

# LEVEL 3 COMMUNICATIONS INC

## **FORM 8-K** (Current report filing)

Filed 07/28/04 for the Period Ending 07/28/04

Address	1025 ELDORADO BOULEVARD BLDG 2000 BROOMFIELD, CO 80021
Telephone	7208881000
CIK	0000794323
Symbol	LVLT
SIC Code	4813 - Telephone Communications, Except Radiotelephone
Industry	Communications Services
Sector	Services
Fiscal Year	12/31

# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## FORM 8-K

### CURRENT REPORT

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

Date of Report (Date of earliest event reported): July 28, 2004

## Level 3 Communications, Inc.

(Exact name of Registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

47-0210602  
(I.R.S. Employer  
Identification No.)

1025 Eldorado Blvd., Broomfield, Colorado  
(Address of principal executive offices)

80021  
(Zip code)

720-888-1000  
(Registrant's telephone number including area code)

Not applicable  
(Former name and former address, if changed since last report)

**Item 7. Financial Statements and Exhibits**

(a) Financial Statements of business acquired

None

(b) Pro forma financial information

None

(c) Exhibits

99.1 Press Release dated July 28, 2004, relating to second quarter 2004 financial results, including third quarter 2004 and certain full year 2004 financial projections.

**Item 12. Results of Operations and Financial Condition**

On July 28, 2004, Level 3 Communications, Inc. ("Level 3") issued a press release relating to, among other things, second quarter 2004 financial results. This press release is filed as Exhibit 99.1 to this Current Report and incorporated by reference as if set forth in full. The furnishing of this information shall not be deemed an admission as to the materiality of the information included in this Current Report. This information is not filed but is furnished to the Securities and Exchange Commission ("SEC") pursuant to Item 12 of Form 8-K.

## SIGNATURES

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

### **Level 3 Communications, Inc.**

*July 28, 2004*  
*Date*

*By: /s/ Neil J. Eckstein*  
*Neil J. Eckstein, Senior Vice President*

Level 3 Communications, Inc. 1025 Eldorado Boulevard Broomfield, Colorado 80021 [www.Level3.com](http://www.Level3.com)

## **NEWS RELEASE**

### **FOR IMMEDIATE RELEASE**

#### **Level 3 Contacts:**

Media: Josh Howell Investors: Robin Grey 720-888-2517 720-888-2518

#### **Level 3 Reports Second Quarter Results**

#### **Reports Communications Revenue of \$391 Million**

#### **New VoIP Customer Contracts Announced**

Increases Investment to Support New Services And Customer Contracts

#### **Outstanding Debt Decreased By \$230 Million**

BROOMFIELD, Colo., July 28, 2004 - Level 3 Communications, Inc. (Nasdaq:LVL3) today announced its second quarter results. Consolidated revenue was \$918 million for the second quarter compared to \$899 million for the first quarter 2004. Communications revenue was \$391 million versus \$389 million for the previous quarter, and information services revenue was \$503 million compared to \$494 million for the previous quarter.

The net loss for the second quarter 2004 decreased to \$63 million or \$0.09 per share compared to a net loss for the previous quarter of \$147 million or \$0.22 per share. Included in the net loss for the second quarter was a \$147 million gain, or \$0.22 per share, associated with the elimination of \$213 million in capital lease obligations due to the termination of a vendor contract. Included in the net loss for the previous quarter was a \$23 million gain on the sale of the company's remaining investment in Commonwealth Telephone Enterprises, Inc. Consolidated Adjusted OIBDA(1) was \$94 million in the second quarter 2004, which exceeded the projection of \$80 million to \$90 million and compares to \$128 million for the previous quarter.

## Overview

"During the second quarter, we completed the launch of our consumer-oriented VoIP services and the expansion of our IP VPN service," said James Q. Crowe, CEO of Level 3. "We also began to see increasing acceptance of these new services in the marketplace along with significant customer interest. In addition, we commenced market trials with potential customers and received several contract awards for these new services."

## Second Quarter Financial Results Compared to Projections (1)

Metric (\$ in millions)	Second Quarter Actuals	Second Quarter Projections (1)
Communications Services Revenue (2) (excluding termination and settlement revenue)	\$363	
Reciprocal Compensation	\$26	
Termination and Settlement Revenue	\$2	
Communications Revenue	\$391	\$375-\$395
Information Services Revenue	\$503	
Other Revenue	\$24	
Consolidated Revenue	\$918	
Consolidated Adjusted OIBDA (3)(4)	\$94	\$80-\$90
Capital Expenditures (5)	\$64	\$70
Unlevered Cash Flow (4)	\$15	
Free Cash Flow (4)	(\$109)	
Communications Gross Margin (4)	70%	

(1) Projections issued April 29, 2004

(2) Communications Services Revenue is GAAP communications revenue minus reciprocal compensation revenue

(3) Consolidated Adjusted OIBDA excludes \$10 million in stock-based compensation expense

(4) See schedule of non-GAAP metrics for definition and reconciliation to GAAP measures

(5) Gross capital expenditures were \$66 million for the quarter and accrual reversals were \$2 million

## Consolidated Cash Flow and Liquidity

During the second quarter 2004, unlevered cash flow(1) was \$15 million, versus \$44 million during the first quarter. Consolidated free cash flow for the second quarter was negative \$109 million, versus negative \$40 million for the previous quarter.

As of June 30, 2004, the company had cash and marketable securities of approximately \$957 million compared to \$1.1 billion at March 31, 2004.

"Our consolidated free cash flow for the second quarter declined primarily due to the timing of certain of our interest expense payments and expected increases in capital expenditures associated with new service initiatives and network build-out related to previously awarded contracts," said Sunit Patel, CFO of Level 3. "Additionally, as a result of the acquisition of ICG's managed modem business and the termination of certain vendor agreements, we saw an increase in network expenses related to the integration of the ICG and Allegiance dial-up networks. We expect to see the benefits of these expenditures in future periods."

## Communications Business Revenue

Communications revenue for the second quarter 2004 was \$391 million, versus \$389 million for the previous quarter. Total communications revenue for the second quarter consisted of \$365 million of communications services revenue and \$26 million of reciprocal compensation revenue, compared to \$366 million and \$23 million in the first quarter.

Included in communications services revenue was \$2 million and \$7 million of settlement and termination revenue for the second and first quarters, respectively. Communications services revenue, excluding settlement and termination revenue, increased by \$4 million quarter over quarter.

This increase is primarily due to additional managed modem revenue from the ICG acquisition completed during the second quarter, partially offset by expected declines in the company's existing managed modem business.

The communications deferred revenue balance increased by \$2 million during the quarter.

## Cost of Revenue

Communications cost of revenue for the second quarter was \$119 million versus \$81 million for the previous quarter. Communications gross margin(1) was 70 percent for the second quarter compared to 79 percent in the first quarter. Communications cost of revenue increased in the second quarter primarily due to expected increases in network expenses associated with the ICG acquisition, and the termination and renegotiation of vendor agreements with Allegiance and KMC Telecom. In addition, the completion of the Genuity migration in the second quarter resulted in higher than expected network expenses in the second quarter. The Genuity integration is now substantially complete and as a result, no additional expenses associated with this acquisition are expected.

As a result of the contract termination with Allegiance, the company assumed a network contract obligation with KMC. This contract was subsequently renegotiated in the second quarter, which resulted in a payment obligation of \$10 million to KMC. This obligation is being paid over the course of 2004, and recognized as cost of revenue. As a result of this renegotiation, the company expects to migrate this traffic to its network by the end of the year, with corresponding improvements in gross margin.

"While the ICG, Allegiance and KMC transactions have a short-term negative effect on gross margins and result in the use of cash, we believe the longer-term benefits from these transactions will be substantial," said Kevin O'Hara, president and COO of Level 3. "We have successfully begun the network migration for the previously announced ICG and Allegiance transactions, and expect to complete these activities over the balance of the year.

**Selling, General and Administrative Expenses (SG&A)** Communications SG&A expenses were \$202 million for the second quarter, versus \$201 million for the previous quarter. For both periods, communications SG&A expenses include \$9 million of non-cash stock compensation expense.

The total number of employees in the communications business increased to approximately 3,500 during the second quarter from approximately 3,380 in the first quarter.

Adjusted Operating Income Before Depreciation and Amortization (OIBDA) Adjusted OIBDA(1) for the communications business decreased to \$79 million for the second quarter from \$116 million for the previous quarter. Communications Adjusted OIBDA margin(1) was 20 percent for the second quarter versus 30 percent in the previous quarter. This decrease in Communications Adjusted OIBDA was primarily the result of the expected increase in network expenses as previously described.

Communications Adjusted OIBDA for the second and first quarter excludes \$9 million in non-cash stock compensation expense.

#### Information Services Business

Results for the information services business include the Software Spectrum and (i)Structure subsidiaries.

#### Revenue and Adjusted Operating Income before Depreciation and Amortization (OIBDA)

Information services revenue was \$503 million for the second quarter. This compares to revenue of \$494 million for the previous quarter, which included \$4 million of termination revenue at (i)Structure, and \$491 million for the same period last year.

Adjusted OIBDA(1) for the information services business was \$11 million for the second quarter, which excludes \$1 million in non-cash stock compensation expense, compared to \$11 million for the previous quarter, which included \$2 million in restructuring charges.

"I am pleased with the second quarter performance of the information services business," said Charles C. Miller, vice chairman of Level 3.

"The strong revenue performance of our information services business reflects the continued strength in the global software market and the benefit of normal seasonal effects. Additionally, our improving margins are a testament to the success of our ongoing cost optimization efforts, which we began last year."

The total number of employees in the information services business decreased to approximately 1,300 at the end of the second quarter from approximately 1,310 at the end of the previous quarter.

#### Other Businesses

The company's other businesses consist primarily of coal mining operations.

#### Revenue and Adjusted OIBDA

Revenue and Adjusted OIBDA(1) from other businesses were \$24 million and \$4 million in the second quarter compared to \$16 million and \$1 million for the previous quarter.

#### Debt Reduction

As a result of the company's termination of its vendor agreement with Allegiance and principal payments on capital leases during the second quarter, capital lease obligations decreased by approximately \$245 million during the second quarter.



New Customer Agreements and Service Offerings "Level 3 has been focused on the successful launch of several new service offerings in 2004, particularly VoIP and IP-based data networking services, which leverage our existing network and increase our addressable market," said O'Hara. "I am pleased that during the second quarter, we began to see early customer acceptance, revenue growth and corresponding network usage increases from these new services.

"The company has recently announced new customer agreements with AOL's Moviefone, Intelsat, Net2Phone, Skype, Tiscali, Teliris and 8x8. The company has seen substantial activity including market trials and contract awards with cable companies, local exchange carriers, long-haul carriers, systems integrators, ISPs, VARs and enhanced service providers. While these contracts were not individually disclosed at the request of the customer, they collectively represent significant opportunities over time."

"Our customers are choosing Level 3 as a provider of VoIP services because of our extensive local infrastructure, our IP network coverage and our softswitch leadership," said O'Hara. "We are pleased that two of our VoIP services, (3) VoIP SM Local Inbound and (3) ToneSM Business, received notable industry awards this quarter that underscore our role as a recognized leader in VoIP innovation and network design."

#### Softswitch Services

During the quarter, the company announced two new consumer VoIP services aimed at cable operators, enhanced service providers, ISPs, IXC's and others who provide residential voice services to end-users.

(3)VoIPSM Enhanced Local service is targeted towards customers who currently operate their own switching infrastructure, but want to deploy residential voice services cost effectively with minimal involvement in local interconnection issues.

The service gives VoIP providers the flexibility to select from a number of functionalities, including: local and long distance calling, access to the traditional telephone network (PSTN), local phone numbers, operator assistance, directory listings, E911 emergency and local number portability.

HomeToneSM is a turnkey VoIP residential service offering local and long distance capabilities. Along with the features of (3)VoIP Enhanced Local service, HomeTone service also includes additional features such as voice mail, call waiting, caller ID, three-way conferencing, and end-user Web-based account management.

#### IP & Data Services

During the second quarter, the company expanded its offering of data networking services, including (3)FlexSM Network IP VPN, to channel partners and value added resellers in the U.S. and Europe. Additionally, Level 3 expanded its wide-area Ethernet, ATM and Frame Relay data networking offerings by adding new lower speed data services.

Business Outlook  
Revenue

"Given our performance for the year so far and the progress we have made in launching our new services, we are confident that we can meet or exceed our previously issued projection for communications revenue, excluding termination revenue, of a high single-digit percent decline in 2004 versus 2003," said Crowe.

Adjusted OIBDA

"We are reaffirming our previously issued projection for Consolidated Adjusted OIBDA for 2004. This projection was that 2004 Consolidated Adjusted OIBDA, excluding termination and settlement revenue, will be consistent with 2003.

"As a result of slightly higher than expected network expenses from the ICG and Allegiance transactions, as well as the additional expenses associated with the KMC transaction that was completed during the quarter, and an acceleration of the timing of all three integrations, we expect Communications Adjusted OIBDA margins for the full year 2004 to be in the mid-20 percent range, a reduction versus our previously issued projections of high-20 percent range."

"While these managed modem transactions put short-term pressure on our communications margins, the longer-term benefits of improved cash flow, network reliability and customer service that will result from the migration of this traffic onto the Level 3 network are significant," Crowe said. "In addition, since the technology we utilize to provide modem service is also VoIP capable, we expect this investment to benefit our VoIP services."

Free Cash Flow

Primarily as a result of higher network expenses as outlined above, as well as an increase in projected capital spending to accommodate growth in the transport and infrastructure and IP businesses, the company is updating its projections for 2004 Consolidated Free Cash Flow.

"We expect full year Consolidated Free Cash Flow to be negative \$200 million to \$250 million versus negative \$180 million to \$200 million," said Crowe. "As a result of various VoIP and data contracts we are pursuing or have won, we expect to fund additional capital expenditures this year. In addition, as previously mentioned, we are incurring additional network expense and capital expenditures associated with the migration of Allegiance, KMC, and ICG traffic to our network. Both of these actions described above are expected to yield cash flow

benefits in future years."

Third Quarter 2004

Metric (\$ in millions)	Third Quarter Projections
Communications Revenue	\$400-\$420
Consolidated Adjusted OIBDA	\$100-\$120
Capital Expenditures	\$85

"We expect communications revenue to increase in the third quarter primarily as a result of a smaller than expected decline in managed modem revenue and an increase in reciprocal compensation and settlement and termination revenue," said Patel.

Consolidated Adjusted OIBDA is expected to increase to \$100 million to \$120 million in the third quarter primarily as a result of higher communications revenue from reciprocal compensation and termination and settlement revenue. In addition, network expenses associated with the ICG acquisition and the integration of Allegiance and KMC are expected to decline in the third quarter.

Communications Adjusted OIBDA margin for the third quarter is expected to be in the mid-20 percent range, as previously projected.

Capital expenditures are expected to increase to approximately \$85 million in the third quarter as the company continues investing in previously announced service initiatives and network build-out related to previously awarded contracts.

#### Summary

"Our market share gains during the second quarter in our service offerings and our initial successes with our new services give me confidence that our competitive advantages are being recognized by our customers and within the industry," said Crowe.

#### Conference Call Information

Level 3 will hold a conference call to discuss the company's second quarter results at 10:00 a.m. Eastern Time today. To join the call, please dial 612-326-1012. A live broadcast of the call can also be heard on Level 3's Web site at [www.level3.com](http://www.level3.com). An audio replay of the call will be accessible on the company's Web site or by dialing 320-365-3844; access code 736357.

#### About Level 3 Communications

Level 3 (Nasdaq:LVT) is an international communications and information services company. The company operates one of the largest Internet backbones in the world, is one of the largest providers of wholesale dial-up service to ISPs in North America and is the primary provider of Internet connectivity for millions of broadband subscribers, through its cable and DSL partners. The company offers a wide range of communications services over its 23,000-mile broadband fiber optic network including Internet Protocol (IP) services, broadband transport and infrastructure services, colocation services, and patented Softswitch managed modem and voice services. Its Web address is [www.Level3.com](http://www.Level3.com).

The company offers information services through its subsidiaries, Software Spectrum and (i)Structure. For additional information, visit their respective Web sites at [www.softwarespectrum.com](http://www.softwarespectrum.com) and [www.i-structure.com](http://www.i-structure.com).

The Level 3 logo, (3)Link Metro Wavelength and (3)Link Metro Ethernet are registered service marks and (3)VoIP Enhanced Local Service and HomeTone are service marks of Level 3 Communications, Inc. in the United States and/or other countries.

#### Forward Looking Statement

Some of the statements made by Level 3 in this press release are forward-looking in nature. Actual results may differ materially from those projected in forward-looking statements. Level 3 believes that its primary risk factors include, but are not limited to: changes in the overall economy relating to, among other things, the September 11 attacks and subsequent events, the challenges of integration, substantial capital requirements; development of effective internal processes and systems; the ability to attract and retain high quality employees; technology; the number and size of competitors in its markets; law and regulatory policy; and the mix of products and services offered in the company's target markets. Additional information concerning these and other important factors can be found within Level 3's filings with the Securities and Exchange Commission. Statements in this release should be evaluated in light of these important factors.

(1) Non-GAAP Metrics Pursuant to Regulation G, the company is hereby providing a reconciliation of non-GAAP financial metrics to the most directly comparable GAAP measure.

The company provides projections that include non-GAAP metrics that the company deems relevant to management and investors. These non-GAAP metrics are Consolidated Adjusted OIBDA, communications gross margin, Communications Adjusted OIBDA margin, unlevered cash flow and consolidated free cash flow. The following reconciliation of these non-GAAP financial metrics to GAAP includes forward-looking statements with respect to the information identified as a projection. Level 3 has made a number of assumptions in preparing our projections, including assumptions as to the components of financial metrics. These assumptions, including dollar amounts of the various components that comprise a financial metric, may or may not prove to be correct. We caution you that these forward-looking statements are only predictions, which are subject to risks and uncertainties including technological uncertainty, financial variations, changes in the regulatory environment, industry growth and trend predictions. Please see the company's Annual Report on Form 10-K for a description of these risks and uncertainties.

In order to provide projections with respect to non-GAAP measures, we are required to indicate a range for GAAP measures that are components of the reconciliation of the non-GAAP metric. The provision of these ranges is in no way meant to indicate that the company is explicitly or implicitly providing projections on those GAAP components of the reconciliation. In order to reconcile the non-GAAP financial metric to GAAP, the company has to use ranges for the GAAP components that arithmetically add up to the non-GAAP financial metric. While the company feels reasonably comfortable about the projections for its non-GAAP financial metrics, it fully expects that the ranges used for the GAAP components will vary from actual results. We will consider our projections of non-GAAP financial metrics to be accurate if the specific non-GAAP metric is met or exceeded, even if the GAAP components of the reconciliation are different from those provided in an earlier reconciliation.

Communications Gross Margin (\$) is defined as communications revenue less communications cost of revenue from the consolidated condensed statements of operations.

Cost of Revenue for the communications business includes leased capacity, right-of-way costs, access charges and other third party circuit costs directly attributable to the network, as well as costs of assets sold pursuant to sales-type leases. Communications Gross Margin (%) is defined as communications gross margin (\$) divided by communications revenue. Management believes that communications gross margin is a relevant metric to provide to investors, as it is a metric that management uses to measure the margin available to the company after it pays third party network services costs; in essence, a measure of the efficiency of the company's network.

#### COMMUNICATIONS GROSS MARGIN (\$ in millions)

	Q104	Q204
Communications Revenue	\$389	\$391
Communications Cost of Revenue	\$81	\$119
Communications Gross Margin (\$)	\$308	\$272
Communications Gross Margin (%)	79%	70%

Consolidated Adjusted OIBDA is defined as operating income from the consolidated condensed statements of operations, plus depreciation and amortization plus non-cash impairment charges plus non-cash stock compensation expense.

Communications Adjusted OIBDA Margin is defined as Communications Adjusted OIBDA divided by communications revenue.

Management believes that Consolidated Adjusted OIBDA and Communications Adjusted OIBDA Margins are relevant and useful metrics to provide to investors, as they are an important part of the company's internal reporting and are indicators of profitability and operating performance, especially in a capital-intensive industry such as telecommunications. Management also uses Consolidated Adjusted OIBDA and Communications Adjusted OIBDA Margins to compare the company's performance to that of its competitors. Consolidated Adjusted OIBDA excludes non-cash impairment charges and non-cash stock compensation expense due to the company's adoption of the expense recognition provisions of SFAS No. 123. Additionally, Consolidated Adjusted OIBDA excludes interest expense and income tax expense and other gains/losses not included in operating income. Excluding these items eliminates the expenses associated with the company's capitalization and tax structures. Consolidated Adjusted OIBDA excludes depreciation and amortization expense in order to eliminate the impact of capital investments which management believes should be evaluated through consolidated free cash flow.

There are limitations to using non-GAAP financial measures, including the difficulty associated with comparing companies that use similar performance measures whose calculations may differ from the company's calculations. Additionally, this financial measure does not include certain significant items such as depreciation and amortization, interest expense and non-cash impairment charges. Consolidated Adjusted OIBDA and Communications Adjusted OIBDA Margin should not be considered a substitute for other measures of financial performance reported in accordance with GAAP.

Consolidated Adjusted OIBDA Three Months Ended June 30, 2004 (\$ in millions)	Communications	Information Services	Other	Con- solidated
Net Earnings/(Loss)	(\$66)	\$1	\$2	(\$63)
Income Tax (Benefit)/Expense	--	\$1	--	\$1
Plus Other (Income)/Expense	(\$33)	\$1	\$1	(\$31)
Operating Income/(Loss)	(\$99)	\$3	\$3	(\$93)
Plus Depreciation and Amortization Expense	\$169	\$7	\$1	\$177
Plus Non-Cash Stock Compensation Expense	\$9	\$1	--	\$10
Consolidated Adjusted OIBDA	\$79	\$11	\$4	\$94

Consolidated Adjusted OIBDA  
Three Months Ended March 31, 2004  
(\$ in millions)

	Communications	Information Services	Other	Con- solidated
Net Earnings/(Loss)	(\$175)	\$5	\$23	(\$147)
Income Tax (Benefit)/Expense	--	--	\$1	\$1
Plus Other (Income)/Expense	\$111	(\$1)	(\$24)	\$86
Operating Income/(Loss)	(\$64)	\$4	--	(\$60)
Plus Depreciation and Amortization Expense	\$171	\$7	\$1	\$179
Plus Non-Cash Stock Compensation Expense	\$9	--	--	\$9
Consolidated Adjusted OIBDA	\$116	\$11	\$1	\$128

Communications Adjusted OIBDA Margin  
(\$ in millions)

	Q104	Q204
Communications Revenue	\$389	\$391
Communications Adjusted OIBDA	\$116	\$79
Communications Adjusted OIBDA Margin	30%	20%

Projected Consolidated Adjusted OIBDA  
Three Months Ended September 30, 2004  
(\$ in millions)

	Consolidated Range	
	Low	High
Net Earnings/(Loss)	(\$200)	(\$180)
Plus Other (Income)/Expense	\$120	\$110
Operating Income/(Loss)	(\$80)	(\$70)
Plus Depreciation and Amortization Expense	\$170	\$180
Plus Non-Cash Stock Compensation Expense	\$10	\$10
Consolidated Adjusted OIBDA	\$100	\$120

Unlevered Cash Flow is defined as net cash provided by (used in) operating activities less capital expenditures offset by release of capital expenditure accruals, and adding back cash interest paid, less interest income all as disclosed in the consolidated statements of cash flows or the consolidated condensed statements of operations. Management believes that unlevered cash flow is a relevant metric to provide to investors, as it is an indicator of the operational strength and performance of the company and, measured over time, provides management and investors with a sense of the growth pattern of the business.

There are material limitations to using unlevered cash flow to measure the company against some of its competitors as it excludes certain material items such as cash spent on merger and acquisition activity and interest expense. Level 3 does not currently pay income taxes due to net operating losses, and therefore, generates higher cash flow than a comparable business that does pay income taxes. Additionally, this financial measure is subject to variability quarter over

quarter as a result of the timing of payments related to accounts receivable and accounts payable. Unlevered cash flow should not be used as a substitute for net change in cash and cash equivalents on the consolidated statements of cash flows.

Consolidated Free Cash Flow is defined as net cash provided by (used in) operating activities less capital expenditures offset by release of capital expenditure accruals as disclosed in the consolidated statements of cash flows. Management believes that consolidated free cash flow is a relevant metric to provide to investors, as it is an indicator of the company's ability to generate cash to service its debt. Consolidated Free Cash Flow excludes cash used for acquisitions or principal repayments.

There are material limitations to using consolidated free cash flow to measure the company against some of its competitors as Level 3 does not currently pay income taxes due to net operating losses, and therefore, generates higher cash flow than a comparable business that does pay income taxes. Additionally, this financial measure is subject to variability quarter over quarter as a result of the timing of payments related to accounts receivable and accounts payable. This financial measure should not be used as a substitute for net change in cash and cash equivalents on the consolidated statements of cash flows.

UNLEVERED CASH FLOW AND CONSOLIDATED FREE CASH FLOW  
Three Months Ended June 30, 2004  
(\$ in millions)

	Unlevered Cash Flow	Consolidated Free Cash Flow
Net Cash Used In Continuing Operations	(\$45)	(\$45)
Gross Capital Expenditures	(\$66)	(\$66)
Release of Capital Expenditure Accruals	\$2	\$2
Cash Interest Paid	\$127	N/A
Interest Income	(\$3)	N/A
Total	\$15	(\$109)

UNLEVERED CASH FLOW AND CONSOLIDATED FREE CASH FLOW  
Three Months Ended March 31, 2004  
(\$ in millions)

	Unlevered Cash Flow	Consolidated Free Cash Flow
Net Cash Provided by Continuing Operations	\$8	\$8
Gross Capital Expenditures	(\$52)	(\$52)
Release of Capital Expenditure Accruals	\$4	\$4
Cash Interest Paid	\$87	N/A
Interest Income	(\$3)	N/A
Total	\$44	(\$40)



PROJECTED CONSOLIDATED FREE CASH FLOW  
Twelve Months Ended December 31, 2004  
(\$ in millions)

Consolidated  
Range

	Low	High
Net Cash Provided by Continuing Operations	\$18	\$38
Gross Capital Expenditures	(\$274)	(\$244)
Release of Capital Accruals	\$6	\$6
Total	(\$250)	(\$200)

# Attachment #1

## LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES Consolidated Condensed Statements of Operations (unaudited)

	Three Months Ended	
	June 30,	March 31,
(dollars in millions)	2004	2004
Revenue:		
Communications	\$ 391	\$ 389
Information Services	503	494
Other	24	16
	--	--
Total Revenue	918	899
Costs and Expenses:		
Cost of Revenue	591	543
Depreciation and Amortization	177	179
Selling, General and Administrative, including non-cash compensation of \$10 and \$9, respectively	243	235
Restructuring Charges, including noncash impairment charges of \$-, and \$-, respectively	-	2
	--	--
Total Costs and Expenses	1,011	959
	-----	-----
Operating Income (Loss)	(93)	(60)
Other Income (Loss), net		
Interest Income	3	3
Interest Expense	(118)	(127)
Other Income	146	38
	--	--
Other Income (Loss)	31	(86)
	--	--
Loss Before Income Taxes	(62)	(146)
Income Tax Expense	(1)	(1)
	--	--
Net Loss	\$ (63)	\$ (147)
	=====	=====
Basic Loss per Share:		
Net Loss	\$ (0.09)	\$ (0.22)
	=====	=====
Weighted Average Shares Outstanding (in thousands)		
Basic	682,629	679,991
	=====	=====

## Attachment #2

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES  
Consolidated Condensed Balance Sheets  
(unaudited)

(dollars in millions)	June 30, 2004	March 31, 2004
<b>Assets</b>		
Current Assets:		
Cash and cash equivalents	\$ 547	\$ 1,161
Marketable securities	221	-
Restricted securities	52	47
Accounts receivable, less allowances of \$26 and \$26, respectively	476	429
Other	122	110
	---	---
Total Current Assets	1,418	1,747
Property, Plant and Equipment, net	5,466	5,598
Marketable Securities	189	
Restricted Securities	62	63
Intangibles, net and Goodwill	463	445
Other Assets, net	90	99
	--	--
	\$ 7,688	\$ 7,952
	=====	=====
<b>Liabilities and Stockholders' Equity (Deficit)</b>		
Current Liabilities:		
Accounts payable	\$ 549	\$ 510
Current portion of long-term debt	141	103
Accrued payroll and employee benefits	90	94
Accrued interest	87	118
Deferred revenue	164	154
Other	243	220
	---	---
Total Current Liabilities	1,274	1,199
Long-Term Debt, less current portion	5,008	5,276
Deferred Revenue	963	970
Other Liabilities	457	476
Stockholders' Equity (Deficit)	(14)	31
	---	--
	\$ 7,688	\$ 7,952
	=====	=====

## Attachment #3

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES  
Consolidated Statements of Cash Flows  
(unaudited)

	Three Months Ended	
	June 30,	March 31,
(dollars in millions)	2004	2004
Cash Flows from Operating Activities:		
Net Loss	\$ (63)	\$ (147)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	177	179
Gain on sale of property, plant and equipment, and other assets	(2)	(32)
Gain on debt extinguishments, net	(147)	-
Non-cash compensation expense attributable to stock awards	10	9
Deferred revenue	1	(16)
Amortization of debt issuance costs	4	4
Accreted interest on discount debt	18	18
Accrued interest on long-term debt	(31)	18
Changes in working capital items net of amounts acquired:		
Receivables	(46)	121
Other current assets	(8)	30
Payables	52	(136)
Other liabilities	(8)	(35)
Other	(2)	(5)
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Net Cash Provided by (Used in) Operating Activities	(45)	8
Cash flows from Investing Activities:		
Decrease (increase) in restricted cash and securities, net	(4)	25
Capital expenditures	(66)	(52)
Release of capital expenditure accruals	2	4
Proceeds from sale of property, plant and equipment	7	9
Purchases of marketable securities	(410)	-
ICG acquisition	(25)	-
Proceeds from sale of Commonwealth Telephone	-	41
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Net Cash Provided by (Used in) Investing Activities	(496)	27
Cash Flows from Financing Activities:		
Payments on long-term debt, including current portion	(75)	(1)
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Net Cash Used in Financing Activities	(75)	(1)
Effect of Exchange Rates on Cash	2	(2)
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Net Change in Cash and Cash Equivalents	(614)	32
Cash and Cash Equivalents at Beginning of Period	1,161	1,129
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Cash and Cash Equivalents at End of Period	\$ 547	\$ 1,161
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Supplemental Disclosure of Cash Flow Information:		
Cash interest paid	\$ 127	\$ 87