# EXHIBIT F

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
**Washington, DC 20549**

# FORM 10-K/A
**(Amendment No 1)**

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

**FOR THE FISCAL YEAR ENDED DECEMBER 31, 2002**

**OR**

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

**FOR THE TRANSITION PERIOD FROM TO**

***COMMISSION FILE NUMBER: 0-24509***

# ALLEGIANCE TELECOM, INC.
(Exact Name of Registrant as Specified in its Charter)

| | |
|---|---|
| **DELAWARE**<br>(State of Incorporation) | **75-2721491**<br>(IRS Employer Identification No ) |
| **9201 NORTH CENTRAL EXPRESSWAY**<br>**DALLAS, TEXAS**<br>(Address of Principal Executive Offices) | **75231**<br>(Zip Code) |

**(214) 261-7100**
Registrant's Telephone Number Including Area Code

Securities Registered Pursuant to Section 12(b) of the Act
**NONE**

Securities Registered Pursuant to Section 12(g) of the Act
**COMMON STOCK, PAR VALUE $ 01**

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 it was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days Yes ☒ No ☐

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

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

The aggregate market value of the registrant's voting stock held by non-affiliates of the registrant as of June 28, 2002 (the last business day of the registrant's most recently completed second fiscal quarter) was approximately $158 6 million Shares of common stock held by each executive officer and director have been excluded since those persons may under certain circumstances be deemed to be affiliates This determination of executive officer or affiliate status is not necessarily a conclusive determination for other purposes

The registrant has 124,778,137 number of shares of common stock outstanding as of March 26, 2003

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive proxy statement for the annual meeting of stockholders for the fiscal year ended December 31, 2002 which will be filed with the SEC by April 30 2003 are incorporated by reference into Part III of this Form 10-K

**EXPLANATORY NOTE**

Allegiance Telecom, Inc is amending its Form 10-K to correct certain portions of Item 8 [Consolidated Financial Statements and Supplementary Data] and Item 15 [Exhibits Financial Statement Schedules and Reports on Form 8-K] of its Form 10-K filed with the Securities and Exchange Commission on March 31, 2003 Specifically this amendment corrects (1) the number of shares of common stock authorized as set forth in the Allegiance Telecom Inc and Subsidiaries Consolidated Balance Sheets as of December 31, 2002 and 2001 and (b) Footnotes 2, 3, 4 9 and 13 in the Allegiance Telecom Inc and Subsidiaries Notes to Consolidated Financial Statements Allegiance Telecom, Inc is not restating its consolidated financial statements under this amendment This amendment amends only the items of the Form 10-K specified and does not otherwise update the disclosures in the Form 10-K as originally filed and does not reflect events occurring after the original filing of the Form 10-K

## PART II

### ITEM 8 CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

**Independent Auditors' Report**

The Board of Directors
Allegiance Telecom Inc

We have audited the consolidated balance sheet of Allegiance Telecom Inc and subsidiaries as of December 31 2002 and the related statements of operations, stockholders' equity, and cash flows for the year then ended In connection with our audit of the consolidated financial statements we also have audited the financial statement schedule These consolidated financial statements and financial statement schedule are the responsibility of the Company's management Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audit The 2001 and 2000 consolidated financial statements and financial statement schedule of the Company as listed in the accompanying index were audited by other auditors who have ceased operations Those auditors expressed an unqualified opinion on those consolidated financial statements and financial statement schedule in their report dated February 19 2002

We conducted our audit in accordance with auditing standards generally accepted in the United States of America Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement An audit includes examining on a test basis evidence supporting the amounts and disclosures in the financial statements An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation We believe that our audit provides a reasonable basis for our opinion

In our opinion the 2002 consolidated financial statements referred to above present fairly in all material respects, the financial position of Allegiance Telecom, Inc and subsidiaries as of December 31, 2002 and the results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America Also in our opinion, the related 2002 financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole presents fairly, in all material respects the information set forth therein

The accompanying 2002 consolidated financial statements have been prepared assuming that the Company will continue as a going concern As discussed in Note 2 to the consolidated financial statements the Company has suffered recurring losses from operations and is dependant on additional external financing to meet current debt repayment requirements which raises substantial doubt about its ability to continue as a going concern Management's plans in regard to these matters are also described in Note 2 The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty

Also, as discussed in Note 4 to the consolidated financial statements Allegiance Telecom Inc , in 2002 adopted the provisions of Statement of Financial Accounting Standard No 142, "Goodwill and Other Intangible Assets "

KPMG LLP

Dallas, Texas
March 3 2003

This is a copy of the audit report previously issued by Arthur Andersen LLP in connection with Allegiance Telecom Inc 's 2001 consolidated financial statements previously filed on Form 10-K This audit report has not been reissued by Arthur Andersen LLP in connection with this filing on Form 10-K

**Report of Independent Public Accountants**

To the Board of Directors and Stockholders of Allegiance Telecom, Inc

We have audited the accompanying consolidated balance sheets of Allegiance Telecom Inc (a Delaware corporation) and subsidiaries (the "Company") as of December 31 2001 and 2000, and the related consolidated statements of operations stockholders' equity and cash flows for the years ended December 31 2001, 2000 and 1999 These financial statements are the responsibility of the Company's management Our responsibility is to express an opinion on these financial statements based on our audits

We conducted our audits in accordance with auditing standards generally accepted in the United States Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation We believe that our audits provide a reasonable basis for our opinion

In our opinion the financial statements referred to above present fairly, in all material respects, the financial position of Allegiance Telecom Inc and its subsidiaries as of December 31, 2001 and 2000, and the results of their operations and their cash flows for the years ended December 31, 2001 2000, and 1999 in conformity with accounting principles generally accepted in the United States

ARTHUR ANDERSEN LLP

Dallas Texas
February 19 2002

ALLEGIANCE TELECOM, INC AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

As of December 31, 2002 and 2001

(in thousands, except share and per share data)

| | 2002 | 2001 |
|---|---|---|
| **ASSETS** | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | $ 253,311 | $ 374 084 |
| Short-term investments | 30 955 | 25 232 |
| Accounts receivable (net of allowance for doubtful accounts of $14 485 and $29 621, respectively) | 153,196 | 141,684 |
| Prepaid expenses and other current assets | 18,916 | 25 406 |
| Total current assets | 456,378 | 566,406 |
| PROPERTY AND EQUIPMENT | | |
| Property and equipment | 1,516,175 | 1,366,710 |
| Accumulated depreciation | (592 069) | (350 460) |
| Property and equipment net | 924 106 | 1,016,250 |
| DEFERRED DEBT ISSUANCE COSTS (net of accumulated amortization of $15 031 and $11,870, respectively) | 15,879 | 19 039 |
| LONG-TERM INVESTMENTS, RESTRICTED | 881 | 954 |
| GOODWILL (net of accumulated amortization of $83,252 as of December 31 2001) | — | 107,468 |
| OTHER ASSETS, net | 43,974 | 64,726 |
| Total assets | $ 1,441,218 | $ 1,774 843 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| CURRENT LIABILITIES | | |
| Accounts payable | $ 59,282 | $ 50,386 |
| Accrued liabilities and other current liabilities | 124,444 | 85 968 |
| Current portion of long-term debt | 561,532 | 3,120 |
| Total current liabilities | 745,258 | 139,474 |
| LONG-TERM DEBT | 639,691 | 1,013,184 |
| OTHER LONG-TERM LIABILITIES | 12,545 | 14,109 |
| COMMITMENTS AND CONTINGENCIES (see Note 11) | | |
| STOCKHOLDERS' EQUITY | | |
| Preferred stock, $ 01 par value, 1,000,000 shares authorized, no shares issued or outstanding at December 31, 2002 and 2001 | — | — |
| Common stock, $ 01 par value, 750,000 000 shares authorized 125 157 605 and 115,542,354 shares issued and 124,830,110 and 115,214,859 shares outstanding at December 31, 2002 and 2001, respectively | 1,251 | 1,155 |
| Additional paid-in capital | 1,808,690 | 1,801,366 |
| Common stock in treasury, at cost, 327 495 shares at December 31, 2002 and 2001 | (45) | (45) |
| Common stock warrants | 1,857 | 1,877 |
| Deferred compensation | (5,149) | (6,067) |
| Accumulated deficit | (1,762,880) | (1,190,210) |
| Total stockholders' equity | 43,724 | 608,076 |
| Total liabilities and stockholders' equity | $ 1,441,218 | $ 1,774,843 |

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

**ALLEGIANCE TELECOM, INC AND SUBSIDIARIES**

***CONSOLIDATED STATEMENTS OF OPERATIONS***

**For the years ended December 31, 2002, 2001 and 2000**

**(in thousands, except share and per share data)**

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| REVENUES | $ 770,982 | $ 516,888 | $ 285 227 |
| OPERATING EXPENSES | | | |
| Network | 404,444 | 251,734 | 150,718 |
| Selling, general and administrative | 438,158 | 377,387 | 252 368 |
| Depreciation and amortization | 282,143 | 256,685 | 130,826 |
| Management ownership allocation charge | — | 175 | 6,480 |
| Non-cash deferred compensation | 2,726 | 4,126 | 10,127 |
| Goodwill impairment charge | 114,722 | — | — |
| Total operating expenses | 1,242,193 | 890,107 | 550 519 |
| Loss from operations | (471,211) | (373,219) | (265,292) |
| OTHER INCOME (EXPENSE) | | | |
| Interest income | 6,594 | 15,665 | 56 969 |
| Interest expense | (108,053) | (74,259) | (69,244) |
| Total other income (expense) | (101,459) | (58,594) | (12,275) |
| NET LOSS APPLICABLE TO COMMON STOCK | $ (572,670) | $ (431,813) | $ (277,567) |
| NET LOSS PER SHARE, basic and diluted | $ (4 88) | $ (3 82) | $ (2 58) |
| WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING, basic and diluted | 117,349,242 | 113,115,871 | 107,773,112 |

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

ALLEGIANCE TELECOM, INC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

For the years ended December 31, 2002, 2001 and 2000

(in thousands, except share and per share data)

| | Preferred Stock | | Common Stock | | | Treasury Stock | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Number of Shares | Amount | Number of Shares | Amount | Additional Paid-In Capital | Number of Shares | Amount | Common Stock Warrants | Deferred Compensation | Deferred Management Ownership Allocation Charge | Accumulated Deficit | Total |
| *Balance, December 31, 1999* | — | $ — | 97,459,677 | $ 975 | $ 940,120 | (37,968) | $ (5) | $ 3,719 | $ (13,573) | $ (6,790) | $ (480 830) | $ 443,616 |
| Issue of stock under the Employee Stock Purchase Plan (see Note 13) | — | — | 109,727 | 1 | 4 408 | - | -- | - | — | - | — | 4,409 |
| *Acquisition of treasury stock* | — | — | — | — | — | (289,527) | (40) | — | — | - | — | (40) |
| Exercise of employee stock options | — | — | 700,820 | 7 | 4,763 | — | — | — | | — | — | 4,770 |
| Stock split | — | — | (577) | — | (52) | — | — | — | — | -- | — | (52) |
| *Conversion of common stock warrants* | — | — | 205 331 | 2 | 1,841 | - | — | (1,842) | — | -- | — | 1 |
| Secondary offering of common stock | — | — | 10,703,109 | 107 | 719,568 | — | — | — | — | — | — | 719,675 |
| Common stock issued for business acquisitions | — | — | 1 214,027 | 12 | 44,159 | — | | | — | - | — | 44 171 |
| Common stock options issued for business acquisitions | — | — | — | — | 3 852 | — | — | — | (957) | — | — | 2,895 |
| Deferred compensation | — | — | - | — | 11,993 | — | — | — | (12 128) | 135 | | — |
| Amortization of deferred compensation | — | — | — | — | — | — | — | — | 10,127 | 6 480 | — | 16,607 |
| Net loss | — | — | — | — | — | — | — | — | — | — | (277,567) | (277,567) |
| Balance, December 31, 2000 | — | $ — | 110,392,114 | $ 1,104 | $ 1,730,652 | (327 495) | $ (45) | $ 1 877 | $ (16,531) | $ (175) | $ (758,397) | $ 958,485 |
| Issue of stock under the Employee Stock Purchase Plan (see Note 13) | — | — | 672 337 | 6 | 4 910 | — | — | — | — | - | — | 4 916 |
| *Exercise of employee stock options* | — | — | 376,151 | 4 | 2,197 | — | — | — | - | — | — | 2 201 |
| Common stock issued for business acquisitions | — | — | 4 101,752 | 41 | 69 698 | - | — | — | — | - | — | 69,739 |
| *Deferred compensation* | — | — | — | — | (6,213) | — | — | — | 6,213 | — | -- | — |
| Amortization of deferred compensation | — | — | — | — | - | — | — | — | 4,251 | 175 | — | 4 426 |
| Other | — | — | — | — | 122 | — | — | — | — | — | — | 122 |
| Net loss | — | — | — | — | — | — | - | — | — | - | (431,813) | (431,813) |
| Balance, December 31, 2001 | — | $ — | 115,542,354 | $ 1,155 | $ 1,801,366 | (327,495) | $ (45) | $ 1,877 | $ (6,067) | $ — | $ (1,190 210) | $ 608,076 |
| Issue of stock under the Employee Stock Purchase Plan (see Note 13) | — | — | 2 474,042 | 25 | 3 862 | — | — | — | — | — | — | 3,887 |
| Issue of restricted stock (see Note 13) | — | — | 6,495 120 | 65 | (65) | — | — | — | - | -- | — | — |
| Exercise of employee stock options | — | — | 85 175 | 1 | 22 | — | — | — | — | | — | 23 |

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Conversion of common stock warrants | — | — | 2,188 | — | 20 | — | — | (20) | - | — | — | - |
| Common stock issued for business acquisitions | — | — | 558,726 | 5 | 1,673 | — | — | — | — | | — | 1,678 |
| Deferred compensation | — | — | — | — | 1,808 | — | — | — | (1 808) | - | — | — |
| Amortization of deferred compensation | — | — | — | — | — | - | — | | 2 726 | | - | 2 726 |
| Other | — | — | — | — | 4 | — | — | — | — | — | — | 4 |
| Net loss | — | — | — | — | — | — | — | — | — | — | (572 670) | (572 670) |
| Balance, December 31, 2002 | — | $ — | 125,157,605 | $ 1,251 | $ 1,808,690 | (327,495) | $ (45) | $ 1,857 | $ (5 149) | $ — | $ (1,762,880) | $ 43,724 |

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

## ALLEGIANCE TELECOM, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

### For the years ended December 31, 2002, 2001 and 2000

### (in thousands, except share and per share data)

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Net loss | $ (572 670) | $ (431 813) | $ (277 567) |
| Adjustments to reconcile net loss to cash used in operating activities — | | | |
| Depreciation and amortization | 282 143 | 256 685 | 130,826 |
| Provision for uncollectible accounts receivable | 66 224 | 41,600 | 25 914 |
| Accretion of investments | (320) | (2 806) | (5 387) |
| Accretion of Series B and $12^7/8$% notes | 48,567 | 43,320 | 38 645 |
| Amortization of deferred debt issuance costs | 3 161 | 4 822 | 10 293 |
| Amortization of management ownership allocation charge and deferred compensation | 2 726 | 4,301 | 16,607 |
| Goodwill impairment charge | 114 722 | — | — |
| Changes in assets and liabilities net of effects of acquisitions— | | | |
| Increase in accounts receivable | (36 942) | (80 122) | (88 391) |
| (Increase) decrease in prepaid expenses and other current assets | 13,253 | (18,836) | (2,283) |
| Increase in other assets | (14,522) | (10,818) | (690) |
| Increase (decrease) in accounts payable | 3 500 | (35,094) | 31 429 |
| Increase in accrued liabilities and other current liabilities | 21 870 | 13,125 | 18 052 |
| Net cash used in operating activities | (68,288) | (215,636) | (102,552) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Purchases of property and equipment | (129,896) | (364,396) | (430,817) |
| Capitalized interest | (6 138) | (16 858) | (14 366) |
| Purchases of subsidiaries net of cash acquired | (28,478) | (28,887) | (63 808) |
| Purchases of investments | (82,532) | (283 926) | (329,884) |
| Proceeds from sale of investments | 77,202 | 536,183 | 122 167 |
| Net cash used in investing activities | (169 842) | (157 884) | (716 708) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |
| Proceeds from borrowings under the credit facilities | 135 300 | 350 000 | — |
| Payment under credit facilities | (15,000) | — | — |
| Proceeds from issuance of common stock, net | 3,910 | 7,117 | 728,855 |
| Deferred debt issuance costs | — | (151) | (12 334) |
| Purchase of treasury stock | — | — | (40) |
| Payments on capital lease obligations | (6,853) | (5,634) | (3,300) |
| Other | — | 169 | (52) |
| Net cash provided by financing activities | 117,357 | 351 501 | 713 129 |
| DECREASE IN CASH AND CASH EQUIVALENTS | (120,773) | (22,019) | (106,131) |
| CASH AND CASH EQUIVALENTS beginning of period | 374,084 | 396,103 | 502,234 |
| CASH AND CASH EQUIVALENTS end of period | $ 253 311 | $ 374,084 | $ 396 103 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION | | | |
| Cash paid for interest | 59,099 | 42 250 | 34 605 |
| SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES | | | |
| Assets acquired under capital lease obligations | 25 032 | 47 516 | 14 511 |
| Fair value of assets acquired in business acquisitions | 51,319 | 84,052 | 38,056 |
| Liabilities assumed in business acquisitions | 25 221 | 28 351 | 19 074 |
| Common stock issued for business acquisitions (558,726, 4,101,752 and 1,214,027 shares, respectively) | 1,678 | 69,739 | 44,171 |
| Common stock options issued for business acquisitions (182,324 shares in 2000) | — | — | 2 895 |

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

## 1. General

Allegiance Telecom Inc is a facilities-based national local exchange carrier that provides integrated telecommunications services to business government and other institutional users in major metropolitan areas across the United States of America Allegiance Telecom Inc was incorporated on April 22, 1997, as a Delaware corporation, and it and its subsidiaries are generally referred to herein as the "Company"

The Company offers services in 36 of the largest metropolitan areas in the United States of America as follows Atlanta Austin Baltimore Boston Chicago Cleveland, Dallas, Denver Detroit Fort Lauderdale, Fort Worth, Houston Long Island Los Angeles Miami Minneapolis/St Paul New York City, Northern New Jersey, Oakland Ontario/Riverside Orange County Philadelphia Phoenix Pittsburgh Portland Sacramento St Louis San Antonio San Diego San Francisco, San Jose, Seattle Tampa Washington, D C West Palm Beach/Boca Raton and White Plains

## 2 Going Concern

The consolidated financial statements have been prepared on a going concern basis, which contemplates continuity of operations realization of assets and satisfaction of liabilities in the ordinary course of business However as a result of recurring operating losses and debt reduction requirements as stipulated by an interim amendment to the Company's senior secured credit facilities, such realization of assets and satisfaction of liabilities are subject to uncertainty

The interim amendment requires the Company to reduce total debt to no more than $645,000 by April 30, 2003 (see Note 7) The Company has been evaluating possible recapitalization transactions and pursuing numerous financial and negotiated strategic alternatives to reduce total indebtedness

If the Company cannot reduce debt to the required levels by April 30, 2003, it will be in default under the senior secured credit facilities If any such default occurs, the Company's senior lenders would have the right to request immediate repayment of all senior debt in which case the Company's noteholders would then have the right to request immediate repayment of the outstanding notes If any of these events occur it would have a material adverse effect and it may result in a foreclosure proceeding or a voluntary or involuntary bankruptcy proceeding These factors raise substantial doubt about the Company's ability to continue as a going concern The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty

Under the terms of the Company's senior secured credit facilities, the Company is required to deliver an unqualified audit report to its senior lenders As such, if the Company does not receive a waiver from its senior lenders or if it is unable to cure this breach within 30 days, there will be an event of default under the senior secured credit facilities

## 3 Summary of Significant Accounting Policies·

***Consolidation.*** The accompanying financial statements include the accounts of Allegiance Telecom, Inc and its wholly owned subsidiaries All significant intercompany balances and transactions have been eliminated

***Cash and Cash Equivalents.*** The Company includes as cash and cash equivalents, cash marketable securities and commercial paper with maturities of three months or less at the date of purchase

***Short-Term Investments.*** Short-term investments consist primarily of commercial paper with original maturities between three and 12 months at the date of purchase Such short-term investments are carried at their accreted value which approximates fair value Short-term investments are held to maturity and unrealized gains and losses are not significant at December 31 2002

***Prepaid Expenses and Other Current Assets.*** Prepaid expenses and other current assets consist of prepaid services, prepaid rent prepaid insurance and refundable deposits Prepayments are expensed on a straight-line basis over the corresponding life of the underlying agreements

***Financial Instruments*** The carrying value of the Company's cash, short-term investments, accounts receivable and accounts payable approximates their fair value At December 31 2002 the Company's 11 3/4% senior discount notes due 2008 12 7/8% senior discount notes due 2008 and senior secured credit facilities were all trading at values below their carrying value The carrying value of these debt instruments in the Company's consolidated financial statements is significantly higher than their fair value

***Property and Equipment*** Property and equipment includes network equipment land leasehold improvements, software, office equipment furniture and fixtures and construction-in-progress These assets are stated at cost which includes direct costs and capitalized interest and are depreciated over their respective useful lives using the straight-line method During the years ended December 31 2002 2001 and 2000 $6 138 $16 858 and $14,366 respectively of interest expense was capitalized related to network construction-in-progress Repair and maintenance costs are expensed as incurred

Property and equipment at December 31 2002 and 2001, consisted of the following

| | 2002 | 2001 | Useful Lives (in years) |
|---|---|---|---|
| Network equipment | $ 1,148,583 | $ 869,011 | 2-20 |
| Land | 9,365 | 9,164 | — |
| Leasehold improvements | 145,713 | 134,618 | 7-10 |
| Software | 125,229 | 114,553 | 3 |
| Office equipment and other | 46,991 | 36,824 | 2-5 |
| Furniture and fixtures | 21,334 | 17,715 | 7 |
| Property and equipment, in service | 1,497,215 | 1,181,885 | |
| Less Accumulated depreciation | (592,069) | (350,460) | |
| Property and equipment, in service, net | 905,146 | 831,425 | |
| Construction-in-progress | 18,960 | 184,825 | |
| Property and equipment, net | $ 924,106 | $ 1,016,250 | |

***Impairment of Long-Lived Assets.*** The Company reviews the carrying values of property and equipment and intangible assets for impairment whenever current events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable If impairment indicators are present the Company analyzes the projected undiscounted cash flows associated with property and equipment and intangible assets to determine the fair value of these assets If the assets are determined to be impaired a loss is recorded in the amount that the carrying value of the assets exceeds their fair value

The Company performed an analysis comparing estimated future cash flows to the carrying value of its property and equipment and intangible assets at December 31, 2002 This analysis did not indicate that an impairment exists as of December 31 2002

***Deferred Debt Issuance Costs*** Deferred debt issuance costs include costs incurred by the Company in raising debt proceeds These costs are amortized to interest expense over the life of the related debt

***Goodwill and Other Intangible Assets.*** Goodwill represents the excess of purchase price over the fair value of net assets of acquired businesses Goodwill related to businesses acquired prior to June 30 2001 was amortized on a straight-line basis over an estimated useful life of three years through December 31 2001 Subsequent to that date, goodwill has not been amortized but is assessed for impairment at least annually

The impairment testing is performed at a reporting unit level The goodwill impairment testing has two steps The first step identifies potential impairment by comparing the fair value of the reporting unit to its carrying value If the fair value of the reporting unit exceeds its carrying value goodwill is not impaired and the second step is not necessary If the carrying value of the reporting unit exceeds its fair value the second step is performed to calculate the possible impairment loss by comparing the implied fair value of goodwill to the carrying value If the implied fair value of goodwill is less than the carrying value, a write-down is recorded The fair value of each reporting unit is determined based on combinations of both the income and market valuation approaches

Intangible assets are included in other assets and consist primarily of acquired customer lists with definite useful lives These intangible assets are amortized on a straight-line basis over their estimated useful lives, generally ranging from one to three years

***Restricted Investments*** Long-term restricted investments include certificates of deposit held as collateral for letters of credit issued on behalf of the Company

***Revenue Recognition*** Revenues for voice data and other services to end users are recognized in the month in which the service is provided Amounts invoiced and collected in advance of services provided are recorded as deferred revenue and are recognized as revenue over the period that the services are provided (see Note 6 for amounts of deferred revenue) Revenues for carrier interconnection, access and reciprocal compensation are recognized in the month in which the service is provided, except when realization of these revenues is not reasonably assured The ability of competitive local exchange carriers (such as the Company) to earn local reciprocal compensation revenues and access revenues is the subject of numerous regulatory and legal challenges Until these issues are ultimately resolved, the Company's policy is to recognize this revenue only when realization is reasonably assured

For customer premise equipment contracts, revenue is recognized using the percentage-of-completion method, based on the percentage which incurred contract costs to date bear to total estimated contract costs after giving effect to the most recent estimates of total cost Risks relating to delivery, usage, productivity and other factors are considered in the estimation process The effect of changes to total estimated contract revenue and costs is recognized in the period such changes are determined Provisions for estimated losses on individual contracts are made in the period in which the loss first becomes apparent

In December 1999, the SEC issued Staff Accounting Bulletin No 101 "Revenue Recognition in Financial Statements" (SAB 101), which provides additional guidance on revenue recognition as well as criteria for when revenue is realized and earned and related costs are incurred The Company adopted SAB 101 on October 1 2000 The adoption of SAB 101 did not have a material effect on the Company's results of operations

***Network Expenses*** Network expense is recognized in the month in which the service is utilized Accruals for unbilled leased network facilities, network access charges and equipment colocation charges are based on circuit counts estimated usage and active colocation sites Additionally accrued network expense includes charges invoiced by carriers which are probable network expenses but have not yet been paid due to rate or volume disputes with other carriers Network expenses do not include an allocation of depreciation or amortization expense

***Stock Splits*** On February 28 2000, the Company effected a three-for-two stock split in the form of a 50% stock dividend All references to the number of common shares and per share amounts have been restated to reflect the stock split for all periods presented

***Stock Based Compensation*** At December 31 2002, the Company had three stock-based compensation plans, the 1997 Nonqualified Stock Option Plan the 1998 Stock Incentive Plan and the Employee Stock Discount Purchase Plan (see Note 13) The Company applies the provisions of Accounting Principles Board Opinion No 25 "Accounting for Stock Issued to Employees" (APB No 25) and the related interpretations in accounting for the Company's plans Fixed stock option awards with pro-rata vesting are recognized as expense using the straight-line method over the vesting period

Had compensation cost for the Company's plans been determined based on the fair value of the stock options as of the grant dates for awards under the plans consistent with the method prescribed in Statement of Financial Accounting Standards No 123 "Accounting for Stock-Based Compensation," the Company's net loss applicable to common stock and net loss per share would have increased to the pro forma amounts indicated below The Company utilized the following assumptions in calculating the estimated fair value of each stock option on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions for grants

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Dividend yield | —% | —% | —% |
| Expected volatility | 123 0% | 115 7% | 109 9% |
| Expected life | 3 0 | 3 7 | 4 4 |
| Risk-free interest rate | 3 32% | 4 27% | 5 83% |

| | | 2002 | | 2001 | | 2000 |
|---|---|---|---|---|---|---|
| Reported net loss | $ | (572,670) | $ | (431,813) | $ | (277,567) |
| Add stock-based employee compensation expense included in reported net income | | 2 726 | | 4,126 | | 10 127 |
| Deduct stock-based employee compensation expense determined under fair value method for all awards | | (61,880) | | (212,384) | | (129 939) |
| *Pro forma net loss* | $ | (631 824) | $ | (640 071) | $ | (397 379) |
| Net loss per share, basic and diluted—as reported | $ | (4 88) | $ | (3 82) | $ | (2 58) |
| Net loss per share basic and diluted—pro forma | $ | (5 38) | $ | (5 66) | $ | (3 69) |

***Treasury Stock*** Treasury stock transactions are accounted for using the cost method

***Loss Per Share*** The Company calculates net loss per share under the provisions of Statement of Financial Accounting Standards No 128 "Earnings per Share "

The securities listed below were not included in the computation of diluted loss per share, as the effect from the conversion would be antidilutive

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| Common Stock Warrants | 205,785 | 207,973 | 207,973 |
| 1997 Nonqualified Stock Option Plan | 475,224 | 531,196 | 791,122 |
| 1998 Stock Incentive Plan | 15,607,460 | 24,666,776 | 20,392,248 |
| Employee Stock Discount Purchase Plan | 56,839 | 432,250 | 82,270 |

***Income Taxes*** Income taxes are accounted for under the asset and liability method Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date

***Segment Reporting.*** The Company operates its business as a single segment, providing integrated telecommunications services This segment includes all services offered by the Company, including local voice service, long distance service, data services, and customer premise equipment sales and maintenance services These services have similar network operations and are sold through similar sales channels to the same targeted customer base The Company manages these services as a single segment and prepares and reviews financial results on this single segment

***Use of Estimates in Financial Statements.*** The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of expenses during the reporting period The Company continually evaluates its estimates, including those related to revenue recognition accounts receivable, network expenses and impairment of long-lived assets The Company bases its estimates on historical experience and on other relevant assumptions that are believed to be reasonable under the circumstances These estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources Actual results could differ from those estimates

***Recent Accounting Pronouncements.*** In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No 143 "Accounting for Asset Retirement Obligations " This statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs The adoption of this statement did not have a material effect on the financial condition or results of operations of the Company

In August 2001 the Financial Accounting Standards Board also issued Statement of Financial Accounting Standards No 144 "Accounting for the Impairment or Disposal of Long-Lived Assets " This statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets Adoption of this statement is required for fiscal years beginning after December 15, 2001 The adoption of this statement did not have a material effect on the financial condition or results of operations of the Company

In June 2002 the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No 146 "Accounting for Costs Associated with Exit or Disposal Activities " This statement addresses financial accounting and reporting for costs associated with exit or disposal activities Adoption of this statement is required for exit or disposal activities initiated after December 31 2002 with early application encouraged The adoption of this statement is not expected to have a material effect on the financial condition or results of operations of the Company

In December 2002 the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No 148 "Accounting for Stock Based Compensation-Transition and Disclosure " This statement provides alternative methods of transition to entities that adopt the fair value method of accounting for stock-based employee compensation The statement also requires expanded disclosure of pro-forma fair value stock compensation information for all companies regardless of whether an entity adopts the fair value method of accounting for stock based compensation These disclosures are generally required for fiscal years ending after December 15 2002 and have been included in the notes to the Company's consolidated financial statements

In November 2002, the Financial Accounting Standards Board's Emerging Issues Task Force reached a consensus on EITF Issue No 00-21, "Revenue Arrangements with Multiple Deliverables " EITF Issue No 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets The provisions of EITF Issue No 00-21 will apply to revenue arrangements entered into in fiscal periods beginning after June 15, 2003 The Company does not expect EITF Issue No 00-21 to have a material effect on its financial condition or results of operations

## 4. Business Combinations

In June 2001 the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No 141 "Business Combinations " This statement addresses financial accounting and reporting for business combinations Adoption of this statement is required for all business combinations consummated after June 30 2001 All of the Company's prior business combinations have been accounted for under the purchase method of accounting Therefore the adoption of this statement did not have a material impact on the Company's business acquisition model

In June 2001, the Financial Accounting Standards Board also issued Statement of Financial Accounting Standards No 142, "Goodwill and Other Intangible Assets " This statement (1) requires that goodwill balances no longer be amortized but rather assessed for impairment at least annually and (2) expands the classifications of other intangible assets and provides guidance for estimating the expected useful lives of these assets

The table below shows the impact of the amortization recognized in prior years for intangibles that are no longer amortized after the adoption of Statement of Financial Accounting Standards No 142

| | 2002 | 2001 | 2000 |
|---|---|---|---|
| | | (unaudited) | |
| Reported net loss | $ (572,670) | $ (431 813) | $ (277,567) |
| Add back Goodwill amortization | — | 55 227 | 22 279 |
| Add back Acquired workforce amortization | — | 1 181 | 401 |
| Adjusted net loss | $ (572 670) | $ (375 405) | $ (254,887) |
| Basic and diluted net loss per share | | | |
| Reported net loss per share | $ (4 88) | $ (3 82) | $ (2 58) |
| Goodwill amortization | — | 0 49 | 0 21 |
| Acquired workforce amortization | — | 0 01 | — |
| *Adjusted net loss per share* | $ (4 88) | $ (3 32) | $ (2 37) |

The Company is required to assess the value of goodwill under the provisions of Statement of Financial Accounting Standards No 142 The Company identified one reporting unit, as defined in Statement of Financial Accounting Standards No 142 As outlined in the authoritative literature, the assessment of whether goodwill has been impaired is based on the Company's estimate of the fair value of the reporting unit using a model which considers both a discounted future cash flow analysis and market capitalization data Upon adoption of Statement of Financial Accounting Standards No 142 on January 1 2002, there was no indication of an impairment in the Company's goodwill intangible

During the six months ended June 30, 2002 the market capitalization of the Company remained at a level well below its book value As this decline in the market capitalization indicates that a potential impairment in the value of goodwill exists management performed an interim valuation as of June 30, 2002 using a valuation model which considers both a discounted future cash flow analysis and market capitalization data A final valuation was performed by an independent valuation services company This valuation indicated that an impairment of goodwill existed as of June 30 2002 Accordingly, the Company recorded a charge of $114,722 during 2002, reflecting the amount of impairment as of June 30 2002 to eliminate the enterprise goodwill intangible

The changes in the carrying value of goodwill during the year ended December 31 2002 are as follows

| | | |
|---|---|---|
| Balance as of December 31, 2001 | $ | 107,468 |
| Reclassification of acquired workforce | | 1 731 |
| Final purchase price adjustments | | 5,523 |
| Impairment charge | | (114,722) |
| Balance at December 31, 2002 | $ | — |

**Business Acquisitions**

On June 17 2002 the Company purchased substantially all of the assets of WorldCom's customer premise equipment sales and WorldCom's customer premise equipment maintenance businesses, known in the industry as "Shared Technologies Fairchild" or "Shared Technologies " The Company acquired these businesses for a cash purchase price of $30,000 and assumption of specified liabilities The excess of purchase price over the fair value of the net assets acquired was recorded as goodwill of $3 902 The acquisition was accounted for using the purchase method, and accordingly, the net assets and results of operations of Shared Technologies have been included in the Company's consolidated financial statements since the date of acquisition Included in the Company's financial statements were $78,705 of revenues and $47 853 of network expenses related to the Shared Technologies businesses for the year ended December 31, 2002

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed related to the Shared Technologies business

| | | |
|---|---|---|
| Current assets | $ | 46,494 |
| Property and equipment | | 4 733 |
| Other Assets | | 92 |
| Goodwill | | 3,902 |
| Total assets acquired | | 55,221 |
| Current liabilities | | 25 221 |
| Total liabilities assumed | | 25,221 |
| Net assets acquired | $ | 30 000 |

The following presents the unaudited pro forma results of the Company for the years ended December 31, 2002 and 2001, as if the acquisition of the Shared Technologies businesses had been consummated at the beginning of each of the periods presented The pro forma results are prepared for comparative purposes only and do not necessarily reflect the results that would have occurred had the acquisitions occurred at the beginning of the periods presented or the results which may occur in the future

| | 2002 | 2001 |
|---|---|---|
| | (unaudited) | |
| Revenue | $ 849,081 | $ 645,312 |
| Net loss | (571 274) | (498 147) |
| Net loss per share basic and diluted | (4 87) | (4 40) |

Additionally during the year ended December 31, 2002 the Company paid contingent consideration totaling $1,928 consisting of $250 in cash and 558 726 shares of its common stock as provided in the merger agreements with Jump Net Inc (acquired in 2000) and Coast to Coast Telecommunications Inc (acquired in 2001) The consideration paid during 2002 was included in accrued liabilities at December 31, 2001 There is no additional consideration payable under any of the Company's acquisition agreements

During the year ended December 31 2001 the Company paid contingent consideration totaling $17,858, consisting of $13 988 in cash of which $2 362 was included in accrued liabilities at December 31 2000 and 407,250 shares of the Company's common stock as provided in the merger agreements with the following businesses acquired during 2001 and 2000 InterAccess Co , Virtualis Systems Inc Jump Net, Inc , CTSnet and Adgrafix Corporation There is no additional consideration payable under these acquisition agreements

During the year ended December 31 2001 the Company acquired the stock of Adgrafix Corporation, an Internet-based web hosting applications specialist and Coast to Coast Telecommunications, Inc , a provider of local and long-distance telecommunications services The Company also acquired certain assets of HarvardNet, Inc an Internet-based web hosting applications specialist and Intermedia Business Internet, a Tier 1 Internet service provider The Company acquired these entities for an aggregate purchase price of $92 602 consisting of $17,651 in cash and 3 694,502 shares of the Company's common stock The excess of purchase price over the fair value of the net assets acquired was recorded as goodwill of $34 896

During the year ended December 31, 2000, the Company acquired the following four regional Internet service providers CONNECTnet Internet Network Services, InterAccess Co CTSnet, a division of Datel Systems Incorporated, and Jump Net, Inc In addition during 2000 the Company acquired Virtualis Systems, Inc an Internet-based, web hosting applications specialist

In connection with its integration plan for the acquired businesses, the Company recorded additional goodwill to establish reserves for certain costs, including the termination of acquired redundant network elements, closure of acquired duplicate facilities, and severance of certain employees If the Company does not utilize the full extent of the established reserves for their intended purposes, the reserves will be reversed and will be included as an extraordinary item in the Company's consolidated financial statements since goodwill has been fully impaired

Each of the acquisitions discussed above were accounted for using the purchase method of accounting Accordingly the net assets and results of operations of the acquired companies have been included in the Company's consolidated financial statements since the acquisition dates The purchase price of the acquisitions was allocated to assets acquired, including identified intangible assets, and liabilities assumed, based on their respective estimated fair values at acquisition The Company's purchase price allocation of the acquisition made in 2002 is preliminary, subject to post-acquisition due diligence of the acquired entity, and may be adjusted as additional information is obtained During the years ended December 31, 2002 and 2001 immaterial adjustments were made to the purchase price allocation of the entities acquired in 2001 and 2000

## 5 Other Assets

Other assets consisted of the following

| | 2002 | 2001 |
|---|---|---|
| Acquired customer lists | $ 62,800 | $ 62,800 |
| Acquired workforce intangibles | — | 3 348 |
| Long-term deposits | 17 030 | 4,040 |
| Equipment pending deployment | 8 688 | 6 827 |
| Other | 5,645 | 6,231 |
| Total other assets | 94 163 | 83 246 |
| Less Accumulated amortization | (50,189) | (18,520) |
| Other assets net | $ 43 974 | $ 64 726 |

On January 1 2002 the Company reclassified the value of the acquired workforce intangibles and related accumulated amortization to goodwill in accordance with Statement of Financial Accounting Standards No 142 (See Note 4)

The acquired intangibles are being amortized over their estimated useful lives of one to three years using the straight-line method Amortization expense related to intangible assets totaled $33,386 and $13,235 during the years ended December 31 2002 and 2001 respectively The estimated aggregate future amortization expense for intangible assets remaining as of December 31, 2002 is as follows

| | |
|---|---|
| 2003 | $ 10 301 |
| 2004 | 2,310 |
| Total | $ 12,611 |

Long-term deposits include a $10,800 prepayment to AT&T for long-distance services Equipment pending deployment consists of equipment purchased and being staged for deployment in the Company's network This equipment will be classified as property and equipment when it is deployed

## 6 Accrued Liabilities and Other Current Liabilities

Accrued liabilities and other current liabilities consisted of the following

| | 2002 | 2001 |
|---|---|---|
| Accrued employee compensation and benefits | $ 11,824 | $ 10,314 |
| Accrued network expenses | 52,643 | 40,313 |
| Business acquisition costs | 10,502 | 15,657 |
| Accrued taxes | 10,051 | 8,171 |
| Accrued interest expense | 4,154 | 4,103 |
| Deferred revenue | 29,009 | 3,088 |
| Other | 6,261 | 4,322 |
| Accrued liabilities and other current liabilities | $ 124 444 | $ 85,968 |

Business acquisition costs primarily included reserves for termination of acquired redundant network elements and closure of acquired duplicate facilities (See Note 4)

## 7. Long-Term Debt

Long-term debt consisted of the following

| | | 2002 | | 2001 |
|---|---|---|---|---|
| Series B 11$^3/_4$% notes, face amount $445,000 due February 15, 2008, effective interest rate of 12 21%, at accreted value | $ | 433,974 | $ | 385,765 |
| 12$^7/_8$% senior notes, face amount $205 000 due May 15, 2008, effective interest rate of 13 24%, at accreted value | | 202,210 | | 201 852 |
| Senior secured credit facilities, variable interest rate | | 470,300 | | 350,000 |
| Capital lease obligations (see Note 8) | | 94 739 | | 78 687 |
| Total debt | | 1,201,223 | | 1,016,304 |
| Less current portion of long-term debt | | 561,532 | | 3 120 |
| Long-term debt | $ | 639,691 | $ | 1,013 184 |

The approximate annual debt maturities for the five years subsequent to December 31 2002, are as follows

| | | |
|---|---|---|
| 2003 | $ | 556,223 |
| 2004 | | 82 060 |
| 2005 | | 145,590 |
| 2006 | | 242,650 |
| 2007 | | — |
| Thereafter | | 93,777 |
| Total | $ | 1,120,300 |

2003 long-term debt maturities include a reduction in debt as required by the Company's interim agreement with its senior bank creditors as discussed below

***Series B 11$^3/_4$% Notes Due 2008.*** On February 3, 1998 the Company raised gross proceeds of approximately $250 477 in an offering of 445 000 units, each of which consists of one 11$^3/_4$% senior discount note due 2008 of the Company and one redeemable warrant to purchase approximately 2 19 shares of common stock at an exercise price of $ 01 per share subject to certain antidilution provisions Of the gross proceeds, $242,294 was allocated to the 11$^3/_4$% notes and $8,184 was allocated to the redeemable warrants The redeemable warrants became exercisable in connection with the Company's initial public offering (see Note 9) in July 1998

A registration statement on Form S-4 (File No 333-49013) registering the 11$^3/_4$% notes, and offering to exchange any and all of the outstanding 11$^3/_4$% notes for Series B 11$^3/_4$% notes due 2008, was declared effective by the Securities and Exchange Commission on May 22, 1998 This exchange offer terminated on June 23, 1998, after substantially all of the outstanding 11$^3/_4$% notes were exchanged The terms and conditions of the Series B notes are identical to those of the 11$^3/_4$% notes in all material respects

The Series B notes have a principal amount at maturity of $445,000 and an effective interest rate of 12 21% The Series B notes are unsecured and mature on February 15, 2008 Commencing August 15, 2003 interest on such notes is payable in cash at the rate of 11$^3/_4$% per annum on February 15 and August 15 of each year From and after February 15, 2003, interest on the Series B notes will be payable semi-annually in cash at the rate of 11$^3/_4$% per annum The Company is required to make an offer to purchase the redeemable warrants for cash at the relevant value upon the occurrence of a repurchase event, as defined in the applicable warrant agreement

Through March 31, 1999, the Company was recognizing the potential future redemption value of the redeemable warrants by recording accretion of the redeemable warrants to their estimated fair market value at February 3 2008 using the effective interest method

Effective April 1 1999 the Company determined that accreting the redeemable warrants to a future potential redemption value was no longer applicable, as the redemption of the redeemable warrants for cash is no longer beyond the control of the Company and the redemption date and amount are not reasonably determinable Accordingly, the accreted value of the redeemable warrants at April 1, 1999, was reclassified to stockholders' equity as common stock warrants, and no further accretion will be recorded If a repurchase event occurs in the future or becomes probable the Company will adjust the warrants to the estimated redemption value at that time

Under the terms of the Series B notes the Company may redeem these notes at certain times and in certain amounts Upon a change of control, as defined the Company is required to make an offer to purchase the $11^3/_4$% notes at a purchase price of 101% of the accreted value thereof together with accrued interest if any

***$12^7/_8$% Senior Notes Due 2008*** On July 7, 1998 the Company raised approximately $200 919 of gross proceeds from the sale of its $12^7/_8$% senior discount notes due 2008 of which approximately $69 033 was used to purchase U S government securities which were placed in a pledged account to secure and fund the first six scheduled payments of interest on the notes

The $12^7/_8$% notes have a principal amount at maturity of $205,000 and an effective interest rate of 13 24% The $12^7/_8$% notes are unsecured and mature on May 15 2008 Interest on the $12^7/_8$% notes is payable semi-annually in cash at the rate of $12^7/_8$% per annum on May 15 and November 15 of each year As of December 31, 2002 and 2001 the Company has recorded accrued interest associated with the $12^7/_8$% notes of $3,299 and $3,299, respectively which is included in other current liabilities

Under the terms of the $12^7/_8$% notes the Company may redeem these notes at certain times and in certain amounts Upon a change of control, as defined, the Company is required to make an offer to purchase the $12^7/_8$% notes at a purchase price of 101% of the principal amount thereof, together with accrued interest if any

The Series B notes and $12^7/_8$% notes contain certain restrictive covenants that, among other things, limit the ability of the Company to incur indebtedness, create liens, engage in sale-leaseback transactions, pay dividends or make distributions in respect to their capital stock, redeem capital stock, make investments or certain other restricted payments, sell assets, issue or sell stock of certain subsidiaries, engage in transactions with stockholders or affiliates or effect a consolidation or merger The Company was in compliance with all such restrictive covenants at December 31, 2002

***Senior Secured Credit Facilities.*** In February 2000 the Company closed on $500,000 of senior secured credit facilities (Credit Facilities) The Credit Facilities consist of a $350 000 seven-year revolving credit facility and a $150,000 two-year delayed draw term loan facility Interest is generally the London Interbank Offered Rate (LIBOR) plus 4 50% The blended borrowing rate on outstanding borrowings at December 31, 2002 is 5 77% and will remain fixed until June 26 2003

The Credit Facilities are secured by (1) the capital stock of Allegiance Telecom Company Worldwide (which stock is owned by the Company's parent holding company, Allegiance Telecom, Inc ) and (2) all of the assets of Allegiance Telecom Company Worldwide, including the capital stock owned by that entity in each of its subsidiaries

As of December 31, 2002, there were $324 800 and $145 500 of borrowings outstanding under the seven-year revolving credit facility and the two-year delayed draw term loan facility respectively, all of which are classified as long-term debt The revolving credit facility will be permanently reduced in accordance with its amortization schedule as follows 20% in 2004 (a pro-rata amount each quarter), 30% in 2005 (a pro-rata amount each quarter) and 50% in 2006 (a pro-rata amount each quarter) Principal amounts of the delayed draw term loan are to be repaid as follows 20% in 2004 (pro-rata payments to be made quarterly), 30% in 2005 (pro-rata payments to be made quarterly) and 50% in 2006 (pro-rata payments to be made quarterly)

The Credit Facilities carry certain restrictive and financial covenants that, among other things, limit the Company's ability to incur indebtedness, create liens, engage in sale-leaseback transactions pay dividends or make distributions in respect of capital stock redeem capital stock, make investments or certain other restricted payments, sell assets issue or sell stock of certain subsidiaries, engage in transactions with stockholders or affiliates, effect a consolidation or merger and require the Company to maintain certain operating and financial performance measures

On November 27 2002 the Company reached an agreement with its senior bank creditors regarding modifications to the Credit Facilities Under this agreement the Company obtained a waiver of all existing financial covenants through April 30 2003 and replaced those covenants during this period with a free cash flow from operations covenant (EBITDA less capital expenditures) and a total leverage covenant Under this interim amendment, the Company cannot permit its consolidated total debt to exceed at any time (i) $1 275 000 from November 27 2002 through April 29 2003 and (ii) $645 000 thereafter Under the terms of the interim amendment the Company repaid $15,000 of the Credit Facilities which was applied to the initial amortization of the facility scheduled to begin in 2004 The Company was in compliance with interim period covenants at December 31, 2002

A permanent amendment to the Credit Facilities must be in place prior to the April 30 2003 waiver expiration In conjunction with the negotiation of this permanent amendment the Company has been evaluating possible recapitalization transactions and pursuing numerous financial and negotiated strategic alternatives to reduce total indebtedness

Under the terms of the Credit Facilities, the Company is required to deliver an unqualified audit report to its senior lenders The Company received an audit report that is modified to express substantial doubt about the Company's ability to continue as a going concern As such, if the Company does not receive a waiver from its senior lenders or if it is unable to cure this breach within 30 days there will be an event of default under the Credit Facilities An event of default under the Credit Facilities could cause all amounts outstanding under the Credit Facilities to become immediately due and payable If they become immediately due and payable, the Company's bondholders may also accelerate the payment of outstanding amounts due under the Series B notes and the $12^{7}/_{8}$% notes No adjustment that might result from the potential impact of these acceleration events is reflected in the debt maturity table above

**8. Leases:**

The Company has entered into various capital lease agreements with expirations through 2022, covering dedicated optical fiber capacity and certain equipment Assets and future obligations related to capital leases are included in the accompanying consolidated balance sheet in property and equipment and long-term debt, respectively Depreciation of assets held under capital leases is included in depreciation and amortization expense

The Company has entered into various operating lease agreements, with expirations through 2015, for network facilities, office space and equipment Rent expense on operating leases for the years ended December 31, 2002 2001 and 2000, was $34 600, $31,765 and $16 950 respectively

Future minimum lease obligations for all non-cancelable capital and operating lease agreements with initial or remaining terms of one year or more at December 31, 2002 are as follows

| Years ending December 31, | Capital Leases | Operating Leases |
|---|---|---|
| 2003 | $ 14,046 | $ 30,545 |
| 2004 | 13 456 | 28 693 |
| 2005 | 12,601 | 27,533 |
| 2006 | 12,658 | 25,300 |
| 2007 | 10,353 | 23,299 |
| Thereafter | 108,652 | 68 322 |
| Total minimum future lease payments | 171,766 | $ 203,692 |
| Amount representing interest | (77 027) | |
| Present value of minimum lease payments | 94,739 | |
| Current portion | (5 309) | |
| Long-term capital lease obligations | $ 89,430 | |

Certain operating and capital lease agreements contain renewal and purchase options at the end of the initial lease terms

**9 Capitalization:**

***Preferred Stock.*** In connection with the Company's initial public offering, the Company authorized 1,000,000 shares of preferred stock with a $ 01 par value At December 31 2002 and 2001, no shares of preferred stock were issued and outstanding

***Common Stock.*** On February 2, 2000, the Company raised $693,000 of gross proceeds from the sale of the Company's common stock The Company sold 9,900,000 shares at a price of $70 per share Net proceeds from this offering were $665 562 On February 29, 2000, the underwriters of this offering exercised an option to purchase an additional 803,109 shares of common stock, providing an additional $56,218 gross proceeds and $54 113 net proceeds to the Company

On February 28, 2000, a three-for-two stock split of the Company's common stock was effected in the form of a 50% stock dividend to shareholders of record on February 18, 2000 Par value remained unchanged at $ 01 per share All references to the number of common shares and per share amounts have been restated to reflect the stock split for all periods presented

At December 31, 2002 and 2001, 125,157,605 and 115,542,354 shares were issued and 124,830,110 and 115,214,859 were outstanding, respectively Of the authorized but unissued common stock 25,758,718 shares were reserved for issuance upon exercise of stock options issued under the Company's stock option, stock incentive and stock purchase plans (see Note 13) and 205,851 shares were reserved for issuance, sale and delivery upon the exercise of warrants (see Note 7) at December 31, 2002

***Warrants*** During 2002, 1,000 warrants formerly referred to as redeemable warrants (see Note 7), were exercised to purchase 2,188 shares of common stock Fractional shares are not issued, cash payments are made in lieu thereof according to the terms of the warrant agreement No warrants were exercised during 2001 At December 31, 2002 and 2001, 94,031 and 95 031 warrants, respectively, were outstanding The warrants will expire on February 3, 2008

***Deferred Compensation*** During 1998 and 1997 certain management investors acquired membership units of Allegiance Telecom, LLC at amounts less than the estimated fair market value of the membership units, consequently the Company recognized deferred compensation of $10 090 and $978 at December 31 1998 and 1997, respectively of which $41 $2,726 and $2,767 was amortized to expense during the periods ended December 31, 2002 2001 and 2000 respectively In connection with the initial public offering the redeemable preferred stock was converted into common stock and Allegiance Telecom LLC was dissolved The deferred compensation charge is amortized based upon the period over which the Company has the right to repurchase certain of the securities (at the lower of fair market value or the price paid by the employee) in the event the management investor's employment with the Company is terminated Deferred compensation also includes stock options granted at an exercise price less than market value, stock options subject to variable plan accounting and restricted stock issued to management employees (see Note 13)

***Deferred Management Ownership Allocation Charge.*** On July 7, 1998 in connection with the initial public offering certain venture capital investors and certain management investors owned 95 0% and 5 0%, respectively of the ownership interests of Allegiance Telecom LLC, which owned substantially all of the Company's outstanding capital stock As a result of the successful initial public offering, Allegiance Telecom, LLC was dissolved and its assets (which consisted almost entirely of such capital stock) were distributed to the venture capital investors and management investors in accordance with the Allegiance Telecom LLC's limited liability company agreement This agreement provided that the equity allocation between the venture capital investors and the management investors be 66 7% and 33 3% respectively, based upon the valuation implied by the initial public offering The Company recorded the increase in the value of the assets of Allegiance Telecom LLC allocated to the management investors as a $193 537 increase in additional paid-in capital, of which $122 476 was recorded as a noncash nonrecurring charge to operating expenses and $71 061 was recorded as a deferred management ownership allocation charge The deferred charge was amortized at $175 and $6 480 as of December 31 2001 and 2000 and was fully amortized as of March 31 2001 The Company repurchased 289,527 shares from terminated management investors during 2000 A remaining deferred charge of $135 related to these shares was reversed to additional paid-in-capital upon the repurchase of the shares

**10 Related Parties:**

During 2002 the Company incurred approximately $450 in legal fees to a law firm in which a member of the Company's board of directors is a senior partner

During 2001, the Company loaned $4,200 to a director and executive vice president of the Company under a full recourse promissory note The note is payable in full on April 4, 2004 The outstanding balance accrues interest at 2 73% per annum which was the November 2001 applicable federal rate, and interest is payable when this note is due In the event the executive resigns or is terminated by Allegiance for cause, this note will become immediately due and payable The note is included in other long-term assets in the accompanying consolidated balance sheet

During 2001, the Company incurred $351 in charges for company business travel on an airplane owned and operated by a company that is wholly-owned by a director and executive vice president of the Company The air travel rate charged for use of the airplane was at least as favorable as the rate charged by private aircraft owners unaffiliated with the Company No such payments were made during 2002

**11 Commitments and Contingencies:**

In April 2000, the Company executed a master procurement agreement with Lucent Technologies Inc for a broad range of advanced telecommunications equipment, software and services This agreement contains a three-year $350,000 purchase commitment In July 2001, this agreement was amended to extend the term to six years Under the amended agreement the Company must complete purchases totaling $100 000 by December 31 2000 an aggregate of $160 000 of purchases by September 30 2001 an aggregate of $210 000 by December 31, 2002 an aggregate of $257,000 by December 31, 2003, an aggregate of $304 000 by December 31 2004 and the full $350,000 of aggregate purchases on or before December 31, 2005 In 2002, Lucent waived $50 000 of the $210,000 purchase commitment for 2002 in exchange for a purchase commitment by the Company of approximately $13 100 of telecommunications equipment

The Company purchased the $13 100 of telecommunications equipment and has satisfied the purchase commitment for 2002 As of December 31, 2002 the remaining commitment under this agreement is approximately $123,800 The agreement provides that, subject to certain conditions if the Company does not meet the required purchase milestones, the Company will be required to provide cash settlement in an amount equal to the shortfall During the term of the contract such shortfall payments may be applied to future purchases in the next succeeding year Given the change in focus in the Company's business to achieving profitability the Company is in the process of renegotiating this contract with Lucent There can be no assurance that the Company will be successful in completing the renegotiation

***12 Federal Income Taxes.***

The Company accounts for income tax under the provisions of Statement of Financial Accounting Standards No 109, "Accounting for Income Taxes" (SFAS 109) SFAS 109 requires an asset and liability approach which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events which have been recognized in the Company's financial statements The Company had approximately *$1 344,311 and $877,794 of net* operating loss carryforwards for federal income tax purposes at December 31, 2002 and 2001 respectively The net operating loss carryforwards will begin to expire in the years 2012 through 2019 if not previously utilized The Company has recorded a valuation allowance equal to the net deferred tax assets at December 31, 2002 and 2001, due to the uncertainty of future operating results The valuation allowance will be reduced at such time as management is able to determine that the realization of the deferred tax assets is more likely than not to occur Generally, reductions in the valuation allowance will reduce future provisions for income tax expense Reductions in the valuation allowance related to tax deductions for employee stock option exercises will reduce the Company's additional paid-in capital

The tax effects of temporary differences that give rise to deferred tax assets and deferred tax liabilities at December 31 2002 and 2001 are presented below

| | 2002 | 2001 |
|---|---|---|
| Deferred tax assets | | |
| Net operating loss carryforward | $ 539 357 | $ 327 417 |
| Start-up costs capitalized for tax purposes | 643 | 1,069 |
| Amortization of intangibles | 16 287 | — |
| Allowance for doubtful accounts | 6,327 | 15,797 |
| Accrued liabilities and other | 6,557 | 21 975 |
| Amortization of original issue discount | 71,109 | 51,906 |
| Total gross deferred tax assets | 640 280 | 418 164 |
| Less valuation allowance | (556,959) | (342,394) |
| Net deferred tax assets | $ 83 321 | $ 75 770 |
| Deferred tax liabilities | | |
| Depreciation | $ (83,321) | $ (71,919) |
| Amortization of intangibles | — | (3,851) |
| Total gross deferred tax liabilities | (83,321) | (75 770) |
| Net deferred tax asset | $ — | $ — |

Amortization of the original issue discount on the Series B notes and the $12^{7}/_{8}$% notes as interest expense is not deductible in the income tax return until paid Amortization of goodwill created in a stock acquisition is not deductible in the Company's income tax return, therefore, the effective income tax rate differs from the statutory rate

Under existing income tax law, all operating expenses incurred prior to commencing principal operations and expansion into new markets are capitalized and amortized over a five-year period for tax purposes

A reconciliation of the Company's effective tax rate and the U S federal and state tax rate is as follows

| | 2002 |
|---|---|
| Statutory U S federal rate | (35)% |
| State income taxes, net of federal benefit | (3)% |
| Valuation allowance for deferred taxes | 32% |
| Goodwill and other identifiable intangibles | 6% |
| | —% |

**13 Stock Option/Stock Incentive/Stock Purchase Plans.**

***1997 Nonqualified Stock Option Plan And 1998 Stock Incentive Plan.*** Under the 1997 stock option plan the Company granted stock options to key employees, a director and a consultant of the Company for an aggregate of 1 580,321 shares of common stock The Company will not grant stock options for any additional shares under the 1997 stock option plan

Under the 1998 stock incentive plan, the Company may grant stock options to certain employees, directors, advisors and consultants of the Company The 1998 stock incentive plan provides for issuance of the following types of incentive awards stock options stock appreciation rights, restricted stock, performance grants and other types of awards that the Compensation Committee of the Board of Directors deems consistent with the purposes of the 1998 stock incentive plan The Company has 24 857,402 shares of common stock reserved for issuance under the 1998 stock incentive plan at December 31 2002

Stock options granted under both plans generally have a term of six years and vest over a three-year period and the Compensation Committee of the Board of Directors administers both option plans

A summary of the status of the 1997 stock option plan as of December 31, 2002, 2001 and 2000 is presented in the table below

| | December 31, 2002 | | December 31, 2001 | | December 31, 2000 | |
|---|---|---|---|---|---|---|
| | Shares | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price |
| Outstanding, beginning of period | 531,196 | $ 1 80 | 745,172 | $ 1 80 | 1,098,155 | $ 1 79 |
| Granted | — | — | — | — | — | — |
| Exercised | (8,532) | 1 65 | (213,300) | 1 80 | (334,216) | 1 76 |
| Forfeited | (47,440) | 1 69 | (676) | 2 27 | (18,767) | 1 88 |
| Outstanding, end of period | 475,224 | 1 82 | 531,196 | 1 80 | 745,172 | 1 80 |
| Options exercisable at period-end | 475,224 | | 531,196 | | 595,660 | |

The following table sets forth the range of exercise prices and weighted average remaining contractual life at December 31, 2002 under the 1997 stock option plan

| | Stock Options Outstanding | | | Stock Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Price | Number of Shares | Weighted Average Contractual Life | Weighted Average Exercise Price | Number of Shares | Weighted Average Exercise Price |
| $1 65 - 2 31 | 475,224 | 1 2 | $ 1 82 | 475,224 | $ 1 82 |

A summary of the status of the 1998 stock incentive plan as of December 31, 2002 2001 and 2000 is presented in the table below

| | December 31 2002 | | December 31, 2001 | | December 31, 2000 | |
|---|---|---|---|---|---|---|
| | Shares | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price |
| Outstanding, beginning of period | 24,615,855 | $ 15 34 | 20,383,461 | $ 29 79 | 6,428,376 | $ 26 68 |
| Granted | 6,681,803 | 1 40 | 14,189,571 | 7 50 | 16,557,703 | 33 33 |
| Exercised | (76,586) | 0 12 | (161,733) | 11 17 | (366,604) | 11 47 |
| Forfeited | (15 613 612) | 11 77 | (9,795,444) | 34 14 | (2,236,014) | 50 07 |
| *Outstanding, end of period* | 15,607,460 | 12 72 | 24,615,855 | 15 34 | 20,383,461 | 29 79 |
| *Options exercisable at period-end* | 7,643,110 | | 7,102,039 | | 2,179,551 | |
| Weighted average fair value of options granted | $ 1 04 | | $ 5 73 | | $ 25 83 | |

The following table sets forth the exercise prices and weighted average remaining contractual life at December 31, 2002 under the 1998 stock incentive plan

| | *Stock Options Outstanding* | | | *Stock Options Exercisable* | |
|---|---|---|---|---|---|
| Range of Exercise Prices | Number of Shares | Weighted Average *Contractual* Life | Weighted Average *Exercise* Price | *Number of* Shares | Weighted Average Exercise Price |
| $0 55 - 0 78 | 1,843,061 | 5 5 | $ 0 65 | 638,171 | $ 0 63 |
| $0 90 - 1 17 | 3 097 848 | 5 4 | $ 1 15 | 0 | |
| $1 94 - 2 31 | 288,286 | 5 2 | $ 2 08 | 0 | |
| $3 01 - 3 01 | 3,283 683 | 4 6 | $ 3 01 | 1,852,333 | $ 3 01 |
| $4 94 - 6 72 | 591,820 | 4 2 | $ 5 90 | 234,685 | $ 5 79 |
| $7 79 - 11 10 | 670 642 | 3 7 | $ 9 90 | 391,496 | $ 9 70 |
| $11 79 - 17 67 | 3,066,671 | 3 4 | $ 14 29 | 2,354,487 | $ 14 36 |
| $19 13 - 21 25 | 337,119 | 3 9 | $ 19 70 | 205 555 | $ 19 69 |
| $33 25 - 49 00 | 1,226,391 | 2 9 | $ 38 54 | 987,895 | $ 37 88 |
| $54 44 - 71 06 | 1 201,939 | 3 0 | $ 65 70 | 978,488 | $ 65 46 |
| | 15,607,460 | | | 7,643,110 | |

As the estimated fair market value of the Company's common stock (as implied by the initial public offering price) exceeded the exercise price of certain stock options granted during 1998 and 1997, the Company recognized deferred compensation of $7,635 and $2,031 at December 31, 1998 and 1997 respectively, of which $423 and $2,889 was amortized to expense during the years ended December 31 2001 and 2000, respectively

In February 1999 the Company granted employee stock options under the 1998 stock incentive plan with an exercise price below market value at the date of grant A deferred compensation charge of $6,807 was recognized, and $189, $2,269 and $2,269 was amortized to expense in the years ended December 31, 2002, 2001 and 2000, respectively

During 2000, the Company recognized a deferred compensation charge of $957 as a result of an exchange of unvested stock options of acquired businesses (see Note 4) for employee stock options under the Company's 1998 stock incentive plan $313, $313 and $96 was amortized to expense in the years ended December 31, 2002, 2001 and 2000, respectively

In November 2000 the Company granted non-qualified, outperform stock options to certain key employees under the 1998 stock incentive plan These outperform options are notated as such due to the nature of the options in which the ultimate number and exercise price of the options are dependent on the performance of the Company's stock price relative to the performance of the NASDAQ 100 Index As the number of options and the exercise price were not fixed at the date of grant the Company accounts for these stock options using variable plan accounting under APB No 25 This accounting will require the Company to measure and record compensation ratably from the date of grant until the options are exercised The outperform stock options vest in equal quarterly amounts through November 2001 and generally expire on March 31 2003 If the Company's exchange-traded stock price outperforms the NASDAQ 100 Index on a go-forward basis it is possible that the Company could have material compensation charges in future periods related to unexercised outperform stock options At December 31 2000, the Company recorded a deferred compensation charge of $12,128 and compensation expense of $2 106 through that date During 2001 this charge and all related expenses were reversed due to downward movement in the market price of the Company's common stock No additional expense related to the outperform stock options was recognized during 2002

During 2001 and 2002, the Company cancelled certain outstanding stock options which caused grants made to the same employees within six months of these cancellations to be subject to variable plan accounting under APB No 25 At December 31 2002 and 2001 the deferred compensation charge related to these options was $31 and $5 288, respectively and the Company had recorded compensation expense of $22 and $0 respectively through those dates The deferred compensation charge will be amortized to expense over the vesting period of the stock options, and will continually be adjusted based on the market price of the Company's common stock

During 2002 the Company issued 3,461 120 shares of restricted stock to certain management employees in exchange for stock options held by such employees that had an exercise price of five dollars and fifty cents or more at a ratio of three shares of restricted stock for every four shares issuable pursuant to such stock options In addition, during 2002, the Company issued 2,920,000 shares of restricted stock to certain senior executives in exchange for stock options issued to such executives on October 15, 2001, at a ratio of four shares for every five shares issuable pursuant to such stock options These restricted shares were issued at no cost to the employees, therefore the Company recognized deferred compensation of $6 509 based on the market value of the stock at the date of issuance The deferred compensation charge will be amortized to expense over the three-year vesting period of the restricted stock $1,605 was amortized to expense in the year ended December 31 2002

***Employee Stock Discount Purchase Plan.*** The Company's stock discount purchase plan is intended to give employees a convenient means of purchasing shares of the Company's common stock through payroll deductions Each participating employee's contributions will be used to purchase shares for the employee's share account as promptly as practicable after each calendar quarter The cost per share will be 85% of the lower of the closing price of the Company's common stock on the Nasdaq National Market on the first or the last day of the calendar quarter The Company has 56,839 shares of common stock reserved for issuance under the stock purchase plan at December 31, 2002 During 2002 and 2001, 2,474,042 and 672 337 shares respectively, were issued under the stock purchase plan for proceeds of $3,887 and $4,916, respectively As of December 31, 2002, participants have contributed $32 which will be used to purchase the remaining 56,839 shares in January 2003 The Compensation Committee of the Board of Directors administers the stock purchase plan

**14 Long-Term Sales Contract.**

Effective in 2000, and amended in 2000, 2001 and 2002, the Company executed a long-term contract to provide an integrated network solution and certain services to Genuity Solutions Inc a network service provider and operator of a nationwide Internet network The contract was established specifically to support Genuity's customer contracts, including that with America Online This contract establishes Genuity as the Company's largest customer Total revenues from Genuity for the years ended December 31, 2002, 2001 and 2000 were $90,342 $46,780 and $22,274 respectively The contract term expires on December 31, 2006 Under this agreement Genuity committed to pay an aggregate of $563 010 over the term of the contract, subject to the Company's performance under the contract and the other terms and conditions of the contract The contract contains specific provisions that decrease Genuity's purchase commitment, including but not limited to, Genuity experiencing a business downturn The agreement also provides that if the Company receives a going concern qualification or experiences an event of default as defined under the Credit Facilities, (a) Genuity may exercise an option to purchase all of the dedicated assets and infrastructure used by the Company to provide the integrated network solution to Genuity and (b) Genuity would still be required to continue to purchase certain services from the Company for the remainder of the term of the agreement If Genuity exercises its option, Genuity would be required to pay (1) for the dedicated assets, the remaining undepreciated value of the dedicated assets and (2) for the certain services, the remaining overall value of the agreement less the amounts paid to purchase the dedicated assets and infrastructure

On November 27 2002 Genuity and Level 3 Communications announced that the two companies reached a definitive agreement in which Level 3 would acquire substantially all of Genuity's assets and operations and assume a significant portion of Genuity's existing long-term operating agreements To facilitate the transaction, Genuity filed voluntary petitions for reorganization under Chapter 11 of the Bankruptcy Code The consummation of Level 3's purchase of this Genuity contract was announced on February 4 2003

### 15 Quarterly Financial Data (Unaudited)·

The following table summarizes results for each of the four quarters in the years ended December 31, 2002 and 2001

| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter | Year |
|---|---|---|---|---|---|
| **Year ended December 31, 2002.** | | | | | |
| Revenues | $ 162 095 | $ 184,437 | $ 219 539 | $ 204,911 | $ 770,982 |
| Gross profit | 80,017 | 89,114 | 101,242 | 96,165 | 366,538 |
| Net loss | (112,590) | (226,815) | (113,110) | (120,155) | (572,670) |
| Net loss per share, basic and diluted | (0 97) | (1 94) | (0 97) | (1 00) | (4 88) |
| **Year ended December 31, 2001.** | | | | | |
| Revenues | $ 105,874 | $ 124,059 | $ 135,137 | $ 151,818 | $ 516,888 |
| Gross profit | 54,646 | 63,258 | 69,423 | 77,827 | 265,154 |
| Net loss | (96,340) | (103,338) | (106,537) | (125,598) | (431,813) |
| Net loss per share, basic and diluted | (0 87) | (0 92) | (0 94) | (1 09) | (3 82) |