisted of the issuance of 340,000 shares of our common stock, which for accounting purposes were assigned a value of $5.00 per share, for total consideration of $1.7 million.

Tie Communications, Inc. Effective August 1, 1998 we completed the acquisition of substantially all the assets and certain of the liabilities of Tie Communications, Inc. ("Tie"). The purchase price consisted of $40.0 million in cash and the assumption of certain liabilities, which with legal and professional and other costs resulted in a total purchase price of approximately $51.4 million. Tie was a telecommunications equipment provider and a nationwide reseller of long-distance service.

We accounted for these acquisitions as business combinations, which were accounted for by the purchase method of accounting. We valued the acquisitions at the fair market value of the consideration given. With regard to our common stock and warrants, we determined the fair market value based upon a number of factors including a market analysis of publicly traded companies and a discounted cash flow analysis. An option pricing model was also used to value our warrants. In connection with the acquisitions, the excess of consideration given over the fair market value of the net assets acquired is being amortized on a straight line basis over the estimated life of the intangible assets acquired which is five to ten years. The accompanying financial statements include the accounts of the acquired companies from the effective dates of the acquisitions.

In addition to the business acquisitions previously discussed, we have also completed purchases of certain assets of other companies as follows:

Big Planet, Inc. In October 1997, we acquired certain assets and assumed certain liabilities of Big Planet, Inc., of Portland, Oregon. Big Planet is an Internet service provider (ISP) offering a full range of Internet services, including Internet access, Web hosting, maintenance, and site design. We paid $250,000 in cash for the assets and the assumption of certain trade payables.

Sigmacom Corporation. In December 1997, we acquired certain data integration assets of Sigmacom Corporation. Sigmacom is a systems integrator for corporate audio, video and data communications, providing state-of-the-art systems that combine telecommunications and computer network technologies. Sigmacom is also developing Internet application software for financial institutions such as credit unions. We paid $875,000 in cash and issued Sigmacom a warrant to purchase 50,000 shares of our common stock at an exercise price of $7.50 per share, which expires in December 1999. We valued the warrants, at an aggregate value of $30,000 utilizing an option pricing model and a number of factors including a market analysis of publicly traded companies and a discounted cash flow analysis. We also acquired a minority interest in Sigmacom's software development business to which we allocated $350,000 of the purchase price.

The consideration paid for acquisitions in 1996, 1997 and 1998, and the allocation of such consideration to the acquired assets and assumed liabilities is as follows:

	1996	1997	1998
Cash paid, net of cash acquired	$1,157,304	$1,542,208	$42,364,328
Common stock issued to the former owners	3,500,000	2,112,500	2,266,400
Notes payable and liability to former owners	1,000,000	100,000	907,500
Receivable eliminated through the acquisition of ICN	75,000	—	—
Warrants issued	—	55,000	—
Total amount to be allocated	$5,732,304	$3,809,708	$45,538,228
Allocation to acquired assets and assumed liabilities:			
Goodwill	$3,212,608	$3,384,168	$42,544,447
Accounts receivable	50,164	399,700	4,812,849
Inventory	—	115,971	4,586,188
Equipment	1,904,796	355,959	2,945,343
Customer lists	—	—	1,683,696
Prepaid expenses, deposits and other current assets	7,262	3,950	669,110
Investments	—	350,000	—
Site contracts	656,682	—	—
Software license	496,643	—	—
Accounts payable and accrued liabilities	(140,107)	(636,747)	(6,804,169)
Deferred revenue, net of costs	—	—	(1,911,946)
Debt	(455,744)	(163,293)	(2,987,290)
Amounts allocated	$5,732,304	$3,809,708	$45,538,228

On a pro forma basis, as though the above combinations had taken place at the beginning of the periods presented, revenue, net loss and net loss per share would have been as follows (unaudited):

	1997	1998
Revenue	$118,964,021	$109,666,921
Net loss	$(26,068,210)	$(59,462,317)
Net loss per share	$ (1.19)	$ (2.14)
Weighted average shares	21,963,316	27,846,802

4. Short-Term Investments:

All of our short-term investments as of December 31, 1997 are classified as available for sale. The investments had an amortized cost basis of $7,388,167 at December 31, 1997 and a fair value of $7,371,303 at December 31, 1997. The unrealized loss at December 31, 1997 related to these investments which matured in 1998 was $16,864.

5. Leases Receivable:

Our wholly owned subsidiary, Convergent Capital Corporation ("CCC"), leases data and telephony equipment to our customers under direct financing leases. The receivables, which are due over two to five years prepaid expenses, deposits and, are collateralized by the equipment being leased. The current portion of leases receivable is included in other current assets. The components of leases receivable and the future minimum payments receivable are as follows:

Receivable in:	December 31, 1998
1999	$ 468,189
2000	402,864
2001	266,832
2002	174,728
2003	78,670
Gross receivables	1,391,283
Unearned income	(216,981)
Lease receivables	1,174,302
Less: current portion	(377,512)
Long-term lease receivables	$ 796,790

6. Property, Network and Equipment:

Property, network and equipment consists of the following:

	December 31, 1997	December 31, 1998
Office furniture and equipment	$2,908,261	$14,057,009
Network equipment	2,256,942	12,906,012
Leasehold improvements	56,559	938,645
Company vehicles	226,421	237,794
	5,448,183	28,139,460
Less accumulated depreciation	(610,386)	(4,882,832)
Net property, network and equipment	$4,837,797	$23,256,628

Depreciation expense was $70,739 for the period from January 1, 1996 to December 16, 1996, $5,365 for the period from inception to December 31, 1996, $515,317 for the year ended December 31, 1997 and $4.3 million for the year ended December 31, 1998. We enter into capital leases for various equipment. Equipment under capital leases is as follows:

	December 31, 1997	December 31, 1998
Network equipment	$ —	$11,865,309
Furniture and equipment	1,674,596	4,020,300
	1,674,596	15,885,609
Less accumulated depreciation	(338,199)	(2,906,152)
	$1,336,397	$12,979,457

7. Notes Payable and Capital Leases:

Notes Payable

Notes payable consist of the following:

	December 31, 1997	December 31, 1998
13% Senior Notes payable, (i) below	$ —	$153,630,080
Note payable for acquisition, interest at 8%, principal and accrued interest due May 1999	—	530,000
Note payable assumed in acquisition, interest at 9.75%, payable in monthly installments of $2,257, through May 2000	—	35,707
Notes payable for vehicles, interest rates ranging from 6.9% to 11.2%, payable in monthly installments totaling $5,848 through June 2002, (ii) below	147,746	138,705
Note payable, interest at 4%, payable in monthly installments of $1,963 through September 2014, (iii) below	287,565	—
Note payable for acquisition, interest at 8%, principal and accrued interest due March 1998	106,670	—
	541,981	154,334,492
Less current portion	(163,220)	(603,919)
Long term portion	$ 378,761	$153,730,573

(i) On April 2, 1998 we completed a private offering of $160.0 million of 13% Senior Notes ("13% Senior Notes") and 640,000 warrants to purchase 1,728,000 of our common shares (the "Warrants") (collectively, the "13% Notes Offering"). The 13% Senior Notes mature on April 1, 2008 and interest is payable semi-annually in arrears on April 1 and October 1 of each year beginning October 1, 1998. At the same time as the closing of the 13% Notes Offering, we deposited U.S. Government Securities in a collateral account. The amount deposited in the collateral account together with the interest earned on those securities, will be enough to pay the first six interest payments on the 13% Senior Notes. The first payment was made on October 1, 1998. The 13% Senior Notes contain certain covenants that restrict our ability to incur additional debt and to make certain payments, including dividends. Each Warrant entitles the holder to purchase 2.7 shares of our common stock at an exercise price of $.01 per share. The Warrants are currently exercisable and expire on April 1, 2008. Each Warrant was assigned a value of $10.76 using an option pricing model, a market analysis of publicly traded companies and a discounted cash flow analysis. The proceeds that were attributable to the Warrants were treated as a discount to the 13% Senior Notes and allocated to shareholders' equity. We received proceeds approximately of $95.6 million after deducting offering costs of approximately $7.6 million and making the deposit of $56.8 million into the collateral account. As of December 31, 1998 the amount outstanding, net of the unaccreted discount of $6.4 million resulting from the allocation of the warrants, was $153.6 million.

(ii) In June 1997, we obtained a one-year renewable line of credit with General Motors Acceptance Corporation in the amount of $538,000 to acquire vehicles for operations. Advances under the line are payable over a four to five year term. We have used $155,521 of this credit facility of which $94,893 was outstanding at December 31, 1997 and $115,803 was outstanding at December 31, 1998. We do not anticipate additional borrowings under this facility.

(iii) This note was paid in April 1998.

Scheduled maturities on debt outstanding are as follows:

Due in:	December 31, 1998
1999	$ 603,919
2000	58,388
2001	37,918
2002	4,187
2003	—
Thereafter	160,000,000
	160,704,412
Less unaccreted discount	(6,369,920)
Total debt	$154,334,492

Capital Leases

Some of our equipment and equipment used by our customers is leased under capital leases. The following is a schedule of the minimum lease payments under capital leases together with the present value of the minimum lease payments.

Due in:	December 31, 1998
1999	$6,082,644
2000	5,440,318
2001	3,596,597
2002	529,588
2003	218,450
Total minimum lease payments	15,867,597
Less amount representing interest	(1,934,292)
Present value of minimum lease payments	13,933,305
Less current portion	(5,179,251)
Long-term portion	$8,754,054

Comdisco Facility. In November 1997 we entered into a three year Program Agreement with Comdisco, Inc. ("Comdisco") which provides for up to $50 million of equipment lease financing. At December 31, 1998, $10 million of the $50.0 million was available for us to use of which $7.6 million was being utilized. The Program Agreement expires on June 30, 2000.

The Comdisco facility is collateralized by the equipment being financed. In addition, we are required to issue a warrant to acquire shares of our common stock in an amount equal to ten percent (10%) of the facility, divided by the exercise price per share. The exercise price per share is equal to the price paid by investors in recent equity offerings, not less than $3.00 per share. The warrants will be issued in three installments based upon amounts available under the facility. We issued a warrant in 1997 for the purchase of 333,333 shares of our common stock at an exercise price of $3.00 per share for the first $10 million of the facility which were valued utilizing an option pricing model, and a number of factors including a market analysis of publicly traded companies and a discounted cash flow analysis. The warrants are being amortized into interest expense over three years.

Sun Financial Facility. In May 1997, we entered into a Master Equipment Lease with Sun Financial Group, Inc. to lease equipment, facilities and related items for our internal expansion as well as equipment to be used for customer installations. The facility is collateralized by a $100,000 standby letter of credit. In connection with the establishment of the facility, we issued a warrant to Sun Financial Group, Inc. for the purchase of 80,571 shares of our common stock at an exercise price of $3.00 per share. We valued the warrant utilizing an option pricing model and a number of other factors including a market analysis of publicly traded companies and a discounted cash flow analysis. The warrant is being amortized into interest expense over three years. We had amounts outstanding under this facility of $1.4 million as of December 31, 1997 and $4.4 million as of December 31, 1998.

8. Commitments:

We lease a portion of our buildings and equipment under operating leases. Future minimum payments under operating leases are as follows:

Due in:	December 31, 1998
1999	$ 4,961,985
2000	3,943,432
2001	3,245,816
2002	2,442,580
2003	1,076,301
Thereafter	205,596
	$15,875,710

Rent expense under operating leases was $45,874 for the period from January 1, 1996 to December 16, 1996, $17,927 for the period from inception to December 31, 1996, $431,930 for the year ended December 31, 1997 and $4.3 million for the year ended December 31, 1998.

9. Shareholders' Equity:

In connection with the acquisition of certain assets of Sigmacom (Note 3), we issued warrants to purchase 50,000 shares of our common stock exercisable at $7.50 per share through December 1999.

On October 31, 1996, we entered into an exclusive engineering and consulting agreement with Services-oriented Open Network Technologies, Inc. ("SONeTech") for engineering services to our internal engineering staff relating solely to the initial configuration of the architecture of the E-POP™ network strategy and the development of service logic for our call processing design. We issued 375,000 shares of our common stock in exchange for a 10% equity interest in SONeTech and an exclusive engineering and consulting agreement. We will be entitled to reacquire a portion of our common stock that was issued to SONeTech at the original price of $0.06 per share if SONeTech terminates the agreement.

In February 1997, we completed the second of two tranches of an offering of an aggregate of 7,000,000 units. Each of the units consisted of one share of common stock and one-half warrant to purchase a share of common stock (the first tranche of 4,739,525 units closed in late 1996). The units were sold at a price of $1.00 each. One warrant entitles the holder to purchase one share of common stock for a price of $1.50 per share for five years from the date of the offering. As part of the offering, we issued warrants to purchase 3,500,000 of our common shares to investors, which are exercisable at $1.50 per share. We also issued warrants to purchase

741,250 of our common shares to the placement agents, which are exercisable at $1.20 per share through November 7, 2001.

In October 1997, we completed an offering of 6,800,000 units consisting of one share of our common stock and one-half warrant to purchase a share of our common stock. The units were sold at a price of $2.50 each. One warrant entitles the holder to purchase one share of our common stock for a price of $3.75 per share, beginning in November 1998 through July 14, 1999. The proceeds, net of related offering costs, were approximately $15.2 million. We also issued warrants to purchase 615,860 of our common shares to the placement agents exercisable at $3.00 per share beginning in May 1998 through November 14, 2002.

In connection with the signing of financing agreements with Comdisco, Inc. and Sun Financial, we granted Comdisco, Inc. warrants to purchase 333,333 shares of our common stock and granted Sun Financial warrants to purchase 80,571 shares of our common stock. All of these warrants are exercisable at $3.00 per share. The Comdisco warrants are currently exercisable and expire on the earlier of (i) November 2007, or (ii) five years following an initial public offering of our common stock. The Sun Financial warrants are exercisable beginning in May 1998 and expire in May 2002.

In August 1998, we entered into a consulting agreement under which the consultant recruited senior management personnel on behalf of our wholly owned subsidiary, Convergent Capital Corporation. As a result of the services performed under this agreement, we issued warrants to the consultant to purchase 125,000 shares of our common stock at $5.00 per share. The warrants are currently exercisable and expire on August 3, 2008. We valued the warrants using an option pricing model and recognized consulting expense of $79,883.

Certain holders of our common stock and the holders of certain warrants have the right to demand that we file a registration statement to register their shares and the shares underlying their warrants in 1999.

Stock Option Plans:

We have adopted the 1996 and 1997 Incentive and Non-Statutory Option Plans and the 1998 Stock Option Plan (the "Plans") which authorize us to grant up to 7,400,000 shares of our common stock to employees, consultants and directors under incentive stock options within the meaning of Section 422A of the Internal Revenue Code of 1986, as amended, and to grant non-statutory stock options.

The Plans require that the exercise price of options we grant must be at least equal to the fair market value of a share of our common stock on the date of the grant and must be exercisable over a period of up to ten years. However, if an employee owns more than 10% of our outstanding common stock, then the exercise price of an incentive option must be at least 110% of the fair market value of a share of our common stock on the date of grant and must be exercisable over a period of five years. All of our options vest over five years.

The Plans are administered by our Board of Directors or a committee thereof which determines the terms of the options granted, including the exercise price, the number of shares of our common stock subject to the option, and the terms and conditions of exercise. No option granted under the Plan is transferable by the optionee other than by will or the laws of descent and distribution and each option is exercisable during the lifetime of the optionee only by such optionee.

In May 1997, we accelerated the vesting provisions related to options of certain employees to purchase 950,000 shares with an exercise price of $0.06 per share and all of the options were exercised. The underlying shares are subject to a repurchase agreement over a five year period whereby we can repurchase a portion of the shares upon termination of employment. The amount available for repurchase is reduced by 20% each year of employment. In late 1997, we repurchased 200,000 shares for $0.06 per share, upon the termination of one of the exercising employees. The repurchased shares are included in the authorized but unissued shares of common stock. At December 31, 1998, approximately 370,000 shares were no longer subject to repurchase.

	Number of Shares	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value
Outstanding at March 1, 1996	—	$ —	$ —
Granted			
At market value	785,000	1.09	0.20
Below market value	1,025,000	0.06	0.46
Exercised	—	—	—
Cancelled	—	—	—
Outstanding at December 31, 1996	1,810,000	0.51	—
Granted			
Above market value	2,810,000	1.80	0.26
At market value	985,000	1.95	0.56
Exercised	(950,000)	0.06	—
Cancelled	(12,000)	1.33	—
Outstanding at December 31, 1997	4,643,000	1.69	—
Granted			
Above market value	2,638,000	5.63	0.08
At market value	641,000	3.74	0.87
Exercised	(87,000)	0.19	—
Cancelled	(1,269,500)	2.63	—
Outstanding at December 31, 1998	6,565,500	$ 3.25	$ —

The following table indicates the number of shares exercisable and the weighted average exercise prices at December 31:

	1996	1997	1998
Options exercisable	—	345,000	990,100
Weighted average exercise price	—	$ 1.29	$ 1.66

At December 31, 1998, the range of exercise prices and weighted average remaining contractual life for options outstanding was as follows:

Number of Shares	Option Price Range	Weighted Average Remaining Contractual Life
2,238,000	$1.00 to $1.10	6.6 years
918,000	$2.00 to $2.50	8.6 years
932,500	$3.00	8.9 years
959,500	$5.00 to $5.50	7.7 years
1,517,500	$6.00	9.8 years

If the compensation cost for the Plan was determined based on the fair value at the grant dates for awards using the method prescribed by SFAS 123, our pro forma net loss and net loss per share would have been as follows:

	For the period from Inception through December 31, 1996	Year ended December 31, 1997	Year ended December 31, 1998
Net loss:			
As reported	$(575,392)	$(9,654,779)	$(50,575,984)
Pro-forma	$(575,808)	$(9,703,446)	$(50,957,542)
Net loss per share:			
As reported	$ (0.07)	$ (0.46)	$ (1.84)
Pro-forma	$ (0.07)	$ (0.46)	$ (1.86)

The fair value of each option grant is estimated on the date of grant using the minimum value method with the following assumptions:

	For the period from Inception through December 31, 1996	Year ended December 31, 1997	Year ended December 31, 1998
Dividend yield	—	—	—
Risk-free interest rate	6.06-6.48%	5.65-6.84%	5.38-5.71%
Expected lives	5 years	5 years	5 years

Because the determination of the fair value of all options granted if we become a public entity will include an expected volatility factor in addition to the factors described in the table above and, because additional option grants are expected to be made the above pro forma disclosures are not necessarily representative of pro forma effects on net income to be reported for future years.

We recognized compensation expense for employee stock grants and stock options of $282,267 for the period ended December 31, 1996, $194,517 for the year ended December 31, 1997 and $633,828 for the year ended December 31, 1998.

10. Business Segments:

We classify our business into five fundamental areas: data services, voice services, ENS, data products and voice products. Senior management evaluates and makes operating decisions about each of these operating segments based on a number of factors. We do not account for assets by business segment and, therefore, depreciation and amortization are not factors used in evaluating operating performance. Two of the most significant factors used in evaluating the operating performance are: *revenue* and *gross margin before depreciation* as presented below:

	For the period from Inception through December 31, 1996	Year ended December 31, 1997	Year ended December 31, 1998
Revenue:			
Data services	$ —	$ 585,385	$ 3,620,222
Voice services	57,754	2,203,182	22,298,886
ENS	—	6,210	2,002,914
Data products	39,387	6,656,813	20,892,491
Voice products	—	758,434	12,785,598
Total	$ 97,741	$ 10,210,024	$ 61,600,111
Gross margin before depreciation:			
Data services	$ —	$ 534,020	$ 2,111,684
Voice services	17,739	979,225	8,915,797
ENS	—	3,266	1,307,685
Data products	543	1,056,705	2,249,700
Voice products	—	268,299	3,312,062
Total	$ 18,282	$ 2,841,515	$ 17,896,928
Reconciliation to net loss:			
Selling, general and administrative	$(552,092)	$(10,982,769)	$(47,861,785)
Depreciation and amortization	(40,698)	(1,453,019)	(7,493,613)
Operating loss	(574,508)	(9,594,273)	(37,458,470)
Interest expense	(884)	(155,450)	(17,501,512)
Interest income	—	251,290	4,632,420
Other income (expense)	—	(156,346)	(248,422)
Net loss	$(575,392)	$ (9,654,779)	$(50,575,984)

11. Deferred Compensation:

We have a Deferred Compensation plan whereby certain management employees can elect to defer a portion of their compensation which will be paid in shares of our common stock at a future date. The plan requires that we issue shares of common stock into a rabbi trust which will then be distributed to the employee at a specified date in the future not less than one year from the deferral date. We have recorded the deferred compensation amount as treasury stock (for accounting purposes) and as a deferred compensation obligation in the shareholders' equity section of the balance sheet. As of December 31, 1998, 154,344 shares of our common stock are being held in the rabbi trust.

12. Income Taxes:

We were originally organized as an S corporation under the provisions of Section 1361 of the Internal Revenue Code. As an S corporation, we were not subject to tax on our income; rather our shareholders were taxed on their share of the taxable income, whether or not the income was distributed. Effective December 5, 1996, we rescinded our S Corporation election under the Internal Revenue Code and became subject to tax on our income. No pro forma tax benefit has been provided for either the Convergent or ICN as Predecessor due to their continuing losses.

The Predecessor was a limited liability company which was treated as a partnership for taxation purposes.

For federal income tax purposes we had net operating loss carryforwards of $44.9 million as of December 31, 1998. Section 382 of the Internal Revenue Code places certain limitations on the annual amount of net operating loss carryforwards which can be utilized if certain changes in ownership occur. As a result, our ability to use these net operating loss carryforwards, which will begin to expire in 2011, may be limited.

The components of the net deferred tax assets are as follows:

	December 31,	
	1997	1998
Deferred tax assets:		
Net operating loss carryforwards	$ 3,461,765	$ 17,057,862
Deferred revenue	—	1,924,474
Accrued vacation and bonus	—	1,342,101
Intangibles	—	548,919
Allowance for doubtful accounts	8,127	527,977
Property and equipment	112,106	462,333
Self-insurance and warranty liabilities	—	448,705
Original issue discount	—	384,006
Valuation allowance	(3,581,998)	(22,696,377)
Total net deferred tax assets	$ —	$ —

The increase in the valuation allowance of $3.5 million in 1997 and $19.1 million in 1998 are due to increased losses during each year. We have recorded a full valuation allowance on the net deferred tax assets due to continuing losses.

Our actual income taxes differed from the expected federal statutory rate of 34% as follows:

	For the period from Inception through December 31, 1996	Year ended December 31, 1997	Year ended December 31, 1998
Statutory tax rate	34%	34%	34%
State taxes, net of federal benefit	4	4	4
Valuation allowance	(38)	(38)	(38)
Effective tax rate	— %	— %	— %

13. Net Loss Per Share:

The net loss available to common shareholders consists of the following:

	For the period from Inception through December 31, 1996	Year ended December 31, 1997	Year ended December 31, 1998
Net loss	$(575,392)	$(9,654,779)	$(50,575,984)
The weighted average shares consist of the following:			
Weighted average common shares used for basic earnings per share	7,774,651	20,921,569	27,463,469
Warrants	—	—	—
Stock options	—	—	—

	For the period from Inception through December 31, 1996	Year ended December 31, 1997	Year ended December 31, 1998
Weighted average common shares used for fully diluted earnings per share	7,774,651	20,921,569	27,463,469
Anti-dilutive weighted average options and warrants not included	307,181	7,653,035	13,950,110

14. Employee Benefit Plans:

We adopted an employee benefit 401(k) plan for all employees effective March 1, 1997. Under the plan, employees may voluntarily elect to have up to 15% of their salaries deducted from earnings and placed in the plan. We may elect to match up to 6% of the employee contributions by contributing our common stock to the plan. Our contributions are determined on a quarterly basis and the number of shares to be contributed is based upon the estimated fair value of the stock at the end of each quarter. During 1998 we contributed $182,792 of our common stock for the year ended December 31, 1997 match and contributed $253,102 of our common stock for the first and second quarters of 1998. An additional $800,000 was accrued as of December 31, 1998 for the third and fourth quarter 1998 match, which will be contributed in 1999.

15. Related Party Transactions:

In August 1998, we entered into a two year agreement with Strategic Healthcare Solutions, LLC ("SHS") under which SHS was engaged to provide new customers in the healthcare industry to us. One of our directors is a principal of Strategic Asset Management which has an ownership interest in SHS. Under the agreement, we pay SHS a monthly fee and commissions (an aggregate of approximately $125,000 in 1998). In addition, we issued a warrant to SHS which entitles them to purchase up to a maximum of 262,500 shares of our common stock at an exercise price of $6.00. The warrant includes performance objectives which are reviewed semiannually. If SHS does not meet those performance objectives, all or a portion of the shares available for each six-month period (65,625 shares) is reduced. The warrant is not exercisable until August 1, 2000 and expires August 1, 2003. For the first six-month period of the agreement which ended February 1, 1999, SHS did not meet the performance objectives and as a result, the 65,625 shares applicable to that period were reduced to zero.

Pursuant to the terms of a non-cancelable license fee related to proprietary telecommunications equipment technology, ICN paid monthly license fees of $2,500 and management fees of $1,200 to a shareholder of ICN. During the period from January 1, 1996 through December 16, 1996, ICN incurred costs of $44,400 under these arrangements.

One of our Directors was a Principal and owner of Shepherd Financial Group. Shepherd Financial Group received total compensation of approximately $1.5 million and was issued 438,000 warrants to purchase our common stock in exchange for placement agent services provided to us in connection with private placements of our common stock in 1996 and 1997. The Director was also a Principal and owner of Shepherd Capital Group, which was paid approximately $0.5 million for financial advisory services provided to us during 1997.

16. Subsequent Events:

In January 1999, we entered into a non-binding letter of intent to purchase substantially all of the assets and assume certain liabilities of Business Systems Solutions, Inc. ("BSSi"). BSSi is a provider of data network integration services in Chicago, Illinois. Total consideration for the purchase will be a maximum of $1.3 million. The acquisition is subject to completion of due diligence, execution of definitive agreements and various other approvals.

In February 1999, we acquired the assets and assumed certain liabilities of Kansas Communications, Inc. ("KCI"). KCI was a telecommunications equipment provider and integrator. The purchase price consisted of \$1.5 million in cash, \$4.5 million in notes payable and 30,000 shares of our common stock which for purchase accounting purposes were assigned a value of \$5.00, and assumed liabilities of \$2.5 million for total consideration of \$8.7 million. Upon the completion of equity or debt financing with net proceeds in excess of \$25.0 million, \$3.5 million of the notes payable would become due.

On March 17, 1999, we executed an agreement pursuant to which various affiliates of the Sandler/21st Century Group agreed to purchase 800,000 shares of Convertible Preferred A Stock and warrants to purchase 1,000,000 shares of our common stock. We sold 640,000 shares of Convertible Preferred A Stock and warrants to purchase 800,000 shares of our common stock on March 17, 1999 for total consideration of \$16.0 million. The balance of the shares and warrants are required to be purchased for \$4.0 million no later than March 31, 1999. Each share of Convertible Preferred A Stock is currently convertible into five shares of our common stock. The Convertible Preferred A Stock will automatically convert into common stock upon a public offering which provides gross proceeds to us in excess of \$50.0 million. At the public offering, each share of Convertible Preferred A Stock will convert into a minimum of 5 and a maximum of 7.14 shares of common stock, depending on the price of common stock in the public offering. Each warrant entitles the holder to purchase one share of our common stock at an exercise price of \$10.00 per share for a period of five years. The proceeds from the first closing, net of related offering costs, were approximately \$15.3 million. One of our directors, Michael Marocco, is a principal of several of the entities in the Sandler/21st Century Group.

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

None

PART III

Item 10. Directors and Executive Officers of the Registrant

Our executive officers and directors as of March 16, 1999 are set forth below. Our directors have staggered terms, with three classes of directors serving terms as set forth below or until the director's death, resignation or removal.

Name	Age	Officer and/or Director Since	Position
John R. Evans(1)(2)(3)	44	1995	Chief Executive Officer, Chairman and Director
Keith V. Burge(3)	44	1995	President, Chief Operating Officer and Director
Philip G. Allen(4)	51	1995	Executive Vice President, Secretary and Director
Roland E. Casati(4)	67	1997	Director
Richard G. Tomlinson, Ph.D.(1)(5)	62	1997	Director
Michael J. Marocco (2)(4)	40	1998	Director
Spencer I. Browne (1)(2)(5)	49	1998	Director
John J. Phibbs	37	1997	Executive Vice President, Chief Financial Officer and Treasurer
Martin E. Freidel	35	1997	Executive Vice President, General Counsel and Assistant Secretary

(1) Member of Audit Committee
(2) Member of Compensation Committee
(3) Elected to Class I, with a term expiring on the annual meeting following the end of the calendar year 2000, and every three years thereafter.
(4) Elected to Class II, with a term expiring on the annual meeting following the end of the calendar year 1999, and every three years thereafter.
(5) Elected to Class III, with a term expiring on the annual meeting following the end of the calendar year 1998, and every three years thereafter.

John R. Evans served as the Chief Financial Officer and Executive Vice President of ICG Communications, Inc. from its inception until December 1995. Mr. Evans has also held various senior accounting and treasury management positions with Northern Telecom Canada Ltd., including strategic financial planning, analysis and budgeting, and held various audit and management information systems positions during six years with Coopers & Lybrand.

Keith V. Burge was the founder, Chief Executive Officer and Chief Operating Officer of Fiber Optic Technologies, Inc., a leading national network services integrator specializing in the design, implementation and support of high-speed data communication infrastructures, from 1986 to 1995. Fiber Optic Technologies became a subsidiary of ICG in 1992. Before founding Fiber Optic Technologies, Mr. Burge was employed by Digital Equipment Corporation for nine years, where, from 1983 to 1986, he was a senior sales executive.

Philip G. Allen was the Vice President of Investor Relations and Corporate Communications for ICG. Before joining ICG in 1992, Mr. Allen was President of Allen & Company Business Communications, a communications company specializing in business development and the design and production of marketing materials in the communications field. Mr. Allen was also an advisor to senior management at what is now Ameritech and U S WEST from 1976 to 1986, where he worked in various media relations, public policy and executive support areas.

Roland E. Casati has developed in excess of three million square feet of high-quality office buildings in and around Chicago, Illinois, during the past 35 years. For the last 15 years, Mr. Casati has been a venture capitalist.

Richard G. Tomlinson, Ph.D. is the President of Connecticut Research, Inc., a management consulting company founded in 1986 which serves the telecommunications, electric utility and computer industries. He has published numerous marketing studies, venture analyses and technical papers, is a contributing author for several books and holds five patents. Before founding Connecticut Research, Inc., he was the Vice President for Strategic Planning of United Technologies Communications Co. Inc., a subsidiary of United Technologies Building Systems Co. His career at United Technologies Corporation spanned 20 years, including 16 years at the UTC Research Laboratory where he was a Senior Principal Scientist.

Michael J. Marocco is the managing director of Sandler Capital Management. Mr. Marocco joined Sandler in 1989 and is currently responsible for analyzing, structuring and managing Sandler's private equity investments. Before joining Sandler, Mr. Marocco held various positions at Morgan Stanley Dean Witter, including a fixed income research analyst specializing in companies in the communications industry and vice president in the Communications Industries group.

Spencer I. Browne is a principal and founder of Strategic Asset Management, LLC, a consulting company that assists small and medium-sized companies in obtaining financing. Mr. Browne was a director and president and chief operating officer of M.D.C. Holdings, Inc. from 1989 to 1996. He was also a co-founder, director and chief executive officer of Asset Investors Corporation and Commercial Assets, Inc. which are publicly-owned real estate investment trusts. Mr. Browne is also a director for Mego Mortgage Corporation and Annaly Mortgage Management, Inc.

John J. Phibbs previously served as our Vice President of Finance and Administration from March 1997 to February 1998. Before joining us, Mr. Phibbs held various financial positions from 1991 through February 1997 with ICG, including Vice President – Accounting and Vice President – Financial Planning and Analysis. From 1985 to 1991, Mr. Phibbs was employed in various financial positions at Lockheed Martin Corporation and McDonnell Douglas Corporation.

Martin E. Freidel previously served as Special Counsel to the law firm of Miller & Welch, LLC in Denver, Colorado, where he also acted as our Associate General Counsel. From December 1992 until December 1996, Mr. Freidel held various positions with ICG and its predecessors, the last having been Vice President and General Counsel. Before joining ICG, Mr. Freidel served as Vice President – Regulatory for LDDS Communications, Inc. (now MCI WorldCom) ("LDDS") and Vice President and General Counsel for MidAmerican Technologies, Inc., MidAmerican Communications, Inc. and Republic Telecom Services, Inc., which were purchased by LDDS in 1991.

Director Compensation

Our Directors are reimbursed for certain reasonable expenses incurred in attending Board or committee meetings. In addition, non-employee Directors are compensated $1,000 per day for on-site meetings and $250 for teleconference meetings. Non-employee Directors also receive options to purchase 5,000 shares of our common stock per quarter for each quarter that they serve as a Director.

Audit Committee

We have an Audit Committee that:

- monitors our financial reporting and our internal and external audits;

- reviews and approves material accounting policy changes;
- monitors internal accounting controls;
- recommends the engagement of independent auditors;
- reviews transactions between our company and our officers or Directors; and
- performs other duties when requested by the Board of Directors.

Messrs. Tomlinson, Browne and Evans are members of the Audit Committee.

Compensation Committee

We also have a Compensation Committee that reviews and approves the compensation and benefits paid to our executive officers, and administers our employee stock option plans. Messrs. Marocco, Browne and Evans are members of the Compensation Committee.

Item 11. Executive Compensation

The following table sets forth in summary form the compensation earned by our Chief Executive Officer and our four other highest paid executive officers (the "Named Officers").

		Annual Compensation			Long-Term Compensation	
Name and Principal Position	Year	Salary(1)	Bonus(2)	Other Annual Compensation(3)	Securities Underlying Options(4)	All Other Compensation(5)
John R. Evans	1996	$ 6,250	—	—	200,000	—
Chairman and Chief	1997	$150,000	$75,000	$12,781	—	$82,500
Executive Officer	1998	$200,000	—	$14,799	100,000	$10,000
Keith V. Burge	1996	$ 5,417	—	—	200,000	—
President and Chief	1997	$130,000	$65,000	$ 8,625	—	$72,022
Operating Officer	1998	$180,000	—	$ 9,775	100,000	$10,000
Philip G. Allen	1996	$ 4,167	—	—	200,000	—
Executive Vice President	1997	$100,000	$50,000	$12,172	—	$55,735
and Secretary	1998	$150,000	—	$ 9,000	100,000	$10,000
John J. Phibbs	1996	—	—	—	—	—
Executive Vice President,	1997	$ 95,833(6)	$32,383	$ 5,000	300,000	$29,134
Chief Financial Officer and Treasurer	1998	$137,500(6)	—	$ 6,250	—	$ 8,523
Martin E. Freidel	1996	—	—	—	—	—
Executive Vice President,	1997	$ 36,939(7)	$19,569	$ 2,199	300,000	$21,445
General Counsel and Asst. Secretary	1998	$139,583(7)	—	$ 6,000	—	$ 9,444

(1) During 1996, we were in our initial formation stage and the executive officers did not receive compensation for their services until December 16, 1996.

(2) Includes the 50% of the individual's bonus under his employment agreement which was paid in cash, plus, in the case of Mr. Phibbs, a signing bonus of $8,425. Each of the individuals received the remaining 50% of his bonus in shares of our common stock, valued at fair market value. The total cash payments made are listed in this column. The total value of cash and deferred bonus payments made to our Named Officers was as follows:

	1997
Mr. Evans	$150,000
Mr. Burge	$130,000
Mr. Allen	$100,000
Mr. Phibbs	$ 47,917
Mr. Freidel	$ 39,139

Bonuses for 1998 have not yet been awarded.

(3) Includes automobile allowance and other fringe benefit payments.

(4) Amounts listed are options granted. 20% of the options to purchase shares vest on each anniversary of the date of grant.

(5) Includes contributions to our 401(k) Plan and 50% of the bonus payments made under the individual's employment agreement which were deferred and paid in shares of our common stock which is held under our deferred compensation plan. These shares are held in a "rabbi trust" for a period we and the employee specify, which cannot be less than one year. The number of shares held for the benefit of the Named Officers are as follows: Mr. Evans, 23,076; Mr. Burge, 20,000; Mr. Allen, 15,384; Mr. Phibbs, 7,371; and Mr. Freidel, 6,021.

(6) Mr. Phibbs' employment commenced on March 3, 1997. His base salary was $130,000 per year and increased to $175,000 on November 1, 1998.

(7) Mr. Freidel's employment commenced on September 15, 1997. His base salary was $125,000 per year and increased to $175,000 on September 15, 1998.

Option Grants Table

Name	Year	Number of Securities Underlying Options Granted(1)	Percent of Total Options Granted to Employees	Exercise Price Per Share	Expiration Date	Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term (2) 5%	10%
John R. Evans	1996	200,000	11.0	$1.10	12/15/2001	$ 35,000	$ 102,000
	1997	—	—	—	—	—	—
	1998	100,000	3.0	$5.50	4/13/2008	$264,000	$ 747,000
Keith V. Burge ...	1996	200,000	11.0	$1.10	12/15/2001	$ 35,000	$ 102,000
	1997	—	—	—	—	—	—
	1998	100,000	3.0	$5.50	4/13/2008	$264,000	$ 747,000
Philip G. Allen ...	1996	200,000	11.0	$1.10	12/15/2001	$ 35,000	$ 102,000
	1997	—	—	—	—	—	—
	1998	100,000	3.0	$5.50	4/13/2008	$264,000	$ 747,000
John J. Phibbs	1996	—	—	—	—	—	—
	1997	300,000	7.9	$1.00	3/3/2007	$189,000	$ 478,000
	1998	—	—	—	—	—	—
Martin E. Freidel ..	1996	—	—	—	—	—	—
	1997	300,000	7.9	$2.50	9/15/2007	$472,000	$1,195,000
	1998	—	—	—	—	—	—

(1) 20% of the option to purchase shares vest on each anniversary of the date of grant.

(2) Potential realizable value is based on an assumption that the price per share of our common stock appreciates annually at the rate shown (compounded annually) from the date of grant until the end of the option term. Potential realizable value is shown net of the exercise price. These rates of appreciation are provided in accordance with the Securities and Exchange Commission regulations and do not represent our estimate or projection of the future common stock price.

Aggregated Option Fiscal Year-End Values

Name	Number of Securities Including Unexercised Options At Fiscal Year-End Exercisable/Unexercisable	Value of Unexercised In-The-Money Options At Fiscal Year-End Exercisable/Unexercisable(1)
John R. Evans	80,000/220,000	$312,000/$468,000
Keith V. Burge	80,000/220,000	$312,000/$468,000
Philip G. Allen	80,000/220,000	$312,000/$468,000
John J. Phibbs	60,000/240,000	$240,000/$960,000
Martin E. Freidel	60,000/240,000	$150,000/$600,000

(1) Assumes a fair market value of our common stock as of December 31, 1998, of $5.00 per share based on recent sales of convertible securities.

Employment Agreements

We have employment agreements with each of the Named Officers.

Each of Messrs. Evans', Burge's and Allen's employment agreement was originally executed effective December 15, 1996 and provides for an initial term of five years. Mr. Evans receives a base salary of $200,000, Mr. Burge receives a base salary of $180,000, and Mr. Allen receives a base salary of $150,000. They also receive a car allowance, benefit package and an incentive bonus of up to 100% of their respective base salaries for Messrs. Evans and Burge, and up to 50% of his base salary for Mr. Allen. The incentive bonus is determined by our Compensation Committee. If we terminate the employment agreement without cause, or if the employee terminates as a result of a change in control, the employee is entitled to continue to receive his salary and accrued bonus for a period of 24 months, as well as the immediate vesting of all options granted to the employee. In addition, each of Messrs. Evans, Burge and Allen is subject to covenants not to compete with our business or interfere with our business and employee relationships.

Mr. Phibbs' employment agreement is effective as of March 3, 1997 and provides for a term of four years. Mr. Phibbs receives an annual base salary of $175,000. In addition, Mr. Phibbs receives a car allowance, benefit package and an incentive bonus of up to 75% of his base salary. The incentive bonus is determined by our Compensation Committee. If we terminate the employment agreement without cause Mr. Phibbs is entitled to continue to receive his salary for a period of 12 months. In the event of a change in control, he is entitled to continue to receive his salary for a period of 24 months. In either case, he will be entitled to the immediate vesting of all options granted to Mr. Phibbs.

Mr. Freidel's employment agreement is effective as of September 15, 1997 and provides for an initial term of five years. Mr. Freidel receives an annual base salary of $175,000. In addition, Mr. Freidel receives a car allowance, benefit package and an incentive bonus of up to 75% of his base salary. The incentive bonus is determined by our Compensation Committee. If we terminate the employment agreement without cause, or if Mr. Freidel terminates his employment as a result of a change in control, Mr. Freidel is entitled to continue to receive his salary and accrued bonus for a period of 24 months as well as the immediate vesting of all options granted to Mr. Freidel.

Stock Option Plans

We have adopted stock option plans for our employees and Directors. The following table provides summary information about our stock option plans:

	Shares Authorized	Options Outstanding	Options Exercisable
1996 Plan	2,700,000	2,188,000	807,000
1997 Plan	1,200,000	934,000	186,800
1998 Plan	3,500,000	3,364,200	282,500
1999 Plan	1,500,000	360,000	0

The stock option plans include the following terms:

- all employee options vest 20% each year over five years from the date of grant
- the exercise prices of options granted must be at least equal to the fair market value of our common stock on the date of grant
- options have a maximum term of ten years
- if an employee owns more than 10% of our outstanding common stock, then the exercise price of the option must be at least 110% of the fair market value of a share of our common stock on the date of grant, and the maximum term of the option is five years
- the aggregate fair market value of the common stock, determined at the time the option is granted, for which incentive stock options become exercisable by an employee during any calendar year is limited to $100,000

Our stock option plans are administered by our Compensation Committee. They determine additional conditions of the options granted, including the exercise price and the number of shares to grant. Options cannot be transferred and they can only be exercised by the person who received the grant. Outstanding options have exercise prices from $1.00 to $6.00.

401(k) Plan

We also provide our employees with a 401(k) plan. Eligible employees may voluntarily elect to have up to 15% of their salaries (subject to the maximum amount allowed under Federal law) deducted from their earnings and contributed to the 401(k) plan. Contributions are invested in several alternatives selected by the employee. At the end of each quarter, we determine whether or not to match our employees' contributions. The maximum amount of our matching contribution would be 6% of an employee's contribution. If we decide to match our employees' contributions, we contribute shares of our common stock into the 401(k) plan. The value of our common stock is determined by an independent valuation at the end of each quarter. Shares of common stock that we contribute into the 401(k) plan are fully vested when they are issued. As of December 31, 1998 we had issued a total of 137,994 shares of stock into the 401(k) Plan.

Incentive Compensation Plan

We have also adopted an Incentive Compensation Plan for most of our employees. Eligible employees may receive a payment based in part upon their individual performance during the preceding fiscal year as measured against predetermined objectives and in part upon our performance during the same period. For director-level employees and above, 50% of the employee's incentive compensation must be taken in the form of common stock. The stock portion can be deferred pursuant to our Deferred Compensation Plan.

Deferred Compensation Plan

Our Deferred Compensation Plan allows management employees the option to defer the common stock portion of their compensation to be paid at a future date. This plan requires us to issue shares of common stock into a trust account which will then be distributed to the employee at a specified date in the future, which can not be less than 1 year from the deferral date. As of December 31, 1998, 154,344 shares of common stock are being held in the trust account.

Item 12. Security Ownership Of Certain Beneficial Owners And Management Principal Shareholders

The following table summarizes certain information regarding the beneficial ownership of our stock as of March 17, 1999, by (i) each of our directors and officers, (ii) each person who we know beneficially owns more than 5% of our common stock and (iii) all of our officers and directors as a group.

Name and Address	Shares of Common Stock Beneficially Owned	Options	Warrants	Other Shares(1)	Total Shares Beneficially Owned	Percent Beneficially Owned(2)
John R. Evans(3)(4)(5) 400 Inverness Drive South, Suite 400 Englewood, CO 80112	6,300,000	100,000	49,536	29,279	6,823,585	24.31%
Keith V. Burge(3)(5) 400 Inverness Drive South, Suite 400 Englewood, CO 80112	6,300,000	100,000	49,536	25,690	6,823,585	24.31%
Philip G. Allen(3)(5) 400 Inverness Drive South, Suite 400 Englewood, CO 80112	6,300,000	100,000	49,536	20,008	6,823,585	24.31%
Roland E. Casati	750,000	45,000	466,800	—	1,261,800	4.44%
Dr. Richard G. Tomlinson	40,000	35,000	21,620	—	96,620	*
Michael J. Marocco(6)	1,200,000	5,000	673,500	—	1,878,500	6.57%
Spencer I. Browne(7)	135,000	5,000	45,000	—	185,000	*
John J. Phibbs	—	120,000	—	11,278	131,278	*
Martin E. Freidel(8)	43,600	60,000	21,800	7,923	133,323	*
First Continental Group, L.C. 5731 Greendale Rd, Box 429 Johnston, Iowa 50131	2,005,000	—	—	—	2,005,000	7.18%
All Officers and Directors as a group (9 persons)	8,468,600	570,000	1,377,328	94,178	10,510,106	35.17%

* Less than 1%

(1) Includes shares in our 401(k) plan and our Deferred Compensation Plan trust account.

(2) Based on 27,920,704 shares of common stock issued and outstanding as of March 16,1999. Percentage ownership is calculated by dividing (i) the sum of the number of shares owned by the stockholder plus the number of shares the stockholder would receive after exercising options and warrants exercisable within sixty (60) days of the date of this prospectus (shares issued after exercising options and warrants are called "conversion shares"), by (ii) the total number of common shares of stock outstanding plus the stockholder's conversion shares.

(3) Messrs. Evans, Burge and Allen and their wives have agreed that the shares of common stock that they beneficially own will be voted together pursuant to a voting agreement. The voting agreement states that the majority vote of the parties will dictate how all of the shares beneficially owned by the parties are voted. As a result each party to the voting agreement is deemed to beneficially own all the shares beneficially owned by the other parties. If such attribution of beneficial ownership were not deemed to occur, the total beneficial ownership of each individual would be 2,148,815 shares owned by Mr. Evans, 2,415,226 shares owned by Mr. Burge, and 2,259,544 shares owned by Mr. Allen.

(4) Includes 205,000 shares held in trusts for the benefit of Mr. Evans' children as Mr. Evans has voting rights over those shares.

(5) Includes 500,000 shares held by the holder's wife.

(6) Includes 813,640 shares owned by 21st Century Communications Partners, L.P., 109,520 shares owned by 21st Century Communications T-E Partners, L.P. and 276,840 shares owned by 21st Century Communications Foreign Partners, L.P. and warrants to purchase shares held by Sandler Capital Partners IV, L.P.; Sandler Capital Partners IV FTE, L.P. and MJM Associates, L.P. as Mr. Marocco has voting power over those shares.

(7) As Mr. Browne is a principal of Strategic Asset Management, LLC, this includes 85,000 shares and warrants to purchase 70,000 shares owned by that firm.

(8) Includes 40,000 shares and warrants to purchase 20,000 shares owned by Freidel Development International, LLC, as Mr. Freidel has voting power over these shares.

Item 13. Certain Relationships And Related Transactions

In August, 1998 our operating subsidiary, Convergent Communications Services, Inc., entered into a Strategic Alliance Agreement with Strategic Healthcare Solutions, LLC. The agreement is a two year agreement and provides for the payment of a monthly fee and commissions to SHS for new customers in the healthcare industry that are introduced to us by Strategic Healthcare Solutions and that become Enterprise Network Services customers. Under the agreement, we issued a warrant to Strategic Healthcare Solutions which entitles it to receive up to a maximum of 262,500 shares of our common stock at an exercise price of $6.00. The warrant includes performance objectives which are reviewed semi-annually. If Strategic Healthcare Solutions does not meet those performance objectives, all or a portion of the shares available for exercise is reduced. As of February 28, 1999, 65,625 shares had been canceled. The warrant is not exercisable until August 1, 2000 and expires August 1, 2003. Spencer I. Browne is a principal of Strategic Asset Management, Strategic Asset Management has an ownership interest in Strategic Healthcare Solutions.

PART IV

Item 14. EXHIBITS, FINANCIAL STATEMENTS SCHEDULES, AND REPORTS ON FORM 8-K

(a)(1) The following consolidated financial statements of Convergent Communications, Inc. are included in Item 8 of this Report on Form 10-K:

Report of Independent Accountants

Consolidated Balance Sheets as of December 31, 1997 and 1998

Consolidated Statements of Operations for the period from January 1, 1996 to December 16, 1996 (predecessor), the period from inception (March 1, 1996) to December 31, 1996, and the years ended December 31, 1997 and 1998

Consolidated Statements of Shareholders' Equity for the period from January 1, 1996 to December 16, 1996 (predecessor), the period from inception (March 1, 1996) to December 31, 1996, and the years ended December 31, 1997 and 1998

Consolidated Statements of Cash Flows for the period from January 1, 1996 to December 16, 1996 (predecessor), the period from inception (March 1, 1996) to December 31, 1996 and the years ended December 31, 1997 and 1998

Notes to Consolidated Financial Statements

(a)(2) The following financial statement schedules of Convergent Communications for the three years ended December 31, 1998 are included in this Report on Form 10-K, as required by Item 14(d):

- Report of Independent Accountants on Financial Statement Schedule
- Schedule II—Valuation and Qualifying Accounts

All other schedules have been omitted because the information is not required or is included in the consolidated financial statements.

(a)(3) List of Exhibits (including management contracts or compensatory plans or arrangements required to be filed)

Exhibit No.	Description
3.1†	Amended and Restated Articles of Incorporation of Convergent Communications, Inc.
3.2†	Bylaws of the Company
3.3	Articles of Amendment to the Amended and Restated Articles of Incorporation of Convergent Communications, Inc.
4.1†	Indenture, dated as of April 2, 1998, by and among the Company and Norwest Bank Colorado, N.A.
4.2†	Warrant Agreement, dated as of April 2, 1998
4.3†	Warrant Registration Rights Agreement, dated as of April 2, 1998
4.4†	Collateral Account Control Agreement, dated as of April 2, 1998
4.5†	Custody and Security Agreement, dated as of April 2, 1998
4.6	Investor Rights Agreement, dated as of March 17, 1999
4.7	Warrant Agreement, dated as of March 17, 1999

Exhibit No.	Description
10.1†	Master Lease Agreement, dated November 11, 1997, between Comdisco, Inc. and the Company
10.2†	Master Lease Agreement, dated November 17, 1997, between Convergent Capital Corporation and the Company
10.3†	Program Agreement, dated November 19, 1997, among Comdisco, Inc., Convergent Communications Services, Inc. and the Company
10.4†	Stock Purchase Agreement, dated October 31, 1996, between SONeTech and the Company
10.5†	Stock Purchase Agreement dated March 1, 1997, among Integrated Communication Networks, Inc., Communications Services of Iowa, Inc., John Shlepphorst and the Company
10.6†	Agreement and Plan of Merger, dated August 29, 1997, among Convergent Communications Services, Inc., A.T.T.Ex Corporation and the Company
10.7†	Agreement and Plan of Merger, dated September 1, 1997, among Convergent Communications Services, Inc., Vital Integration Solutions and the Company
10.8†	Asset Purchase Agreement, dated October 1, 1997, between Big Planet, Inc. and Convergent Communications Services, Inc.
10.9†	Asset Purchase Agreement, dated December 3, 1997, between Sigmacom Corporation and Convergent Communications Services, Inc.
10.10†	Asset Purchase Agreement, dated February 1, 1998, between Peak Comm, Inc. d/b/a Telephone Communications Company and Convergent Communications Services, Inc.
10.11†	Agreement and Plan of Merger, dated March 13, 1998, among Convergent Communications Services, Inc., Communication Services of Colorado, Inc., Donna Sipes and the Company
10.12†	Asset Purchase Agreement, dated March 27, 1998, between Network Computing Solutions, LLC and Convergent Communications Services, Inc.
10.13†	Employment Agreement, dated December 15, 1996, between Keith V. Burge and the Company, as amended April 13, 1998
10.14†	Employment Agreement, dated December 15, 1996, between John R. Evans and the Company, as amended April 13, 1998
10.15†	Employment Agreement, dated December 15, 1996, between Philip G. Allen and the Company, as amended April 13, 1998
10.16†	Employment Agreement, dated August 7, 1997, between Martin E. Freidel and the Company.
10.17†	Asset Purchase Agreement, dated May 15, 1990, among Convergent Communications Services, Inc., H, H & H Communications Technologies, Inc.
10.18†	Telephone Company Acquisition Agreement between Convergent Communications, Inc., First Continental Group, L.C., and ICN, LLC dated July 1996
10.19†	Asset Purchase Agreement, dated June 16, 1998 (as amended) by and between Convergent Communications Services, Inc. and Tie Communications, Inc., Debtor-in-Possession
10.20†	Asset Purchase Agreement, dated June 30, 1998 by and between Convergent Communications, Inc. and CMB Holdings, Inc.
10.21	Asset Purchase Agreement, dated February 1, 1999, by and between Convergent Communications, Services, Inc. and Kansas Communications, Inc.

Exhibit No.	Description
10.22†	Employment Agreement, dated March 3, 1997, between John J. Phibbs and the Company, as amended on April 13, 1998.
10.23	Securities Purchase Agreement, dated as of March 17, 1999, by and between Convergent Communications, Inc., and the purchasers signatory thereto.
10.24	First Amendment to Employment Agreement by and between Convergent Communications, Inc. and Martin E. Freidel, dated September 15, 1998.
10.25	Second Amendment to Employment Agreement by and between Convergent Communications, Inc. and John J. Phibbs, dated February 1, 1999.
24.1	Power of Attorney
27.1	Financial Data Schedule

†Previously filed and incorporated by reference to Registration Statement 333-53953.

(b) Reports on Form 8-K

Inapplicable

SUPPLEMENTAL INFORMATION TO BE FURNISHED WITH REPORTS FILED PURSUANT TO SECTION 15(d) OF THE ACT BY REGISTRANTS WHICH HAVE NOT REGISTERED SECURITIES PURSUANT TO SECTION 12 OF THE ACT.

The registrant has not sent to security holders any annual report covering the registrant's last fiscal year or any proxy material relating to a meeting of security holders. Copies of such annual report and proxy will be furnished to the Commission when it is sent to security holders.

SIGNATURES

Pursuant to the requirements of Section 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on March 17, 1999.

CONVERGENT COMMUNICATIONS, INC.

By: /s/ John R. Evans
John R. Evans
Chief Executive Officer

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

Signature	Title	Date
/s/ John R. Evans **John R. Evans**	Chairman, Chief Executive Officer and Director (Principal Executive Officer)	March 17, 1999
/s/ John J. Phibbs **John J. Phibbs**	Chief Financial Officer, Executive Vice President and Treasurer (Principal Financial and Principal Accounting Officer)	March 17, 1999
/s/ Keith V. Burge* **Keith V. Burge**	President, Chief Operating Officer and Director	March 17, 1999
/s/ Philip G. Allen* **Philip G. Allen**	Executive Vice President, Secretary and Director	March 17, 1999
Roland E. Casati	Director	March 17, 1999
/s/ Richard G. Tomlinson* **Richard G. Tomlinson**	Director	March 17, 1999
/s/ Michael J. Marocco* **Michael J. Marocco**	Director	March 17, 1999
Spencer I. Browne	Director	March 17, 1999

By: /s/ Martin E. Freidel
Martin E. Freidel
Attorney-in-fact

REPORT OF INDEPENDENT ACCOUNTANTS ON FINANCIAL STATEMENT SCHEDULE

To the Board of Directors of
Convergent Communications, Inc.

Our audits of the consolidated financial statements referred to in our report dated March 5, 1999, except for Note 16, as to which the date is March 17, 1999, appearing in Item 8 of this Annual Report on Form 10-K also included an audit of the financial statement schedule listed in the index in Item 14(a)(2) of this Form 10-K. In our opinion, this financial statement schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

PricewaterhouseCoopers LLP

Denver, Colorado
March 5, 1999

SCHEDULE II

Valuation and Qualifying Accounts

	Balance at Beginning of Period	Charged to Costs and Expenses	Deductions/ Writeoffs	Other	Balance at End of Period
Allowance for uncollectible trade receivables:					
Period ended December 31, 1996 . .	$ —	$ —	$ —	$ —	$ —
Year ended December 31, 1997 . . .	$ —	$ 21,389	$ —	$ —	$ 21,389
Year ended December 31, 1998 . . .	$ 21,389	$ 401,451	$(204,919)	$1,690,890(A)	$ 1,908,811
Allowance for obsolete or excess inventory:					
Period ended December 31, 1996 . .	$ —	$ —	$ —	$ —	$ —
Year ended December 31, 1997 . . .	$ —	$ —	$ —	$ —	$ —
Year ended December 31, 1998 . . .	$ —	$ 67,896	$ —	$ —	$ 67,896
Valuation allowance for deferred tax assets:					
Period ended December 31, 1996 . .	$ —	$ —	$ —	$ —	$ —
Year ended December 31, 1997 . . .	$ —	$ 3,581,998(B)	$ —	$ —	$ 3,581,998
Year ended December 31, 1998 . . .	$3,581,998	$19,114,379(B)	$ —	$ —	$22,696,377

(A) Represents amount from acquisition of certain assets of Tie Communications, Inc.

(B) Represents a full valuation against the net deferred tax assets.

John R. Evans has served as the Chief Executive Officer and Chairman of the Board of Directors since our founding. Prior to this, he served as the Chief Financial Officer and Executive Vice President of ICG Communications, Inc. ("ICG") from 1991 until December 1995. Before joining ICG, Mr. Evans held various senior accounting and treasury management positions for five years with Northern Telecom Canada Ltd., including strategic financial planning, analysis and budgeting, and held various audit and management information systems positions during six years with Coopers & Lybrand.

Keith V. Burge has served as the President, Chief Operating Officer and a member of the Board of Directors since 1996. Prior to this, he was the founder, President, Chief Executive Officer and Chief Operating Officer of Fiber Optic Technologies, Inc., a leading national network services integrator specializing in the design, implementation and support of high-speed data communication infrastructures, from 1986 to 1995. Fiber Optic Technologies became a subsidiary of ICG in 1992 and Mr. Burge continued to serve as its President until 1995. Before founding Fiber Optic Technologies, Mr. Burge was employed by Digital Equipment Corporation for nine years, where, from 1983 to 1986, he was a senior sales executive.

Philip G. Allen has served as Executive Vice President, Secretary and a member of the Board of Directors since our founding. Prior to this, he was the Vice President of Investor Relations and Corporate Communications for ICG from 1992 to 1995. Before joining ICG, Mr. Allen was President of Allen & Company Business Communications, a communications company specializing in business development and the design and production of marketing materials in the communications field. Mr. Allen was also an advisor to senior management at what is now Ameritech Corporation and U S WEST from 1976 to 1986, where he worked in various media relations, public policy and executive support areas.

Spencer I. Browne is a member of the Board of Directors, and was elected to that position in 1998. He is a principal and founder of Strategic Asset Management, LLC, a consulting company that assists small and medium sized companies in obtaining financing. Mr. Browne was a director, president and chief operating officer of M.D.C. Holdings, Inc. from 1989 to 1996. He was also a co-founder, director and chief executive officer of Asset Investors Corporation and Commercial Assets. He is also a director of Altiva Financial Corporation and Annaly Mortgage Management, Inc.

Roland E. Casati has been a Director since 1997. He has developed in excess of three million square feet of office buildings in and around Chicago, Illinois, during the past 35 years. For the last 15 years, Mr. Casati has been a venture capitalist. Mr. Casati is also a director for Adams Golf.

Michael J. Marocco was elected to our Board of Directors in 1998. He is a managing director of Sandler Capital Management. Mr. Marocco joined Sandler in 1989 and is currently responsible for analyzing, structuring and managing Sandler's private equity investments. Before joining Sandler, Mr. Marocco held various positions at Morgan Stanley & Co. Incorporated, including a fixed income research analyst specializing in companies in the communications industry and vice president in the Communications Industries group. Mr. Marocco is also a director of Source Media, Inc.

Richard G. Tomlinson, Ph.D. has served as a Director since 1997, and is also the President of Connecticut Research, Inc., a management consulting company founded in 1986 which serves the telecommunications, electric utility and computer industries. He has published numerous marketing studies, venture analyses and technical papers, is a contributing author for several books and holds five patents. Before founding Connecticut Research, Inc., he was the Vice President for Strategic Planning of United Technologies Communications Co. Inc., a subsidiary of United Technologies Building Systems Co. His career at United Technologies Corporation spanned 20 years, including 16 years at the UTC Research Laboratory where he was a Senior Principal Scientist.

Martin E. Freidel has been Executive Vice President, General Counsel and Assistant Secretary since 1997. He previously served as Special Counsel to the law firm of Miller & Welch, LLC in Denver, Colorado, where he also acted as our Associate General Counsel. From December 1992 until December 1996, Mr. Freidel was Vice President and General Counsel at ICG and its predecessors. Before joining ICG, Mr. Freidel served as Vice President—Regulatory for LDDS Communications, Inc. (now MCI WorldCom) ("LDDS") and Vice President and General Counsel for MidAmerican Technologies, Inc., MidAmerican Communications, Inc. and Republic Telecom Services, Inc., which were purchased by LDDS in 1991.