PRIMUS TELECOMMUNICATIONS GROUP INC
Form 10-Q
November 09, 2007
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# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# FORM 10-Q

**x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF**

**THE SECURITIES EXCHANGE ACT OF 1934.**

**For the quarterly period ended September 30, 2007**

**OR**

**¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF**

**THE SECURITIES EXCHANGE ACT OF 1934.**

**Commission File No. 0-29092**

# PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Delaware**<br>**(State or other jurisdiction of**<br>**incorporation or organization)** | **54-1708481**<br>**(I.R.S. Employer Identification No.)** |
| **7901 Jones Branch Drive, Suite 900,**<br>**McLean, VA**<br>**(Address of principal executive offices)** | **22102**<br>**(Zip Code)** |

**(703) 902-2800**

**(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), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨**

**Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):**

**Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨**

**Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No x**

**Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.**

| Class | Outstanding as of October 31, 2007 |
|---|---|
| **Common Stock $0.01 par value** | **142,632,540** |

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**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**

**CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS**

(in thousands, except per share amounts)

(unaudited)

| | Three Months Ended September 30, 2007 | Three Months Ended September 30, 2006 | Nine Months Ended September 30, 2007 | Nine Months Ended September 30, 2006 |
|---|---|---|---|---|
| NET REVENUE | $ 225,283 | $ 245,319 | $ 679,660 | $ 763,024 |
| OPERATING EXPENSES | | | | |
| Cost of revenue (exclusive of depreciation included below) | 136,464 | 157,676 | 423,338 | 503,356 |
| Selling, general and administrative | 72,771 | 71,639 | 209,983 | 219,030 |
| Depreciation and amortization | 7,328 | 6,976 | 21,228 | 41,044 |
| (Gain) loss on sale or disposal of assets | | (205) | 684 | 14,302 |
| Asset impairment write-down | | | | 209,248 |
| Total operating expenses | 216,563 | 236,086 | 655,233 | 986,980 |
| INCOME (LOSS) FROM OPERATIONS | 8,720 | 9,233 | 24,427 | (223,956) |
| INTEREST EXPENSE | (15,810) | (13,188) | (45,668) | (40,658) |
| ACCRETION ON DEBT DISCOUNT, NET | (37) | 222 | (411) | (1,344) |
| CHANGE IN FAIR VALUE OF DERIVATIVES EMBEDDED WITHIN CONVERTIBLE DEBT | | | | 5,373 |
| GAIN (LOSS) ON EARLY EXTINGUISHMENT OR RESTRUCTURING OF DEBT | 364 | | (7,910) | 7,409 |
| INTEREST AND OTHER INCOME | 1,141 | 845 | 3,695 | 3,405 |
| FOREIGN CURRENCY TRANSACTION GAIN | 12,232 | 3,895 | 30,287 | 8,520 |
| INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES | 6,610 | 1,007 | 4,420 | (241,251) |
| INCOME TAX BENEFIT (EXPENSE) | (2,161) | (1,219) | 3,525 | (3,697) |
| INCOME (LOSS) FROM CONTINUING OPERATIONS | 4,449 | (212) | 7,945 | (244,948) |
| INCOME FROM DISCONTINUED OPERATIONS, net of tax | 140 | 333 | 145 | 2,002 |
| GAIN FROM SALE OF DISCONTINUED OPERATIONS, net of tax | 174 | | 6,132 | 7,415 |
| NET INCOME (LOSS) | $ 4,763 | $ 121 | $ 14,222 | $ (235,531) |
| BASIC INCOME (LOSS) PER COMMON SHARE: | | | | |
| Income (loss) from continuing operations | $ 0.03 | $ (0.00) | $ 0.06 | $ (2.19) |
| Income from discontinued operations | 0.00 | 0.00 | 0.00 | 0.01 |
| Gain from sale of discontinued operations | 0.00 | | 0.05 | 0.07 |
| Net income (loss) | $ 0.03 | $ 0.00 | $ 0.11 | $ (2.11) |
| DILUTED INCOME (LOSS) PER COMMON SHARE: | | | | |
| Income (loss) from continuing operations | $ 0.02 | $ (0.00) | $ 0.05 | $ (2.19) |
| Income from discontinued operations | 0.00 | 0.00 | 0.00 | 0.01 |
| Gain from sale of discontinued operations | 0.00 | | 0.03 | 0.07 |

| | | | | |
|---|---|---|---|---|
| Net income (loss) | $ 0.02 | $ 0.00 | $ 0.08 | $ (2.11) |
| | | | | |
| WEIGHTED AVERAGE COMMON SHARES OUTSTANDING: | | | | |
| BASIC | 142,143 | 113,844 | 124,100 | 111,866 |
| DILUTED | 208,042 | 160,779 | 192,412 | 111,866 |

See notes to consolidated condensed financial statements.

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**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**

**CONSOLIDATED BALANCE SHEETS**

(in thousands, except share amounts)

(unaudited)

| | September 30, 2007 | December 31, 2006 |
|---|---|---|
| **ASSETS** | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 108,724 | $ 64,317 |
| Accounts receivable (net of allowance for doubtful accounts receivable of $12,473 and $17,296) | 120,108 | 118,012 |
| Prepaid expenses and other current assets | 23,484 | 24,278 |
| Total current assets | 252,316 | 206,607 |
| RESTRICTED CASH | 9,689 | 8,415 |
| PROPERTY AND EQUIPMENT Net | 137,677 | 111,682 |
| GOODWILL | 39,552 | 34,893 |
| OTHER INTANGIBLE ASSETS Net | 1,801 | 2,762 |
| OTHER ASSETS | 30,496 | 27,891 |
| TOTAL ASSETS | $ 471,531 | $ 392,250 |
| **LIABILITIES AND STOCKHOLDERS DEFICIT** | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | $ 79,097 | $ 70,586 |
| Accrued interconnection costs | 42,922 | 48,942 |
| Deferred revenue | 16,990 | 18,315 |
| Accrued expenses and other current liabilities | 54,678 | 46,984 |
| Accrued income taxes | 22,799 | 17,921 |
| Accrued interest | 11,583 | 13,627 |
| Current portion of long-term obligations | 13,637 | 36,997 |
| Total current liabilities | 241,706 | 253,372 |
| LONG-TERM OBLIGATIONS (net of premium (discount) of $2,490 and ($5,354)) | 676,236 | 607,077 |
| OTHER LIABILITIES | 51 | 56 |
| Total liabilities | 917,993 | 860,505 |
| COMMITMENTS AND CONTINGENCIES (See Note 5.) | | |
| STOCKHOLDERS DEFICIT: | | |
| Preferred stock: not designated, $0.01 par value 1,410,050 shares authorized; none issued and outstanding; Series A and B, $0.01 par value 485,000 shares authorized; none issued and outstanding; Series C, $0.01 par value 559,950 shares authorized; none issued and outstanding | | |
| Common stock, $0.01 par value 300,000,000 shares authorized; 142,632,540 and 113,848,540 shares issued and outstanding | 1,426 | 1,138 |
| Additional paid-in capital | 718,634 | 692,941 |
| Accumulated deficit | (1,074,622) | (1,082,853) |
| Accumulated other comprehensive loss | (91,900) | (79,481) |
| Total stockholders deficit | (446,462) | (468,255) |

| | | | | |
|---|---|---|---|---|
| TOTAL LIABILITIES AND STOCKHOLDERS DEFICIT | $ | 471,531 | $ | 392,250 |

See notes to consolidated condensed financial statements.

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**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**

**CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS**

(in thousands)

(unaudited)

| | Nine Months Ended September 30, 2007 | Nine Months Ended September 30, 2006 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income (loss) | $ 14,222 | $ (235,531) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Provision for doubtful accounts receivable | 7,358 | 11,156 |
| Stock compensation expense | 184 | 481 |
| Depreciation and amortization | 21,288 | 41,746 |
| (Gain) loss on sale or disposal of assets | (5,447) | 6,911 |
| Asset impairment write-down | | 209,248 |
| Accretion of debt discount | 411 | 1,344 |
| Change in fair value of derivatives embedded within convertible debt | | (5,373) |
| Deferred income taxes | (860) | |
| (Gain) loss on early extinguishment or restructuring of debt | 7,910 | (7,409) |
| Other | | (1,595) |
| Unrealized foreign currency transaction gain on intercompany and foreign debt | (32,629) | (9,676) |
| Changes in assets and liabilities, net of acquisitions: | | |
| Decrease in accounts receivable | 293 | 15,638 |
| Decrease in prepaid expenses and other current assets | 2,598 | 7,238 |
| Decrease in other assets | 1,313 | 91 |
| Increase (decrease) in accounts payable | 2,829 | (12,536) |
| Decrease in accrued interconnection costs | (8,245) | (15,850) |
| Increase (decrease) in accrued expenses, accrued income taxes, deferred revenue, other current liabilities and other liabilities, net | (1,017) | 7,335 |
| Decrease in accrued interest | (2,043) | (4,243) |
| Net cash provided by operating activities | 8,165 | 8,975 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of property and equipment | (29,717) | (23,926) |
| Cash from disposition of business, net of cash disposed | 6,140 | 12,947 |
| Cash used in business acquisitions, net of cash acquired | (200) | (224) |
| Increase (decrease) in restricted cash | (340) | 1,196 |
| Net cash used in investing activities | (24,117) | (10,007) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from issuance of long-term obligations | 109,275 | 35,291 |
| Deferred financing costs | (6,570) | (2,850) |
| Principal payments on long-term obligations | (64,867) | (9,117) |
| Proceeds from sale of common stock, net of issuance costs | 19,170 | 4,935 |
| Net cash provided by financing activities | 57,008 | 28,259 |
| EFFECTS OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS | 3,351 | 602 |
| NET CHANGE IN CASH AND CASH EQUIVALENTS | 44,407 | 27,829 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 64,317 | 42,999 |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | $ 108,724 | $ 70,828 |

| | | |
|---|---|---|
| SUPPLEMENTAL CASH FLOW INFORMATION: | | |
| Cash paid for interest | $ 46,000 | $ 43,197 |
| Cash paid for taxes | $ 1,056 | $ 2,946 |
| Non-cash investing and financing activities: | | |
| Capital lease additions | $ 2,175 | $ 66 |
| Leased fiber capacity additions | $ 1,786 | $ |
| Settlement of outstanding debt with issuance of common stock | $ 6,627 | $ 1,351 |
| Settlement of outstanding debt with issuance of new convertible debt | $ | $ (27,417) |
| Issuance of new convertible debt in exchange for convertible subordinated debentures | $ | $ 27,481 |
| Settlement of outstanding debt with issuance of new exchangeable debt | $ | $ (54,750) |
| Issuance of new exchangeable debt in exchange for convertible senior debentures | $ | $ 47,102 |
| Business disposition proceeds in note receivable | $ 845 | $ |

See notes to consolidated condensed financial statements.

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**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**

**CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

(in thousands)

(unaudited)

| | Three Months Ended September 30, 2007 | Three Months Ended September 30, 2006 | Nine Months Ended September 30, 2007 | Nine Months Ended September 30, 2006 |
|---|---|---|---|---|
| NET INCOME (LOSS) | $ 4,763 | $ 121 | $ 14,222 | $ (235,531) |
| OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX | | | | |
| Foreign currency translation adjustment | (4,008) | (2,594) | (12,419) | (883) |
| Reclassification of foreign currency translation adjustment for loss from the India transaction included in net loss | | | | (349) |
| COMPREHENSIVE INCOME (LOSS) | $ 755 | $ (2,473) | $ 1,803 | $ (236,763) |

See notes to consolidated condensed financial statements.

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**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS**

**(UNAUDITED)**

## 1. BASIS OF PRESENTATION

The accompanying unaudited consolidated condensed financial statements of Primus Telecommunications Group, Incorporated and subsidiaries (the Company or Primus ) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial reporting and Securities and Exchange Commission ( SEC ) regulations. Certain information and footnote disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such principles and regulations. In the opinion of management, the financial statements reflect all adjustments (all of which are of a normal and recurring nature), which are necessary to present fairly the financial position, results of operations, cash flows and comprehensive income (loss) for the interim periods. The results for the three or nine months ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

The results for the three months and nine months ended September 30, 2007 and September 30, 2006 reflect the activities of certain operations as discontinued operations (see Note 10 Discontinued Operations ).

The financial statements should be read in conjunction with the Company s audited consolidated financial statements included in the Company s most recently filed Form 10-K.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

*Correction of error* Subsequent to the issuance of the 2006 consolidated financial statements, the Company determined that $5.1 million of foreign currency losses were improperly recorded in the 2005 consolidated statement of operations related to settlements of intercompany balances between foreign subsidiaries. Because those intercompany balances were long-term in nature, related foreign currency transaction gains and losses were previously recorded in the currency translation account, a component of accumulated other comprehensive loss, and should remain there until and unless the Company s investment in the foreign subsidiary is sold or liquidated.

As a result, the Company has corrected the presentation of the December 31, 2006 balances within the condensed consolidated balance sheet in this Quarterly Report on Form 10-Q. It is the Company s intention to correct its presentation for the years ended December 31, 2005 and 2006 in its 2007 Annual Report on Form 10-K.

The following is a summary of the effect of the immaterial restatement on the Company s 2005 and 2006 consolidated financial statements (in thousands, except for per share amounts). The adjustment has no impact on total stockholders deficit for either year, but rather only on the components indicated below.

| | For the year ended December 31, | | | |
|---|---|---|---|---|
| | 2006 As Reported | 2006 As Restated | 2005 As Reported | 2005 As Restated |
| Foreign currency transaction gain (loss) | $ | $ | $ (17,628) | $ (12,485) |
| Net loss | $ | $ | $ (154,380) | $ (149,237) |
| Basic and diluted loss from continuing operations per common share | $ | $ | $ (1.64) | $ (1.58) |
| Basic and diluted net loss per common share | $ | $ | $ (1.62) | $ (1.56) |

| | December 31, | | | |
|---|---|---|---|---|
| | 2006 As Reported | 2006 As Restated | 2005 As Reported | 2005 As Restated |

| | | | | |
|---|---|---|---|---|
| Accumulated deficit | $ (1,087,996) | $ (1,082,853) | $ (850,038) | $ (844,895) |
| Accumulated other comprehensive loss | $ (74,338) | $ (79,481) | $ (73,545) | $ (78,688) |

Additionally, in its previous disclosures of consolidating financial information (see Note 12) the Company presented its entire consolidated currency translation account, which is a component of accumulated other comprehensive loss, as relating solely to non-guarantor, other subsidiaries. Subsequent to the issuance of the 2006 consolidated financial statements and considering the correction of error detailed above, the Company determined that it is more appropriate to allocate this amount between its guarantor and non-guarantor subsidiaries and to also reflect the related balances in each of the PTGI, PTHI and Guarantor Subsidiaries columns of the consolidating condensed balance sheets. Accordingly, the previous presentation of consolidating balance sheets at December 31, 2006 as contained in Note 12 have been corrected to reflect the amounts presented below: In each consolidating presentation, the above described changes are completely offset by corresponding increases in the elimination entries. Accordingly, these changes have no effect on the Company s consolidated financial statements.

| | December 31, 2006 | | | | |
|---|---|---|---|---|---|
| | | | | | Non Guarantor |
| | PTGI | PTHI | Other | Guarantor Subsidiaries | Subsidiaries |
| Investment in subsidiaries | $ (4,854) | $ (707,997) | $ | $ (129,392) | $ |
| Accumulated deficit | $ (1,082,853) | $ (1,088,104) | $ (943,866) | $ (1,088,104) | $ (417,070) |
| Accumulated other comprehensive loss | $ (79,481) | $ (78,680) | $ (69,975) | $ (78,680) | $ (74,720) |

*Principles of Consolidation* The consolidated financial statements include the Company s accounts, its wholly-owned subsidiaries and all other subsidiaries over which the Company exerts control. All intercompany profits, transactions and balances have been eliminated in consolidation. The Company owns 90% of the common stock of Matrix Internet, S.A. ( Matrix ), of which 39% of the common stock of Matrix was purchased for cash in September 2007. In August 2007, the Company sold its full 51% interest of the shares of CS Communications Systems GmbH and CS Network GmbH ( Citrus ). The Company uses the equity method of accounting for its investment in Bekkoame Internet, Inc. ( Bekko ). The Company entered into a share purchase agreement in the second quarter 2007 to sell its minority equity interest in Bekko. The sale is expected to be completed by the end of 2007.

*Presentation of sales taxes collected* The Company reports any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between the Company and a customer (including sales, use, value-added and some excise taxes) on a net basis (excluded from revenues).

*Stock-Based Compensation* On January 1, 2006, the Company adopted Statement of Financial Accounting Standards( SFAS ) No. 123(R), Share-Based Payments, which addresses the accounting for stock-based payment transactions whereby an entity receives employee services in exchange for equity instruments, including stock options. SFAS No. 123(R) eliminates the ability to account for stock-based compensation transactions using the intrinsic value method under Accounting Principles Board Opinion ( APB ) No. 25, Accounting for Stock Issued to Employees, and instead generally requires that such transactions be accounted for using a fair-value based method. The Company has elected the modified prospective transition method as permitted under SFAS No. 123(R), and accordingly prior periods have not been restated to reflect the impact of SFAS No. 123(R). The modified prospective transition method requires that stock-based compensation expense be recorded for all new and unvested stock options that are ultimately expected to vest as the requisite service is rendered beginning on January 1, 2006. Stock-based compensation for awards granted prior to January 1, 2006 is based upon the grant-date fair value of such compensation as determined under the pro forma provisions of SFAS No. 123, Accounting for Stock-Based Compensation. The Company issues new shares of common stock upon the exercise of stock options.

In November 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position No. FAS 123R-3, Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards. The Company elected to adopt the alternative transition method provided in the FASB Staff Position for calculating the tax effects of share-based compensation. The alternative transition method includes simplified methods to determine the beginning balance of the additional paid in capital (APIC) pool related to the tax effects of share-based compensation and to determine the subsequent impact on the APIC pool and the statement of cash flows of the tax effects of share-based award that were fully vested and outstanding upon the adoption of SFAS No. 123(R).

The Company uses a Black-Scholes option valuation model to determine the fair value of stock-based compensation under SFAS No. 123(R), consistent with that used for pro forma disclosures under SFAS No. 123. The Black-Scholes model incorporates various assumptions including the expected term of awards, volatility of stock price, risk-free rates of return and dividend yield. The expected term of an award is no less than the option vesting period and is based on the Company s historical experience. Expected volatility is based upon the historical volatility of the Company s stock price. The risk-free interest rate is approximated using rates available on U.S. Treasury securities with a remaining term similar to the option s expected life. The Company uses a dividend yield of zero in the Black-Scholes option valuation model as it does not anticipate paying cash dividends in the foreseeable future. The Company also had an Employee Stock Purchase Plan, which was suspended on July 27, 2006, and which allowed employees to elect to purchase stock at 85% of fair market value (determined monthly) and was considered compensatory under SFAS No. 123(R).

The Company recorded an incremental $59 thousand and $184 thousand stock-based compensation expense during the three months and nine months ended September 30, 2007 and an incremental $246 thousand and $481 thousand during the three months and nine months ended September 30, 2006, as a result of the adoption of SFAS No. 123(R).

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The Company granted 15,000 options during the three months ended September 30, 2007. The weighted average fair value at date of grant for options granted during the three months ended September 30, 2007 was $0.26 per option. The Company granted 20,000 options during the three months ended September 30, 2006. The weighted average fair value at date of grant for options granted during the three months ended September 30, 2006 was $0.29 per option. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

| | For the Three Months Ended September 30, | |
|---|---|---|
| | 2007 | 2006 |
| Expected dividend yield | 0% | 0% |
| Expected stock price volatility | 94.9% | 94.9% |
| Risk-free interest rate | 4.5% | 5.1% |
| Expected option term | 4 years | 4 years |

As of September 30, 2007, the Company had 0.9 million unvested awards outstanding of which $0.3 million of compensation expense will be recognized over the weighted average remaining vesting period of 1.23 years.

*Foreign Currency Transaction* Foreign currency transactions are transactions denominated in a currency other than a subsidiary s functional currency. A change in the exchange rates between a subsidiary s functional currency and the currency in which a transaction is denominated increases or decreases the expected amount of functional currency cash flows upon settlement of the transaction. That increase or decrease in expected functional currency cash flows is reported by the Company as a foreign currency transaction gain (loss). The primary component of the Company s foreign currency transaction gain (loss) is due to written agreements in place with certain subsidiaries in foreign countries regarding intercompany loans. The Company anticipates repayment of these loans in the foreseeable future, and recognizes the realized and unrealized gains or losses on these transactions that result from foreign currency changes in the period in which they occur as foreign currency transaction gain (loss).

*Use of Estimates* The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of net revenue and expenses during the reporting period. Actual results may differ from these estimates. Significant estimates include allowance for doubtful accounts receivable, accrued interconnection cost disputes, the fair value of embedded derivatives, market assumptions used in estimating the fair values of certain assets and liabilities such as long-term obligations, the calculation used in determining the fair value of the Company s stock options required by SFAS No. 123(R), various tax contingencies and the asset impairment write-down.

*Reclassification* Certain previous year amounts have been reclassified to conform with current year presentations, as related to the reporting of the Company s discontinued operations.

*New Accounting Pronouncements*

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company anticipates that the adoption of this standard will not have a material impact on our results of operations, financial position and cash flows.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value

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measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurement. SFAS No. 157 does not require new fair value measurements, and the Company does not expect the application of this standard to change its current practices. The provisions of SFAS No. 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company anticipates that the adoption of this standard will not have a material impact on its results of operations, financial position and cash flows.

*Newly Adopted Accounting Principle*

In July 2006, the FASB issued FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes, which is effective for fiscal years beginning after December 15, 2006. FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS Statement No. 109, Accounting for Income Taxes. This Interpretation prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that a company has taken or expects to take on a tax return. See Note 8 Income Taxes.

**3. GOODWILL AND OTHER INTANGIBLE ASSETS**

Acquired intangible assets subject to amortization consisted of the following (in thousands):

| | As of September 30, 2007 | | | As of December 31, 2006 | | |
|---|---|---|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Net Book Value | Gross Carrying Amount | Accumulated Amortization | Net Book Value |
| Customer lists | $ 4,021 | $ (2,341) | $ 1,680 | $ 3,537 | $ (933) | $ 2,604 |
| Other | 1,273 | (1,152) | 121 | 252 | (94) | 158 |
| Total | $ 5,294 | $ (3,493) | $ 1,801 | $ 3,789 | $ (1,027) | $ 2,762 |

Amortization expense for customer lists and other intangible assets for the three months ended September 30, 2007 and 2006 was $0.6 million and $0.7 million, respectively. Amortization expense for customer lists and other intangible assets for the nine months ended September 30, 2007 and 2006 was $2.1 million and $4.3 million, respectively. The Company expects amortization expense for customer lists and other intangible assets for the remainder of 2007 and the years ended December 31, 2008 and 2009 to be approximately $0.4 million, $1.2 million and $0.2 million, respectively.

Acquired intangible assets not subject to amortization consisted of the following (in thousands):

| | As of September 30, 2007 | As of December 31, 2006 |
|---|---|---|
| Goodwill | $ 39,552 | $ 34,893 |

The changes in the carrying amount of goodwill for the nine months ended September 30, 2007 are as follows (in thousands):

| | United States And Other | Canada | Asia-Pacific | Total |
|---|---|---|---|---|
| Balance as of January 1, 2007 | $ | $ 23,082 | $ 11,811 | $ 34,893 |
| Goodwill acquired during period | 188 | | | 188 |
| Effect of change in foreign currency exchange rates | 12 | 3,636 | 823 | 4,471 |

| | | | | |
|---|---|---|---|---|
| Balance as of September 30, 2007 | $ 200 | $ 26,718 | $ 12,634 | $ 39,552 |

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**4. LONG-TERM OBLIGATIONS**

Long-term obligations consisted of the following (in thousands):

| | September 30, 2007 | December 31, 2006 |
|---|---|---|
| Obligations under capital leases | $ 7,438 | $ 6,451 |
| Leased fiber capacity | 11,613 | 13,543 |
| Senior secured term loan facility | 97,500 | 98,250 |
| Financing facility | 35,000 | 30,149 |
| Senior notes | 262,573 | 306,560 |
| Senior secured notes | 114,281 | |
| Exchangeable senior notes | 64,771 | 66,180 |
| Convertible senior notes | 76,106 | 75,842 |
| Step up convertible subordinated debentures | 20,044 | 23,534 |
| Convertible subordinated debentures | | 22,702 |
| Other | 547 | 863 |
| Subtotal | 689,873 | 644,074 |
| Less: Current portion of long-term obligations | (13,637) | (36,997) |
| Total long-term obligations | $ 676,236 | $ 607,077 |

Payments of principal and interest of the September 30, 2007 long-term obligations are due as follows:

| Year Ending December 31, | Vendor Financing | Senior Secured Term Loan Facility (1) | Financing Facility and Other (2) | Senior Notes | Convertible and Exchangeable Senior Notes (3) | Step Up Convertible Subordinated Debentures | Senior Secured Notes | Total |
|---|---|---|---|---|---|---|---|---|
| 2007 (as of September 30, 2007) | $ 2,585 | $ 3,151 | $ 1,086 | $ 1,515 | $ 1,407 | $ | $ 7,710 | $ 17,454 |
| 2008 | 10,293 | 12,528 | 3,498 | 21,831 | 5,713 | 1,724 | 15,420 | 71,007 |
| 2009 | 4,128 | 12,409 | 3,347 | 49,404 | 5,713 | 24,280 | 15,420 | 114,701 |
| 2010 | 3,237 | 12,290 | 3,347 | 18,800 | 137,878 | | 15,420 | 190,972 |
| 2011 | 338 | 94,250 |   | | | | | |