

LEVEL 3 COMMUNICATIONS INC

FORM 10-Q (Quarterly Report)

Filed 05/15/98 for the Period Ending 03/31/98

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 March 31, 1998

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.)

3555 Farnam Street, Omaha, Nebraska
(Address of principal executive offices)

68131
(Zip Code)

(402)-536-3677

(Registrant's telephone number,
including area code)
Peter Kiewit Sons', Inc.
(Former name if changed since last report)

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 X No

The number of shares outstanding of each class of the issuer's common stock, as of May 1, 1998:

Common Stock 149,677,680 shares Class R Convertible Common Stock 6,538,231 shares

LEVEL 3 COMMUNICATIONS, INC.

Part I - Financial Information

Item 1. Financial Statements:

Consolidated Condensed Statements of Earnings Consolidated Condensed Balance Sheets Consolidated Condensed Statements of Cash Flows
Consolidated Statement of Changes in Stockholders' Equity Notes to Condensed Financial Statements

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

Part II - Other Information

Item 2. Changes in Securities**Item 6. Exhibits and Reports on Form 8-K****Signatures****Index to Exhibits**

LEVEL 3 COMMUNICATIONS, INC.
Consolidated Condensed Statements of Earnings
(unaudited)

(dollars in millions, except per share data)	Three Months Ended	
	March 31, 1998	1997
Revenue	\$ 87	\$ 80
Costs and Expenses:		
Operating expenses	42	39
Depreciation and amortization	6	5
General and administrative expenses	48	16
	-----	-----
Total costs and expenses	96	60
	-----	-----
Earnings (Loss) from Operations	(9)	20
Other Income (Expense):		
Interest income	26	7
Interest expense	(4)	(3)
Other, principally equity losses of unconsolidated entities	(22)	(3)
	-----	-----
Total other income	-	1
	-----	-----
Earnings (Loss) Before Income Taxes and Discontinued Operations	(9)	21
Income Tax (Provision) Benefit	3	(5)
	-----	-----
Earnings (Loss) from Continuing Operations	(6)	16
Discontinued Operations:		
Gain on separation of construction operations	608	-
Gain on disposition of energy business, net of income tax expense of \$174	324	-
Energy, net of income tax expense of \$2	-	4
Construction, net of income tax expense of \$10	-	15
	-----	-----
Earnings from discontinued operations	932	19
	-----	-----
Net Earnings	\$ 926	\$ 35
	=====	=====
Earnings (Loss) Per Share:		
Continuing Operations:		
Basic	\$ (0.04)	\$0.12
	=====	=====
Diluted	\$ (0.04)	\$0.12
	=====	=====
Discontinued Operations:		
Basic	\$ 6.38	\$0.04
	=====	=====
Diluted	\$ 6.38	\$0.04
	=====	=====
Net Earnings:		
Basic	\$ 6.34	\$0.16
	=====	=====
Diluted	\$ 6.34	\$0.16
	=====	=====
Net Earnings excluding gain on split-off of construction operations:		

Basic	\$ 2.18	\$0.16
	=====	=====
Diluted	\$ 2.18	\$0.16
	=====	=====

See accompanying notes to consolidated condensed financial statements.

LEVEL 3 COMMUNICATIONS, INC.
Consolidated Condensed Balance Sheets

	March 31, 1998	December 27, 1997
(dollars in millions, except per share data)		
(unaudited)		
Assets		
Current Assets		
Cash and cash equivalents	\$ 806	\$ 87
Marketable securities	1,289	678
Restricted securities	24	22
Accounts receivable	54	42
Investment in discontinued operations - energy	-	643
Other	24	22
	-----	-----
Total Current Assets	2,197	1,494
Property, Plant and Equipment, less accumulated depreciation and amortization of \$224 and \$228	192	184
Investments	342	383
Investment in discontinued operations - construction	-	652
Other Assets	63	66
	-----	-----
	\$2,794	\$2,779
	=====	=====

See accompanying notes to consolidated condensed financial statements.

LEVEL 3 COMMUNICATIONS, INC.

Consolidated Condensed Balance Sheets

	March 31, 1998	December 27, 1997
(dollars in millions, except per share data)		
(unaudited)		
Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts payable	\$ 54	\$ 31
Current portion of long-term debt	4	3
Accrued reclamation and other mining costs	14	19
Deferred income taxes	14	15
Income taxes payable	198	-
Other	20	21
	-----	-----
Total Current Liabilities	304	89
Long-Term Debt, less current portion	137	137
Deferred Income Taxes	66	83
Accrued Reclamation Costs	101	100
Other Liabilities	137	140
Stockholders' Equity:		
Preferred stock, no par value, authorized 250,000 shares;		
no shares outstanding in 1998 and 1997	-	-
Common Stock, \$.01 par value in 1998:		
Common Stock (Class D in 1997), authorized 500,000,000 shares;		
147,199,552 shares outstanding in 1998 and 135,517,140 outstanding in 1997	1	8
Class R Common Stock, authorized 8,500,000 shares;		
6,538,231 shares outstanding in 1998 and no shares outstanding in 1997	-	-
Class B, authorized 8,000,000 shares; no shares		

outstanding in 1998 or 1997	-	-
Class C, authorized 125,000,000 shares; no shares		
outstanding		
in 1998 and 10,132,343 outstanding in 1997	-	1
Additional paid-in capital	447	427
Accumulated other comprehensive income (loss)	13	(5)
Retained earnings	1,588	1,799
	-----	-----
Total Stockholders' Equity	2,049	2,230
	-----	-----
	\$2,794	\$2,779
	=====	=====

See accompanying notes to consolidated condensed financial statements.

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

	Three Months Ended March 31,	
(dollars in millions)	1998	1997
Cash flows from continuing operations:		
Net cash provided by continuing operations	\$ 17	\$ 108
Cash flows from investing activities:		
Proceeds from sales and maturities of marketable securities	819	25
Purchases of marketable securities	(1,422)	(14)
Investments	(3)	(25)
Proceeds from sale of property, plant and equipment and other investments	20	-
Capital expenditures	(18)	(7)
Other	-	(2)
	-----	-----
Net cash used in investing activities	(604)	(23)
Cash flows from financing activities:		
Payments on long-term debt including current portion	(2)	-
Issuances of common stock	17	-
Proceeds from exercise of stock options	10	-
Dividends paid	-	(12)
Exchange of Class C Stock for Common Stock, net	122	71
Other	-	1
	-----	-----
Net cash provided by financing activities	147	60
Cash flows from discontinued operations:		
Proceeds from sale of energy operations	1,159	-
Investments in discontinued energy operations	-	(13)
	-----	-----
Net cash provided by (used in) discontinued operations	1,159	(13)
Cash and cash equivalents of C-TEC at the beginning of 1997	-	(76)
	-----	-----
Net change in cash and cash equivalents	719	56
Cash and cash equivalents at beginning of year	87	147
	-----	-----
Cash and cash equivalents at end of period	\$ 806	\$ 203
	=====	=====

The activities of the Construction & Mining Group have been removed from the Consolidated Condensed Statements of Cash Flows.

See accompanying notes to consolidated condensed financial statements.

LEVEL 3 COMMUNICATIONS, INC.

Consolidated Statement of Changes in Stockholders' Equity For the three months ended March 31, 1998

(unaudited)

Class Common Class

B&C Stock R Additional Other (dollars Common (Class D Common Paid-in Comprehensive Retained in millions) Stock in 1997) Stock
Capital Income(Loss) Earnings Total

Balance at December 28, 1997	\$ 1	\$ 8	\$ -	\$ 427	\$ (5)	\$1,799	\$2,230
Common Stock:							
Issuance of Common Stock	-	-	-	17	-	-	17
Stock options exercised	-	1	-	9	-	-	10
Designation of par value to \$.01	-	(8)	-	8	-	-	-
Stock option grants	-	-	-	2	-	-	2
Income tax benefit from exercise of options	-	-	-	1	-	-	1
Issuance of Class R Stock	-	-	-	92	-	(92)	-
Class C Stock:							
Repurchases	-	-	-	(25)	-	-	(25)
Conversion of debentures	-	-	-	10	-	-	10
Net earnings	-	-	-	-	-	926	926
Other comprehensive income	-	-	-	-	3	-	3
Split-off of the Construction & Mining Group (1)	----	----	----	(94)	15	(1,045)	(1,125)
Balance at March 31, 1998	\$ - =====	\$ 1 =====	\$ - =====	\$ 447 =====	\$ 13 =====	\$ 1,588 =====	\$2,049 =====

See accompanying notes to consolidated condensed financial statements.

LEVEL 3 COMMUNICATIONS, INC.

Notes to Consolidated Condensed Financial Statements

1. Basis of Presentation

The consolidated condensed balance sheet of Level 3 Communications, Inc. and subsidiaries ("Level 3" or "the Company"), at December 27, 1997 has been condensed 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, as amended, for the year ended December 27, 1997. These financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto. The preparation of the consolidated condensed financial statements in conformity with generally accepted accounting principles 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.

In 1997, the Company agreed to sell its energy assets to CalEnergy Company, Inc. ("CalEnergy") and to separate the Construction & Mining Group from the Diversified Group. On January 2, 1998, the Company completed the sale of its energy assets to CalEnergy. On March 31, 1998 the Company completed the split-off of the Construction & Mining Group to stockholders that held Class C Stock. Therefore, the assets and liabilities and results of operations of both businesses were classified as discontinued operations on the consolidated condensed balance sheet, statements of earnings and cash flows for all periods presented.

The results of operations for the three months ended March 31, 1998 are not necessarily indicative of the results to be expected for the full year.

On May 1, 1998, the Company's Board of Directors changed Level 3's fiscal year end from the last Saturday in December to a calendar year end. The additional five days in the 1998 fiscal year will be reflected in the Company's Form 10-K.

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

2. Reorganization - Discontinued Construction Operations

On March 31, 1998 a separation of the Company's Construction & Mining Group and Diversified Group was completed through the split-off of the Construction and Mining Group ("the Split-off").

The Company recognized a gain of \$608 million equal to the difference between the carrying value of the Construction & Mining Group and its fair value in accordance with the Financial Accounting Standards Board Emerging Issues Tax Force Issue 96-4. No taxes were provided on this gain due to the tax-free nature of the Split-off. The Company then reflected the fair value of the Construction & Mining Group as a distribution to the Class C stockholders.

In connection with the Split-off, Level 3 and the Construction & Mining Group entered into various agreements including a Separation Agreement, a Tax Sharing Agreement and an amended Mine Management Agreement.

The Separation Agreement, as amended, provides for the allocation of certain risks and responsibilities between Level 3 and the Construction & Mining Group and for cross-indemnifications that are intended to allocate financial responsibility to the Construction & Mining Group for liabilities arising out of the construction business and to allocate to Level 3 financial responsibility for liabilities arising out of the non-construction businesses. The Separation Agreement also allocates certain corporate-level risk exposures not readily allocable to either the construction businesses or the non-construction businesses.

Under the Tax Sharing Agreement, with respect to periods, or portions thereof, ending on or before the Split-off, Level 3 and the Construction & Mining Group generally will be responsible for paying the taxes relating to such returns, including any subsequent adjustments resulting from the redetermination of such tax liabilities by the applicable taxing authorities, that are allocable to the non-construction businesses and construction businesses, respectively. The Tax Sharing Agreement also provides that Level 3 and the Construction & Mining Group will indemnify the other from certain taxes and expenses that would be assessed if the Split-off were determined to be taxable, but solely to the extent that such determination arose out of the breach by Level 3 or the Construction & Mining Group, respectively, of certain representations made to the Internal Revenue Service in connection with the ruling issued with respect to the Split-off. If the Split-off were determined to be taxable for any other reason, those taxes would be allocated equally to Level 3 and the Construction & Mining Group. Finally, under certain circumstances, Level 3 would make certain liquidated damage payments to the Construction & Mining Group if the Split-off was determined to be taxable, in order to indirectly compensate Class C stockholders for taxes assessed upon them in that event.

In connection with the Split-off, the Mine Management Agreement, pursuant to which the Construction & Mining Group provides mine management and related services to Level 3's coal mining operations, was amended to provide the Construction & Mining Group with a right of offer in the event that Level 3 were to determine to sell any or all of its coal mining properties. Under the right of offer, Level 3 would be required to offer to sell those properties to the Construction & Mining Group. If the Construction & Mining Group were to decline to purchase the properties at that price, Level 3 would be free to sell them to a third party for an amount greater than or equal to that price. If Level 3 were to sell the properties to a third party, thus terminating the Mine Management Agreement, it would be required to pay the Construction & Mining Group an amount equal to the discounted present value of the Mine Management Agreement, determined, if necessary, by an appraisal process.

Following the Split-off, the Company's Common Stock began trading on The Nasdaq National Market on April 1, 1998, under the symbol "LVL3". In connection with the Split-off, the construction business was renamed "Peter Kiewit Sons', Inc." and the Class D Stock became the common stock of Level 3 Communications, Inc. ("Common Stock"). Accordingly, the separate financial statements of Peter Kiewit Sons', Inc. should be obtained to review the financial position of the Construction & Mining Group as of March 31, 1998 and December 27, 1997, and the results of operations for the three months ended March 31, 1998 and 1997.

The Company's certificate of incorporation gave stockholders the right to exchange their Class C Stock for Class D Stock under a set conversion formula. That right was eliminated as a result of the Split-off. To replace that conversion right, Class C stockholders received 6.5 million shares of a new Class R Convertible Stock ("Class R Stock") in January 1998, which is convertible into Level 3 Common Stock in accordance with terms ratified by stockholders in December 1997. The Company reflected in the equity accounts the exchange of the conversion right and issuance of the Class R Stock at its fair value of \$92 million at the date of the Split-off.

On May 1, 1998, the Board of Directors of Level 3 Communications, Inc. determined to force conversion of all shares of the Company's Class R Stock into common stock of the Company, effective May 15, 1998. The Class R Stock will be converted into Level 3 Common Stock in accordance with the formula set forth in the Certificate of Incorporation of the Company. The formula provides for a conversion ratio equal to \$25, divided by the average of the midpoints between the high and low sales prices for Level 3 Common Stock on each of the fifteen trading days during the period beginning April 9 and ending April 30. That average for that period was \$64.28125. Accordingly, each holder of Class R Stock will receive .3889 of a share of Level 3 Common Stock for each share of Class R Stock held. As a result of the forced conversion, certain adjustments will be made to the cost sharing and risk allocation provisions of the Separation Agreement and Tax Sharing Agreement between Level 3 and Peter Kiewit Sons', Inc. which will reduce the costs and risks allocated to the Company.

The Company intends to become a facilities-based provider (that is, a provider that owns or leases a substantial portion of the plant, property and equipment necessary to provide its services) of a broad range of integrated communications services. To reach this goal, the Company plans to expand substantially the business of its PKS Information Services, Inc. subsidiary and to create, through a combination of construction, purchase and leasing of facilities and other assets, an international, end-to-end, facilities-based communications network (the "Business Plan"). The Company is designing the network based on IP technology in order to leverage the efficiencies of this technology to provide lower cost communications services.

3. Discontinued Energy Operations

On January 2, 1998, the Company completed the sale of its energy assets to CalEnergy. Level 3 recognized an after-tax gain on the disposition of \$324 million and the after-tax proceeds of approximately \$967 million from the transaction will be used to fund in part the Business Plan. Results of operations for the period through January 2, 1998 were not considered significant and the gain on disposition was calculated using the carrying amount of the energy assets as of December 27, 1997.

4. Earnings Per Share

Basic earnings per share have been computed using the weighted average number of shares during each period. Diluted earnings per share have been computed by including stock options considered to be dilutive common stock equivalents.

The Company had a loss from continuing operations for the period ended March 31, 1998, therefore, no potential common shares related to Company stock options have been included in the computation of the diluted earnings per share calculations. For the period ending March 31, 1997, potentially dilutive stock options are calculated in accordance with the treasury stock method which assumes that proceeds from exercise of all options are used to repurchase common stock at the average market value. The number of shares remaining after the proceeds are exhausted represent the potentially dilutive effect of the options.

The following details the earnings per share calculations for Level 3 Common Stock:

	Three Months Ended March 31, 1998 1997	
Earnings (loss) from continuing operations (in millions):	\$ (6)	\$ 16
Earnings from discontinued operations	932	4
	-----	-----
Net earnings	\$ 926	\$ 20
	=====	=====
Total number of weighted average shares outstanding used to compute basic earnings per share (in thousands)	146,163	122,207
Additional dilutive stock options	-	271
	-----	-----
Total number of shares used to compute dilutive earnings per share	146,163	122,478
	=====	=====
Continuing operations:		
Basic earnings (loss) per share	\$(0.04)	\$ 0.12
	=====	=====
Diluted earnings (loss) per share	\$(0.04)	\$ 0.12
	=====	=====
Discontinued operations:		
Basic earnings per share	\$ 6.38	\$ 0.04
	=====	=====
Diluted earnings per share	\$ 6.38	\$ 0.04
	=====	=====
Net earnings:		
Basic earnings per share	\$ 6.34	\$ 0.16
	=====	=====
Diluted earnings per share	\$ 6.34	\$ 0.16
	=====	=====
Net earnings excluding gain on split-off of construction operations		
Basic earnings per share	\$ 2.18	\$ 0.16
	=====	=====
Diluted earnings per share	\$ 2.18	\$ 0.16
	=====	=====

The Company has 10,032,111 options outstanding that were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive for the three months ended March 31, 1998.

Effective December 26, 1997, the Company issued a dividend of four shares of Level 3 Common Stock (previously Class D Stock) for each share of Level 3 Common Stock outstanding. All share information and per share data have been restated to reflect this dividend.

5. Investments

On September 5, 1997, C-TEC Corporation ("C-TEC") announced that its board of directors had approved the planned restructuring of C-TEC into three publicly traded companies effective September 30, 1997. Under the terms of the restructuring C-TEC shareholders received stock in the following companies:

Commonwealth Telephone Enterprises, Inc., containing the local telephone group and related engineering business;

Cable Michigan, Inc. containing the cable television operations in Michigan; and

RCN Corporation, Inc. which consists of RCN Telecom Services; C-TEC, existing cable systems in the Boston-Washington D.C. corridor; and the investment in Megacable S.A. de C.V., a cable operator in Mexico. RCN Telecom Services is a provider of packaged local and long distance telephone, video and internet access services provided over fiber optic networks to residential customers in Boston, New York City and Washington, D.C.

As a result of the restructuring, Level 3 owns less than 50% of each of the outstanding shares and voting rights of each entity, and therefore accounts for each entity using the equity method.

The following is summarized financial information of the three entities created as a result of the C-TEC restructuring for the three months ended March 31, 1998 and 1997, and as of March 31, 1998 and December 31, 1997(in millions):

	Three Months Ended March 31,	
	1998	1997
Operations		
Commonwealth Telephone Enterprises:		
Revenue	\$ 53	\$ 46
Net income (loss) available to common shareholders	4	(7)
Level 3's share:		
Net income (loss)	2	(3)
Goodwill amortization	(1)	(1)
	-----	-----
Equity in net income (loss)	\$ 1	\$ (4)
	=====	=====
Cable Michigan:		
Revenue	\$ 21	\$ 20
Net loss available to common shareholders	(1)	(2)
Level 3's share:		
Net loss	(1)	(1)
Goodwill amortization	(1)	-
	-----	-----
Equity in net loss	\$ (2)	\$ (1)
	=====	=====
RCN Corporation:		
Revenue	\$ 40	\$ 30
Net loss available to common shareholders	(68)	(11)
Level 3's share:		
Net loss	(31)	(5)
Goodwill amortization	-	-
	-----	-----
Equity in net loss	\$ (31)	\$ (5)
	=====	=====

	Commonwealth Telephone Enterprises		Cable Michigan		RCN Corporation	
Financial Position	1998	1997	1998	1997	1998	1997
Current assets	\$ 63	\$ 71	\$ 16	\$ 23	\$ 989	\$ 703
Other assets	313	303	117	120	589	448
	-----	-----	-----	-----	-----	-----
Total assets	376	374	133	143	1,578	1,151
Current liabilities	75	76	18	16	107	70
Other liabilities	259	260	156	166	1,086	708
Minority interest	-	-	14	15	23	16
	-----	-----	-----	-----	-----	-----

Total liabilities	334	336	188	197	1,216	794
	-----	-----	-----	-----	-----	-----
Net assets (liabilities)	\$ 42	\$ 38	\$ (55)	\$ (54)	\$ 362	\$ 357
	=====	=====	=====	=====	=====	=====
Level 3's share:						
Equity in net assets						
(liabilities)	\$ 20	\$ 18	\$ (27)	\$ (26)	\$ 167	\$ 173
Goodwill	56	57	71	72	16	41
	-----	-----	-----	-----	-----	-----
	\$ 76	\$ 75	\$ 44	\$ 46	\$ 183	\$ 214
	=====	=====	=====	=====	=====	=====

The Company recognizes gains and losses from the sale, issuance and repurchase of stock by its subsidiaries and equity method investees once any unamortized goodwill associated with the investment has been reduced to a zero balance. During the first quarter of 1998, RCN Corporation issued stock in the acquisition of two Internet service providers. The increase in the Company's proportionate share of RCN Corporation's net assets as a result of these acquisitions reduced unamortized goodwill attributable to the Company's investment in RCN Corporation.

On March 31, 1998 the market value of Level 3's investments in Commonwealth Telephone, Cable Michigan and RCN was \$247 million, \$85 million and \$668 million, respectively.

6. Level 3 Stock Plan

Subsequent to the Split-off, the Company adopted the recognition provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock Based Compensation ("SFAS No. 123") when it adopted an outperform stock option program ("OSO"). Under SFAS No. 123, the fair value of an option (as computed in accordance with accepted option valuation models) on the date of grant is amortized over the vesting period of the option. The recognition provisions of SFAS No. 123 are applied prospectively upon adoption. As a result, they are applied to all stock awards granted in the year of adoption and are not applied to awards granted in previous years unless those awards are modified or settled in cash after adoption of the recognition provisions.

The OSO program was designed by the Company so that its stockholders receive a market return on their investment before OSO holders receive any return on their options. The Company believes that the OSO program aligns directly management's and stockholders' interests by basing stock option value on the Company's ability to outperform the market in general, as measured by the Standard & Poor's ("S&P") 500 Index. Participants in the OSO program do not realize any value from options unless the Level 3 Common Stock price outperforms the S&P 500 Index. When the stock price gain is greater than the corresponding gain on the S&P 500 Index, the value received for options under the OSO plan is based on a formula involving a multiplier related to how much the Level 3 Common Stock outperforms the S&P 500 Index. To the extent that the Level 3 Common Stock outperforms the S&P 500, the value of OSOs to an option holder may exceed the value of non-qualified stock options.

The Company believes that the fair value method of accounting more appropriately reflects the substance of the transaction between an entity that issues stock options, or other stock-based instruments, and its employees; that is, an entity has granted something of value to an employee (the stock option or other instrument) generally in return for their continued employment and services. The Company believes that the value of the instrument granted to employees should be recognized in financial statements because nonrecognition implies that either the instruments have no value or that they are free to employees, neither of which is an accurate reflection of the substance of the transaction. Although the recognition of the value of the instruments results in compensation expense in an entity's financial statements, the expense differs from other compensation expense in that these charges will not be settled in cash, but rather, generally, through issuance of common stock.

The Company believes that the adoption of SFAS 123 will result in material non-cash charges to operations in 1998 and thereafter. The amount of the non-cash charge will be dependent upon a number of factors, including the number of options granted and the fair value of each option estimated at the time of its grant. The expense recognized for the three months ended March 31, 1998 was \$2 million. On a pro forma basis, adopting SFAS No. 123 would not have had a material impact on the results of operations in the first quarter of 1997.

7. Comprehensive Income

In the first quarter of 1998, the Company adopted Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income." The standard requires the display and reporting of comprehensive income which includes all changes in stockholders' equity with the exception of additional investments by stockholders or distributions to stockholders. Comprehensive income for the Company includes net earnings, unrealized gains (losses) on securities and foreign currency translation adjustments, which are charged or credited to the cumulative translation account within stockholders' equity.

Comprehensive income for the three months, ended March 31, 1998

and 1997 was as follows (in millions):

Three Months Ended
March 31,
1998
1997

Net earnings	\$ 926	\$ 35
Other comprehensive income before tax:		
Foreign currency translation adjustments	1	2
Unrealized holding gains (losses) arising during period	8	(17)
Less: reclassification adjustment for gains (losses) included in net earnings	(5)	-
	-----	-----
Other comprehensive income (loss), before tax	4	(15)
Income tax (expense) benefit related to items of other comprehensive income	(1)	6
	-----	-----
Other comprehensive income, net of taxes	3	(9)
	-----	-----
Comprehensive income	\$ 929	\$ 26
	=====	=====

8. New Accounting Pronouncements

On April 3, 1998, the Accounting Standards Executive Committee issued Statement of Position 98-5 ("SOP 98-5"), Reporting on the Costs of Start-Up Activities, which provides guidance on the financial reporting of start-up and organization costs. It requires costs of start-up activities and organization costs to be expensed as incurred. SOP 98-5 is effective for financial statements for fiscal years beginning after December 15, 1998. The Company is required to reflect the initial application of SOP 98-5 as the cumulative effect of a change in accounting principle, as described in Accounting Principles Board Opinion No. 20, Accounting Changes. As a result of the cumulative effect of a change in accounting treatment, the Company expects to record a charge to earnings in the first quarter of 1999 for any unamortized start-up or organization costs as of the beginning of 1999.

9. Other Matters

In January 1998, approximately 2.3 million shares of Class C Stock, with a redemption value of \$122 million were converted into 10.5 million shares of Level 3 Common Stock (formerly Class D Stock).

The Company is involved in various lawsuits, claims and regulatory proceedings incidental to its business. Management believes that any resulting liability for legal proceedings beyond that provided should not materially affect the Company's financial position, future results of operations or future cash flows.

On March 23, 1998, the Company and Frontier Communications International, Inc. ("Frontier") entered into an agreement ("Frontier Agreement") enabling the Company to lease approximately 8,300 miles of OC-12 network capacity on Frontier's new 13,000 mile SONET fiber optic, IP-capable network currently under construction for a period of up to five years. The leased network will initially connect 15 of the larger cities across the United States. While requiring an aggregate minimum payment of \$165 million over its five-year term, the Frontier Agreement does not impose monthly minimum consumption requirements on the Company, allowing the Company to order, alter or terminate circuits as it deems appropriate. The Company expects to recognize these costs as the leased network is utilized.

10. Subsequent Events

On April 2, 1998, the Company announced it had reached a definitive agreement with Union Pacific Railroad Company ("Union Pacific") granting the Company the use of approximately 7,800 miles of rights-of-way along Union Pacific's rail routes for construction of the Company's North American intercity network. The Company expects that the Union Pacific agreement will satisfy substantially all of its anticipated right-of-way requirements west of the Mississippi River and approximately 50% of the right-of-way requirements for its North American intercity network. The agreement provides for initial fixed payments of up to \$8 million to Union Pacific upon execution of the agreement and throughout the construction period, recurring payments in the form of cash, communications capacity, and other communications services based on the number of conduits that are operational and certain construction obligations of the Company to provide fiber or conduit connections for Union Pacific at the Company's incremental cost of construction.

On April 23, 1998, the Company acquired XCOM Technologies, Inc. ("XCOM"), a privately held company that has developed technology which the Company believes will provide certain key components necessary for the Company to develop an interface between its IP-based network and the public switched telephone network. The Company issued approximately 2.6 million shares of Level 3 Common Stock and 0.4 million options and warrants to purchase Level 3 Common Stock in exchange for all the stock, options and warrants of XCOM. The value of the transaction will be determined through an appraisal. The Company expects to account for this transaction as a purchase and expects to recognize a significant charge to earnings during the second quarter of 1998 for the portion of the cost of the purchase attributable to in-process research and development efforts.

On April 28, 1998, the Company received \$1.937 billion of proceeds from an offering of \$2 billion aggregate principal amount 9.125% Senior Notes Due 2008 ("the Offering"). The Senior Notes are senior, unsecured obligations of the Company, ranking pari passu with all existing and future senior unsecured indebtedness of the Company. The Senior Notes contain certain covenants, which among others, limit consolidated debt, dividend payments, and transactions with affiliates. The Company intends to use the net proceeds of the Offering in connection with the implementation of its Business Plan to increase substantially its information services business and to expand the range of services it offers by

building an advanced international, facilities-based communications network based on IP technology.

LEVEL 3 COMMUNICATIONS, INC.

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 condensed financial statements (including the notes thereto), included elsewhere herein.

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 the Company. When used in this document, the words "anticipate", "believe", "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.

Recent Developments

Split-off

In October 1996, the Board of Directors of the Company (the "Board") directed management of the Company to pursue a listing of the Company's Class D Diversified Group Convertible Exchangeable Common Stock, par value \$.0625 per share (the "Class D Stock"), as a way to address certain issues created by the Company's then two-class capital stock structure and the need to attract and retain the best management for the Company's businesses. During the course of its examination of the consequences of a listing of the Class D Stock, management concluded that a listing of the Class D Stock would not adequately address these issues, and instead began to study a separation of the Construction Group from the other businesses of the Company (the "Diversified Group"), thereby forming two independent companies. At the regular meeting of the Board on July 23, 1997, management submitted to the Board for consideration a proposal for separation of the Construction Group and the Diversified Group through a split-off of the Construction Group (the "Split-off"). At a special meeting on August 14, 1997, the Board approved the Split-off.

The separation of the Construction Group and the Diversified Group was contingent upon a number of conditions, including the favorable ratification by a majority of the holders of both the Company's Class C Construction & Mining Group Restricted Redeemable Convertible Exchangeable Common Stock, par value \$.0625 per share (the "Class C Stock"), and the Class D Stock, and the receipt by Company of an Internal Revenue Service ruling or other assurance acceptable to the Board that the separation would be tax-free to U.S. stockholders. On December 8, 1997, the holders of Class C Stock and Class D Stock approved the Split-off and on March 5, 1998, the Company received a favorable ruling from the Internal Revenue Service. The Split-off occurred on March 31, 1998. In connection with the Split-off, (i) the Company exchanged each outstanding share of Class C Stock for one share of common stock of PKS Holdings, Inc. ("New PKS"), the company formed to hold the Construction Group, to which eight-tenths of a share of the Company's Class R Convertible Common Stock, par value \$.01 per share (the "Class R Stock"), was attached, (ii) New PKS was renamed "Peter Kiewit Sons', Inc.," (iii) the Company was renamed "Level 3 Communications, Inc." and (iv) Class D Stock was designated as common stock, par value \$.01 per share ("Common Stock"). As a result of the Split-off, the Company no longer owns any interest in New PKS or the Construction Group. Accordingly, the separate financial statements and management's discussion and analysis of financial condition and results of operations of Peter Kiewit Sons', Inc. should be obtained to review the financial position of the Construction Group as of March 31, 1998 and December 27, 1997, and the results of operations for the quarters ended March 31, 1998 and 1997.

On March 31, 1998, as a result of the Split-off, the Company recognized, within discontinued operations, a gain of \$608 million equal to the difference between the carrying value of the Construction Group and its fair value in accordance with Financial Accounting Standards Board Emerging Issues Task Force Issue 96-4. No taxes were provided on this gain due to the tax-free nature of the Split-off. Also on March 31, 1998, the Company reflected the fair value of the Construction Group as a distribution to the Class C stockholders.

Listing of Common Stock

Effective April 1, 1998, the Company's Common Stock began trading on The Nasdaq National Market under the symbol "LVLT."

Conversion of Class R Stock

On May 1, 1998, the Board of the Company determined to force conversion of all shares of the Company's Class R Stock into Common Stock of the Company, effective May 15, 1998. The Class R Stock will be converted into the Company's Common Stock in accordance with the formula set forth in the Company's Certificate of Incorporation. The formula provides for a conversion ratio equal to \$25, divided by the average of the midpoints between the high and low sales prices for the Company's Common Stock on each of the fifteen trading days during the period beginning April 9 and ending April 30, 1998. That average for that period was \$64.28125. Accordingly, each holder of Class R Stock will receive .3889 of a share of Common Stock for each share of Class R Stock held. In total, the 6.5 million shares of Class R Stock will convert into 2.5 million shares of Common Stock on May 15, 1998. As a result of the forced conversion, certain adjustments will be made to

the cost sharing and risk allocation provisions of the Separation Agreement and Tax Sharing Agreement between the Company and Peter Kiewit Sons', Inc. which will reduce the costs of the Split-off and risks allocated to the Company.

Conversion of Class C Stock in January 1998

Prior to the Split-Off, as of January 1 of each year, holders of Class C Stock had the right to convert Class C Stock into Class D Stock, subject to certain conditions. In January 1998, holders of Class C Stock converted 2.3 million shares, with a redemption value of \$122 million, into 10.5 million shares of Level 3 Common Stock (formerly Class D Stock).

CalEnergy Transaction

In January 1998, the Company and CalEnergy Company, Inc. ("CalEnergy") closed the sale of the Company's energy assets to CalEnergy (the "CalEnergy Transaction"). The Company received proceeds of approximately \$1.16 billion and recognized an after-tax gain of \$324 million in the first quarter of 1998. The after-tax proceeds from this transaction of approximately \$967 million will be used to fund in part the Company's planned expansion of its information services business and the development of an advanced, international, facilities-based communications network ("Business Plan").

Stock Options

Subsequent to the Split-off, the Company adopted the recognition provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock Based Compensation ("SFAS No. 123") when it adopted an outperform stock option program ("OSO"). Under SFAS No. 123, the fair value of an option (as computed in accordance with accepted option valuation models) on the date of grant is amortized over the vesting period of the option. The recognition provisions of SFAS No. 123 are applied prospectively upon adoption. As a result, they are applied to all stock awards granted in the year of adoption and are not applied to awards granted in previous years unless those awards are modified or settled in cash after adoption of the recognition provisions.

The OSO program was designed by the Company so that its stockholders receive a market return on their investment before OSO holders receive any return on their options. The Company believes that the OSO program aligns directly management's and stockholders' interests by basing stock option value on the Company's ability to outperform the market in general, as measured by the Standard & Poor's ("S&P") 500 Index. Participants in the OSO program do not realize any value from options unless the Level 3 Common Stock price outperforms the S&P 500 Index. When the stock price gain is greater than the corresponding gain on the S&P 500 Index, the value received for options under the OSO plan is based on a formula involving a multiplier related to how much the Level 3 Common Stock outperforms the S&P 500 Index. To the extent that the Level 3 Common Stock outperforms the S&P 500, the value of OSOs to an option holder may exceed the value of non-qualified stock options.

The Company believes that the fair value method of accounting more appropriately reflects the substance of the transaction between an entity that issues stock options, or other stock-based instruments, and its employees; that is, an entity has granted something of value to an employee (the stock option or other instrument) generally in return for their continued employment and services. The Company believes that the value of the instrument granted to employees should be recognized in financial statements because nonrecognition implies that either the instruments have no value or that they are free to employees, neither of which is an accurate reflection of the substance of the transaction. Although the recognition of the value of the instruments results in compensation expense in an entity's financial statements, the expense differs from other compensation expense in that these charges will not be settled in cash, but rather, generally, through issuance of common stock.

The Company believes that the adoption of SFAS No. 123 will result in material non-cash charges to operations in 1998 and thereafter. The amount of the non-cash charge will be dependent upon a number of factors, including the number of options granted and the fair value of each option estimated at the time of its grant. The expense recognized for the three months ended March 31, 1998 was \$2 million.

Corporate Headquarters

In February 1998, the Company announced that it was moving its corporate headquarters to Broomfield, Colorado, a northwest suburb of Denver. The campus facility is expected to encompass over 500,000 square feet of office space at a construction cost of over \$70 million. The Company is leasing space in the Denver area while the campus is under construction. The first phase of the complex is scheduled for completion in the summer of 1999.

Frontier Agreement

On March 23, 1998, the Company and Frontier Communications International, Inc. ("Frontier") entered into an agreement ("Frontier Agreement") enabling the Company to lease approximately 8,300 miles of OC-12 network capacity on Frontier's new 13,000 mile SONET fiber optic, IP-capable network currently under construction for a period of up to five years. The leased network will initially connect 15 of the larger cities across the United States. While requiring an aggregate minimum payment of \$165 million over its five-year term, the Frontier Agreement does not impose monthly minimum consumption requirements on the Company, allowing the Company to order, alter or terminate circuits as it deems appropriate. The Company expects to recognize these costs as the leased network is utilized.

Union Pacific Rights-of-Way

On April 2, 1998, the Company announced it had reached a definitive agreement with Union Pacific Railroad Company (the "Union Pacific Agreement") granting the Company the use of approximately 7,800 miles of rights-of-way along Union Pacific's rail routes for construction of the Company's North American intercity network. The Company expects that the Union Pacific Agreement will satisfy substantially all of its anticipated right-of-way requirements west of the Mississippi River and approximately 50% of the right-of-way requirements for its North American intercity network. The agreement provides for initial fixed payments of up to \$8 million to Union Pacific upon execution of the agreement and throughout the construction period, recurring payments in the form of cash, communications capacity, and other communications services based on the number of conduits that are operational and certain construction obligations of the Company to provide fiber or conduit connections for Union Pacific at the Company's incremental cost of construction.

XCOM Technologies, Inc. Acquisition

On April 23, 1998, the Company acquired XCOM Technologies, Inc. ("XCOM"), a privately held company that has developed technology which the Company believes will provide certain key components necessary for the Company to develop an interface between its IP-based network and the public switched telephone network. The Company issued approximately 2.6 million shares of Level 3 Common Stock and 0.4 million options and warrants to purchase Level 3 Common Stock in exchange for all the common and preferred stock of XCOM. The value of the transaction will be determined through an appraisal. The Company expects to account for this transaction as a purchase and expects to recognize a significant charge to earnings during the second quarter of 1998 for the portion of the cost of the purchase attributable to in-process research and development efforts.

Senior Notes

On April 28, 1998, the Company received \$1.937 billion of proceeds from an offering of \$2 billion aggregate principal amount 9.125% Senior Notes Due 2008 ("the Offering"). The Senior Notes are senior, unsecured obligations of the Company, ranking pari passu with all existing and future senior unsecured indebtedness of the Company. The Senior Notes contain certain covenants, which among others, limit consolidated debt, dividend payments and transactions with affiliates. The Company intends to use the net proceeds of the Offering in connection with the implementation of its Business Plan to increase substantially its information services business and to expand the range of services it offers by building an advanced international, facilities-based communications network based on IP technology.

Results of Operations

In late 1997, the Company announced a plan to increase substantially its information services business and to expand the range of services it offers by building an advanced, international, facilities-based communications network based on Internet Protocol ("IP") technology. Since the Business Plan represents a significant expansion of the Company's communications and information services business, the Company does not believe that the Company's financial condition and results of operations for prior periods will serve as a meaningful indication of the Company's future financial condition or results of operations. The Company expects to incur substantial net operating losses for the foreseeable future, and there can be no assurance that the Company will be able to achieve or sustain operating profitability in the future.

First Quarter 1998 vs. First Quarter 1997

Revenue for the quarters ended March 31, is summarized as follows (in millions):

	1998	1997
Communications and Information Services	\$ 29	\$ 16
Coal Mining	53	61
Other	5	3
	-----	-----
	\$ 87	\$ 80
	=====	=====

Communications and Information Services revenue consists of computer outsourcing revenue of \$15 million and systems integration revenue of \$14 million in 1998. The comparable amounts in 1997 were \$11 million and \$5 million. Computer outsourcing revenues increased due to the addition of several new customers since the first quarter of 1997. The increase in systems integration revenue in the first quarter of 1998 reflects the pattern of growth experience throughout 1997 as the Company expanded its computer network systems integration, consulting, and Year 2000 and software reengineering activities since this business commenced operations in 1997.

The Company plans to begin offering IP network services in 15 U.S. cities in the fall of 1998. In preparation for the product launch, the Company made significant progress during the first quarter in 1998 in obtaining appropriate licenses, agreements and technical facilities. The Company has secured approximately 750,000 square feet of space for technical gateway and collocation sites in these 15 cities, and received Certificates of Public Convenience and Necessity in eight states. The Company also obtained collocation agreements in 56 Central Offices and has begun construction in most of these locations, and is currently in discussions with all the incumbent local exchange carriers for Interconnection Agreements.

Coal mining revenues decreased in 1998 due primarily to the expiration of a long term sales contract at the end of 1997 and continued lower prices for new customer contracts. Coal mining revenue for the year ended 1998 is expected to approximate 1997 revenue, due to additional alternative source and brokerage revenue expected during the remainder of 1998.

Operating Expenses increased to \$42 million in 1998 from \$39 million in 1997 primarily due to costs associated with increased systems integration revenue. Margins from the computer outsourcing and systems integration businesses improved in 1998 primarily due to increased revenues from new customers obtained since the first quarter of 1997 and from the systems integration business, which was in a start-up mode in 1997. Coal margins declined slightly in 1998 due to the expiration of a long term sales contract at the end of 1997. Coal mining margins for the year ended 1998 are expected to approximate margins recognized in 1997 due to additional high margin alternative source coal expected to be sold throughout the remainder of 1998. If current market conditions continue, the Company will experience a significant decline in coal revenue and earnings over the next several years as delivery requirements under long-term contracts decline and as long-term contracts begin to expire.

Depreciation and Amortization increased slightly in 1998 to \$6 million from \$5 million in 1997 primarily due to increased depreciation on PKS Information Services equipment purchased for new computer outsourcing customers. The Company expects to incur additional amortization expense beginning in the second quarter of 1998 due to the acquisition of XCOM. Additional depreciation is expected beginning in the third quarter of 1998 when the Company commences operations on its IP network.

General and Administrative Expenses increased significantly in 1998 to \$48 million from \$16 million in 1997 primarily due to the cost of activities associated with preparing for the expected launch of the IP network in the third quarter of 1998. In addition, the Company incurred approximately \$7 million of professional service costs associated with the initial development of a substantial, scalable business support system infrastructure, specifically designed to enable the Company to offer services efficiently to its targeted customers. In addition to these costs, the Company incurred incremental compensation and relocation costs for the substantial number of new employees that have been hired to begin implementation of the Business Plan, legal costs associated with obtaining licenses, agreements and technical facilities and other development costs associated with the Company's plans to begin offering services in 15 U.S. cities in the fall of 1998. Other than costs associated with the business support system, which the Company will begin to capitalize in the second quarter of 1998, general and administrative costs are expected to increase significantly in future periods as the Company implements the Business Plan.

EBITDA which consists of earnings (losses) before interest, income taxes, depreciation, amortization, non cash stock-based compensation and other non-operating income or expenses was \$(3) million in 1998 and \$25 million in 1997. The primary reason for the decrease between periods is the significant increase in general and administrative expenses, described above, incurred in connection with the implementation of the Company's Business Plan. EBITDA is commonly used in the communications industry to analyze companies on the basis of operating performance. EBITDA is not intended to represent cash flow for the periods. See Consolidated Condensed Statements of Cash Flows.

Interest Income increased significantly in 1998 to \$26 million from \$7 million in 1997 as the Company's average cash, cash equivalents and marketable securities balance approximated \$2 billion in the first quarter of 1998. Proceeds on the sale of the Company's energy assets to CalEnergy of \$1.16 billion were received on January 2, 1998. The Company's average cash, cash equivalents and marketable securities balance approximated \$550 million in 1997. Pending utilization of the cash equivalents and marketable securities in implementing the Business Plan, the Company intends to invest the funds primarily in government and governmental agency securities. This investment strategy will provide for less yield on the funds, but is expected to reduce the risk to principal prior to using the funds in implementing the Business Plan.

Interest Expense increased slightly in 1998 to \$4 million from \$3 million in 1997 due primarily to interest incurred on a \$15 million mortgage with Metropolitan Life established in June 1997 with the Company's Pavilion Towers office building in Aurora, Colorado serving as collateral. The majority of the interest expense relates to bank and institutional notes with recourse only to the SR91 toll road project. Interest expense will increase substantially in future periods due to the completion of the offering of \$2 billion aggregate principle amount of 9.125% Senior Notes Due 2008 issued on April 28, 1998. Amortization of debt issuance costs associated with its offering will also increase interest expense in future periods. A significant portion of the interest will be capitalized as the Company develops the IP network.

Other Expense, net increased substantially in 1998 to \$(22) million from \$(3) million in 1997 due primarily to increased losses recognized by the Company's equity method investee, RCN Corporation, Inc. ("RCN"), a full service provider of local, long distance, internet and cable television services primarily to residential users in densely populated areas in the Northeast United States. The Company's share of these losses approximated \$31 million. RCN is incurring significant costs in developing its business plan and during the first quarter of 1998 it acquired Ultranet Communications, Inc. and Erols Internet, Inc., two Internet service providers with operations in the Boston to Washington, D.C. corridor. RCN recognized a charge to earnings of approximately \$45 million (Company's share \$21 million) with respect to certain costs of the acquisitions associated with in- process research and development activities.

Also included in Other Income (Expense) are equity earnings in Commonwealth Telephone Enterprises, Inc., a Pennsylvania public utility providing telephone service, equity in losses of Cable Michigan, Inc., a cable television operator in the State of Michigan, and realized gains and losses on the sale of marketable securities, investments and other assets each not individually significant to the Company's results of operations.

Income Tax Benefit approximates the statutory rate in 1998. The income tax provision in 1997 is slightly below the statutory rate due primarily to depletion allowances and other individually insignificant deductions for tax purposes in excess of that recognized for financial reporting purposes.

Discontinued Operations includes the one-time gain of \$608 million recognized upon the distribution of the Construction Group to former Class C stockholder on March 31, 1998. Also included in discontinued operations is the gain, net of tax, of \$324 million from the Company's sale of its energy assets to CalEnergy on January 2, 1998.

Financial Condition-March 31, 1998

The Company's working capital increased substantially during the first quarter of 1998 due primarily to the sale of the Company's energy assets to CalEnergy for \$1.16 billion on January 2, 1998. The Company's working capital was \$1.9 billion on March 31, 1998 and \$1.4 billion on December 27, 1997. The Company's operations provided \$17 million of cash during the first quarter of 1998, primarily from coal mining operations partially offset by costs in implementing the Business Plan.

The Company made capital expenditures of \$18 million during the first quarter of 1998, primarily related to the development of the infrastructure associated with the IP network and the purchase of equipment used by the computer outsourcing business. The Company also had net purchases of marketable securities of \$603 million, primarily attributable to the investment of the CalEnergy transaction proceeds. The Company also made several small investments in development stage businesses during the first quarter of 1998.

Financing activities in the first quarter of 1998 consisted primarily of cash received upon the conversion of 2.3 million shares of Class C Stock, with a redemption value of \$122 million, into 10.5 million shares of Level 3 Common Stock (formerly Class D Stock) during January 1998, proceeds from sales of Level 3 Common Stock of \$17 million and the exercise of the Company's stock options for \$10 million. The Company reflected in the equity accounts the exchange of the conversion right and the issuance of the Class R Stock at its fair value of \$92 million on the date of the Split-off. The Company will recognize a similar adjustment to the equity accounts of approximately \$70 million during the second quarter of 1998 due to the forced conversion of the Class R Stock effective May 15, 1998.

On April 28, 1998, the Company received \$1.937 billion of proceeds from an offering of \$2 billion aggregate principal amount 9.125% Senior Notes Due 2008 ("the Offering"). The Senior Notes are senior, unsecured obligations of the Company, ranking pari passu with all existing and future senior unsecured indebtedness of the Company. The Senior Notes contain certain covenants, which among others, limit consolidated debt, dividend payments and transactions with affiliates. The Company intends to use the net proceeds of the Offering in connection with the implementation of its Business Plan to increase substantially its information services business and to expand the range of services it offers by building an advanced international, facilities-based communications network based on IP technology.

Liquidity and Capital Resources

Since late 1997, the Company has substantially increased the emphasis it places on and the resources devoted to its communications and information services business. The Company intends to become a facilities-based provider (that is, a provider that owns or leases a substantial portion of the plant, property and equipment necessary to provide its services) of a broad range of integrated communications services. To reach this goal, the Company plans to expand substantially the business of its subsidiary, PKS Information Services, Inc., and to create, through a combination of construction, purchase and leasing of facilities and other assets, an international, end-to-end, facilities-based communications network. The Company is designing its network based on IP technology in order to leverage the efficiencies of this technology to provide lower cost communications services.

The development of the Business Plan will require significant capital expenditures, a substantial portion of which will be incurred before any significant related revenues from the Business Plan are expected to be realized. These expenditures, together with the associated early operating expenses, will result in substantial negative operating cash flow and substantial net operating losses for the Company for the foreseeable future. The Company estimates that its capital expenditures in connection with the Business Plan will be in excess of \$500 million in 1998 and will approximate \$ 2 billion in 1999. The Company's current liquidity in addition to the net proceeds of the Offering should be sufficient to fund the currently committed portions of the Business Plan.

The Company currently estimates that the implementation of the Business Plan, as currently contemplated, will require between \$8 and \$10 billion over the next 10 years. The Company's ability to implement the Business Plan and meet its projected growth is dependent upon its ability to secure substantial additional financing in the future. The Company expects to meet its additional capital needs with the proceeds from sales or issuance of equity securities, credit facilities and other borrowings, or additional debt securities. The Offering was issued under an indenture which permits the Company and its subsidiaries to incur substantial amounts of debt. In addition, the Company may sell or dispose of existing businesses or investments to fund portions of the Business Plan. The Company may, as part of its ordinary course of business, sell or lease capacity, its conduits or access to its conduits. There can be no assurance that the Company will be successful in producing sufficient cash flow, raising sufficient debt or equity capital on terms that it will consider acceptable, or selling or leasing fiber optic capacity or access to its conduits, or that proceeds of dispositions of the Company's assets will reflect the assets' intrinsic value. Further, there can be no assurance that expenses will not exceed the Company's estimates or that the financing needed will not likewise 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 implementation of the Business Plan. There can be no assurance that the Company will be able to obtain such financing if and when it is needed or that, if available, such financing will be on terms acceptable to the Company. If the Company is unable to obtain additional financing when needed, it may be required to scale back significantly its Business Plan and, depending upon cash flow from its existing businesses, reduce the scope of its plans and operations.

In connection with implementing the Business Plan, management will continue reviewing the existing businesses of the Company to determine how those businesses will complement the Company's focus on communications and information services. If it is decided that an existing business is not compatible with the communications and information services business and if a suitable buyer can be found, the Company may dispose of that business.

New Accounting Pronouncement

On April 3, 1998, the Accounting Standards Executive Committee issued Statement of Position 98-5, ("SOP 98-5") Reporting on the Costs of Start-Up Activities, which provides guidance on the financial reporting of start-up costs and organization costs. It requires costs of start-up activities and organization costs to be expensed as incurred. SOP 98-5 is effective for financial statements for fiscal years beginning after December 15, 1998. The Company is required to reflect the initial application of SOP 98-5 as the cumulative effect of a change in accounting principle, as described in Accounting Principles Board Opinion No. 20, Accounting Changes. As a result of the cumulative effect of a change in accounting treatment, the Company expects to record a charge to earnings in the first quarter of 1999 for any unamortized start-up or organization costs as of the beginning of 1999.

LEVEL 3 COMMUNICATIONS, INC.

PART II - OTHER INFORMATION

Item 2. Changes in Securities

Pursuant to an agreement dated March 2, 1998, the Company sold 200,000 shares of Common Stock, par value \$.01 per share to Mr. James Goodwin, in connection with financial advisory services to be provided to the Company at an aggregate purchase price of \$8,000,000. The sale to Mr. Goodwin was made pursuant to the exemption from registration contained in Section 4(2) under the Securities Act of 1933, as amended.

Item 6. Exhibits and Reports on Form 8-K

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

Exhibit
Number

3.1 Articles of Incorporation. (Incorporated by reference to Exhibit No. 1 to Amendment No. 1 to the Company's Registration Statement on Form 8-A File No. 0-15658).

3.4 By-laws. (Incorporated by reference to Exhibit No. 2 to Amendment No. 1 to the Company's Registration Statement on Form 8-A File No. 0-15658).

18 Letter re change in accounting principles.

27 Financial Data Schedule.

(b) The Company filed a Form 8-K on January 15, 1998 reporting the disposition of its energy assets to CalEnergy Company, Inc. which closed on January 2, 1998.

SIGNATURES

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

LEVEL 3 COMMUNICATIONS, INC.

Dated: May 15, 1998

*\s\Eric J. Mortensen
Eric J. Mortensen
Controller
Chief Accounting Officer*

LEVEL 3 COMMUNICATIONS, INC.

INDEX TO EXHIBITS

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No.

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18 Letter re change in accounting principles.

27 Financial Data Schedule.

Exhibit 18

Level 3 Communications, Inc.
3555 Farnam Street
Omaha, NE 68131

We are providing this letter to Level 3 Communications, Inc. (the "Company") for inclusion as an exhibit to your Form 10-Q filing pursuant to Item 601 of Regulation S-K.

We have read management's disclosure for the change in accounting from the intrinsic value based method for measuring stock compensation cost to the fair value based method contained in the Company's Form 10-Q for the quarter ended March 31, 1998. Because the fair value based method is designated as the preferred method by Statement of Financial Accounting Standards (SFAS) No. 123, we concur that the newly adopted accounting principle described above is preferable in the Company's circumstances to the method previously applied.

We have not audited any financial statements of the Company as of any date or for any period subsequent to December 27, 1997, nor have we audited the application of the change in accounting principle disclosed in Form 10-Q of the Company for the three months ended March 31, 1998; accordingly, our comments are subject to revision on completion of an audit of the financial statements that include the accounting change.

Coopers & Lybrand L.L.P.

May 15, 1998
Omaha, Nebraska

ARTICLE 5

This schedule contains summary financial information extracted from the Form 10-Q for the period ending March 31, 1998 and is qualified in its entirety by reference to such financial statements.

MULTIPLIER: 1,000,000

PERIOD TYPE	3 MOS
FISCAL YEAR END	DEC 31 1998
PERIOD END	MAR 31 1998
CASH	806
SECURITIES	1,313
RECEIVABLES	54
ALLOWANCES	0
INVENTORY	4
CURRENT ASSETS	2,197
PP&E	416
DEPRECIATION	224
TOTAL ASSETS	2,794
CURRENT LIABILITIES	304
BONDS	137
PREFERRED MANDATORY	0
PREFERRED	0
COMMON	1
OTHER SE	2,048
TOTAL LIABILITY AND EQUITY	2,197
SALES	53
TOTAL REVENUES	87
CGS	26
TOTAL COSTS	45
OTHER EXPENSES	51
LOSS PROVISION	0
INTEREST EXPENSE	4
INCOME PRETAX	(9)
INCOME TAX	(3)
INCOME CONTINUING	(6)
DISCONTINUED	932
EXTRAORDINARY	0
CHANGES	0
NET INCOME	926
EPS PRIMARY	\$2.18 ¹
EPS DILUTED	\$2.18 ¹

¹ \$2.18 excludes the gain on the split off of the construction operations.

End of Filing

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