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Level 3 Communications, Inc. (Nasdaq/LVLT)

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BUY Streaming to Higher Prices

Level 3 communications is a Tier 1 Internet Provider and Content Delivery Network

Investment Highlights

1) Level 3 Communications has reversed the downward trend on revenues and has posted **sequential quarter to quarter gains in 3Q/2010 and 4Q/2010**. Revenues increased from \$908 million in 2Q/2010, to \$912 million in 3Q/2010, and to \$921 million in 4Q/2010. Fueled by growth in European markets and from mid-sized businesses, we anticipate that the Company will continue to grow revenues on a sequential quarter to quarter basis at a 1-2% rate going forward.

2) Level 3 operates in a favorable growth environment. Industry experts forecast that **internet traffic will quadruple over the next 4 years, with mobile data traffic increasing by 39X over the same period¹**. Driving the exponential growth in bandwidth usage anticipated over the next several years will be the rise of the use of streaming media and cloud computing, which in turn will help to eliminate the current oversupply of fiber which has put downward pressure on bandwidth pricing.

3) The Company has managed their costs well and has maintained stable gross margins of 60% for the past 4 years. With \$25 billion already invested in PP&E, based on original cost, the company is able to **translate a large portion of every dollar earned directly into EBITDA**. We anticipate that going forward the Company will be able to continue to improve their financial metrics by growing revenues and further controlling costs.

4) Level 3 has also done an admirable job in **reducing and restructuring its long-term debt**, and currently has no significant debt maturities due for more than a year (June 2012) and enough cash on hand (pro forma as of December 2010) to pay off all existing maturities through the end of 2013. Further down the road, the Company's recent success in refinancing later debt maturities will help them face larger yearly payments due in later years, for example 2014.

¹Cisco Systems "Cisco Visual Networking Index: Forecast and Methodology, 2009-2014".

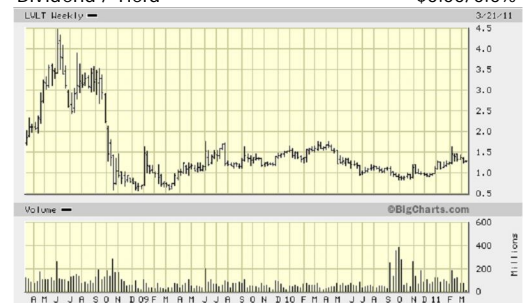
Current Price \$1.34

Price Target \$3.00

| Estimates | F2009A | F2010A | F2011E |
|-----------------|----------|----------|------------|
| Revenue(\$000s) | \$3,762 | \$3,651 | \$3,800 E |
| 1Q March | 980 | 910 | 933 E |
| 2Q June | 942 | 908 | 944 E |
| 3Q September | 916 | 912 | 955 E |
| 4Q December | 924 | 921 | 968 E |
| EPS | (\$0.38) | (\$0.37) | (\$0.31) E |
| 1Q March | (0.08) | (0.14) | (0.08) E |
| 2Q June | (0.08) | (0.10) | (0.08) E |
| 3Q September | (0.10) | (0.10) | (0.08) E |
| 4Q December | (0.11) | (0.03) | (0.07) E |
| P/E (x) | N/A | N/A | N/A |

| | | | |
|---------------|--------|--------|--------|
| EBITDA/Share | \$0.52 | \$0.45 | \$0.53 |
| EV/EBITDA (x) | 10.0 | 11.5 | 9.8 |

| Stock Data | |
|--|---------------|
| 52-Week Range | \$0.83-\$1.77 |
| Shares Outstanding (mil.) | 1,669 |
| Market Capitalization (mil.) | \$2,236 |
| Enterprise Value (mil.) | \$8,684 |
| Debt to Capital (12/10) | 102.5% |
| Book Value/Share (12/10) | (\$0.09) |
| Price/Book | N/A X |
| Average Trading Volume (Mill)(3-month) | 20.7 |
| Insider Ownership | 15.5% |
| Institutional Ownership | 73.1% |
| Short interest | 13.9% |
| Dividend / Yield | \$0.00/0.0% |



Price target and ratings changes over the past 3 years:
Initiated - March 22, 2011 – Target \$3.00

Conclusion

Level 3 Communications is one of the largest internet backbone providers with \$25 billion invested into their fiber optic network. The anticipated exponential increase in internet traffic over the next four years (as forecasted by Cisco Systems, Nasdaq/CSCO/Not Rated, see footnote on page 1) should help absorb the current oversupply of fiber and reduce the downward pressure on bandwidth pricing, allowing the Company to continue their recent achievement of quarterly revenue growth. Although the company is currently highly leveraged, they have been successful recently in rolling over the principal on their debt, and we forecast that the current favorable interest rate environment will continue for the foreseeable future. We believe that Level 3 Communications is a deep value play, due to investors' overreaction to concerns about debt. Therefore, we are initiating coverage on LVLT with a BUY rating and a 12-24 month price target of \$3.00 per share, or approximately 2X estimated 2011 revenues, adjusted for a 50% risk premium because of long-term debt leverage.

Company Business

Level 3 Communications is a Tier 1 Internet Service Provider with over 81,000 miles of intercity fiber optic cabling and 27,000 miles of metropolitan cabling. The Company was founded in 1985 and was previously known as Kiewit Diversified Group. In 1998, the Company was renamed to Level 3 Communications to reflect its focus as a provider of communication services and went public on April 1, 1998. The Company's business divisions are comprised of Network and Internet Services; Colocation Services; Media Services; Voice Services; and Coal Mining. These divisions are explained in detail below:

Network and Internet Services

Level 3 provides data transport services that include wavelength private lines. Wavelength bandwidth speeds vary from 1 gigabits/second to 40 gigabits/second and are provided over the Company's intercity, metropolitan, and transoceanic fiber network. As a Tier 1 internet provider and one of the largest internet backbones (major provider of Internet Protocol networks), the Company also offers High Speed Internet Protocol (IP) services that are operated primarily on its own network. Level 3 is also able to offer Dedicated Internet Access to enterprise businesses utilizing the same internet backbone that hosts the previously mentioned IP services. Additionally, the Company offers Virtual Private Network services that allow customers to create point-to-point and point-to-multipoint networks at multiple remote locations. Finally, Level 3 offers direct leasing of portions of their dark fiber (unlit fiber optic cabling) to internet service providers, government agencies, and large enterprise businesses.

Colocation Services

Level 3 leases space in their data centers where customers can locate their servers, content storage devices, and communications network equipment in a safe and secure environment. Additionally, the Company's data centers offer direct connections to their metro and intercity networks. Approximately 2 million of the Company's 7 million square feet of storage space is allocated for colocation services.

Media Services

Level 3's Content Delivery Network utilizes their IP Network to provide caching and downloading of large files such as video, software, security patches, audio, and graphics to mass audiences. Additionally, the Company offers media delivery services geared towards streaming live and on-demand video content. Level 3's November 2010 announcement that they had been selected as the primary content delivery network for online

streaming movies on Netflix (Nasdaq/NFLX/Not Rated) highlights the potential for growth in this segment. Finally, the Company's Vyvx platform offers live video streaming from remote locations. This year, the Vyvx platform and Level 3's network were used to deliver both the Superbowl and the Academy Awards directly to the television studios.

Voice Services

The Company provides local services to broadband cable operators and Voice Over IP (VoIP) providers such as local phone numbers, 911, operator assistance, and directory listings. Additionally, Level 3 offers SIP Trunking, Local Inbound, Primary Rate Interference, Long Distance, and Toll Free services to enterprise customers.

Coal Mining

Level 3 engages in coal mining through its subsidiary KCP. KCP has a 50 percent stake in the Decker mine and the Black Butte mine in Montana and Wyoming, respectively. The coal is mined using the surface method and is sold primarily to electric utility companies. The coal mining operations are a legacy business and account for only a small portion of the company's overall revenue.

Intellectual Property

Level 3 has approximately 850 patents and pending patents. Their intellectual property portfolio covers data and voice services; content distribution; transmission; and networking equipment. Additionally, the Company also has a license for use of approximately 42,000 of IBM's (NYSE/IBM/Not Rated) relevant patents. Level 3 was unsuccessful in their patent infringement lawsuit, filed in December 2007, against Limelight Networks (Nasdaq/LLNW/Not Rated) and the decision was upheld in the appeals courts on May 5, 2010.

Recent Results

The Company reported financial results for their fourth quarter and fiscal year ending December 31, 2010 in mid-February. For Q4/2010, Level 3 recorded total revenues of \$921 million versus \$924 million in the prior year period, a decrease of less than 1% year-over-year. The Core Network Services component of Communications revenues increased 2% year-over-year, led by strength in European, Mid-Market, Content and Wireless customer facing groups. Operating loss for Level 3 was only \$4 million in Q4/2010, a considerable improvement compared with operating losses of \$17 million in the prior quarter and \$43 million in the prior year period. After interest expense and an income tax benefit in Q4, net loss per share was (\$0.03) for Level 3 in Q4/2010, compared with net losses of (\$0.10) in Q3/2010 and (\$0.11) in Q4/2009.

For fiscal year 2010 as a whole, the Company reported top line revenue of \$3.7 billion, down 3% from \$3.8 billion in 2009. The Company was able to achieve positive sequential revenue growth over the past two quarters of 2010, however, with revenues rising from \$908 million in Q2/2010 to \$912 million in Q3/2010 to \$921 million in Q4/2010. Level 3 has been effective in managing their costs, with gross margins stable at 60% for over 3 years. Higher selling, general, and administrative expenses in 2010 over 2009 were offset by lower depreciation and amortization costs and lower interest expenses this year, down 1.5% from \$595 million in 2009 to \$586 million in 2010. Loss per share in 2010 was (\$0.37), slightly better than the (\$0.38) loss in 2009.

Table 1 below outlines total communication revenues and revenues by type for the five most recent quarters for Level 3, along with sequential quarterly growth rates for each type of sales:

Table 1. Recent Communications Sales by Type (\$Millions)

| Type | 4Q09 | 1Q10 | 2Q10 | 3Q10 | 4Q10 |
|------------------|-------|-------|-------|-------|-------|
| Voice | \$162 | \$165 | \$163 | \$161 | \$161 |
| | | 1.9% | -1.2% | -1.2% | 0.0% |
| Wholesale | \$353 | \$343 | \$342 | \$343 | \$347 |
| | | -2.8% | -0.3% | 0.3% | 1.2% |
| Large Enterprise | \$129 | \$136 | \$142 | \$144 | \$144 |
| | | 5.4% | 4.4% | 1.4% | 0.0% |
| Mid-Market | \$151 | \$151 | \$146 | \$147 | \$151 |
| | | 0.0% | -3.3% | 0.7% | 2.7% |
| Europe | \$73 | \$71 | \$69 | \$73 | \$78 |
| | | -2.7% | -2.8% | 5.8% | 6.8% |
| Total | \$868 | \$866 | \$862 | \$868 | \$881 |
| | | -0.2% | -0.5% | 0.7% | 1.5% |

Balance Sheet and Operating Cash Flow

As of December 31, 2010 Level 3 had \$616 million in cash and equivalents on its balance sheet, down from \$836 million on December 31, 2009. Adjusted EBITDA for 2010 was \$849 million with operating cash flows of \$339 million. During 2010, Level 3 actively worked to refinance their long-term debt by issuing \$201 million in convertible senior notes at 6.5% due in 2016 and \$640 million in senior notes at 10% due in 2018. Subsequent to year-end, the Company issued \$605 million of 11.875% Senior Notes due 2019, part for cash and part in exchange of \$295 million of 9% Convertible Senior Discount Notes due in 2013; announced the redemption of its 5.25% Convertible Senior Notes due 2011. On a pro forma basis for the financings after year-end 2010, Level 3 had approximately \$709 million in cash and \$6.5 billion in long-term debt. Table 2 below outlines Level 3's long-term debt maturity schedule:

Table 2. Long-Term Debt Maturity Schedule by Year (Pro Forma for February 2011 financings)

| Year | Principal (\$Mills) | Mean Interest Rate | Percentage of Total |
|--------|---------------------|--------------------|---------------------|
| 2011 | \$0 | 0.00% | 0.0% |
| 2012 | \$294 | 3.50% | 4.5% |
| 2013 | \$400 | 15.00% | 6.1% |
| 2014 | \$2,930 | 5.75% | 44.8% |
| 2015 | \$775 | 5.99% | 11.8% |
| 2016 | \$201 | 6.50% | 3.1% |
| 2017 | \$700 | 9.00% | 10.7% |
| 2018 | \$640 | 10.00% | 9.8% |
| 2019 | <u>\$605</u> | 10.75% | 9.2% |
| Total: | \$6,545 | | |

Outlook/Growth Drivers

During the dot-com bubble in the late 90's, many companies, including Level 3, aggressively expanded fiber optic networks leading to an over-abundance of supply. The Associated Press estimated that in 2002, 95% of fiber optic cabling remained dormant. In addition, the adoption of multiplexing greatly increased the amount of data that could be transmitted over the cabling that had already been laid. The result was that an excess of

supply drove down the price of bandwidth by up to 60% a year. However, the rise of Fourth Generation (4G) mobile telecommunications and the spread of streaming video content is expected to reduce excess capacity over the next several years. According to projections by Cisco Systems (see footnote on page 1), global internet traffic will quadruple from 2010 to 2014 from 176 exabytes (1 billion gigabytes) per year to 767 exabytes per year. They also project that mobile data traffic will increase by 39X over the same period at a compound annual growth rate of 108%.

Level 3's recent announcement that they were chosen as the primary content delivery network for Netflix's (Nasdaq/NFLX/Not Rated) streaming movie business positions the Company to capture a large share of the growing market to supply bandwidth for streaming video. The Company has already invested roughly \$25 billion, based on original cost, into the build-out of their fiber optic network and support facilities. Due to these past large capital outlays, approximately \$0.60 of every \$1.00 in new revenue goes directly into the Company's EBITDA going forward. We anticipate that the Company will continue to increase quarter to quarter top line revenues on a sequential basis by 1-2%. Based upon the company's 60% conversion rate of revenue to EBITDA, we forecast that the Company will be able to reduce their debt/EBITDA ratio from 7.5 to 5-6 over the next 12-24 months. Additional factors contributing to growth include:

- **Expanded Metropolitan Network** – There are over 100,000 buildings within 500 feet of Level 3's current network. The company plans to add new TAPs (transfer access points) continually in both the US and Europe enabling them to serve additional mid-market business. Level 3's recent deals to expand network infrastructure in Atlanta (Global Net Access) and Los Angeles (TSI) are evidence of this strategic effort in the US, while in Europe recent announcements of network additions in Zurich, Milan and Toulouse, France (covering France and Spain) point to potential growth in that market.
- **Colocation Services** – The growing demand for disaster recovery and cloud computing services represents an opportunity for Level 3 to grow their colocation services offered to enterprise businesses.
- **4G Rollouts** – Major growth of 4G cellular networks is expected in 2011 and 2012 as large carriers such as AT&T (NYSE/T/Not Rated) and Verizon (NYSE/VZ/Not Rated) expand their HSPA+ (Evolved High-Speed Packet Access) and LTE (Long-Term Evolution) offerings, respectively. This trend represents an opportunity for Level 3 to grow their wholesale segment, as much of the data backhaul from cellular towers is transmitted over fiber optic cabling.

The principal on approximately 40% of the company's \$6.6 billion in debt comes due in calendar year 2014. To date, the company has not had difficulties in issuing new debt and we anticipate a favorable interest rate environment for the foreseeable future.

We forecast that Level 3 will earn top line revenues of \$3.8 billion in 2011, up 4.1% from \$3.65 billion in 2010 with a loss per share of (\$0.31), as compared with (\$0.37) in 2010. Our forecasts also assume slightly improved gross margins for the year, at 60.4%, comparable to gross margins achieved for Q4/2010, as well as other overhead costs as a percentage of revenues declining slightly, from 37.6% in 2010 to 37.4% in 2011, due to economies of scale from higher volumes. Revenue growth for 2010 is expected to come from growth in Europe and Mid-market segments of the Core Network Services group.

For 2012, we are projecting that Level 3 will record \$4.0 billion in revenues, an increase of 5.3% year-over-year, with revenue growth once again coming from Europe and Mid-market accounts, with the added bonus of a possible rebound in sales to Large Enterprise and Federal accounts. We are also assuming that other operating metrics will improve slightly from 2011 to 2012, using gross margins of 60.5% and S, G & A costs of 36.3% as a percentage of revenues, with projected interest expenses also declining slightly as the Company continues to repay or restructure its long-term debt. All-in-all, we are estimating that Level 3's net loss per share will improve to (\$0.22) with increase EBITDA and cash flow as well.

Table 3 below shows revenues by type and annual growth rates for Level 3 for historical years 2008-2010 as well as projections for 2011E and 2012E:

Table 3. Projected Revenues by Type with Estimated Growth Rates (\$Millions)

| Division | 2008 | 2009 | 2010 | 2011E | 2012E |
|--------------------------|----------------|----------------|----------------|----------------|----------------|
| Core Network Services | \$3,136 | \$2,840 | \$2,827 | \$2,988 | \$3,200 |
| | | -10.42% | -0.46% | 5.70% | 7.10% |
| Wholesale Voice Services | \$724 | \$663 | \$650 | \$645 | \$640 |
| | | -8.43% | -1.96% | -0.77% | -0.78% |
| Other Communications | \$366 | \$192 | \$114 | \$110 | \$105 |
| | | -47.54% | -40.63% | -3.51% | -4.55% |
| Coal Mining | \$75 | \$67 | \$60 | \$57 | \$55 |
| | | -10.67% | -10.45% | -5.00% | -3.51% |
| Total | \$4,301 | \$3,762 | \$3,651 | \$3,800 | \$4,000 |
| | | -12.53% | -2.95% | 4.08% | 5.26% |

Management

James Crowe has served as Chief Executive Officer and Director since August 1997, after prior executive experience as CEO and President of MFS Communications from 1993 to 1997, and as Chairman of WorldCom (now Verizon, NYSE/VZ/Not Rated) in 1997. **Jeff Storey** has served as Chief Operating Officer and President since December 2008, after prior experience as President of Leucadia Telecommunications from 2005 until 2008, and President and CEO of WilTel Communications from 2002-2005. **Sunit Patel** has served as Chief Financial Officer since March 2003, after prior experience as CFO of Looking Glass Networks from 2000-2003, and as Treasurer of WorldCom from 1997-2000. **John Waters** has served as Chief Technology Officer since 2004, after prior experience as an executive at MCI Communications. Outside directors include **Walter Scott Jr.**, Chairman of the Board since 1979, a director at Berkshire Hathaway (NYSE/BRK/Not Rated), MidAmerican Energy, and Valmont Industries (NYSE/VMI/Not Rated); **Charles Miller**, current Executive Vice President of the Company and former President of Bellsouth International; **Douglas Bradbury**, former CFO of the company from 1997-2000; **Douglas Eby**, CEO of Realty Finance Corporation, a commercial real estate financing company; **Admiral James Ellis**, President and CEO of the Institute of Nuclear Power Operations; **Richard Jaros**, former President of the company from 1996-1997; **Robert Julian**, former CFO of the company from 1992-1995; **Michael Mahoney**, former President and CEO of Commonwealth Telephone Enterprises; **Rahul Merchant**, a partner at Exigen Capital; **Arun Netravali**, managing partner of OmniCapital Group; **John Reed**, former Chairman of HMG Properties; **Michael Yanney**, Chairman of the Burlington Capital Group; and **Dr. Albert Yates**, former President of Colorado State University.

Stock Valuation/Comparables

We have compiled a six-stock comparison group for Level 3 Communications, including two companies that primarily provide content delivery networks, Limelight Networks (Nasdaq/LLNW/Not Rated) and Akamai Technologies (Nasdaq/AKAM/Not Rated); two companies that provide enterprise network services, TW Telecom (Nasdaq/TWTC/Not Rated) and Abovenet (Nasdaq/ABVT/Not Rated); a single tier one internet provider, Global Crossing (Nasdaq/GLBC/Not Rated); and a single diversified communications company, Qwest (NYSE/Q/Not Rated). Table 4 below outlines price/revenues for 2011E and price/earnings where applicable for 2011E and 2012E for Level 3 Communications and six comparable networking companies.

Based on valuation metrics such as price/revenues and price/EBITDA for 2011 and 2012, Level 3 shares can be considered undervalued by as much as 200-300%, perhaps reflecting investors' concerns about long-term debt levels at the Company. However, to account for Level 3's debt position relative to its competitors we are factoring in a risk premium. Thus, we are recommending that investors purchase these shares with a 12-24 month price target of \$3.00, or 2X 2011 revenues of \$3.8 billion, adjusted for a risk premium.

Risk Factors

We believe an investment in Level 3 involves the following risks:

- **Lack of profitability** – Level 3 has yet to produce a profitable fiscal year and there are no guarantees that they will be able to do so in the future. The company has returned to quarter to quarter sequential revenue growth, but will need to continue to control costs going forward to achieve positive earnings per share.
- **Risk of default** – The Company is highly leveraged, with a high debt/EBITDA ratio relative to its peers and a low interest coverage ratio. Failure to roll over the large portion of long-term debt due in 2014 could result in the Company defaulting. However, to date the company has not had difficulties in issuing new debt and has proactively worked to refinance its debt with over \$800 million in new issuances in 2010 and over \$1 billion in new issuances thus far in 2011 at favorable interest rates.
- **Competitive Markets** – Level 3 faces significant competition as an Internet Provider from larger companies that include Verizon (NYSE/VZ/Not Rated), AT&T (NYSE/T/Not Rated), and Global Crossing (Nasdaq/GLBC/Not Rated). Highly competitive markets have greatly reduced the price of bandwidth since the late 1990's. The company also faces significant competition in the Content Delivery Network market primarily from Akamai Technologies (Nasdaq/AKAM/Not Rated) and Limelight Networks (Nasdaq/LLNW/Not Rated). However, Level 3 has an extensive network in place and considerable experience in serving customers in the communications market, and intends to use these resources to compete successfully in the future.

Table 4. IP Services/CDN Services Comparable Company Analysis

| Company | Symbol | Price | Shares | Market Cap | Calendar Year | | Revenues | Calendar Year | | Price/Revs | Earnings | EBITDA | Price | Notes |
|------------------------|--------|--------|--------|--------------|---------------|----------|---------------|---------------|----------|------------|----------|--------|--------|---|
| | | | (Mill) | (\$Millions) | EPS '11E | EPS '12E | 2011E(\$Mill) | P/E '11E | P/E '12E | 2011E | Growth | 2010A | EBITDA | |
| Limelight Networks | LLNW | \$6.13 | 112 | \$685 | (\$0.04) | \$0.05 | \$219 | N/A | 122.6 | 3.13 | N/A | \$436 | 1.6 | Content Delivery Network Services |
| Global Crossing | GLBC | 14.01 | 61 | \$850 | (2.31) | (1.21) | \$2,750 | N/A | N/A | 0.31 | N/A | 396 | 2.1 | Integrated Global IP Based Network |
| Abovenet | ABVT | 63.04 | 26 | \$1,626 | 2.67 | 2.96 | \$461 | 23.6 | 21.3 | 3.53 | 10.9% | 168 | 9.7 | High Bandwidth Connectivity to Corporations |
| Qwest | Q | 6.79 | 1,765 | \$11,986 | 0.42 | 0.42 | \$11,380 | 16.2 | 16.2 | 1.05 | 0.0% | 4,190 | 2.9 | Diversified Communications |
| Akamai Technologies | AKAM | 36.56 | 187 | \$6,842 | 1.60 | 1.84 | \$1,180 | 22.9 | 19.9 | 5.80 | 15.0% | 390 | 17.5 | Content Delivery Network Services |
| TW Telecom | TWTC | 18.62 | 151 | \$2,803 | 0.39 | 0.57 | \$1,350 | 47.7 | 32.7 | 2.08 | 46.2% | 436 | 6.4 | Managed Network Services |
| Average | | | | | | | | 27.59 | 42.52 | 2.65 | 18.0% | | 6.7 | |
| Level 3 Communications | LVL3 | \$1.34 | 1,669 | \$2,236 | (\$0.31) | (\$0.22) | \$3,800 | N/A | N/A | 0.59 | N/A | \$849 | 2.6 | Tier 1 Service Provider |

Source: DJSI Research; FactSet

Level 3 Communications, Inc.
Consolidated Statements of Operations
(In \$Millions)

| FYE December | 2007 | 2008 | 2009 | 1Q10 | 2Q10 | 3Q10 | 4Q10 | 2010 | 1Q11E | 2Q11E | 3Q11E | 4Q11E | 2011E | 2012E |
|---|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|
| | | | | Mar | June | Sept | Dec | | Mar | June | Sept | Dec | | |
| Revenues | \$4,269 | \$4,301 | \$3,762 | \$910 | \$908 | \$912 | \$921 | \$3,651 | \$933 | \$944 | \$955 | \$968 | \$3,800 | \$4,000 |
| Cost of revenues (excluding depreciation) | 1,833 | 1,809 | 1,565 | 383 | 374 | 368 | 365 | 1,490 | 370 | 374 | 378 | 382 | 1,504 | 1,580 |
| Gross Profit | 2,436 | 2,492 | 2,197 | 527 | 534 | 544 | 556 | 2,161 | 563 | 570 | 577 | 586 | 2,296 | 2,420 |
| Operating Expenses: | | | | | | | | | | | | | | |
| Selling, general & administrative expenses | 1,723 | 1,505 | 1,338 | 343 | 338 | 345 | 347 | 1,373 | 350 | 353 | 357 | 360 | 1,420 | 1,450 |
| Depreciation and amortization | 942 | 931 | 915 | 225 | 223 | 215 | 213 | 876 | 211 | 209 | 207 | 205 | 832 | 820 |
| Impairment charges & other one-time | 12 | 25 | 9 | 0 | 1 | 1 | 0 | 2 | 1 | 1 | 1 | 1 | 4 | 5 |
| Total operating expenses | 2,677 | 2,461 | 2,262 | 568 | 562 | 561 | 560 | 2,251 | 562 | 563 | 565 | 566 | 2,256 | 2,275 |
| Income (loss) from operations | (241) | 31 | (65) | (41) | (28) | (17) | (4) | (90) | 1 | 7 | 12 | 20 | 40 | 145 |
| Other Income | | | | | | | | | | | | | | |
| Interest income/(expense), net | (577) | (570) | (595) | (149) | (145) | (144) | (148) | (586) | (148) | (146) | (144) | (142) | (580) | (550) |
| Other expenses, including discontinued ops. | (318) | 227 | 43 | (47) | 4 | (1) | 7 | (37) | 5 | 5 | 5 | 5 | 20 | 0 |
| Income (loss) before tax | (1,136) | (312) | (617) | (237) | (169) | (162) | (145) | (713) | (142) | (134) | (127) | (117) | (520) | (405) |
| Provision for income taxes | (22) | 0 | 0 | 0 | 0 | 0 | (91) | (91) | 0 | 0 | 0 | 0 | 0 | (25) |
| Net income (loss) | (1,114) | (312) | (617) | (237) | (169) | (162) | (54) | (622) | (142) | (134) | (127) | (117) | (520) | (380) |
| Basic income per share | (\$0.73) | (\$0.20) | (\$0.38) | (\$0.14) | (\$0.10) | (\$0.10) | (\$0.03) | (\$0.37) | (\$0.08) | (\$0.08) | (\$0.08) | (\$0.07) | (\$0.31) | (\$0.22) |
| Diluted income per share | (\$0.73) | (\$0.20) | (\$0.38) | (\$0.14) | (\$0.10) | (\$0.10) | (\$0.03) | (\$0.37) | (\$0.08) | (\$0.08) | (\$0.08) | (\$0.07) | (\$0.31) | (\$0.22) |
| Basic shares outstanding | 1,518 | 1,565 | 1,633 | 1,647 | 1,660 | 1,664 | 1,669 | 1,660 | 1,675 | 1,680 | 1,685 | 1,690 | 1,683 | 1,700 |
| Diluted shares outstanding | 1,518 | 1,565 | 1,633 | 1,647 | 1,660 | 1,664 | 1,669 | 1,660 | 1,675 | 1,680 | 1,685 | 1,690 | 1,683 | 1,700 |
| Key ratios: | | | | | | | | | | | | | | |
| Revenue growth | | 0.7% | -12.5% | | | | | -3.0% | 2.5% | 4.0% | 4.7% | 5.1% | 4.1% | 5.3% |
| Gross margin | 57.1% | 57.9% | 58.4% | 57.9% | 58.8% | 59.6% | 60.4% | 59.2% | 60.3% | 60.4% | 60.4% | 60.5% | 60.4% | 60.5% |
| S, G&A/Revenues | 40.4% | 35.0% | 35.6% | 37.7% | 37.2% | 37.8% | 37.7% | 37.6% | 37.5% | 37.4% | 37.4% | 37.2% | 37.4% | 36.3% |
| Depreciation, amort, non-cash comp | \$942 | \$931 | \$915 | \$225 | \$223 | \$215 | \$213 | \$876 | \$211 | \$209 | \$207 | \$205 | \$832 | \$820 |
| Operating margin | -6% | 1% | -2% | -4.5% | -3.1% | -1.9% | -0.4% | -2.5% | 0.1% | 0.7% | 1.3% | 2.1% | 1.1% | 3.6% |
| Cash Flow/share | (\$0.11) | \$0.40 | \$0.18 | (\$0.01) | \$0.03 | \$0.03 | \$0.10 | \$0.15 | \$0.04 | \$0.04 | \$0.05 | \$0.05 | \$0.19 | \$0.26 |
| EBITDA/share | \$0.46 | \$0.61 | \$0.52 | \$0.08 | \$0.12 | \$0.12 | \$0.13 | \$0.45 | \$0.13 | \$0.13 | \$0.13 | \$0.14 | \$0.53 | \$0.57 |

Balance Sheets

| | (\$Mils) | |
|--------------------------------|----------|----------|
| Assets: | 12/31/09 | 12/31/10 |
| Cash and equivalents | \$839 | \$618 |
| Accounts receivable, net | 323 | 264 |
| Other | 97 | 90 |
| Total current | 1,259 | 972 |
| Property & equipment, net | 5,687 | 5,302 |
| Goodwill | 1,429 | 1,427 |
| Intangible assets, net & other | 687 | 654 |
| TOTAL ASSETS | \$9,062 | \$8,355 |
| Liabilities: | | |
| Accounts payable | \$364 | \$329 |
| Current debt | 705 | 180 |
| Accrued expenses | 191 | 230 |
| Deferred revenue, current | 162 | 151 |
| Other | 97 | 66 |
| Total current | 1,519 | 956 |
| Long-term debt | 5,755 | 6,268 |
| Deferred revenue, long-term | 740 | 736 |
| Other | 557 | 552 |
| Total liabilities | 8,571 | 8,512 |
| Stockholders' equity | 491 | (157) |
| TOTAL LIAB & EQ | \$9,062 | \$8,355 |

Quarterly Earnings Comparisons

| | Mar | June | Sept | Dec | Total |
|---------------------|--------|--------|--------|--------|----------|
| Revenues (in 000's) | | | | | |
| 2009 | | | | | 3,762 |
| 2010 | 910 | 908 | 912 | 921 | 3,651 |
| 2011E | 933 | 944 | 955 | 968 | 3,800 |
| Earnings per Share | | | | | |
| 2009 | | | | | (\$0.38) |
| 2010 | (0.14) | (0.10) | (0.10) | (0.03) | (0.37) |
| 2011E | (0.08) | (0.08) | (0.08) | (0.07) | (0.31) |

Operating Statistics

| | 2008 | 2009 | 2010 | 2011E | 2012E |
|--------------------------|---------|---------|---------|---------|---------|
| Sales by Type (\$000s) | | | | | |
| Core Network Services | \$3,136 | \$2,840 | \$2,827 | \$2,988 | \$3,200 |
| Wholesale Voice Services | 724 | 663 | 650 | 645 | 640 |
| Other Communications | 366 | 192 | 114 | 110 | 105 |
| Coal Mining | 75 | 67 | 60 | 57 | 55 |
| Total | \$4,301 | \$3,762 | \$3,651 | \$3,800 | \$4,000 |
| Sales by Region (\$000s) | | | | | |
| US | \$3,975 | \$3,436 | \$3,335 | 3,470 | 3,655 |
| EU | 326 | 326 | 316 | 330 | 345 |
| Total | \$4,301 | \$3,762 | \$3,651 | \$3,800 | \$4,000 |

Source: Dawson James Securities, Inc. estimates; Company documents

Important Disclosures:

Price Chart:



Price target and ratings changes over the past 3 years:

Initiated – March 22, 2011 – Price Target \$3.00

Analyst Certification: The analyst(s) whose name appears on this research report certifies that 1) all of the views expressed in this report accurately reflect his personal views about any and all of the subject securities or issuers discussed; and 2) no part of the research analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst in this research report; and 3) all Dawson James employees, including the analyst(s) responsible for preparing this research report, may be eligible to receive non-product or service specific monetary bonus compensation that is based upon various factors, including total revenues of Dawson James and its affiliates as well as a portion of the proceeds from a broad pool of investment vehicles consisting of components of the compensation generated by investment banking activities, including but not limited to shares of stock and/or warrants, which may or may not include the securities referenced in this report.

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Ratings definitions: **1) Buy:** the stock is expected to appreciate and produce a total return of at least 20% over the next 12-18 months; **2) Neutral:** the stock is fairly valued for the next 12-18 months; and **3) Sell:** the stock is expected to decline at least 20% over the next 12-18 months and should be sold.

| Ratings Distribution | Company Coverage | | Investment Banking | |
|----------------------|------------------|------------|--------------------|-------------|
| | # of Companies | % of Total | # of Companies | % of Totals |
| Buy | 20 | 80% | 7 | 35% |
| Neutral | 5 | 20% | 4 | 80% |
| Sell | 0 | 0% | 0 | 0% |
| Total | 25 | 100% | 11 | 44% |

Information about valuation methods and risks can be found in the “STOCK VALUATION” and “RISK FACTORS” sections of this report.

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