

LEVEL 3 COMMUNICATIONS INC

FORM 10-Q (Quarterly Report)

Filed 08/09/05 for the Period Ending 06/30/05

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

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FORM 10-Q
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

(Mark One)



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

For the Quarterly Period Ended **June 30, 2005**

or



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

For the transition period to

Commission file number **0-15658**

LEVEL 3 COMMUNICATIONS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State of Incorporation)

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

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

80021
(Zip Code)

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☒ No ☐

The number of shares outstanding of each class of the issuer's common stock, as of August 1, 2005:

Common Stock: 698,376,902 shares

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

Part I - Financial Information

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

(dollars in millions, except per share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
Revenue:				
Communications	\$ 371	\$ 391	\$ 881	\$ 780
Information Services	520	503	1,003	997
Coal Mining	19	24	36	40
Total revenue	910	918	1,920	1,817
Costs and Expenses (exclusive of depreciation and amortization shown separately below):				
Cost of revenue:				
Communications	110	119	226	200
Information Services	469	455	911	904
Coal Mining	9	17	22	30
Total cost of revenue	588	591	1,159	1,134
Depreciation and amortization	166	177	337	356
Selling, general and administrative	217	243	443	478
Restructuring and impairment charges	4	—	19	2
Total costs and expenses	975	1,011	1,958	1,970
Operating Loss	(65)	(93)	(38)	(153)
Other Income (Expense):				
Interest income	10	3	14	6
Interest expense	(139)	(118)	(253)	(245)
Other, net	9	146	15	184
Total other income (expense)	(120)	31	(224)	(55)
Loss Before Income Tax	(185)	(62)	(262)	(208)
Income Tax Expense	(3)	(1)	(3)	(2)
Net Loss	<u>\$ (188)</u>	<u>\$ (63)</u>	<u>\$ (265)</u>	<u>\$ (210)</u>
Loss per Share of Level 3 Common Stock:				
Basic and Diluted	<u>\$ (0.27)</u>	<u>\$ (0.09)</u>	<u>\$ (0.38)</u>	<u>\$ (0.31)</u>

See accompanying notes to consolidated financial statements.

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

(dollars in millions)	June 30, 2005	December 31, 2004
Assets		
Current Assets:		
Cash and cash equivalents	\$ 448	\$ 443
Marketable securities	329	225
Restricted cash and securities	27	48
Receivables, less allowances of \$22 and \$23, respectively	544	545
Other	132	141
Total Current Assets	1,480	1,402
Property, Plant and Equipment, net	5,158	5,408
Marketable Securities	506	114
Restricted Cash and Securities	70	67
Goodwill and Intangibles, net	421	457
Other Assets, net	98	96
Total Assets	<u>\$ 7,733</u>	<u>\$ 7,544</u>

See accompanying notes to consolidated financial statements.

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

(dollars in millions, except per share data)	June 30, 2005	December 31, 2004
Liabilities and Stockholders' Deficit		
Current Liabilities:		
Accounts payable	\$ 578	\$ 614
Current portion of long-term debt	1	144
Accrued payroll and employee benefits	57	82
Accrued interest	107	73
Deferred revenue	182	255
Other	115	134
Total Current Liabilities	1,040	1,302
Long-Term Debt, less current portion	5,945	5,067
Deferred Revenue	731	840
Other Liabilities	461	492
Commitments and Contingencies		
Stockholders' Deficit:		
Preferred stock, \$.01 par value, authorized 10,000,000 shares: no shares outstanding	—	—
Common stock:		
Common stock, \$.01 par value, authorized 1,500,000,000 shares: 696,734,487 outstanding in 2005 and 686,496,721 outstanding in 2004	7	7
Class R, \$.01 par value, no shares authorized in 2005, authorized 8,500,000 shares: no shares outstanding in 2004	—	—
Additional paid-in capital	7,412	7,371
Accumulated other comprehensive income (loss)	(44)	19
Accumulated deficit	(7,819)	(7,554)
Total Stockholders' Deficit	(444)	(157)
Total Liabilities and Stockholders' Deficit	\$ 7,733	\$ 7,544

See accompanying notes to consolidated financial statements.

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

(dollars in millions)	Six Months Ended June 30,	
	2005	2004
Cash Flows from Operating Activities:		
Net Loss	\$ (265)	\$ (210)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	337	356
Loss on impairments	4	—
Gain on debt extinguishments, net		(147)
Gain on sale of property, plant and equipment, and other assets	(2)	(34)
Non-cash compensation expense attributable to stock awards	21	19
Deferred revenue	(169)	(15)
Amortization of debt issuance costs	8	8
Accreted interest on long-term discount debt	23	37
Accrued interest on long-term debt	35	(13)
Change in working capital items net of amounts acquired:		
Receivables	(14)	75
Other current assets	11	22
Payables	(25)	(84)
Other liabilities	(26)	(43)
Other	(15)	(8)
Net Cash Used in Operating Activities	(77)	(37)
Cash Flows from Investing Activities:		
Purchases of marketable securities	(648)	(410)
Proceeds from sales and maturities of marketable securities	150	41
Decrease in restricted cash and securities, net	1	21
Capital expenditures	(149)	(118)
Release of capital expenditure accruals	3	6
Investments and acquisitions	(10)	(25)
Proceeds from sale of property, plant and equipment, and other assets	4	16
Net Cash Used in Investing Activities	\$ (649)	\$ (469)

See accompanying notes to consolidated financial statements.

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

	Six Months Ended June 30,	
	2005	2004
Cash Flows from Financing Activities:		
Long-term debt borrowings, net of issuance costs	\$ 877	\$ —
Payments on long-term debt, including current portion (net of restricted cash)	(130)	(76)
Net Cash Provided by (Used in) Financing Activities	747	(76)
Effect of Exchange Rates on Cash and Cash Equivalents	(16)	—
Net Change in Cash and Cash Equivalents	5	(582)
Cash and Cash Equivalents at Beginning of Period	443	1,129
Cash and Cash Equivalents at End of Period	\$ 448	\$ 547
Supplemental Disclosure of Cash Flow Information:		
Cash interest paid	\$ 187	\$ 214
Non Cash Financing and Investing Activities:		
Use of restricted securities to repay long-term debt	\$ 13	\$ —

See accompanying notes to consolidated financial statements.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES
Consolidated Statement of Changes in Stockholders' Deficit
For the six months ended June 30, 2005
(unaudited)

(dollars in millions)	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total
Balances at December 31, 2004	\$ 7	\$ 7,371	\$ 19	\$ (7,554)	\$ (157)
Common Stock:					
Stock plan grants	—	15	—	—	15
Shareworks plan	—	17	—	—	17
401(k) plan	—	9	—	—	9
Net Loss	—	—	—	(265)	(265)
Other Comprehensive Loss	—	—	(63)	—	(63)
Balances at June 30, 2005	<u>\$ 7</u>	<u>\$ 7,412</u>	<u>\$ (44)</u>	<u>\$ (7,819)</u>	<u>\$ (444)</u>

See accompanying notes to consolidated financial statements.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Loss
(unaudited)

(dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
Net Loss	\$ (188)	\$ (63)	\$ (265)	\$ (210)
Other Comprehensive Income (Loss) Before Tax:				
Foreign currency translation gains (losses)	(35)	1	(64)	(7)
Unrealized holding losses and other arising during period	(1)	(2)	(1)	(2)
Reclassification adjustment for (gains) losses included in net income (loss)	(2)	4	2	(17)
Other Comprehensive Income (Loss), Before Tax	(38)	3	(63)	(26)
Income Tax Benefit Related to Items of Other Comprehensive Income (Loss)	—	—	—	—
Other Comprehensive Income (Loss) Net of Taxes	(38)	3	(63)	(26)
Comprehensive Loss	<u>\$ (226)</u>	<u>\$ (60)</u>	<u>\$ (328)</u>	<u>\$ (236)</u>

See accompanying notes to consolidated financial statements.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies

The consolidated financial statements include the accounts of Level 3 Communications, Inc. and subsidiaries (the “Company” or “Level 3”) in which it has control, which are engaged in enterprises primarily related to communications, information services, and coal mining. Fifty-percent-owned mining joint ventures are consolidated on a pro rata basis. Investments in other companies in which the Company exercises significant influence over operating and financial policies or has significant equity ownership are accounted for by the equity method. All significant intercompany accounts and transactions have been eliminated.

The consolidated balance sheet of Level 3 Communications, Inc. and subsidiaries at December 31, 2004 has been taken from the Company’s audited balance sheet as of that date. All other financial statements contained herein are unaudited and, in the opinion of management, contain all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation of financial position, results of operations and cash flows for the periods presented. The Company’s accounting policies and certain other disclosures are set forth in the notes to the consolidated financial statements contained in the Company’s Annual Report on Form 10-K, for the year ended December 31, 2004. These financial statements should be read in conjunction with the Company’s audited consolidated financial statements and notes thereto. The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities and the reported amount of revenue and expenses during the reported period. Actual results could differ from these estimates.

The results of operations for the three and six months ended June 30, 2005 are not necessarily indicative of the results expected for the full year.

Termination revenue is recognized when a customer disconnects service prior to the end of the contract period, for which Level 3 had previously received consideration and for which revenue recognition was deferred. Termination revenue is also recognized when customers make termination penalty payments to Level 3 to settle contractually committed purchase amounts that the customer no longer expects to meet or when a customer and Level 3 renegotiate a contract under which Level 3 is no longer obligated to provide product or services for consideration previously received and for which revenue recognition has been deferred. Termination revenue is reported in the same manner as the original product or service provided, and amounted to \$2 million and \$131 million during the three and six months ended June 30, 2005, respectively, and \$2 million and \$13 million during the three and six months ended June 30, 2004, respectively (See Note 4).

Emerging Issues Task Force (“EITF”) Issue No. 04-6, “Accounting for Stripping Costs Incurred during Production in the Mining Industry” (“EITF 04-6”) establishes appropriate accounting for stripping costs incurred during the production phase and is effective for the first reporting period in fiscal years beginning after December 15, 2005, with early adoption permitted. EITF No. 04-6 concludes that stripping costs incurred during the production phase of a mine are variable production costs that should be included in the costs of the inventory produced during the period that the stripping costs are incurred. EITF No. 04-6 further defines inventory produced as mineral that has been extracted. As a result, stripping costs related to exposed, but not extracted mineral will be expensed as incurred rather than deferred until the mineral is extracted. The Company’s coal mining business currently defers stripping costs and amortizes these costs over the period in which the underlying coal is mined. The Company expects to adopt EITF 04-6 beginning January 1, 2006 and the adoption is not expected to have a significant impact on the Company’s financial position or results of operations.

In March 2005, the FASB issued FASB Interpretation No. 47 “Accounting for Conditional Asset Retirement Obligations”, (“FIN 47”). FIN 47 provides additional clarification as to when companies should recognize asset retirement obligations pursuant to SFAS No. 143, “Accounting for Asset Retirement Obligations.” The Company expects to adopt FIN 47 effective January 1, 2006. The adoption of FIN 47 is not expected to have a material effect on the Company’s results of operations or financial position as Level 3

recognized the discounted value of its conditional asset retirement obligations when it adopted FASB No. 143 at the beginning of 2003.

The FASB issued SFAS No. 153, "Exchanges of Non-Monetary Assets," which is effective for Level 3 starting January 1, 2006 ("SFAS No. 153"). In the past, the Company was required to measure the value of assets exchanged in non-monetary transactions by using the net book value of the asset relinquished. Under SFAS No. 153, the Company will measure assets exchanged at fair value, as long as the transaction has commercial substance and the fair value of the assets exchanged is determinable within reasonable limits. A non-monetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The adoption of SFAS No. 153 is not anticipated to have a material effect on the Company's financial position or results of operations as Level 3 is a party only to a limited number of non-monetary transactions and those transactions have not been material.

In December 2004, the FASB issued SFAS No. 123R, "Share Based Payment" ("SFAS No. 123R"). SFAS No. 123R requires that compensation cost relating to share-based payment transactions be recognized in the financial statements based on the fair value of equity or liability instruments issued. The U.S. Securities and Exchange Commission extended the effective date of SFAS No. 123R such that the Company is first required to adopt SFAS No. 123R beginning January 1, 2006 although the Company is permitted to adopt SFAS No. 123R in periods prior to this effective date. The Company expects to adopt SFAS No. 123R beginning January 1, 2006 and the adoption is not expected to have a significant impact on the Company's financial position or results of operations as the Company adopted the expense recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" in 1998.

Where appropriate, items within the consolidated financial statements have been reclassified from the previous periods to conform to current period presentation.

2. Acquisitions

On October 1, 2004, the Company acquired the wholesale dial internet access business of Sprint Communications Company, L.P. ("Sprint"). Level 3 paid \$34 million in cash to acquire the business, which provides dial-up Internet access to leading Internet service providers throughout the United States and agreed to provide discounted services to Sprint that were valued at \$5 million, which was accounted for as part of the purchase price. Level 3 and Sprint entered into a transition services agreement for the migration of customers onto the Level 3 network, which Level 3 expects to complete in the third quarter of 2005. During the migration period, until such time as a customer contract is assumed or assigned, amounts received for services provided by Sprint are accounted for as a reduction in purchase price as opposed to revenue. The net amount received prior to the assumption or assignment of these contracts totaled \$5 million through June 30, 2005 and therefore reduced the purchase price to \$29 million. The net amount received prior to the assumption or assignment of these contracts was less than \$1 million for the three and six month periods in 2005. At June 30, 2005, all customer contracts, with the exception of one minor contract, had been assigned to Level 3 or Level 3 had entered into new contractual arrangements with the customers acquired from Sprint. The results of operations attributable to the Sprint assets acquired and liabilities assumed are included in the consolidated financial statements from the date of assumption or assignment of contracts.

On April 1, 2004, the Company acquired the wholesale dial-up internet access customer contracts of ICG Communications, Inc. ("ICG"). The Company agreed to pay approximately \$35 million in cash to acquire the contracts and related equipment, which provide dial-up Internet access to various large customers and other leading ISPs. The purchase price was subject to post-closing adjustments, but those adjustments were not material. Level 3 migrated the traffic from the customer contracts acquired from ICG onto its own network infrastructure and the migration was substantially complete by the end of 2004. The results of operations attributable to the ICG assets acquired and liabilities assumed are included in the consolidated financial statements from the date of acquisition.

The following is unaudited pro-forma financial information of the Company assuming the Sprint and ICG transactions occurred at the beginning of the period presented :

(dollars in millions, except per share data)	Pro-Forma	
	Three Months Ended June 30, 2004	Six Months Ended June 30, 2004
Revenue	\$ 927	\$ 1,852
Net Loss	(59)	(201)
Net Loss per Share	\$ (0.09)	\$ (0.30)

3 . Restructuring and Impairment Charges

During the three and six month periods ended June 30, 2004, the information services business recognized less than \$1 million and approximately \$2 million, respectively, of restructuring charges related to the ongoing integration and restructuring of Software Spectrum announced in 2003. As of December 31, 2004, the Company had completed the workforce reductions and paid the remaining severance and employee related obligations associated with the actions announced in 2003 and 2004.

In the first quarter of 2005, the Company initiated a workforce reduction of approximately 470 employees in its North American and European communications business. As a result of the reduction, Level 3 incurred severance and related charges of approximately \$15 million in the first quarter of 2005. As of June 30, 2005, the Company had remaining obligations of less than \$1 million associated with the workforce reduction.

A summary of the restructuring charges and related activity follows:

	Severance and Related		Facilities Related	
	Number of Employees	Amount (in millions)	Amount (in millions)	
Balance December 31, 2003	109	\$ 7	\$ 12	
2004 Charges	80	1	15	
2004 Payments	(189)	(8)	(8)	
Balance December 31, 2004	—	—	\$ 19	
2005 Charges	472	15	—	
2005 Payments	(472)	(15)	(3)	
Balance June 30, 2005	—	\$ —	\$ 16	

Non-cash impairment charges were \$4 million for the second quarter of 2005 and resulted from the decision to terminate projects for certain Softswitch related products in the communications business. The costs incurred for these projects, including capitalized operating expenses, were impaired as the carrying value of these projects exceeded their estimated fair value.

Level 3 continues to periodically conduct comprehensive reviews of the long-lived assets of its businesses, specifically communications assets deployed along its intercity network and in its gateway

facilities. It is possible that assets may be identified as impaired and additional impairment charges may be recorded to reflect the realizable value of these assets in future periods.

4. Termination Revenue

On February 22, 2005, France Telecom Long Distance USA, LLC (“France Telecom”) and Level 3 finalized an agreement to terminate a dark fiber agreement signed in 2000. Under the terms of the agreement France Telecom returned the fiber to Level 3. Under the original IRU agreement, the cash received by Level 3 was deferred and amortized to revenue over the 20-year term of the agreement. As a result of this transaction, Level 3 recognized the unamortized deferred revenue of approximately \$40 million of unamortized deferred revenue as non-cash termination revenue in the first quarter of 2005.

On March 1, 2005, Level 3 entered into an agreement with 360networks (USA), Inc. (“360networks”) in which both parties agreed to terminate a 20-year IRU agreement. Under the new agreement 360networks returned the dark fiber originally provided by Level 3. Under the original IRU agreement, signed in 2000, the cash received by Level 3 was deferred and amortized to revenue over the 20-year term of the agreement. As a result of this transaction, Level 3 recognized the unamortized deferred revenue of approximately \$86 million as non-cash termination revenue in the first quarter of 2005.

5. Loss Per Share

The Company had a loss from continuing operations for the three and six months ended June 30, 2005 and 2004. Therefore, the dilutive effect of the approximately 417 million and 83 million shares issuable pursuant to the convertible debt securities at June 30, 2005 and 2004, respectively, have not been included in the computation of diluted loss per share because their inclusion would have been anti-dilutive to the computation. In addition, the dilutive effect of the approximately 59 million and 50 million options and warrants outstanding at June 30, 2005 and 2004, respectively, have not been included in the computation of diluted loss per share because their inclusion would have been anti-dilutive to the computation.

The following details the loss per share calculations for the Level 3 common stock:

(dollars in millions, except per share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
Net Loss	\$ (188)	\$ (63)	\$ (265)	\$ (210)
Total Number of Weighted Average Shares Outstanding used to Compute Basic and Dilutive Loss Per Share (in thousands)	695,533	682,629	692,888	681,302
Loss Per Share of Level 3 Common Stock:				
Basic and Diluted	\$ (0.27)	\$ (0.09)	\$ (0.38)	\$ (0.31)

6. Receivables

Receivables at June 30, 2005 and December 31, 2004 were as follows (dollars in millions):

	Communications	Information Services	Coal	Total
June 30, 2005				
Accounts Receivable – Trade:				
Services and Software Sales	\$ 171	\$ 386	\$ 9	\$ 566
Allowance for Doubtful Accounts	(16)	(6)	—	(22)
	<u>\$ 155</u>	<u>\$ 380</u>	<u>\$ 9</u>	<u>\$ 544</u>
December 31, 2004				
Accounts Receivable – Trade:				
Services and Software Sales	\$ 138	\$ 418	\$ 12	\$ 568
Allowance for Doubtful Accounts	(17)	(6)	—	(23)
	<u>\$ 121</u>	<u>\$ 412</u>	<u>\$ 12</u>	<u>\$ 545</u>

The Company recognized bad debt expense in selling, general and administrative expenses of less than \$1 million and \$1 million for the three and six month periods ended June 30, 2005, respectively and \$2 million and \$4 million for the three and six month periods ended June 30, 2004, respectively. Level 3 received proceeds for amounts previously deemed uncollectible of less than \$1 million and \$1 million for the three and six months ended June 30, 2005 and less than \$1 million and \$1 million for the three and six months ended June 30, 2004, respectively. The Company decreased accounts receivable and allowance for doubtful accounts by approximately \$2 million and \$6 million for the six months ended June 30, 2005 and 2004, respectively, for previously reserved amounts the Company deemed as uncollectible.

7. Property, Plant and Equipment, net

Costs associated directly with expansions and improvements to the network and customer installations, including employee related costs, have been capitalized. The Company generally capitalizes costs associated with network construction, provisioning of services and software development. Capitalized labor and related costs associated with employees and contract labor working on capital projects were approximately \$11 million and \$23 million for the three and six months ended June 30, 2005, respectively. Included in capitalized labor and related costs was less than \$1 million and \$1 million of capitalized non-cash compensation costs related to options and warrants for the three and six months ended June 30, 2005. Capitalized labor and related costs associated with employees and contract labor working on capital projects were approximately \$17 million and \$34 million for the three and six months ended June 30, 2004, respectively. Included in capitalized labor and related costs was less than \$1 million and \$1 million of capitalized non-cash compensation costs related to options and warrants for the three and six months ended June 30, 2004, respectively.

The Company continues to develop business support systems required for its business. The external direct costs of software, materials and services, payroll and payroll related expenses for employees directly associated with the project, and interest costs incurred when developing the business support systems are capitalized and included in the capitalized costs above. Upon completion of a project, the total cost of the business support system is amortized over a useful life of three years.

Depreciation expense was \$149 million and \$302 million for the three and six months ended June 30, 2005, respectively. Depreciation expense was \$159 million and \$323 million for the three and six months ended June 30, 2004, respectively.

8. Goodwill and Intangibles, net

Goodwill and Intangibles, net at June 30, 2005 and December 31, 2004 were as follows (dollars in millions):

	Goodwill	Intangibles
June 30, 2005		
360networks	\$ —	\$ 4
Sprint	—	23
ICG	—	14
Telverse	—	19
Genuity	—	42
McLeod	41	—
Software Spectrum (including Corpsoft)	196	52
XCOM	30	—
	<u>\$ 267</u>	<u>\$ 154</u>
December 31, 2004		
Sprint	\$ —	\$ 28
ICG	—	23
Telverse	—	23
Genuity	—	55
McLeod	41	—
Software Spectrum (including Corpsoft)	202	55
XCOM	30	—
	<u>\$ 273</u>	<u>\$ 184</u>

In the first quarter of 2005, Level 3 purchased a customer contract from 360networks for cash and future services valued at \$4 million. The total purchase price was recorded as an intangible asset and will be amortized over the remaining four year term of the customer contract.

During the first quarter of 2005, the Company determined that \$6 million of income tax obligations recorded in the original purchase price allocation for the 2002 acquisitions of CorpSoft, Inc. and Software Spectrum, Inc. were no longer required. As a result, the Company reduced the goodwill attributable to the acquisitions by \$6 million in 2005.

Goodwill has been or will be assessed at least annually for impairment in accordance with SFAS No. 142, beginning with the first anniversary of the acquisition and December 31 of each year thereafter. As of June 30, 2005, the Company has not recorded impairment expenses for the goodwill or intangible assets identified in the previous table.

Intangible asset amortization expense was \$17 million and \$35 million for the three and six months ended June 30, 2005, respectively. Intangible asset amortization expense was \$18 million and \$33 million for the three and six months ended June 30, 2004, respectively.

The amortization expense related to intangible assets currently recorded on the Company's books for each of the five succeeding years is estimated to be the following for the years ended December 31: 2005-\$69 million; 2006-\$55 million; 2007-\$26 million; 2008-\$12 million and 2009-\$8 million.

9. Long-Term Debt

At June 30, 2005 and December 31, 2004, long-term debt was as follows:

(dollars in millions)	June 30, 2005	December 31, 2004
Senior Secured Term Loan (10.34% due 2011)	\$ 730	\$ 730
Senior Notes (9.125% due 2008)	954	954
Senior Notes (11.0% due 2008)	132	132
Senior Discount Notes (10.5% due 2008)	144	144
Senior Euro Notes (10.75% due 2008)	60	68
Convertible Senior Notes (2.875% due 2010)	374	374
Senior Discount Notes (12.875% due 2010)	487	475
Senior Euro Notes (11.25% due 2010)	125	142
Senior Notes (11.25% due 2010)	96	96
Senior Notes (10.75% due 2011)	500	500
Convertible Senior Notes (10.0% due 2011)	880	—
Convertible Senior Notes (5.25% due 2011)	345	345
Convertible Senior Discount Notes (9.0% due 2013)	241	230
Convertible Subordinated Notes (6.0% due 2009)	362	362
Convertible Subordinated Notes (6.0% due 2010)	514	514
Commercial Mortgage:		
GMAC (due 2005)	—	117
Capital leases assumed in Genuity transaction	—	24
Other	2	4
	5,946	5,211
Less current portion	(1)	(144)
	<u>\$ 5,945</u>	<u>\$ 5,067</u>

On April 4, 2005, Level 3 completed the offering of \$880 million of 10% Convertible Senior Notes due 2011 to institutional investors. Interest on the notes will be payable semi-annually beginning on November 1, 2005. The notes will be convertible by holders at any time after January 1, 2007 (or sooner if certain corporate events occur) into shares of Level 3 common stock at a conversion price of \$3.60 per share (subject to adjustment in certain events). This is equivalent to a conversion rate of approximately 277.77 shares per \$1,000 principal amount of notes.

The net proceeds from this offering were approximately \$877 million after giving effect to offering expenses. Level 3 intends to use the net proceeds from this offering for general corporate purposes, including possible acquisitions, working capital, capital expenditures, debt refinancing and debt repurchases.

On June 30, 2005, the GMAC Commercial Mortgage matured and the Company repaid the outstanding balance of \$116 million with \$103 million in cash and \$13 million in restricted securities.

The debt instruments above contain certain financial and non-financial covenants with which the Company believes it is in full compliance as of June 30, 2005.

10. Stock-Based Awards

The Company recognized in the consolidated statement of operations a total of \$10 million and \$21 million of non-cash compensation for the three and six months ended June 30, 2005, respectively. In addition, the Company capitalized less than \$1 million and \$1 million of non-cash compensation for those employees and contractors directly involved in the construction of the network, installation of customers or development of the business support systems for the three and six months ended June 30, 2005, respectively.

The Company recognized on the consolidated statement of operations a total of \$10 million and \$19 million of non-cash compensation for the three and six months ended June 30, 2004, respectively. In addition, the Company capitalized less than \$1 million and \$1 million of non-cash compensation for those

employees and contractors directly involved in the construction of the network, installation of customers or development of the business support systems for the three and six months ended June 30, 2004, respectively.

The following table summarizes non-cash compensation expense and capitalized non-cash compensation for the three and six months ended June 30, 2005 and 2004.

(dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
Warrants	—	\$ —	\$ —	\$ —
OSO	4	3	9	7
C-OSO	—	—	—	1
Restricted Stock and Units	5	1	6	2
Shareworks Match Plan	(3)	1	(2)	2
401(k) Match Expense	4	5	8	9
Shareworks Grant Plan and Profit Sharing	—	—	1	(1)
	10	10	22	20
Capitalized Non-cash Compensation	—	—	(1)	(1)
	\$ 10	\$ 10	\$ 21	\$ 19

Warrants

At June 30, 2005, there were approximately 15.1 million warrants outstanding ranging in exercise prices from \$4.00 to \$60.06. All of the warrants were exercisable at June 30, 2005, with a weighted average exercise price of \$8.21 per warrant.

Outperform Stock Option Plan

The fair value under SFAS No. 123 for the approximately 2.1 million Outperform Stock Options (“OSOs”) awarded to participants during the six months ended June 30, 2005 was approximately \$8 million using a modified Black-Scholes valuation model with a S&P 500 volatility rate of 13% over the term, a Level 3 common stock volatility rate of 55%, an expected correlation factor of 30% and a S&P 500 dividend yield of 1.99%, which resulted in a decrease in the theoretical value per option to 116% of the stock price on the date of grant, from 120% in 2004. As of June 30, 2005, the Company had not reflected \$8 million of unamortized compensation expense in its financial statements for previously granted OSOs.

As part of a comprehensive review of its long-term compensation program, the Company temporarily suspended awards of OSOs in April 2005. During the second quarter of 2005, the Company granted participants of the plan restricted stock units.

Restricted Stock and Units

During the six months of 2005, approximately 15.9 million shares of restricted stock or restricted stock units were granted to employees and independent members of the Board of Directors. The restricted stock units and shares were granted to employees at no cost. The instruments vest over one to four year periods. The fair value of restricted units and stock granted in 2005 was \$32 million as calculated using the value of the Level 3 common stock the day prior to the grant and is being amortized over the vesting periods of the options in accordance with FIN 28, “Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans.” As of June 30, 2005, the Company had not reflected \$27 million of unamortized compensation expense in its financial statements for restricted stock instruments previously granted.

Beginning in the third quarter, the Company intends to utilize both restricted stock units and OSOs as part of its long-term compensation program. The Company is expected to make annual grants of restricted

stock units that vest ratably over four years. In addition, the Company will continue to make quarterly OSO grants to employees. The OSOs are expected to have similar terms as those OSOs granted in the first quarter of 2005.

401(k) Plan

The Company and its subsidiaries offer their qualified employees the opportunity to participate in a defined contribution retirement plan qualifying under the provisions of Section 401(k) of the Internal Revenue Code. Each employee is eligible to contribute, on a tax deferred basis, a portion of annual earnings not to exceed \$14,000 in 2005. The Company matches 100% of employee contributions up to 7% of eligible earnings or applicable regulatory limits. Employees of Software Spectrum are eligible to receive matching contributions of \$.50 for every dollar contributed up to 6% of eligible earnings. The Company's matching contribution is made with Level 3 common stock based on the closing stock price on each pay date. Employees are able to diversify the Company's matching contribution as soon as it is made, even if they are not fully vested. The Company's matching contributions will be fully vested upon completion of three years of service. The Company made matching contributions of \$4 million and \$8 million for the three and six months ended June 30, 2005, respectively, and \$5 million and \$9 million for the three and six months ended June 30, 2004, respectively, which were recorded as selling, general and administrative expenses.

The Company made a discretionary contribution to the 401(k) Plan in Level 3 common stock as of December 31, 2004, equal to two percent of eligible employees' 2004 eligible earnings. The deposit was made into the employees' 401(k) accounts during the first quarter of 2005.

11. Industry and Segment Data

SFAS No. 131 "Disclosures about Segments of an Enterprise and Related Information" defines operating segments as components of an enterprise for which separate financial information is available and which is evaluated regularly by the Company's chief operating decision maker, or decision making group, in deciding how to allocate resources and assess performance. Operating segments are managed separately and represent separate business units that offer different products and serve different markets. The Company's reportable segments include: communications; information services; and coal mining. Other primarily includes other corporate assets and overhead not attributable to a specific segment. The geographic region Other primarily includes the Asia-Pacific region.

Adjusted OIBDA, as defined by the Company, consists of income (loss) from operations before (1) depreciation and amortization expense, (2) stock-based compensation expense included within selling, general and administrative expenses on the consolidated statements of operations and (3) any non-cash impairment costs included within restructuring and impairment expenses all as reported on the consolidated statements of operations. The Company excludes stock-based compensation due to its adoption of the expense recognition provisions of SFAS No. 123. Adjusted OIBDA is an important part of the Company's internal reporting and is an indicator of profitability and operating performance used by the chief operating decision maker or decision making group, especially in a capital-intensive industry such as telecommunications to evaluate performance and allocate resources. It is also a commonly used indicator in the communications industry to analyze companies on the basis of operating performance over time. Adjusted OIBDA is not intended to represent net income or cash flow for the periods presented, is not calculated consistently with the commonly used metric "EBITDA", and is not recognized under Generally Accepted Accounting Principles ("GAAP") but is used by management to assess segment results and allocate resources.

The data presented in the following tables includes information for the three and six months ended June 30, 2005 and 2004 for all statement of operations and cash flow information presented, and as of June 30, 2005 and December 31, 2004 for all balance sheet information presented. Information related to acquired businesses is included from their respective acquisition dates. Revenue and the related expenses are attributed to countries based on where services are provided.

Industry and geographic segment financial information follows. Certain prior year information has been reclassified to conform to the 2005 presentation.

(dollars in millions)	Communications	Information Services	Coal Mining	Other	Total
Three Months ended June 30, 2005					
Revenue:					
North America	\$ 334	\$ 320	\$ 19	\$ —	\$ 673
Europe	37	180	—	—	217
Other	—	20	—	—	20
	<u>\$ 371</u>	<u>\$ 520</u>	<u>\$ 19</u>	<u>\$ —</u>	<u>\$ 910</u>
Adjusted OIBDA:					
North America	\$ 83	\$ 10	\$ 7	\$ 5	
Europe	5	4	—	—	
Other	—	1	—	—	
	<u>\$ 88</u>	<u>\$ 15</u>	<u>\$ 7</u>	<u>\$ 5</u>	
Gross Capital Expenditures:					
North America	\$ 75	\$ 4	\$ 1	\$ —	\$ 80
Europe	8	—	—	—	8
Other	—	—	—	—	—
	<u>\$ 83</u>	<u>\$ 4</u>	<u>\$ 1</u>	<u>\$ —</u>	<u>\$ 88</u>
Depreciation and Amortization:					
North America	\$ 139	\$ 4	\$ 1	\$ —	\$ 144
Europe	22	—	—	—	22
Other	—	—	—	—	—
	<u>\$ 161</u>	<u>\$ 4</u>	<u>\$ 1</u>	<u>\$ —</u>	<u>\$ 166</u>
Six Months ended June 30, 2005					
Revenue:					
North America	\$ 809	\$ 623	\$ 36	\$ —	\$ 1,468
Europe	72	346	—	—	418
Other	—	34	—	—	34
	<u>\$ 881</u>	<u>\$ 1,003</u>	<u>\$ 36</u>	<u>\$ —</u>	<u>\$ 1,920</u>
Adjusted OIBDA:					
North America	\$ 286	\$ 14	\$ 10	\$ 3	
Europe	3	7	—	—	
Other	—	1	—	—	
	<u>\$ 289</u>	<u>\$ 22</u>	<u>\$ 10</u>	<u>\$ 3</u>	
Gross Capital Expenditures:					
North America	\$ 126	\$ 6	\$ 1	\$ —	\$ 133
Europe	16	—	—	—	16
Other	—	—	—	—	—
	<u>\$ 142</u>	<u>\$ 6</u>	<u>\$ 1</u>	<u>\$ —</u>	<u>\$ 149</u>
Depreciation and Amortization:					
North America	\$ 283	\$ 9	\$ 2	\$ —	\$ 294
Europe	43	—	—	—	43
Other	—	—	—	—	—
	<u>\$ 326</u>	<u>\$ 9</u>	<u>\$ 2</u>	<u>\$ —</u>	<u>\$ 337</u>

<u>(dollars in millions)</u>	<u>Communications</u>	<u>Information Services</u>	<u>Coal Mining</u>	<u>Other</u>	<u>Total</u>
Three Months ended June 30, 2004					
Revenue:					
North America	\$ 357	\$ 351	\$ 24	\$ —	\$ 732
Europe	34	138	—	—	172
Other	—	14	—	—	14
	<u>\$ 391</u>	<u>\$ 503</u>	<u>\$ 24</u>	<u>\$ —</u>	<u>\$ 918</u>
Adjusted OIBDA:					
North America	\$ 78	\$ 7	\$ 5	\$ (1)	
Europe	1	4	—	—	
Other	—	—	—	—	
	<u>\$ 79</u>	<u>\$ 11</u>	<u>\$ 5</u>	<u>\$ (1)</u>	
Gross Capital Expenditures:					
North America	\$ 56	\$ 2	\$ —	\$ —	\$ 58
Europe	8	—	—	—	8
Other	—	—	—	—	—
	<u>\$ 64</u>	<u>\$ 2</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 66</u>
Depreciation and Amortization:					
North America	\$ 146	\$ 7	\$ 1	\$ —	\$ 154
Europe	23	—	—	—	23
Other	—	—	—	—	—
	<u>\$ 169</u>	<u>\$ 7</u>	<u>\$ 1</u>	<u>\$ —</u>	<u>\$ 177</u>
Six Months ended June 30, 2004					
Revenue:					
North America	\$ 711	\$ 642	\$ 40	\$ —	\$ 1,393
Europe	69	330	—	—	399
Other	—	25	—	—	25
	<u>\$ 780</u>	<u>\$ 997</u>	<u>\$ 40</u>	<u>\$ —</u>	<u>\$ 1,817</u>
Adjusted OIBDA:					
North America	\$ 195	\$ 17	\$ 7	\$ (2)	
Europe	—	5	—	—	
Other	—	—	—	—	
	<u>\$ 195</u>	<u>\$ 22</u>	<u>\$ 7</u>	<u>\$ (2)</u>	
Gross Capital Expenditures:					
North America	\$ 103	\$ 2	\$ —	\$ —	\$ 105
Europe	13	—	—	—	13
Other	—	—	—	—	—
	<u>\$ 116</u>	<u>\$ 2</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 118</u>
Depreciation and Amortization:					
North America	\$ 292	\$ 14	\$ 2	\$ —	\$ 308
Europe	48	—	—	—	48
Other	—	—	—	—	—
	<u>\$ 340</u>	<u>\$ 14</u>	<u>\$ 2</u>	<u>\$ —</u>	<u>\$ 356</u>

Communications Revenue and Adjusted OIBDA include termination revenue of \$2 million and \$131 million for the three and six months ended June 30, 2005, respectively, and \$2 million and \$9 million for the three and six months ended June 30, 2004, respectively.

(dollars in millions)	Communications	Information Services	Coal Mining	Other	Total
Identifiable Assets					
June 30, 2005					
North America	\$ 4,866	\$ 536	\$ 84	\$ 1,230	\$ 6,716
Europe	780	158	—	59	997
Other	—	17	—	3	20
	<u>\$ 5,646</u>	<u>\$ 711</u>	<u>\$ 84</u>	<u>\$ 1,292</u>	<u>\$ 7,733</u>
December 31, 2004					
North America	\$ 4,909	\$ 600	\$ 84	\$ 785	\$ 6,378
Europe	906	196	—	42	1,144
Other	—	14	—	8	22
	<u>\$ 5,815</u>	<u>\$ 810</u>	<u>\$ 84</u>	<u>\$ 835</u>	<u>\$ 7,544</u>
Long-Lived Assets (excluding Goodwill)					
June 30, 2005					
North America	\$ 5,058	\$ 112	\$ 69	\$ —	\$ 5,239
Europe	745	1	—	—	746
Other	—	1	—	—	1
	<u>\$ 5,803</u>	<u>\$ 114</u>	<u>\$ 69</u>	<u>\$ —</u>	<u>\$ 5,986</u>
December 31, 2004					
North America	\$ 4,824	\$ 119	\$ 66	\$ —	\$ 5,009
Europe	859	1	—	—	860
Other	—	—	—	—	—
	<u>\$ 5,683</u>	<u>\$ 120</u>	<u>\$ 66</u>	<u>\$ —</u>	<u>\$ 5,869</u>
Goodwill					
June 30, 2005					
North America	\$ 71	\$ 196	\$ —	\$ —	\$ 267
Europe	—	—	—	—	—
	<u>\$ 71</u>	<u>\$ 196</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 267</u>
December 31, 2004					
North America	\$ 71	\$ 202	\$ —	\$ —	\$ 273
Europe	—	—	—	—	—
	<u>\$ 71</u>	<u>\$ 202</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 273</u>

Communications revenue is classified into two categories, services revenue and reciprocal compensation. The Company further segregates its communications services into three separate categories with each being in a different phase of the product life cycle, incorporating different marketing and distribution strategies and different contributions to the Company's profitability. The categories include: 1) growth services (voice services and IP-VPN services) 2) core services (transport & infrastructure and IP & data products) and 3) mature services (managed modem and DSL services).

The December 31, 2004 financial statements presented communications services revenue by service types; transport and infrastructure, softswitch and IP and data.

(dollars in millions)	Growth	Services Core	Mature	Reciprocal Compensation	Total
Communications Revenue					
Three Months Ended June 30, 2005					
North America	\$ 26	\$ 152	\$ 127	\$ 29	\$ 334
Europe	2	35	—	—	37
Other	—	—	—	—	—
	<u>\$ 28</u>	<u>\$ 187</u>	<u>\$ 127</u>	<u>\$ 29</u>	<u>\$ 371</u>
Six Months Ended June 30, 2005					
North America	\$ 52	\$ 429	\$ 271	\$ 57	\$ 809
Europe	3	69	—	—	72
Other	—	—	—	—	—
	<u>\$ 55</u>	<u>\$ 498</u>	<u>\$ 271</u>	<u>\$ 57</u>	<u>\$ 881</u>
Three Months Ended June 30, 2004					
North America	\$ 10	\$ 152	\$ 169	\$ 26	\$ 357
Europe	1	33	—	—	34
Other	—	—	—	—	—
	<u>\$ 11</u>	<u>\$ 185</u>	<u>\$ 169</u>	<u>\$ 26</u>	<u>\$ 391</u>
Six Months Ended June 30, 2004					
North America	\$ 18	\$ 310	\$ 334	\$ 49	\$ 711
Europe	1	68	—	—	69
Other	—	—	—	—	—
	<u>\$ 19</u>	<u>\$ 378</u>	<u>\$ 334</u>	<u>\$ 49</u>	<u>\$ 780</u>

Core includes termination revenue of \$1 million and \$130 million for the three and six months ended June 30, 2005, respectively, and \$2 million and \$9 million for the three and six months ended June 30, 2004, respectively.

The majority of North American revenue consists of services delivered within the United States. The majority of European revenue consists of services delivered within the United Kingdom, but also includes France and Germany. Transoceanic revenue is allocated to Europe.

Product information for the Company's information services segment follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
Services Revenue				
(i) Structure:				
Outsourcing	\$ 16	\$ 16	\$ 33	\$ 38
Software Spectrum	—	—	—	1
	16	16	33	39
Software Sales Revenue				
Software Spectrum	504	487	970	958
	\$ 520	\$ 503	\$ 1,003	\$ 997

The following information provides a reconciliation of Net Income (Loss) to Adjusted OIBDA by operating segment, as defined by the Company, for the three and six months ended June 30, 2005 and 2004:

(dollars in millions)	Communications	Information Services	Coal Mining	Other
Three Months Ended June 30, 2005				
Net Income (Loss)	\$ (205)	\$ 8	\$ 5	\$ 4
Income Tax Expense	—	1	1	1
Total Other (Income) Expense	119	1	—	—
Operating Income (Loss)	(86)	10	6	5
Depreciation and Amortization Expense	161	4	1	—
Non-Cash Compensation Expense	9	1	—	—
Non-Cash Impairment Charge	4	—	—	—
Adjusted OIBDA	\$ 88	\$ 15	\$ 7	\$ 5
Six Months Ended June 30, 2005				
Net Income (Loss)	\$ (284)	\$ 9	\$ 7	\$ 3
Income Tax Expense	—	1	1	1
Total Other (Income) Expense	224	1	—	(1)
Operating Income (Loss)	(60)	11	8	3
Depreciation and Amortization Expense	326	9	2	—
Non-Cash Compensation Expense	19	2	—	—
Non-Cash Impairment Charge	4	—	—	—
Adjusted OIBDA	\$ 289	\$ 22	\$ 10	\$ 3

(dollars in millions)	Communications	Information Services	Coal Mining	Other
Three Months Ended June 30, 2004				
Net Income (Loss)	\$ (66)	\$ 1	\$ 4	\$ (2)
Income Tax Expense	—	1	—	—
Total Other (Income) Expense	(33)	1	—	1
Operating Income (Loss)	(99)	3	4	(1)
Depreciation and Amortization Expense	169	7	1	—
Non-Cash Compensation Expense	9	1	—	—
Adjusted OIBDA	\$ 79	\$ 11	\$ 5	\$ (1)
Six Months Ended June 30, 2004				
Net Income (Loss)	\$ (241)	\$ 6	\$ 4	\$ 21
Income Tax Expense	—	1	1	—
Total Other (Income) Expense	78	—	—	(23)
Operating Income (Loss)	(163)	7	5	(2)
Depreciation and Amortization Expense	340	14	2	—
Non-Cash Compensation Expense	18	1	—	—
Adjusted OIBDA	\$ 195	\$ 22	\$ 7	\$ (2)

12. Related Party Transactions

Level 3 receives certain mine management services from Peter Kiewit Sons', Inc. The expense for these services was \$3 million and \$4 million for the three and six months ended June 30, 2005, respectively, and is recorded in selling, general and administrative expenses. The expense for these services was \$2 million and \$3 million for the three and six months ended June 30, 2004. As of June 30, 2005, the Company owed approximately \$3 million for the second quarter mine management services.

13. Other Matters

At the Company's Annual Meeting on May 17, 2005, the Company's stockholders approved an amendment of the Company's amended and restated Certificate of Incorporation to remove the provisions relating to the Class R Convertible Common Stock.

On May 13, 2005, Technology Spectrum, Inc., a wholly owned subsidiary of the Company, filed a registration statement with the Securities and Exchange Commission to enable the sale of its common stock to the public in an initial public offering. Technology Spectrum, Inc. is the principal holding company for Level 3's information services business. This registration statement has not yet become effective.

On November 19, 2002, Gary Haegle commenced a stockholder's derivative suit on behalf of the Company in the District Court of Colorado for the City and County of Broomfield entitled *Haegle v. Scott, et al.*, (Index No. 02-CV-0196) (the "Complaint"). The action is brought against the Company as a nominal defendant and against the directors of the Company, a former director of the Company and Peter Kiewit Sons', Inc. ("PKS"). The Complaint alleges that the director defendants, aided and abetted by PKS, breached their fiduciary duties to the Company in connection with several transactions between the Company and PKS including contracts under which PKS constructed the Company's fiber optic cable network and manages the Company's mine properties. The Complaint also alleges that in building the fiber optic cable network, the defendants caused the Company to violate the property rights of landowners, thereby subjecting the Company to substantial potential liability. In addition, the Complaint alleges that Company assets were transferred to its officers and directors in the form of personal loans, excessive salaries and the payment of personal expenses. The action seeks both equitable and legal relief, including restitution, compensatory and punitive damages of an unspecified amount, imposition of a constructive trust, disgorgement and injunctive relief. The defendants filed a motion to dismiss, which was denied by the court in early October 2003. Subsequently, the Board of Directors of the Company appointed a Special Litigation Committee comprised of an independent director with the exclusive power to conduct or cause to be conducted an impartial and independent investigation of all matters alleged by the Plaintiff and to determine whether the litigation should be maintained, terminated, or otherwise disposed, in accordance with its findings as to whether the litigation is in the best interests of the Company. On August 2, 2004, the Special Litigation Committee delivered its report in which it concluded that it is not in the best interests of either the Company or its stockholders to pursue any of the claims the plaintiff asserted in the Complaint. The Company has filed a motion to dismiss the Complaint based on the recommendation of the Special Litigation Committee. The disposition of this motion is currently pending. The Company also filed a second motion to dismiss for lack of subject matter jurisdiction. The disposition of this motion is currently pending. In July 2005, the parties began to discuss the dismissal of the lawsuit in full with each side to the litigation to bear their own costs and expenses. No compensation in any form will pass directly or indirectly from the Company or any of the defendants to the plaintiff or plaintiff's attorneys. The parties are currently documenting this agreement and expect to have it submitted to the court shortly.

Although it remains too early for the Company to reach a conclusion as to the ultimate outcome of these actions, management continues to believe that there are substantial defenses to the claims asserted in this action, and intends to defend them vigorously.

In May 2001, Level 3 Communications, Inc., and two of its subsidiaries were named as a defendant in *Bauer, et. al. v. Level 3 Communications, LLC, et al.*, a purported multi-state class action, filed in the U.S. District Court for the Southern District of Illinois. In April 2002, the same plaintiffs filed a second nearly identical purported multi-state class action in state court in Madison County, Illinois. In

July 2001, the Company was named as a defendant in *Koyle, et. al. v. Level 3 Communications, Inc., et. al.* , a purported multi-state class action filed in the U.S. District Court for the District of Idaho. In September 2002, Level 3 Communications,

LLC was named as a defendant in *Smith et al v. Sprint Communications Company, L.P., et al.*, a purported nationwide class action filed in the United States District Court for the Northern District of Illinois. These actions involve the Company's right to install its fiber optic cable network in easements and right-of-ways crossing the plaintiffs' land. In general, the Company obtained the rights to construct its network from railroads, utilities, and others, and is installing its network along the rights-of-way so granted. Plaintiffs in the purported class actions assert that they are the owners of lands over which the Company's fiber optic cable network passes, and that the railroads, utilities, and others who granted the Company the right to construct and maintain its network did not have the legal ability to do so. The complaints seek damages on theories of trespass, unjust enrichment and slander of title and property, as well as punitive damages. The Company has also received, and may in the future receive, claims and demands related to rights-of-way issues similar to the issues in these cases that may be based on similar or different legal theories. To date, all adjudicated attempts to have class action status granted on complaints filed against the Company or any of its subsidiaries involving claims and demands related to rights-of-way issues have been denied.

On July 25, 2003, the *Smith* Court entered an Order preliminarily approving a settlement agreement that would have resolved all claims against the Company arising out of the Company's location of fiber optic cable and related telecommunications facilities that the Company owns within railroad rights-of-way throughout the United States. In connection with the Court's Order preliminarily approving the settlement, the Court entered an Order enjoining the parties in all pending federal and state railroad rights-of-way class action litigation involving the Company from further pursuing those pending actions at this time.

In September 2003, a petition for appeal was granted which sought reversal of the *Smith* Court's decision to preliminarily approve the settlement and certify a nationwide class for settlement purposes. On October 19, 2004, the Seventh Circuit Court of Appeals issued a 2-1 decision vacating the nationwide certification which was a necessary element of the nationwide settlement. The Court also vacated the injunction against competing class actions and remanded the case to the district court for further proceedings. Level 3 and the other defendants in *Smith* filed a Petition for Certiorari with the United States Supreme Court seeking review of the decision of the Seventh Circuit Court of Appeals. On June 20, 2005, the United States Supreme Court denied the Petition for Certiorari.

It is still too early for the Company to reach a conclusion as to the ultimate outcome of these actions. However, management believes that the Company and its subsidiaries have substantial defenses to the claims asserted in all of these actions (and any similar claims which may be named in the future), and intends to defend them vigorously if a satisfactory form of settlement is not approved.

The Company and its subsidiaries are parties to many other legal proceedings. Management believes that any resulting liabilities for these legal proceedings, beyond amounts reserved, will not materially affect the Company's financial condition or future results of operations, but could impact future cash flows.

On January 20, 2004, the Company sold its remaining shares in Commonwealth Telephone for \$41 million in cash, resulting in a gain of approximately \$23 million.

It is customary in Level 3's industries to use various financial instruments in the normal course of business. These instruments include items such as letters of credit. Letters of credit are conditional commitments issued on behalf of Level 3 in accordance with specified terms and conditions. As of June 30, 2005, Level 3 had outstanding letters of credit of approximately \$19 million which are collateralized by restricted cash and securities.

14. Condensed Consolidating Financial Information

In October 2003, Level 3 Financing, Inc., a wholly owned subsidiary of Level 3 Communications, Inc. ("Level 3 Financing"), issued \$500 million 10.75% Senior Notes due 2011. These notes are unsecured obligations of Level 3 Financing, however, they are jointly, severally, fully and unconditionally guaranteed on an unsecured senior basis by Level 3 Communications, Inc. and Level 3 Communications, LLC (a wholly-owned subsidiary).

In conjunction with the registration of the 10.75% Senior Notes, the accompanying condensed consolidating financial information has been prepared and presented pursuant to SEC Regulation S-X Rule 3-10 "Financial statements of guarantors and affiliates whose securities collateralize an issue registered or being registered." This information is not intended to present the financial position, results of operations and cash flows of the individual companies or groups of companies in accordance with generally accepted accounting principles.

Condensed Consolidating Statements of Operations for the three and six months ended June 30, 2005 and 2004 follow. Level 3 Communications, LLC leases equipment and certain facilities from other wholly owned subsidiaries of Level 3 Communications, Inc. These transactions are eliminated in the consolidated results of the Company.

Condensed Consolidating Statements of Operations
For the three months ended June 30, 2005
(unaudited)

(dollars in millions)	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Other Subsidiaries	Eliminations	Total
Revenue	\$ —	\$ —	\$ 336	\$ 615	\$ (41)	\$ 910
Costs and Expenses:						
Cost of Revenue	—	—	141	485	(38)	588
Depreciation and Amortization	—	—	108	58	—	166
Selling, General and Administrative	2	—	158	60	(3)	217
Restructuring and Impairment						
Charges	—	—	4	—	—	4
Total Costs and Expenses	2	—	411	603	(41)	975
Operating Income (Loss)	(2)	—	(75)	12	—	(65)
Other Income (Loss), net:						
Interest Income	6	—	2	2	—	10
Interest Expense	(102)	(32)	(1)	(4)	—	(139)
Interest Income (Expense)						
Affiliates, net	201	127	(328)	—	—	—
Equity in Net Earnings (Losses) of						
Subsidiaries	(292)	(387)	(1)	—	680	—
Other Income (Expense)	1	—	7	1	—	9
Other Income (Loss)	(186)	(292)	(321)	(1)	680	(120)
Income (Loss) Before Income Taxes	(188)	(292)	(396)	11	680	(185)
Income Tax Expense	—	—	—	(3)	—	(3)
Net Income (Loss)	\$ (188)	\$ (292)	\$ (396)	\$ 8	\$ 680	\$ (188)

Condensed Consolidating Statements of Operations
For the six months ended June 30, 2005
(unaudited)

(dollars in millions)	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Other Subsidiaries	Eliminations	Total
Revenue	\$ —	\$ —	\$ 813	\$ 1,187	\$ (80)	\$ 1,920
Costs and Expenses:						
Cost of Revenue	—	—	286	946	(73)	1,159
Depreciation and Amortization	—	—	226	111	—	337
Selling, General and Administrative	4	—	319	127	(7)	443
Restructuring and Impairment						
Charges	—	—	15	4	—	19
Total Costs and Expenses	4	—	846	1,188	(80)	1,958
Operating Loss	(4)	—	(33)	(1)	—	(38)
Other Income (Loss), net:						
Interest Income	6	—	5	3	—	14
Interest Expense	(183)	(64)	(1)	(5)	—	(253)
Interest Income (Expense)						
Affiliates, net	401	255	(661)	5	—	—
Equity in Net Earnings (Losses) of						
Subsidiaries	(487)	(678)	(2)	—	1,167	—
Other Income (Expense)	2	—	9	4	—	15
Other Income (Loss)	(261)	(487)	(650)	7	1,167	(224)
Income (Loss) Before Income Taxes	(265)	(487)	(683)	6	1,167	(262)
Income Tax Expense	—	—	—	(3)	—	(3)
Net Income (Loss)	\$ (265)	\$ (487)	\$ (683)	\$ 3	\$ 1,167	\$ (265)

Condensed Consolidating Statements of Operations
For the three months ended June 30, 2004
(unaudited)

(dollars in millions)	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Other Subsidiaries	Eliminations	Total
Revenue	\$ —	\$ —	\$ 348	\$ 623	\$ (53)	\$ 918
Costs and Expenses:						
Cost of Revenue	—	—	163	477	(49)	591
Depreciation and Amortization	—	—	99	78	—	177
Selling, General and Administrative	—	—	176	71	(4)	243
Restructuring Charges	—	—	—	—	—	—
Total Costs and Expenses	—	—	438	626	(53)	1,011
Operating Loss	—	—	(90)	(3)	—	(93)
Other Income (Loss), net:						
Interest Income	—	—	3	—	—	3
Interest Expense	(103)	(14)	(1)	—	—	(118)
Interest Income (Expense)						
Affiliates, net	207	96	(304)	1	—	—
Equity in Net Earnings (Losses) of						
Subsidiaries	(168)	(250)	(6)	—	424	—
Other Income (Expense)	1	—	149	(4)	—	146
Other Income (Loss)	(63)	(168)	(159)	(3)	424	31
Income (Loss) Before Income Taxes	(63)	(168)	(249)	(6)	424	(62)
Income Tax Expense	—	—	—	(1)	—	(1)
Net Income (Loss)	\$ (63)	\$ (168)	\$ (249)	\$ (7)	\$ 424	\$ (63)

Condensed Consolidating Statements of Operations
For the six months ended June 30, 2004
(unaudited)

(dollars in millions)	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Other Subsidiaries	Eliminations	Total
Revenue	\$ —	\$ —	\$ 691	\$ 1,232	\$ (106)	\$ 1,817
Costs and Expenses:						
Cost of Revenue	—	—	290	941	(97)	1,134
Depreciation and Amortization	—	—	191	165	—	356
Selling, General and Administrative	6	—	347	134	(9)	478
Restructuring Charges	—	—	—	2	—	2
Total Costs and Expenses	6	—	828	1,242	(106)	1,970
Operating Loss	(6)	—	(137)	(10)	—	(153)
Other Income (Loss), net:						
Interest Income	—	—	5	1	—	6
Interest Expense	(205)	(28)	(10)	(2)	—	(245)
Interest Income (Expense)						
Affiliates, net	427	184	(606)	(5)	—	—
Equity in Net Earnings (Losses) of Subsidiaries	(427)	(583)	(10)	—	1,020	—
Other Income (Expense)	1	—	152	31	—	184
Other Income (Loss)	(204)	(427)	(469)	25	1,020	(55)
Income (Loss) Before Income Taxes	(210)	(427)	(606)	15	1,020	(208)
Income Tax Expense	—	—	—	(2)	—	(2)
Net Income (Loss)	<u>\$ (210)</u>	<u>\$ (427)</u>	<u>\$ (606)</u>	<u>\$ 13</u>	<u>\$ 1,020</u>	<u>\$ (210)</u>

Condensed Consolidating Balance Sheets as of June 30, 2005 and December 31, 2004 follow:

Condensed Consolidating Balance Sheets
June 30, 2005
(unaudited)

(dollars in millions)	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Other Subsidiaries	Eliminations	Total
Assets						
Current Assets:						
Cash and cash equivalents	\$ 111	\$ 12	\$ 175	\$ 150	\$ —	\$ 448
Marketable securities	139	—	190	—	—	329
Restricted cash and securities	—	3	16	8	—	27
Accounts receivable, net	—	—	133	411	—	544
Due from (to) affiliates	9,587	4,302	(13,821)	(68)	—	—
Other	20	4	44	64	—	132
Total Current Assets	9,857	4,321	(13,263)	565	—	1,480
Property, Plant and Equipment, net	—	—	3,060	2,098	—	5,158
Marketable Securities	506	—	—	—	—	506
Restricted Cash and Securities	16	—	—	54	—	70
Intangibles, net and Goodwill	—	—	113	308	—	421
Investment in Subsidiaries	(6,012)	(10,623)	(1)	—	16,636	—
Other Assets, net	49	22	14	13	—	98
Total Assets	<u>\$ 4,416</u>	<u>\$ (6,280)</u>	<u>\$ (10,077)</u>	<u>\$ 3,038</u>	<u>\$ 16,636</u>	<u>\$ 7,733</u>
Liabilities and Stockholders' Equity						
(Deficit)						
Current Liabilities:						
Accounts payable	\$ —	\$ —	\$ 141	\$ 437	\$ —	\$ 578
Current portion of long-term debt	—	—	—	1	—	1
Accrued payroll and employee benefits	—	—	34	23	—	57
Accrued interest	90	17	—	—	—	107
Deferred revenue	—	—	134	48	—	182
Other	1	—	53	61	—	115
Total Current Liabilities	91	17	362	570	—	1,040
Long-Term Debt, less current portion	4,715	1,230	—	—	—	5,945
Deferred Revenue	—	—	613	118	—	731
Other Liabilities	54	1	194	212	—	461
Stockholders' Equity (Deficit)	(444)	(7,528)	(11,246)	2,138	16,636	(444)
Total Liabilities and Stockholders' Equity (Deficit)	<u>\$ 4,416</u>	<u>\$ (6,280)</u>	<u>\$ (10,077)</u>	<u>\$ 3,038</u>	<u>\$ 16,636</u>	<u>\$ 7,733</u>

Condensed Consolidating Balance Sheets
December 31, 2004
(unaudited)

(dollars in millions)	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Other Subsidiaries	Eliminations	Total
Assets						
Current Assets:						
Cash and cash equivalents	\$ 3	\$ 17	\$ 245	\$ 178	\$ —	\$ 443
Marketable securities	—	—	225	—	—	225
Restricted cash and securities	—	6	14	28	—	48
Accounts receivable, net	—	—	113	432	—	545
Due from (to) affiliates	9,169	4,100	(13,293)	24	—	—
Other	13	4	26	98	—	141
Total Current Assets	9,185	4,127	(12,670)	760	—	1,402
Property, Plant and Equipment, net	—	—	3,271	2,137	—	5,408
Marketable Securities	—	—	114	—	—	114
Restricted Cash and Securities	16	—	—	51	—	67
Intangibles, net and Goodwill	—	—	136	321	—	457
Investment in Subsidiaries	(5,457)	(10,190)	1	—	15,646	—
Other Assets, net	43	24	17	12	—	96
Total Assets	<u>\$ 3,787</u>	<u>\$ (6,039)</u>	<u>\$ (9,131)</u>	<u>\$ 3,281</u>	<u>\$ 15,646</u>	<u>\$ 7,544</u>
Liabilities and Stockholders' Equity (Deficit)						
Current Liabilities:						
Accounts payable	\$ —	\$ —	\$ 120	\$ 494	\$ —	\$ 614
Current portion of long-term debt	—	—	26	118	—	144
Accrued payroll and employee benefits	—	—	53	29	—	82
Accrued interest	52	17	3	1	—	73
Deferred revenue	—	—	172	83	—	255
Other	1	—	61	72	—	134
Total Current Liabilities	53	17	435	797	—	1,302
Long-Term Debt, less current portion	3,836	1,230	—	1	—	5,067
Deferred Revenue	—	—	707	133	—	840
Other Liabilities	55	1	198	238	—	492
Stockholders' Equity (Deficit)	(157)	(7,287)	(10,471)	2,112	15,646	(157)
Total Liabilities and Stockholders' Equity (Deficit)	<u>\$ 3,787</u>	<u>\$ (6,039)</u>	<u>\$ (9,131)</u>	<u>\$ 3,281</u>	<u>\$ 15,646</u>	<u>\$ 7,544</u>

Condensed Consolidating Statements of Cash Flows for the six months ended June 30, 2005 and 2004 follow:

Condensed Consolidating Statements of Cash Flows
For the six months ended June 30, 2005
(unaudited)

(dollars in millions)	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Other Subsidiaries	Eliminations	Total
Net Cash Provided by (Used in)						
Operating Activities	\$ (118)	\$ (62)	\$ 56	\$ 47	\$ —	\$ (77)
Cash Flows from Investing Activities:						
Proceeds from sale and maturity of marketable securities	—	—	150	—	—	150
Purchases of marketable securities	(648)	—	—	—	—	(648)
Decrease (increase) in restricted cash and securities, net	—	3	(2)	—	—	1
Capital expenditures, net	—	—	(70)	(76)	—	(146)
Investments and acquisitions	(10)	—	—	—	—	(10)
Proceeds from sale of property, plant and equipment and other assets	—	—	2	2	—	4
Net Cash Provided by (Used in)						
Investing Activities	(658)	3	80	(74)	—	(649)
Cash Flows from Financing Activities:						
Long-term debt borrowings, net of issuance costs	877	—	—	—	—	877
Payments on long-term debt, including current portion (net of restricted cash)	—	—	(25)	(105)	—	(130)
Increase (decrease) due from affiliates, net	8	54	(171)	109	—	—
Net Cash Provided by (Used in)						
Financing Activities	885	54	(196)	4	—	747
Effect of Exchange Rates on Cash	(1)	—	(10)	(5)	—	(16)
Net Change in Cash and Cash Equivalents	108	(5)	(70)	(28)	—	5
Cash and Cash Equivalents at Beginning of Period	3	17	245	178	—	443
Cash and Cash Equivalents at End of Period	<u>\$ 111</u>	<u>\$ 12</u>	<u>\$ 175</u>	<u>\$ 150</u>	<u>\$ —</u>	<u>\$ 448</u>

Condensed Consolidating Statements of Cash Flows
For the six months ended June 30, 2004
(unaudited)

(dollars in millions)	Level 3 Communications, Inc.	Level 3 Financing, Inc.	Level 3 Communications, LLC	Other Subsidiaries	Eliminations	Total
Net Cash Provided by (Used in)						
Operating Activities	\$ (202)	\$ —	\$ 17	\$ 148	\$ —	\$ (37)
Cash Flows from Investing Activities:						
Purchases of marketable securities	—	—	(410)	—	—	(410)
Proceeds from sale of marketable securities	—	—	—	41	—	41
Decrease (increase) in restricted cash and securities, net	7	21	(7)	—	—	21
Capital expenditures, net	—	—	(74)	(38)	—	(112)
Investments and acquisitions	—	—	(25)	—	—	(25)
Proceeds from sale of property, plant and equipment, and other assets	—	—	7	9	—	16
Net Cash Provided by (Used in)						
Investing Activities	7	21	(509)	12	—	(469)
Cash Flows from Financing Activities:						
Payments on long-term debt, including current portion	—	—	(74)	(2)	—	(76)
Increase (decrease) due from affiliates, net	195	(21)	378	(552)	—	—
Net Cash Provided by (Used in)						
Financing Activities	195	(21)	304	(554)	—	(76)
Effect of Exchange Rates on Cash	—	—	(3)	3	—	—
Net Change in Cash and Cash Equivalents	—	—	(191)	(391)	—	(582)
Cash and Cash Equivalents at Beginning of Period	1	15	582	531	—	1,129
Cash and Cash Equivalents at End of Period	\$ 1	\$ 15	\$ 391	\$ 140	\$ —	\$ 547

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the Company's consolidated financial statements (including the notes thereto), included elsewhere herein and the Company's 2004 Annual Report on Form 10-K filed with the Securities and Exchange Commission.

This document contains forward looking statements and information that are based on the beliefs of management as well as assumptions made by and information currently available to Level 3 Communications, Inc. and its subsidiaries ("Level 3" or the "Company"). When used in this document, the words "anticipate", "believe", "plans", "estimate" and "expect" and similar expressions, as they relate to the Company or its management, are intended to identify forward-looking statements. Such statements reflect the current views of the Company with respect to future events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described in this document. For a more detailed description of these risks and factors, please see the Company's 2004 Annual Report on Form 10-K filed with the Securities and Exchange Commission.

Level 3 Communications, Inc., through its operating subsidiaries, is primarily engaged in the communications and information services businesses, with additional operations in coal mining.

Communication Services

The Company is a facilities-based provider of a broad range of integrated communications services including voice, private line, wavelengths, colocation, Internet access, managed modem, data services and dark fiber. Revenue for communications services is recognized on a monthly basis as these services are provided. For contracts involving private line, wavelengths and dark fiber services, Level 3 may receive up-front payments for services to be delivered for a period of up to 20 years. In these situations, Level 3 will defer the revenue and amortize it on a straight-line basis to earnings over the term of the contract.

The Company segregates its communication services into three separate groups with each being in a different phase of the product life cycle, incorporating different marketing and distribution strategies and different contributions to the Company's profitability. Growth services include both wholesale and consumer oriented voice services and IP-VPN services. The Company's core services consist of transport & infrastructure and IP & data products. Level 3 also provides managed modem and DSL services to customers which are deemed to be mature services by the Company.

Management of Level 3 believes that growth in recurring revenue is critical to the long-term success of the communications business. The Company believes it must continue to increase revenue from its core services in the transport and IP business units, as well as from the new growth services including VoIP and IP-VPN services. At the same time, the Company believes it must continue to effectively manage the positive cash flows from its mature managed modem services.

The Company is developing new voice services that in addition to its existing voice services target large and existing markets. The Company believes that the efficiencies of Level 3's IP and optical based network, including its Softswitch technology, will provide customers a lower cost alternative than the existing circuit-switched networks of its competitors. Several other competitors with IP technologies have announced that they will be entering this market as well. While the voice services being launched by Level 3 target a large addressable market, the Company must quickly develop both its capability to market and sell in the voice market and develop the internal systems and processes necessary to support the new services being launched. The market for voice services is large, however it is expected to continue to decline over time as a result of the new low cost IP and optical based technologies. In addition, the market for voice services is being targeted by many competitors, several of which are larger and have more financial resources than the Company.

The Company's IP-VPN services permit businesses to replace multiple networks with a single, cost-effective solution that greatly simplifies the converged transmission of voice, video and data. This convergence to a single platform can be obtained without sacrificing the quality of service or security levels of traditional ATM and Frame Relay offerings. IP-VPN services also permit customers to prioritize network application traffic so that high priority applications such as voice and video, are not compromised in performance by the flow of low priority applications such as email.

Growth in transport & infrastructure revenue is largely dependent on increased demand for bandwidth services, the pricing of those services and available capital of companies requiring communications capacity for their own use or in providing capacity as a service provider to their customers. These expenditures may be in the form of up-front payments or monthly payments for private line, wavelength or dark fiber services. An increase in demand will likely be partially offset by declines in unit pricing.

The conversion from narrow band dial-up services to higher speed broadband services is expected to increase demand for the Company's IP and data services. Revenue growth in this area is dependent on continued increases in usage by both enterprises and consumers and the pricing environment. An increase in the reliability and security of information transmitted over the Internet and declines in the cost to transmit data have resulted in increased utilization of e-commerce or web based services by businesses. The Company continues to experience price compression for its IP and data services. Current high levels of available capacity and the numerous companies competing in this market have resulted in a very competitive pricing environment.

The Company experienced price compression in the 25% - 45% range for transport and IP services in 2004. Level 3 believes that industry-wide, excess network inventory has been significantly reduced. The Company continued to see pricing pressure in the first half of 2005 for those customers that require simple, low quality, point-to-point services, as competitors aggressively pursued this business. However, Level 3 is seeing some indication that competitors are less willing to discount these services if it requires investment in incremental capacity to meet the customer's requirements. Therefore, the amount of new capacity added may not be sufficient to meet future demand.

For those customers that provide high quality content or require complex regional or national solutions, Level 3 is beginning to see some early indications that price compression is starting to moderate, but it is far too early to draw conclusions. Level 3 intends to remain disciplined in its approach to pricing for its transport and IP services. The Company does not intend to pursue volume at the expense of profitability.

The emergence of a number of companies from bankruptcy protection and additional competition from other distressed carriers continues to contribute to the difficult and competitive operating environment. The Company does not expect this environment to change significantly until the industry consolidates and/or the demand accelerates.

SBC and Verizon announced that they intended to acquire AT&T and MCI, respectively. While these proposed transactions still require regulatory and stockholder approval and are not expected to be completed until 2006, the Company believes that the completion of these transactions will benefit Level 3. Not only will price compression potentially be mitigated by the elimination of competitors, but there will be increased pressure on the combined entities to reduce the cost of providing services in order to improve historical operating results. Accordingly, Level 3's position as a low cost provider in the industry could provide future revenue opportunities as the combined entities seek low cost service offerings.

The Company and its customers continue to see consumers migrate from narrow band dial-up services to higher speed broadband services as the narrow band market matures. This trend is expected to result in declines in managed modem revenue in the future. The Company recognized \$488 million and \$210 million of managed modem revenue in fiscal 2004 and for the six months ended June 30, 2005, respectively. These declines may be mitigated in the mid to longer term by growth in IP-based services offered by the Company that address the market shift to higher speed broadband services. Level 3 believes that the low cost structure of its network will enable it to aggressively compete for new business in the IP-based market.

The exclusivity provisions in the contract with the Company's primary DSL customer expired at the end of the first quarter of 2005. The customer substantially completed the migration of its existing DSL subscribers to its own network during the second quarter of 2005. Since the customer did not fully complete the migration by June 30, 2005, Level 3 will receive additional compensation in the third quarter of 2005. The Company recognized \$112 million of DSL revenue attributable to this customer in 2004, and \$54 million for the six months ended June 30, 2005 and is expecting DSL revenue to decline significantly through the remainder of 2005.

Level 3's management continues to review the Company's existing lines of business and service offerings to determine how those lines of business and service offerings assist with the Company's focus on delivery of communications and information services and meeting its financial objectives. To the extent that certain lines of business or service offerings are not considered to be compatible with the delivery of communications and information services or with obtaining financial objectives, Level 3 may exit those lines of business or stop offering those services.

Management focuses on Adjusted OIBDA, cash flows from operating activities and capital expenditures to assess the operating performance of the communications business. Management believes that Adjusted OIBDA, when viewed over time, reflects the operating trend and performance of its communications business. Adjusted OIBDA, or similar measures, also is an indicator of performance used by Level 3's competitors and is used by management in evaluating relative performance.

The expected increase in revenue attributable to the Company's voice and IP-VPN services and the expected decline in revenue from the managed modem and DSL services will likely result in lower gross profit margins in the future. Profit margins for the Company's mature services have historically been higher than the average profit margins earned by the Company's communications business while the profit margins for the Company's growth services are expected to be below the current average profit margin earned by the communication business.

In January 2005, the Company announced cost containment initiatives that are intended to reduce operating expenses by approximately \$60 to \$70 million in 2005. The initiatives included the elimination of approximately 470 jobs primarily in the non-growth and support areas of the communications business. The Company recorded a restructuring charge of \$15 million in the first quarter of 2005 attributable to this action.

Management believes that cash flows from operating activities as reported on the consolidated statement of cash flows, also is a measure of operating performance, but in addition measures the generation of cash from or use of cash for working capital (particularly accounts receivable, accounts payable and deferred revenue) purposes which is important as the Company monitors and maintains its liquidity.

Management of Level 3 believes the introduction of new products or technologies, as well as the further development of existing technologies may reduce the cost or increase the supply of certain services similar to those provided by Level 3. The ability of the Company to anticipate, adapt and invest in these technology changes in a timely manner may affect the future success of the Company.

In the second quarter of 2005, Level 3 agreed to deploy the latest generation of optical equipment developed by Infinera Corporation. Level 3 believes that the equipment will allow the Company to optimize the amount of traffic it carries over the network and lower the cost of providing services.

The Company is focusing its attention on 1) growing revenue through existing core services, existing growth services and new service development efforts, 2) continuing to show improvements in Adjusted OIBDA as a percentage of revenue, 3) managing working capital and 4) making certain its capital expenditures are made primarily for activities that directly generate revenue. The anticipated change in the composition of the Company's revenue will require the Company to carefully manage operating expenses and concentrate its capital expenditures on those technologies and assets that will enable the Company to further develop its growth services and replace the decline in revenue and earnings from mature services.

In addition to the operational metrics, the Company is also focusing on improving its financial condition and extending the maturity dates of and lowering the effective interest rate on its outstanding debt. In 2004, the Company was able, through a series of transactions, to extend approximately \$1.1 billion of debt maturing in 2008 to 2011 and to reduce the effective interest rate on the debt outstanding. In addition, on April 4, 2005, Level 3 completed the offering of \$880 million of 10% Convertible Senior Notes due 2011 to institutional investors. Level 3 intends to use the net proceeds from this offering for general corporate purposes, including possible acquisitions, working capital, capital expenditures, debt refinancing and debt repurchases. The Company will continue to look for opportunities to improve its financial position in 2005 and focus its resources on growing revenue and managing costs for the communications business.

Information Services

The Company's information services business is comprised of two operating units: (i)Structure, LLC and Software Spectrum, Inc. (i) Structure provides computer outsourcing services primarily to small and medium-sized businesses that want to concentrate their resources on their core business rather than expend capital and incur overhead costs to operate their own computing environments. Efforts to grow this business are largely dependent on (i)Structure's ability to effectively market itself to businesses while competing against other outsourcing providers with greater financial resources and name recognition. (i) Structure recognizes revenue in the period the services are provided.

Software Spectrum is a global reseller of business software, primarily to large and medium sized businesses. Software Spectrum recognizes revenue at the time the product is shipped or in accordance with the terms of the licensing contracts. Sales under certain licensing programs permit Software Spectrum to recognize only a service fee paid by the software publisher as revenue. Software Spectrum has experienced an increase in sales under this form of licensing program and management expects further adoption of agency licensing programs in the future. The Company's ability to resell software is influenced by the general economic environment, specifically in North America and Western Europe, as well as the level of IT spending for business software by large and medium sized companies.

The software distribution and resale business is very competitive with profitability largely dependent upon rebates received from the software publishers. The amount of rebates received from the publisher is tied directly to the value of software sold for that publisher. These programs vary from publisher to publisher, but typically contain sales targets that are tiered so that Software Spectrum can earn higher rebates on incremental sales above certain sales targets. Alternatively, Software Spectrum may forfeit publisher rebates if certain minimum sales targets are not achieved. As such, it is not uncommon for software resellers, including Software Spectrum, to price software at or below their cost, primarily at the end of the second and fourth quarters of the Company's fiscal year, in order to attain the next sales target and thus earn higher rebates from software publishers.

Microsoft is the primary provider of business software to the Company's Software Spectrum business. If Microsoft should successfully implement programs for the direct sale of software through volume purchase agreements or other arrangements intended to exclude the distribution or resale channel, Software Spectrum's results of operations would be materially and adversely affected.

Microsoft has recently notified Software Spectrum of proposed changes to Microsoft's sales agency program which, once finalized by Microsoft, will take effect for customer contracts entered into after January 1, 2006. All contracts completed prior to January 1, 2006, will be grandfathered under the existing sales agency program. Under the proposed revised program for agency type sales as currently drafted, the number of performance metrics against which Software Spectrum is measured and the standard of performance on those metrics are expected to increase. The Company expects, based on a preliminary evaluation of Microsoft's proposed program changes, that the program changes will not have a significant affect on the Company's results of operation or financial position in 2006. However, since Microsoft has yet to finalize the proposed changes, the Company is not able to definitively determine the effects of Microsoft's proposed changes on the Company's results of operations and financial position after January 1, 2006.

In order to achieve a desired return on invested capital, Management of the information services business focuses on the Adjusted OIBDA metric and cash flow from operating activities to assess the overall operating performance of the information services business. Specifically, for the (i)Structure business, Adjusted OIBDA reflects the operating results of the business and, viewed in conjunction with net capital expenditures required to support existing and new customer contracts, provides Management with visibility to the financial condition and operating performance of the business. For the Software Spectrum business, Management focuses on Adjusted OIBDA and cash flow from operating activities, including changes in working capital accounts, to assess the financial condition and operating performance of the business. Software Spectrum's working capital requirements are determined primarily by changes in its accounts receivable and accounts payable balances. Management is focusing its attention on minimizing working capital requirements by lowering its days sales outstanding through consistent collection procedures. Management expects working capital requirements for the Software Spectrum business to decline in the future as software publishers continue to adopt the agency licensing model.

Coal Mining

Level 3, through its two 50% owned joint venture surface mines in Montana and Wyoming, sells coal primarily through long-term contracts with public utilities. The long-term contracts for the delivery of coal establish the price, volume, and quality requirements of the coal to be delivered. Revenue under these and other contracts is recognized when coal is shipped to the customer. The remainder of Level 3's sales are made on the spot market where prices are generally lower than those in the Company's long-term contracts.

Results of Operations 2005 vs. 2004

Revenue for the periods ended June 30, is summarized as follows (dollars in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
Communications	\$ 371	\$ 391	\$ 881	\$ 780
Information Services	520	503	1,003	997
Coal Mining	19	24	36	40
	<u>\$ 910</u>	<u>\$ 918</u>	<u>\$ 1,920</u>	<u>\$ 1,817</u>

Communications revenue is classified into two categories, services revenue and reciprocal compensation. The Company further segregates its communications services into three separate categories with each being in a different phase of the product life cycle, incorporating different marketing and distribution strategies and different contributions to the Company's profitability. The categories include: 1) growth services (voice and IP-VPN services) 2) core services (transport & infrastructure and IP & data products) and 3) mature services (managed modem and DSL services). Revenue for these services is identified in the following table:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
Services:				
Growth Services	\$ 28	\$ 11	\$ 55	\$ 19
Core Services	187	185	498	378
Mature Services	127	169	271	334
Total Services Revenue	<u>342</u>	<u>365</u>	<u>824</u>	<u>731</u>
Reciprocal Compensation	29	26	57	49
Total Communications Revenue	<u>\$ 371</u>	<u>\$ 391</u>	<u>\$ 881</u>	<u>\$ 780</u>

Growth services revenue for the three months ended June 30, 2005 is comprised of \$25 million for voice services and \$3 million for IP-VPN services versus \$9 million for voice services and \$2 million for IP-VPN services in the same period in 2004. For the six months ending June 30, 2005, growth services revenue was comprised of \$51 million of voice revenue and \$4 million of IP-VPN revenue compared to \$17 million and \$2 million for voice and IP-VPN services, respectively, for the corresponding period in 2004. The increase in IP-VPN revenue is attributable to several contracts that were awarded late in 2004 and the beginning of 2005 for which services are now being provided. Voice revenue improved as a result of the increased market acceptance of the new services introduced in 2003 and 2004, particularly the wholesale services which include voice termination, local inbound and enhanced local services. Voice termination revenue increased significantly in 2005; however the Company's largest voice termination revenue customer significantly decreased the amount of traffic on Level 3's network during the second quarter of 2005. As a result, growth in voice termination revenue will be mitigated until Level 3 signs new customer contracts, increases traffic with existing customers or the significant customer increases traffic on the Level 3 network. The Company expects revenue from its other voice services to continue to increase in future periods as a result of the future service introductions, the timing of our customers' rollout of VoIP services, and the acceptance of VoIP technology by businesses and consumers.

Revenue attributable to the Company's core services for the three months ended June 30, 2005 is comprised of \$123 million of transport and infrastructure revenue and \$64 million of IP and data revenue. Revenue for the corresponding period in 2004 was \$118 million and \$67 million for transport and infrastructure and IP and data, respectively. Revenue attributable to the transport and infrastructure business increased as a result of higher demand for colocation and wavelength services. Colocation revenue increased in 2005 as a result of

higher utilization rates in certain of the Company's facilities and stabilization of pricing. The increase in wavelength revenue is primarily attributable to the contract purchased from 360networks in the first quarter of 2005, new agreements with France Telecom and additional services provided to new and existing customers. The increases in transport and infrastructure revenue were partially offset by lower amortized dark fiber and operations and maintenance revenue resulting from the settlement agreements reached with France Telecom and 360networks in 2005 and McLeodUSA in the fourth quarter of 2004.

The Company expects colocation revenue to remain above 2004 levels as there is strong demand for data center space in large markets and utilization of the Company's existing colocation space has increased in the first six months of 2005.

In addition to transport and infrastructure, the Company's core services also include IP & Data services. Revenue attributable to these services in the second quarter of 2005 declined 4% from the same period in 2004. The decline in this revenue is primarily attributable to a decline in revenue for wholesale Internet access. Although demand for IP and data services is increasing, price declines more than offset revenues relating to the increase in volume.

For the six months ending June 30, 2005, revenue attributable to the Company's core services was comprised of \$371 million for transport and infrastructure and \$127 million for IP and data. For the same period in 2004, revenue was \$240 million and \$138 million for transport and infrastructure services and IP and data services, respectively. Transport and infrastructure revenue increased significantly from the same period in 2004 primarily as a result of the recognition of \$130 million of termination revenue in 2005 versus \$9 million in 2004. The termination revenue in 2005 is primarily attributable to agreements reached with France Telecom and 360networks relating to the termination of existing dark fiber lease agreements with those customers described below.

On February 22, 2005, France Telecom and Level 3 finalized an agreement to terminate a dark fiber agreement signed in 2000. Under the terms of the agreement France Telecom returned the fiber to Level 3. Under the original IRU agreement, the cash received by Level 3 was deferred and amortized to revenue over the 20-year term of the agreement. As a result of this transaction, Level 3 recognized the unamortized deferred revenue of approximately \$40 million of unamortized deferred revenue as non-cash termination revenue in the first quarter of 2005.

On March 1, 2005, Level 3 entered into an agreement with 360networks in which both parties agreed to terminate a 20-year IRU agreement. Under the new agreement 360networks returned the dark fiber originally provided by Level 3. Under the original IRU agreement, signed in 2000, the revenue associated with the cash received by Level 3 was deferred and amortized to revenue over the 20-year term of the agreement. As a result of this transaction, Level 3 recognized the unamortized deferred revenue of approximately \$86 million as non-cash termination revenue in the first quarter of 2005.

Excluding termination revenue, transport & infrastructure revenue for the six months ended June 30, 2005 increased 5% from the corresponding period in 2004 due to an increase in colocation and wavelength revenue previously disclosed.

The Company expects to recognize termination revenue in the future if customers desire to renegotiate contracts or are required to terminate service. The Company is not able to estimate the specific value of these types of transactions until they occur, but does not currently expect to recognize significant termination revenue for the remainder of 2005.

IP and data revenue for the six months ended June 30, 2005 declined from the same period in 2004 for the same reasons described above.

Revenue attributable to the Company's mature services was comprised of managed modem revenue of \$103 million and DSL revenue of \$24 million for the three months ending June 30, 2005. Revenue attributable to these two services was \$136 and \$33 million, respectively, for the three months ended

June 30, 2004. For the six months ended June 30, 2005, managed modem and DSL revenue was \$210 million and \$61 million, respectively, compared to \$270 million and \$64 million for the six months ended June 30, 2004. In 2004, Level 3's largest managed modem customer, America Online, informed the Company that it would reduce its overall purchases of fixed service ports for its U.S. dial-up network. America Online reduced the number of ports it purchased from Level 3 by approximately 30% in 2004. In addition to the port cancellation provisions, the contracts with America Online contain market-pricing provisions which had the effect of lowering revenue. Partially offsetting the price declines was an increase in managed modem usage revenue attributable to the acquisitions of certain ICG and Sprint customer contracts at the beginning of the second and fourth quarters of 2004, respectively.

As a result of concessions to America Online in early 2004, the market-pricing provisions of these contracts are not expected to be enforced until at least the second half of 2005 for a portion of the ports and January 2006 for the remaining ports. The contract with America Online continues to contain pricing provisions whereby Level 3 is obligated to provide America Online a reduced price per port rate if Level 3 offers a third party better pricing for a lower volume of comparable services. The Company expects, excluding the effects of acquisitions, managed modem related revenue to continue to decline in the future primarily due to an increase in the number of subscribers migrating to broadband services and pricing concessions under existing contracts.

The Company's DSL aggregation services are primarily provided to a customer on an exclusive basis in certain markets, which exclusivity expired at the end of the first quarter of 2005. The customer began limited migration of its customers off of the Level 3 network during the first quarter of 2005 and was substantially complete by the end of the second quarter of this year. For the three and six months ending June 30, 2005, DSL revenue attributable to this customer represented 83% and 88%, respectively, of the total DSL revenue recognized in the period. These migration activities resulted in the decrease in DSL revenue for the three and six months ended June 30, 2005 compared to the same periods in 2004. The Company expects DSL revenue to decrease significantly in the second half of 2005 as the Company expects its primary DSL aggregation customer to discontinue purchasing services by the end of the third quarter of 2005.

Reciprocal compensation revenue increased to \$29 million and \$57 million for the three and six months ended June 30, 2005 from \$26 million and \$49 million for the corresponding periods in 2004. This increase is primarily attributable to new or amended agreements reached with BellSouth and Verizon Communications in the second and third quarters of 2004, respectively, and SBC Communications in the first quarter of 2005. These agreements establish intercarrier rate structures to terminate local, ISP bound traffic through 2006 and 2007.

In October 2004, the FCC approved certain aspects of a forbearance petition filed by Core Communications in July 2003. Specifically, the FCC lifted ISP-bound traffic growth caps and new market exclusion. The FCC rate cap of \$.0007 per minute did not change in this order. Certain of the Company's interconnection agreements contain language that supersedes this order.

Certain ISP-bound traffic that is terminated on the Level 3 network is expected to be subject to the FCC's ISP Remand Order, which has been pending at the FCC for two years. The FCC has indicated that it will rule on the ISP Remand Order in the future. The ruling is expected to address, among other things, the FCC's basis for asserting jurisdiction over ISP-bound traffic.

Once the FCC has ruled on the ISP Remand Order, the Company will determine the impact of that decision on its current interconnection agreements. If an agreement contains a change-in-law provision, a party will be able to invoke the change-of-law clauses to prospectively modify the terms of that agreement. If there is no change-of-law provision in the agreement, the previously negotiated terms will stay in place until expiration of the agreement. When an agreement expires, the parties would default to the FCC rules on ISP-bound traffic.

With the three agreements reached in 2004 and 2005, Level 3 has interconnection agreements in place for the majority of traffic subject to reciprocal compensation. Level 3 continues to negotiate new interconnection agreements with other local carriers. To the extent that the Company is unable to sign new interconnection

agreements or signs new agreements containing lower rates, or there is a significant decline in the Company's managed modem dial-up business, or FCC or state regulations change such that carriers are not required to compensate other carriers for terminating ISP-bound traffic, reciprocal compensation revenue may decline significantly over time.

Information services revenue increased for the three months ended June 30, 2005 from 2004 primarily as a result of increased sales for Software Spectrum. The software reseller industry is seasonal, with revenue and Adjusted OIBDA typically being higher in the second and fourth quarters of the Company's fiscal year.

Revenue for Software Spectrum increased to \$504 million for the three months ended June 30, 2005 from \$487 million for the three months ended June 30, 2004. The increase in revenue for Software Spectrum is primarily due to higher sales to the mid-market business segment in 2005. Software Spectrum has increased its sales efforts to target this segment of the market. Software Spectrum defines the mid-market segment as comprised of businesses with fewer than 2,500 desktops. The increase in mid-market sales was partially offset by a decline in revenue due to an increase in sales under Microsoft's 6.0 licensing program. Software Spectrum began experiencing an increase in sales under Microsoft's 6.0 licensing program and similar programs offered by other suppliers in 2003. Under these programs, new enterprise-wide licensing arrangements are priced, billed and collected directly by the software publishers. Software Spectrum continues to provide sales and support services related to these transactions and earns a service fee directly from publishers for these activities. The Company recognizes the service fee it receives as revenue and not the entire value of the software under this program. Software Spectrum recorded approximately \$22 million and \$18 million of revenue attributable to these types of contracts in the second quarter of 2005 and 2004, respectively. The estimated selling price of the software sold under these agreements was \$379 million and \$338 million for the corresponding periods.

If Microsoft and the other suppliers are successful in implementing agency licensing programs, it will result in a significant decline in the amount of information services revenue recognized by the Company. The decline in revenue is not expected to have a meaningful effect on operating income (loss), as the Company should experience a corresponding decline in cost of revenue.

Revenue attributable to (i) Structure's business for the second quarter of 2005 was consistent with revenue for the second quarter of 2004 at \$16 million. Revenue from new services provided was offset by continued price compression in the mainframe outsourcing business.

Information services revenue for the six months ended June 30, 2005 was comprised of \$970 million from Software Spectrum and \$33 million attributable to (i) Structure. For the six months ended June 30, 2004 revenue for Software Spectrum and (i) Structure was \$959 million and \$38 million, respectively. The increase in Software Spectrum revenue in 2005 is due to the same factors that were described earlier for the three-month periods ending June 30, 2005 and 2004. The decrease in (i) Structure revenue was attributable to two customers terminating their outsourcing contracts and as a result, (i) Structure recognized \$4 million of termination revenue in the first quarter of 2004.

Coal mining revenue decreased to \$19 million in the second quarter of 2005 from \$24 million in the second quarter of 2004. Revenue was \$36 million for the six months ended June 30, 2005 compared to \$40 million for the same period in 2004. The decline in revenue for 2005 is attributable to a significant reduction in coal required to be purchased in 2005 under a contract with Detroit Edison from 2004 levels. The Company has signed new agreements with Detroit Edison, but with lower tonnage requirements and lower prices.

Cost of Revenue for the communications business, as a percentage of revenue was 30% for both of the three month periods ended June 30, 2005 and 2004. Cost of revenue declined in 2005 as a result of the migration of ICG, KMC and Allegiance traffic to the Level 3 network in the second half of 2004 and first half of 2005, and the incremental costs incurred in the second quarter of 2004 for the completion of the Genuity migration. The decrease in cost of revenue was offset by the decline in higher margin managed modem and DSL revenue and increased sales for certain voice services, for which margins are lower.

For the six months ended June 30, 2005 and 2004, the cost of revenue for the communications business, as a percentage of revenue was 26% for both periods. An increase in termination revenue, with no corresponding cost of revenue, in 2005 to \$131 million from \$9 million in 2004 positively affected the percentage in 2005. Excluding termination revenue in 2005, the cost of revenue, as a percentage of revenue, would have been 30%. The exclusion of termination revenue in 2004 had little effect on the percentage. As described above, the change in the revenue mix from high margin mature services to low margin growth services, combined with the additional costs of the ICG, KMC, Allegiance transactions completed in the second quarter of 2004 and the Sprint transaction completed in the fourth quarter of 2004, increased cost of revenue as a percentage of revenue in 2005.

As the Company's revenue mix changes to a higher percentage of voice revenue and a lower percentage of managed modem and DSL revenue, the cost of revenue, as a percentage of revenue, will increase due to the lower margin earned on certain of the Company's voice services.

The cost of revenue for the information services businesses, as a percentage of revenue, improved slightly to 90.2% for the second quarter of 2005 from 90.5% for the second quarter of 2004. This decrease was primarily attributable to an increase in sales under new licensing programs implemented by software publishers for which the cost of revenue is minimal. Software Spectrum is very reliant on rebates received from software publishers to improve its operating results. For the three months ended June 30, 2005 and 2004, Software Spectrum earned approximately \$10 million and \$12 million, respectively, in rebates which reduced cost of revenue. Software Spectrum does not earn rebates from Microsoft on agency program sales. As a result, as agency program sales increase, the amount of rebates earned is expected to be below that earned in 2004. This decline is partially offset, by Software Spectrum earning, in general, higher margins on Microsoft agency sales than on Microsoft non-agency sales.

The cost of revenue, as a percentage of revenue, for the six months ended June 30, 2005 increased to 90.8% from 90.7% for the same period in 2004. Included in the 2004 results was \$4 million of termination revenue attributable to the outsourcing business. This termination revenue had no corresponding cost of revenue. The decline in termination revenue in 2005 was offset by higher agency sales. Software Spectrum earned \$19 million and \$22 million in rebates for the six months ended June 30, 2005 and 2004, respectively.

Cost of revenue, as a percentage of revenue, for the coal mining business decreased for the three and six months ending June 30, 2005 compared to the same periods in 2004 primarily as a result of the favorable resolution of certain production tax issues. The resolution of these issues resulted in a \$5 million decrease in the cost of revenue for the mining business in the second quarter of 2005.

Depreciation and Amortization expenses for the quarter were \$166 million for the second quarter of 2005, a 6% decrease from the depreciation and amortization expenses of \$177 million in the second quarter of 2004. The decrease is primarily attributable to shorter-lived communications assets that were placed in service in prior years becoming fully depreciated during 2004. In addition, the McLeod intangible assets were fully amortized during the third quarter of 2004. These decreases were partially offset by the amortization expense attributable to the intangible assets acquired in the Sprint acquisition completed in the fourth quarter of 2004.

Depreciation and amortization expenses for the six months ending June 30, 2005 and 2004 were \$337 million and \$356 million, respectively. This decrease is mainly attributable to shorter-lived assets becoming fully depreciated in the prior year. Amortization expense for the six months ended June 30, 2005 was consistent with amortization expense for the same period in 2004.

Selling, General and Administrative expenses were \$217 million in the three months ended June 30, 2005, an 11% decrease from selling, general and administrative expenses in the same period of 2004. This decrease is primarily attributable to lower compensation and employee related costs resulting from the workforce reduction for the communications business which occurred in the first quarter of 2005. Specifically, declines in base compensation, bonus, travel, recruiting and facilities expenses all contributed to the decrease in selling, general and administrative expenses in 2005.

Selling, general and administrative expenses for the Company's information services business in 2005 did not fluctuate significantly from 2004 expenses.

Selling, general and administrative expenses attributable to the Company's other businesses also declined in the second quarter of 2005 as a result of the favorable settlement of an obligation to provide insurance for employees of the Company's former packaging business and the receipt of insurance proceeds reimbursing the Company for payments made to settle legacy environmental litigation. These items contributed to a \$6 million decline in selling, general and administrative expenses. The Company does not expect to realize cost reductions of this magnitude in the future for these businesses.

Included in operating expenses for both the second quarter of 2005 and 2004, were \$10 million of non-cash compensation and professional expenses recognized under SFAS No. 123 related to grants of stock options, warrants and other stock-based compensation programs. In the second quarter of 2005, the Company increased the value of stock based compensation distributed to employees, and recognized additional non-cash compensation expense in the quarter for these grants. This increase in non-cash compensation expense was offset by the reversal of expense in Europe attributable to certain discontinued equity compensation programs.

For the six months ended June 30, 2005, selling, general and administrative expenses declined by approximately 7% compared to the same period in 2004. The decline is attributable to the factors described above.

The Company expects 2005 selling, general and administrative expenses to remain below 2004 levels as the Company realizes the cost savings from the workforce reduction that occurred in the first quarter of 2005 and ongoing non-workforce related cost containment efforts.

Restructuring and Impairment Charges were \$4 million and \$19 million for the three and six months ended June 30, 2005, respectively, and less than \$1 million and \$2 million for the three and six months ended June 30, 2004, respectively. During the first quarter of 2005, the Company recognized \$15 million related to the workforce reductions of the communications business in North America and Europe. The employees affected by this workforce reduction provided support functions or worked directly on mature services. As of June 30, 2005, the Company had less than \$1 million of remaining obligations attributable to the 2005 restructuring activities. For the three and six months ended June 30, 2004, the Company recognized restructuring charges of less than \$1 million and \$2 million, respectively, for the ongoing restructuring activities of Software Spectrum.

Non-cash impairment charges were \$4 million for the second quarter of 2005 and resulted from the decision to terminate projects for certain Softswitch related products in the communications business. The costs incurred for these projects, including capitalized operating expenses, were impaired as the carrying value of these projects exceeded their estimated fair value.

Adjusted OIBDA, is defined by the Company as operating income (loss) from the consolidated statements of operations, less depreciation and amortization expense, less non-cash compensation expense included within selling, general and administration expense on the consolidated statements of operations, and less the non-cash portion of restructuring and impairment charges. Adjusted OIBDA is not a measurement under accounting principles generally accepted in the United States and may not be used by other companies. Management believes that Adjusted OIBDA is an important part of the Company's internal reporting and is an indicator of profitability and operating performance used by the chief operating decision maker or decision making group, especially in a capital-intensive industry such as telecommunications. 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. Note 11 of the consolidated financial statements provides a reconciliation of Adjusted OIBDA for each of the Company's operating segments.

Adjusted OIBDA for the communications business increased to \$88 million in the second quarter of 2005 from \$79 million for the same period in 2004. The increase in 2005 is primarily attributable to the declines in cost of revenue and selling, general and administrative expenses partially offset by a decline in communications revenue.

For the six months ended June 30, 2005, Adjusted OIBDA for the communications business was \$289 million compared to \$195 million in the same period of 2004. This difference was predominately due to an increase in termination revenue and a decline in selling, general and administrative expenses in 2005. Partially offsetting these items was a change in the revenue mix from high margin mature services to lower margin growth services, combined with the additional network costs of the ICG, KMC, Allegiance transactions completed in the second quarter of 2004 and the Sprint transaction completed in the fourth quarter of 2004.

The operations of the information services business resulted in Adjusted OIBDA of \$15 million for the three months ended June 30, 2005 versus \$11 million for the same period in 2004. This increase is due to higher sales and gross margin for Software Spectrum in 2005.

Adjusted OIBDA for the information services business was \$22 million for the six months ended June 30, 2005 which remained unchanged from the same period in 2004. The increase in Software Spectrum sales and gross margin in 2005 was offset by the lack of termination revenue attributable to the outsourcing business that took place in 2004. In the first quarter of 2004, (i) Structure recognized \$4 million of revenue as two customers terminated their contracts.

Adjusted OIBDA for the Company's coal and other businesses for the three and six months ended June 30, 2005 was \$12 million and \$13 million, respectively. In 2004, Adjusted OIBDA was \$4 million and \$5 million for the corresponding periods. The increase in both 2005 periods is attributable to the favorable resolution of certain production tax issues which resulted in a \$5 million decrease in the cost of revenue for the mining business in the second quarter of 2005, and the \$6 million benefit contributing to the lower selling, general and administrative expenses of the Company's other businesses. The reduction in expenses was partially offset by a decline in higher margin coal sales to Detroit Edison.

Interest Income was \$10 million and \$14 million for the three and six months ended June 30, 2005, respectively, increasing from \$3 million and \$6 million for the same periods in 2004. Interest income increased in 2005 compared to 2004 due to the increase in the Company's average return on its portfolio to 2.6% and 2.4% for the three and six months ended June 30, 2005 from 1.2% and 1.1% for the three and six months ended June 30, 2004. In addition, net proceeds received from the Company's issuance of the \$880 million aggregate principal amount of 10% Convertible Senior Notes due 2011 on April 4, 2005 caused the portfolio balance to increase in the second quarter of 2005. The average balance was \$1.4 billion for the second quarter of 2005 and \$1.1 billion for the second quarter of 2004. The average portfolio balance for the six months ended June 30, 2005 and 2004 remained consistent at \$1.1 billion. Pending utilization of cash and cash equivalents, the Company invests the funds primarily in government and government agency securities and money market funds. The investment strategy generally provides lower yields on the funds than on alternative investments, but reduces the risk to principal in the short term prior to these funds being used in the Company's business.

In 2004 and 2005, the Company elected to take advantage of the yield curve and purchase longer-term U.S. government securities. The government securities currently mature through February 2007. The Company intends to hold these securities until they mature.

Interest Expense increased by \$21 million to \$139 million during the second quarter of 2005 compared to the second quarter in 2004, primarily as a result of increased interest expense from the issuance of the Company's \$880 million of 10% Convertible Senior Notes due 2011 in the second quarter of 2005. In addition, there was an increase in interest expense due to the accretion on discount notes and higher interest rates on the variable rate mortgage. This was partially offset by the refinancing transaction that occurred in the fourth quarter of 2004. The Company entered into a \$730 million Senior Secured Term Loan due 2011 and issued \$345 million of 5.25% Senior Convertible Notes due 2011 in the fourth quarter of 2004. The Company used the proceeds

from these transactions to repurchase approximately \$1.1 billion of the Company's public debt due in 2008. Overall, the refinancing transaction in the fourth quarter of 2004 reduced the Company's quarterly interest expense by approximately \$5 million in the second quarter of 2005 compared to the second quarter of 2004.

Interest Expense, net increased by \$8 million to \$253 million during the six months ended June 30, 2005 primarily as a result of the transactions described above. In addition, the extinguishment of the Allegiance capital lease obligation in the second quarter of 2004 resulted in a decrease in interest expense for the six months ended June 30, 2005.

Other, net decreased significantly for the three and six months ended June 30, 2005 compared to the same periods in 2004 as a result of the \$147 million gain recognized on the extinguishment of the Allegiance capital lease obligation in the second quarter of 2004. The Company also recognized a gain of \$23 million on the sale of Commonwealth Telephone common stock in the first quarter of 2004.

Income Tax Expense for the first six months of 2005 was \$3 million compared to \$2 million for the same period in 2004. The expense in both periods is attributable to state income taxes for the coal business and foreign jurisdiction tax relating to the Software Spectrum business.

Financial Condition—June 30, 2005

Cash flows provided by (used in) operating activities for the six months ended June 30 are as follows (dollars in millions) :

	Six Months Ended June 30,	
	2005	2004
Communications**	\$ (72)	\$ (51)
Information Services	(7)	22
Other	2	(8)
Total	<u>\$ (77)</u>	<u>\$ (37)</u>

** Includes interest expense, net of interest income

The decrease in operating cash flows for the communications business for the six months ended June 30, 2005 compared to the same period in 2004 was attributable to lower operating results after excluding termination revenue, and an increase in working capital requirements primarily due to the timing of payments from large customers. Partially offsetting these items was a decrease in the cash interest paid on the Company's debt and an increase in interest income.

For the information services business, the decrease in cash provided by operating activities is a result of an increase in the working capital requirements compared to the same period in 2004. The fluctuation in working capital is primarily attributable to the timing of payments to software publishers and the collection of accounts receivable from customers.

The increase in operating cash flows for the other businesses is primarily attributable to the payment of state tax obligations in 2004 for which liabilities had previously been recorded. During 2005, the Company also received insurance proceeds of \$2 million reimbursing the Company for payments made in prior periods to settle environmental litigation.

Investing activities in 2005 include \$648 million used to purchase marketable securities, \$146 million used for net capital expenditures, primarily in the communications business, and \$10 million for a cost investment in a communications company. Partially offsetting these activities were \$150 million from the maturity of marketable securities and \$4 million of proceeds from the sale of property, plant and equipment in the first six months of 2005.

Financing activities in 2005 include the issuance of 10% Convertible Senior Notes due 2011 which resulted in \$877 million of net proceeds for the Company. In addition, the Company repaid \$130 million of outstanding indebtedness using cash and cash equivalents. The indebtedness primarily consisted of the GMAC mortgage which was repaid in the second quarter of 2005 using \$103 million of cash and \$13 million of restricted securities. In the future, the Company may pursue a new mortgage to replace all or a portion of the former GMAC mortgage.

Liquidity and Capital Resources

The Company provides a broad range of integrated communications services as a facilities-based provider (that is, a provider that owns or leases a substantial portion of the property, plant and equipment necessary to provide its services). The Company has created, generally by constructing its own assets but also through a combination of purchasing and leasing facilities, an advanced, international, end-to-end, facilities-based communications network. The Company has designed its network based on optical and Internet protocol technologies in order to leverage the efficiencies of these technologies to provide lower cost communications services.

The further development of the communications business will continue to require significant expenditures, including new service development costs. The Company expects that these expenditures will result in negative cash flows from operating activities and operating losses for the Company in the near future. The Company's expenditures will be primarily attributable to operating expenses, capital expenditures and interest payments. The Company expects base capital expenditures (capital required to keep the network operating efficiently) to be approximately \$100 million in 2005. The majority of the Company's ongoing capital expenditures are expected to be success-based, which are tied to incremental revenue. The Company expects success-based capital expenditures for voice customers to increase in 2005.

As a result of continued growth and demand for the Company's services, the Company is increasing its investment in network technologies, product development and supporting capabilities in 2005 in order to increase the attractiveness of its offerings and maintain its low-cost position.

The Company does not have any significant principal amounts due on its outstanding debt until 2008. In 2005, the Company expects to pay in cash, based on current debt levels approximately \$445 million of interest expense.

Level 3 has approximately \$1.3 billion of cash, cash equivalents and marketable securities on hand at June 30, 2005. Based on information available at this time, management of the Company believes that the Company's current liquidity is sufficient to fund its anticipated negative cash flows from operating activities, capital expenditures and interest costs until such time as it is able to grow the business and begin generating positive cash flows from operating activities sufficient to also cover capital expenditure requirements, cash interest expense and debt obligations.

Cash flows will fluctuate in 2005 and will be a function of revenue fluctuations from existing and new services, the Company's management of network, selling, general and administrative expenses, capital expenditures and fluctuations in working capital for both the communications and information services businesses. The Company's previous debt and equity offerings have given the Company the ability to develop its business. However, if additional investment opportunities should present themselves, the Company may be required to secure additional financing in the future. There can be no assurance that the Company could raise such amounts on acceptable terms or at the time the funding is necessary.

In addition to raising capital through the debt and equity markets, the Company may sell or dispose of existing businesses, investments or other non-core assets to fund portions of its business.

In the second quarter of 2005, Level 3 announced that its wholly owned subsidiary, Technology Spectrum, Inc., had filed a registration statement with the Securities and Exchange Commission to enable the sale of that subsidiary's common stock to the public in an initial public offering. Technology Spectrum, Inc. is the principal holding company for Level 3's information services business. The registration statement relating to these securities has not yet become effective.

The Company may not be successful in producing sufficient cash flow, raising sufficient debt or equity capital on terms that it will consider acceptable. In addition, proceeds from dispositions of the Company's assets may not reflect the assets' intrinsic values. Further, expenses may exceed the Company's estimates and any financing needed may be higher than estimated. Failure to generate sufficient funds may require the Company to delay or abandon some of its future expansion or expenditures, which could have a material adverse effect on the business.

Level 3's management continues to review the Company's existing lines of business and service offerings to determine how those lines of business and service offerings assist with the Company's focus on delivery of communications and information services and meeting its financial objectives. To the extent that certain lines of business or service offerings are not considered to be compatible with the delivery of communications and information services or with achieving financial objectives, Level 3 may exit those lines of business or stop offering those services.

Level 3 is aware that the various issuances of its outstanding senior notes, senior discount notes and convertible notes may trade at discounts to their respective face or accreted amounts. In order to continue to reduce future cash interest payments, as well as future amounts due at maturity, Level 3 or its affiliates may, from time to time, enter into debt for debt, debt for equity or cash transactions to purchase these outstanding debt securities in open market or privately negotiated transactions. Level 3 will evaluate any such transactions in light of then existing market conditions and the possible dilutive effect to stockholders. The amounts involved in any such transactions, individually or in the aggregate, may be material.

Current economic conditions of the telecommunications and information services industry, combined with Level 3's financial position and significant liquidity, have created potential opportunities for Level 3 to acquire companies or portions of companies at attractive prices. Level 3 continues to evaluate these opportunities and could make additional acquisitions in 2005.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Level 3 is subject to market risks arising from changes in interest rates and foreign exchange rates. As of June 30, 2005, the Company had borrowed a total of \$730 million under a Senior Secured Term Loan. Amounts drawn on the debt instrument bear interest at LIBOR rates plus an applicable margin. As the LIBOR rates fluctuate, so too will the interest expense on amounts borrowed under the debt instrument. The weighted average interest rate on the variable rate instrument at June 30, 2005, was approximately 10.34%. A hypothetical increase in the variable portion of the weighted average rate by 1% (i.e. a weighted average rate of 11.34%) would increase annual interest expense of the Company by approximately \$7.3 million. At June 30, 2005, the Company had \$5.22 billion of fixed rate debt bearing a weighted average interest rate of 8.74%. A decline in interest rates in the future will not benefit the Company with respect to the fixed rate debt due to the terms and conditions of the loan agreements that require the Company to repurchase the debt at specified premiums.

The Company's business plan includes operating a telecommunications network and information services business in Europe. As of June 30, 2005, the Company had invested significant amounts of capital in the region for its communications business. The Company issued €800 million (€154 million outstanding at June 30, 2005) in Senior Euro Notes in February 2000 as an economic hedge against its net investment in its European subsidiaries at the time. As of June 30, 2005, the Company held enough foreign denominated currency to fund its current working capital obligations and remaining interest payments on its Euro

denominated debt through maturity. The Company has not made significant use of financial instruments to minimize its exposure to foreign currency fluctuations.

The change in interest rates is based on hypothetical movements and is not necessarily indicative of the actual results that may occur. Future earnings and losses will be affected by actual fluctuations in interest rates and foreign currency rates.

Item 4. Controls and Procedures

(a) *Disclosure controls and procedures.* The Company's Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the Company's disclosure controls and procedures as of June 30, 2005. Based upon such review, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's controls and procedures are effective and are designed to ensure that information required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934, as amended, and the rules there under, is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in reports it files or submits under the Securities Exchange Act is accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

(b) *Internal controls.* There were no changes in Level 3's internal controls over financial reporting that have occurred during the second quarter 2005 that have materially affected or are reasonably likely to materially affect, Level 3's internal controls over financial reporting.

LEVEL 3 COMMUNICATIONS, INC. AND SUBSIDIARIES

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The Company has provided an update to two legal proceedings involving the Company in Note 13 of the consolidated financial statements contained in Part I, Item I of this Form 10-Q. This disclosure is hereby incorporated by reference.

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

At the annual meeting of stockholders held on May 17, 2005 the following matters were submitted to a vote:

1. Election of three Class II Directors to the Board of Directors of Level 3 for a three-year term until the 2008 Annual Meeting of Stockholders:

	<u>In Favor</u>	<u>Withheld</u>
James O. Ellis, Jr.	606,810,092	8,880,434
Richard R. Jaros	599,925,059	15,765,467
Albert C. Yates	606,871,295	8,819,231

2. To approve the granting to the Level 3 Board of Directors discretionary authority to amend our amended and restated Certificate of Incorporation to effect a reverse stock split at one of four ratios:

Affirmative votes	592,717,307
Negative votes	21,322,355
Abstain	1,650,864
Broker non-vote	0

3. To approve an amendment and restatement of the Level 3 Communications, Inc. Certificate of Incorporation:

Affirmative votes	603,020,683
Negative votes	10,888,872
Abstain	1,780,971
Broker non-vote	0

Item 6. Exhibits

- (a) Exhibits filed as part of this report are listed below.

- 31.1 Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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.

Dated: August 9, 2005

/s/ Eric J. Mortensen

Eric J. Mortensen
Senior Vice President, Controller
and Principal Accounting Officer

CERTIFICATIONS*

I, James Q. Crowe, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Level 3 Communications, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2005

/s/ James Q. Crowe

James Q. Crowe
Chief Executive Officer

* Provide a separate certification for each principal executive officer and principal financial officer of the registrant. See Rules 13a-14(a) and 15d-14(a).

CERTIFICATIONS*

I, Sunit S. Patel, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Level 3 Communications, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2005

/s/ Sunit S. Patel
Sunit S. Patel
Chief Financial Officer

* Provide a separate certification for each principal executive officer and principal financial officer of the registrant. See Rules 13a-14(a) and 15d-14(a).

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Level 3 Communications, Inc. (the "Company") on Form 10-Q for the three and six months ended June 30, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James Q. Crowe, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ James Q. Crowe

James Q. Crowe
Chief Executive Officer
August 9, 2005

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Exhibit 32.2

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Level 3 Communications, Inc. (the "Company") on Form 10-Q for the three and six months ended June 30, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Sunit S. Patel, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/Sunit S. Patel

Sunit S. Patel
Chief Financial Officer
August 9, 2005

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