

**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended March 31, 2006

OR

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

Commission File No. 0-29092

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**54-1708481**  
(I.R.S. Employer  
Identification No.)

**7901 Jones Branch Drive, Suite 900,**  
**McLean, VA**  
(Address of principal executive offices)

**22102**  
(Zip Code)

**(703) 902-2800**

(Registrant's telephone number, including area code)

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

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

Class	Outstanding as of April 28, 2006
Common Stock \$0.01 par value	113,798,235

[Table of Contents](#)

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**  
**INDEX TO FORM 10-Q**

	<u>Page No.</u>
Part I.	FINANCIAL INFORMATION
Item 1.	FINANCIAL STATEMENTS (UNAUDITED)
	<a href="#">Consolidated Condensed Statements of Operations</a> 1
	<a href="#">Consolidated Condensed Balance Sheets</a> 2
	<a href="#">Consolidated Condensed Statements of Cash Flows</a> 3
	<a href="#">Consolidated Condensed Statements of Comprehensive Loss</a> 4
	<a href="#">Notes to Consolidated Condensed Financial Statements</a> 5
Item 2.	<a href="#">MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</a> 26
Item 3.	<a href="#">QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</a> 39
Item 4.	<a href="#">CONTROLS AND PROCEDURES</a> 41
Part II.	OTHER INFORMATION
Item 1.	<a href="#">LEGAL PROCEEDINGS</a> 42
Item 1A.	<a href="#">RISK FACTORS</a> 42
Item 2.	<a href="#">UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</a> 51
Item 3.	<a href="#">DEFAULTS UPON SENIOR SECURITIES</a> 51
Item 4.	<a href="#">SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS</a> 51
Item 5.	<a href="#">OTHER INFORMATION</a> 51
Item 6.	<a href="#">EXHIBITS</a> 51
	<a href="#">SIGNATURES</a> 52
	<a href="#">EXHIBIT INDEX</a> 53

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**  
**CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS**  
(in thousands, except per share amounts)  
(unaudited)

	Three Months Ended	
	March 31,	
	2006	2005
NET REVENUE	\$ 272,379	\$ 313,718
OPERATING EXPENSES		
Cost of revenue (exclusive of depreciation included below)	180,247	202,095
Selling, general and administrative	77,269	105,533
Depreciation and amortization	17,909	22,963
Loss on sale or disposal of assets	1,036	—
Total operating expenses	<u>276,461</u>	<u>330,591</u>
LOSS FROM OPERATIONS	(4,082)	(16,873)
INTEREST EXPENSE	(13,679)	(12,442)
ACCRETION ON DEBT DISCOUNT	(392)	—
CHANGE IN FAIR VALUE OF DERIVATIVES EMBEDDED WITHIN CONVERTIBLE DEBT	2,523	—
EQUITY INVESTMENT LOSS	—	(281)
GAIN ON EARLY EXTINGUISHMENT OF DEBT	2,613	—
INTEREST AND OTHER INCOME	568	576
FOREIGN CURRENCY TRANSACTION LOSS	(1,967)	(3,135)
LOSS BEFORE INCOME TAXES	(14,416)	(32,155)
INCOME TAX EXPENSE	(1,282)	(2,472)
NET LOSS	<u>\$ (15,698)</u>	<u>\$ (34,627)</u>
BASIC AND DILUTED LOSS PER COMMON SHARE	<u>\$ (0.15)</u>	<u>\$ (0.38)</u>
BASIC AND DILUTED WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	107,882	90,059

See notes to consolidated condensed financial statements.

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**  
**CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share amounts)  
(unaudited)

	March 31, 2006	December 31, 2005
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 58,711	\$ 42,999
Accounts receivable (net of allowance for doubtful accounts receivable of \$14,643 and \$16,788)	126,096	141,909
Prepaid expenses and other current assets	29,224	31,905
Total current assets	214,031	216,813
RESTRICTED CASH	9,103	10,619
PROPERTY AND EQUIPMENT—Net	275,899	285,881
GOODWILL	85,778	85,745
OTHER INTANGIBLE ASSETS—Net	9,624	11,392
OTHER ASSETS	29,899	30,639
<b>TOTAL ASSETS</b>	<b>\$ 624,334</b>	<b>\$ 641,089</b>
<b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 79,624	\$ 83,941
Accrued interconnection costs	57,436	64,333
Deferred revenue	28,234	30,037
Accrued expenses and other current liabilities	38,239	31,400
Accrued income taxes	17,416	16,339
Accrued interest	8,831	13,268
Derivatives embedded within convertible debt, at estimated fair value	13,140	—
Current portion of long-term obligations	15,281	16,092
Total current liabilities	258,201	255,410
LONG-TERM OBLIGATIONS (net of discount of \$16,985 and \$0)	609,776	619,120
OTHER LIABILITIES	2,861	2,893
Total liabilities	870,838	877,423
<b>COMMITMENTS AND CONTINGENCIES (See Note 6.)</b>		
<b>STOCKHOLDERS' DEFICIT:</b>		
Preferred stock: not designated, \$0.01 par value—1,410,050 shares authorized; none issued and outstanding; Series A and B, \$0.01 par value—485,000 shares authorized; none issued and outstanding; Series C, \$0.01 par value—559,950 shares authorized; none issued and outstanding	—	—
Common stock, \$0.01 par value—150,000,000 shares authorized; 113,787,301 and 105,254,552 shares issued and outstanding	1,138	1,053
Additional paid-in capital	692,544	686,196
Accumulated deficit	(865,736)	(850,038)
Accumulated other comprehensive loss	(74,450)	(73,545)
Total stockholders' deficit	(246,504)	(236,334)
<b>TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT</b>	<b>\$ 624,334</b>	<b>\$ 641,089</b>

See notes to consolidated condensed financial statements.

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**  
**CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS**  
(in thousands)  
(unaudited)

	Three Months Ended March 31,	
	2006	2005
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$(15,698)	\$(34,627)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Provision for doubtful accounts receivable	3,943	5,986
Stock compensation expense	113	—
Depreciation and amortization	17,909	22,963
Loss on sale or disposal of assets	1,036	—
Accretion of debt discount	392	—
Equity investment write-off and loss	—	281
Change in estimated fair value of embedded derivatives	(2,523)	—
Gain on early extinguishment of debt	(2,613)	—
Minority interest share of loss	(101)	(123)
Unrealized foreign currency transaction loss on intercompany and foreign debt	1,366	1,433
Changes in assets and liabilities, net of acquisitions:		
Decrease in accounts receivable	11,784	12,459
Decrease in prepaid expenses and other current assets	2,676	1,360
Decrease in other assets	190	617
Decrease in accounts payable	(4,434)	(11,949)
Decrease in accrued interconnection costs	(6,873)	(7,329)
Increase (decrease), net, in deferred revenue, accrued expenses, accrued income taxes, other current liabilities and other liabilities	6,207	(1,719)
Decrease in accrued interest	(4,348)	(3,281)
Net cash provided by (used in) operating activities	<u>9,026</u>	<u>(13,929)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of property and equipment	(9,388)	(14,234)
Cash used for business acquisitions, net of cash acquired	(62)	(165)
Decrease in restricted cash	1,349	3,640
Net cash used in investing activities	<u>(8,101)</u>	<u>(10,759)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from issuance of long-term obligations	14,790	97,000
Principal payments on capital leases, vendor financing and other long-term obligations	(4,591)	(5,310)
Proceeds from sale of common stock, net of issuance costs	4,970	122
Net cash provided by financing activities	<u>15,169</u>	<u>91,812</u>
EFFECTS OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	<u>(382)</u>	<u>(508)</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	15,712	66,616
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	42,999	49,668
CASH AND CASH EQUIVALENTS, END OF PERIOD	<u>\$ 58,711</u>	<u>\$116,284</u>
<b>SUPPLEMENTAL CASH FLOW INFORMATION</b>		
Cash paid for interest	\$ 17,365	\$ 15,083
Cash paid for taxes	\$ 653	\$ 1,153
Non-cash investing and financing activities:		
Capital lease additions	\$ 21	\$ 778
Business acquisition, financed by long-term obligations	\$ —	\$ 984
Settlement of outstanding debt with issuance of common stock	\$ 1,351	\$ —
Settlement of outstanding debt with issuance of new convertible debt	\$(27,417)	\$ —
Issuance of new convertible debt in exchange for convertible subordinated debentures	\$ 27,481	\$ —

See notes to consolidated condensed financial statements.

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**  
**CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE LOSS**  
(in thousands)  
(unaudited)

	Three Months Ended	
	March 31,	
	2006	2005
NET LOSS	\$(15,698)	\$(34,627)
OTHER COMPREHENSIVE LOSS, NET OF TAX—		
Foreign currency translation adjustment	(905)	(2,233)
COMPREHENSIVE LOSS	<u>\$ (16,603)</u>	<u>\$ (36,860)</u>

See notes to consolidated condensed financial statements.

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**  
**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**1. BASIS OF PRESENTATION**

The accompanying unaudited consolidated condensed financial statements of Primus Telecommunications Group, Incorporated and subsidiaries (“the Company” or “Primus”) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial reporting and Securities and Exchange Commission (“SEC”) regulations. Certain information and footnote disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such principles and regulations. In the opinion of management, the financial statements reflect all adjustments (all of which are of a normal and recurring nature), which are necessary to present fairly the financial position, results of operations, cash flows and comprehensive loss for the interim periods. The results for the three months ended March 31, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006.

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

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Principles of Consolidation*—The consolidated financial statements include the Company’s accounts, its wholly-owned subsidiaries and all other subsidiaries over which the Company exerts control. The Company owns 51% of the common stock of Matrix Internet, S.A. (“Matrix”), 51% of CS Communications Systems GmbH and CS Network GmbH (“Citrus”) and approximately 85% of Direct Internet Limited (“DIL”), in all of which the Company has a controlling interest. The Company has agreed to purchase an additional 39% of Matrix with the purchase price to be paid in the Company’s common stock and is awaiting certain conditions to be met before closing can be completed. All intercompany profits, transactions and balances have been eliminated in consolidation. The Company uses the equity method of accounting for its investment in Bekkoame Internet, Inc. (“Bekko”).

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

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

## [Table of Contents](#)

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

The Company recorded an incremental \$113 thousand of stock-based compensation expense during the three months ended March 31, 2006 as a result of the adoption of SFAS No. 123(R). The following table presents the impact of the adoption of SFAS No. 123(R) (in thousands) on selected statement of operations line items for the three months ended March 31, 2006:

	For the Three Months Ended March 31, 2006		
	As Reported Under SFAS No. 123(R)	As Previously Determined Under APB No. 25	Difference
Net loss	\$ (15,698)	\$ (15,585)	\$ (113)
Basic loss per share	\$ (0.15)	\$ (0.15)	\$ 0
Diluted loss per share	\$ (0.15)	\$ (0.15)	\$ 0

Prior to the adoption on January 31, 2006 of SFAS No. 123(R), the Company used the intrinsic value method to account for these plans under the recognition and measurement principles of APB Opinion No. 25 and related interpretations. The following table illustrates the effect on net loss and loss per share if the Company had applied the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," to stock-based employee compensation during 2005.

	For the Three Months Ended March 31, 2005		
	As Determined Under SFAS No. 123(R)	As Reported Under APB No. 25	Difference
Net loss	\$ (36,250)	\$ (34,627)	\$ (1,623)
Basic loss per share	\$ (0.40)	\$ (0.38)	\$ (0.02)
Diluted loss per share	\$ (0.40)	\$ (0.38)	\$ (0.02)

The weighted average fair value at date of grant for options granted during the three months ended March 31, 2006 and March 31, 2005 was \$0.60 and \$1.04 per option, respectively. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	For the Three Months Ended March 31, 2005	
	2006	2005
Expected dividend yield	0%	0%
Expected stock price volatility	98.4%	103.55%
Risk-free interest rate	4.5%	3.8%
Expected option term	4 years	4 years

Under SFAS No. 123(R), the Company is required to apply expense recognition provisions beginning January 1, 2006. As of March 31, 2006, we had 2.0 million unvested awards outstanding of which \$1.0 million of compensation expense will be recognized over the weighted average remaining vesting period of 2.7 years.

## [Table of Contents](#)

On December 21, 2005, the Company accelerated the vesting of certain unvested stock options previously awarded under the Company's Equity Incentive Plan and Director Plan. The Company took this action because the future costs to be recognized if this action were not taken were disproportionate to the employee retention value of the stock options. As a result of this action, stock options to purchase up to 1.5 million shares of common stock, which would otherwise have vested over the next three years, became exercisable effective December 21, 2005. These stock options have exercise prices ranging from \$1.61 to \$6.30 per share. Based upon the closing stock price for the Company's common stock of \$0.82 per share on December 21, 2005, all of these stock options were "under water" or "out-of-the-money." Of the stock options whose vesting was accelerated, 0.6 million stock options were held by executive officers and 30,000 stock options were held by non-employee directors. Outstanding unvested stock options to purchase 1.5 million shares of the Company's common stock, with per share exercise prices ranging from \$0.62 to \$0.92, were not accelerated.

*Derivative Instruments*—The Company does not hold or issue derivative instruments for trading purposes. The Company has entered into financing arrangements that contain embedded derivative features. The Company accounts for these arrangements in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", and Emerging Issues Task Force ("EITF") Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock", as well as related interpretations of these standards. The Company bifurcates embedded derivatives that are not clearly and closely related to the host contract and records them as a liability in its balance sheet at their estimated fair value. Changes in their estimated fair value are recognized in earnings during the period of change.

The Company, with the assistance of a third party, estimates the fair value of its embedded derivatives using available market information and appropriate valuation methodologies. These embedded derivatives derive their value primarily based on changes in the price and volatility of the Company's common stock. Due to the term of three and one-half years for the Step Up Convertible Subordinated Debentures and the historical volatility of the Company's common stock, changes in the estimated fair value of the embedded derivatives are expected to have a material effect on the Company's results of operations.

Considerable judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts, if any, that the Company may eventually pay to settle these embedded derivatives.

*Use of Estimates*—Accounting for derivatives is based upon valuations of derivative instruments determined using various valuation techniques including Black-Scholes and binomial pricing methodologies. The Company considered such valuations to be significant estimates.

### *New Accounting Pronouncements*

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140." SFAS No. 155 clarifies certain issues relating to embedded derivatives and beneficial interests in securitized financial assets. The provisions of SFAS No. 155 are effective for all financial instruments acquired or issued after fiscal years beginning after September 15, 2006. The Company is currently assessing the impact that the adoption of SFAS 155 will have on its results of operations and financial position.

[Table of Contents](#)

**3. GOODWILL AND OTHER INTANGIBLE ASSETS**

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

	March 31, 2006			December 31, 2005		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Customer lists	\$ 188,084	\$ (178,839)	\$ 9,245	\$ 190,370	\$ (179,863)	\$ 10,507
Brand name acquired	3,341	(3,341)	0	3,420	(3,148)	272
Other	2,261	(1,882)	379	2,400	(1,787)	613
Total	<u>\$ 193,686</u>	<u>\$ (184,062)</u>	<u>\$ 9,624</u>	<u>\$ 196,190</u>	<u>\$ (184,798)</u>	<u>\$ 11,392</u>

Amortization expense for customer lists, brand name and other intangible assets for the three months ended March 31, 2006 and 2005 was \$2.0 million and \$4.8 million, respectively. The Company expects amortization expense for customer lists, brand name and other intangible assets for the remainder of 2006 and the fiscal years ended December 31, 2007, 2008 and 2009 to be approximately \$3.2 million, \$3.3 million, \$2.5 million and \$0.6 million, respectively.

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

	March 31, 2005	December 31, 2005
Goodwill	\$85,778	\$ 85,745

The changes in the carrying amount of goodwill for the three months ended March 31, 2006 are as follows (in thousands):

	United States and Other	Canada	Europe	Asia-Pacific	Total
Balance as of January 1, 2006	\$ 36,771	\$31,427	\$1,822	\$15,725	\$85,745
Effect of change in foreign currency exchange rates	222	78	32	(299)	33
Balance as of March 31, 2005	<u>\$ 36,993</u>	<u>\$31,505</u>	<u>\$1,854</u>	<u>\$15,426</u>	<u>\$85,778</u>

**4. LONG-TERM OBLIGATIONS**

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

	March 31, 2006	December 31, 2005
Obligations under capital leases	\$ 6,635	\$ 7,612
Leased fiber capacity	16,278	19,717
Senior secured term loan facility	99,000	99,250
Financing facility and other	31,386	17,454
Senior notes	306,560	309,060
Convertible senior notes	127,893	132,000
Step up convertible subordinated debentures	14,603	—
Convertible subordinated debentures	22,702	50,119
Subtotal	625,057	635,212
Less: Current portion of long-term obligations	(15,281)	(16,092)
Total long-term obligations	<u>\$609,776</u>	<u>\$ 619,120</u>

## Table of Contents

Payments of principal and interest were due as follows:

Year Ending December 31,	Vendor Financing	Senior Secured Term Loan Facility (1)	Financing Facility and Other	Senior Notes	Convertible Senior Notes	Step Up Convertible Subordinated Debentures	Convertible Subordinated Debentures	Total
2006 (as of March 31, 2006)	\$ 12,060	\$ 9,349	\$ 2,374	\$ 18,524	\$ 2,475	\$ 764	\$ 653	\$ 46,199
2007	6,608	12,363	2,911	27,924	4,950	1,820	23,355	79,931
2008	3,220	12,247	30,656	27,924	4,950	2,095	—	81,092
2009	1,524	12,131	32	99,484	4,950	29,679	—	147,800
2010	2,110	12,015	32	18,800	136,950	—	—	169,907
Thereafter	—	94,250	135	300,800	—	—	—	395,185
Total Minimum Principal & Interest Payments	25,522	152,355	36,140	493,456	154,275	34,358	24,008	920,114
Less: Amount Representing Cash Interest	(2,609)	(53,355)	(4,754)	(186,896)	(22,275)	(6,877)	(1,306)	(278,072)
	22,913	99,000	31,386	306,560	132,000	27,481	22,702	642,042
Less: Amount Representing Discount	—	—	—	—	(4,107)	(12,878)	—	(16,985)
	<u>\$22,913</u>	<u>\$ 99,000</u>	<u>\$ 31,386</u>	<u>\$ 306,560</u>	<u>\$ 127,893</u>	<u>\$ 14,603</u>	<u>\$ 22,702</u>	<u>\$ 625,057</u>

(1) For the purpose of preparation of this table, we have assumed the interest rate of the \$100 million Senior Secured Term Loan Facility to be 11.6%, which is the interest rate at March 31, 2006.

The indentures governing the senior notes, senior secured term loan facility, convertible senior notes, step up convertible subordinated debentures and convertible subordinated debentures, as well as other credit arrangements, contain certain financial and other covenants which, among other things, will restrict the Company's ability to incur further indebtedness and make certain payments, including the payment of dividends and repurchase of subordinated debt held by the Company's subsidiaries. The Company was in compliance with the above covenants at March 31, 2006.

### Senior Secured Term Loan Facility

In February 2005, a direct wholly-owned subsidiary of the Company, Primus Telecommunications Holding, Inc. (PTHI), completed a six-year, \$100 million senior secured term loan facility (the "Facility"). Each borrowing made under the Facility may be, at the election of PTHI at the time of the borrowing, a London Inter-Bank Offered Rate (LIBOR) loan (which will bear interest at a rate equal to LIBOR + 6.50%), or a base rate loan (which will bear interest at a rate equal to the greater of the prime rate plus 5.50% or the federal funds effective rate plus 6.0%). The interest rate at March 31, 2006 was 11.6%. The Facility contains no financial maintenance covenants. The Company borrowed \$100 million under this facility in February 2005. The Facility will be repaid in 24 quarterly installments, which began on June 30, 2005, at a rate of one percent of the principal per year over the next five years and nine months, and the remaining balance repaid on the sixth anniversary date of the Facility, with early redemption at a premium to par at PTHI's option at any time after February 18, 2006. The Facility is guaranteed by the Company and certain of PTHI's subsidiaries and is secured by certain assets of PTHI and its guarantor subsidiaries.

### Senior Notes, Convertible Senior Notes, Step Up Convertible Subordinated Debentures and Convertible Subordinated Debentures

In the first quarter 2006, the Company completed the exchange of \$27.4 million principal amount of the Company's 5<sup>3</sup>/<sub>4</sub>% convertible subordinated debentures due 2007 ("2000 Convertible Subordinated Debentures") for \$27.5 million principal amount of the Company's step up convertible subordinated debentures due August 2009 ("Step Up Convertible Subordinated Debentures") through two transactions. The Company recognized a gain on early extinguishment of debt of \$1.5 million in connection with this exchange. The Step Up Convertible

## [Table of Contents](#)

Subordinated Debentures will mature on August 15, 2009. Interest will be payable from February 27, 2006 to December 31, 2006 at the rate of 6% per annum; from January 1, 2007 to December 31, 2007 at the rate of 7% per annum; and from January 1, 2008 to maturity at the rate of 8% per annum. Accrued interest will be paid each February 15 and August 15, beginning August 15, 2006, to holders of record on the preceding February 1 and August 1, respectively. The Step Up Convertible Subordinated Debentures are convertible into the Company's common stock at a conversion price of \$1.187 per share of common stock through August 15, 2009. The Step Up Convertible Subordinated Debentures are convertible in the aggregate into 23,151,643 shares of the Company's common stock. The Indenture permits the Company, at its sole option, to require conversion if the Company's stock trades at 150% of the conversion price for at least 20 days within a 30 day period. In the event of a change in control, as defined, the holders may put the instrument to the Company at which time the Company has the option to settle in cash or common stock at an adjusted conversion price. The Step Up Convertible Subordinated Debentures are subordinated to all indebtedness of the Company, except for other subordinated indebtedness.

At the time of issuance of the Step Up Convertible Subordinated Debentures, the Company did not have sufficient authorized and unissued shares of common stock to satisfy exercise and conversion of all of its convertible instruments. Accordingly, the Company determined that the Step Up Convertible Subordinated Debentures, the 5<sup>3/4</sup>% Convertible Subordinated Debentures due 2007 ("2000 Convertible Subordinated Debentures") and the 3<sup>3/4</sup>% Convertible Senior Notes due 2010 ("2003 Convertible Senior Notes") were hybrid instruments with characteristics of a debt host agreement and contained embedded derivative features that had characteristics and risks that were not clearly and closely associated with the debt host. The conversion options were determined to be derivative instruments to be bifurcated and recorded as a current liability at fair value.

The Company recorded a corresponding debt discount to the Step Up Convertible Subordinated Debentures and the 2003 Convertible Senior Notes in the amount of the fair value of the embedded derivative at the issue date. An additional debt discount of \$1.7 million was recorded for the Step Up Convertible Subordinated Debentures to bring the carrying value to fair value. The carrying value of the Step Up Convertible Subordinated Debentures at issuance was approximately \$14.3 million, and the carrying value of the 2003 Convertible Senior Notes at issuance of the Step Up Convertible Subordinated Debentures was approximately \$127.8 million. The Company is accreting the difference between the face values of the Step Up Convertible Subordinated Debentures (\$27.5 million) and the 2003 Convertible Senior Notes (\$132 million) and the corresponding carrying values to interest expense under the effective interest method on a monthly basis over the lives of the Step Up Convertible Subordinated Debentures and the 2003 Convertible Senior Notes. The effective interest rate of the Step Up Convertible Subordinated Debentures and the 2003 Convertible Senior Notes at March 31, 2006 was 29.2% and 5.2%, respectively.

In January 2004, PTHI, a direct, wholly-owned subsidiary of the Company, completed the sale of \$240 million in aggregate principal amount of 8% senior notes due 2014 ("2004 Senior Notes") with semi-annual interest payments due on January 15<sup>th</sup> and July 15<sup>th</sup>, with early redemption at a premium to par at PTHI's option at any time after January 15, 2009. The Company recorded \$6.7 million in costs associated with the issuance of the 2004 Senior Notes, which have been recorded as deferred financing costs in other assets. The effective interest rate at March 31, 2006 was 8.4%. During specified periods, PTHI may redeem up to 35% of the original aggregate principal amount with the net cash proceeds of certain equity offerings of the Company. During the year ended December 31, 2004, the Company reduced the principal balance of the senior note through \$5.0 million of open market purchases.

In September 2003, the Company completed the sale of \$132 million in aggregate principal amount of 3<sup>3/4</sup>% convertible senior notes due 2010 ("2003 Convertible Senior Notes") with semi-annual interest payments due on March 15<sup>th</sup> and September 15<sup>th</sup>. The Company recorded \$5.2 million in costs associated with the issuance of the 2003 Convertible Senior Notes, which have been recorded as deferred financing costs in other assets. The effective interest rate at March 31, 2006 was 5.2%. Holders of these notes may convert their notes into the Company's common stock at any time prior to maturity at an initial conversion price of \$9.3234 per share, which

## [Table of Contents](#)

is equivalent to an initial conversion rate of 107.257 shares per \$1,000 principal amount of the notes, subject to adjustment in certain circumstances. The notes are convertible in the aggregate into 14,157,925 shares of the Company's common stock. In the event of a change in control, as defined, the holders may put the instrument to the Company at which time the Company has the option to settle in cash or common stock at an adjusted conversion price.

In February 2000, the Company completed the sale of \$250 million in aggregate principal amount of 2000 Convertible Subordinated Debentures with semi-annual interest payments due on February 15th and August 15th. On March 13, 2000, the Company announced that the initial purchasers of the 2000 Convertible Subordinated Debentures had exercised their \$50 million over-allotment option granted pursuant to a purchase agreement dated February 17, 2000. During the years ended December 31, 2001 and 2000, the Company reduced \$36.4 million principal balance of the debentures through open market purchases and \$192.5 million principal balance through exchanges for its common stock. The principal that was exchanged for common stock was retired upon conversion and in February 2002, the Company retired all of the 2000 Convertible Subordinated Debentures that it had previously purchased in December 2000 and January 2001. The retired principal had been held by the Company as treasury bonds and had been recorded as a reduction of long-term obligations. During the year ended December 31, 2004, the Company retired \$4.0 million principal amount of the 2000 Convertible Subordinated Debentures through open market purchases. During the year ended December 31, 2005, the Company exchanged 9,820,000 shares of the Company's common stock for the extinguishment of \$17.0 million in principal amount of these debentures. In accordance with SFAS No. 84, "Induced Conversion of Convertible Debt," the Company recognized an induced conversion expense of \$6.1 million in connection with this conversion. During the quarter ended March 31, 2006, the Company exchanged \$27.4 million of the 2000 Convertible Subordinated Debentures for \$27.5 million principal amount of the Company's 2006 Step Up Convertible Subordinated Debentures. The remaining debentures are convertible at a conversion price of \$49.7913 per share in the aggregate into 455,943 shares of the Company's common stock. In the event of a change in control, as defined, the holders may put the instrument to the Company at which time the Company has the option to settle in cash or common stock at an adjusted conversion price.

In October 1999, the Company completed the sale of \$250 million in aggregate principal amount of 12.75% senior notes due 2009 (the "October 1999 Senior Notes"). The October 1999 Senior Notes are due October 15, 2009, with semi-annual interest payments due on October 15th and April 15<sup>th</sup> with early redemption at a premium to par at the Company's option at any time after October 15, 2004. During the years ended December 31, 2002, 2001 and 2000, the Company reduced the principal balance of these senior notes through open market purchases. In June and September 2002, the Company retired all of the October 1999 Senior Notes that it had previously purchased in the principal amount of \$134.3 million in aggregate. The retired principal had been held by the Company as treasury bonds and had been recorded as a reduction of long-term obligations. During the year ended December 31, 2004, the Company retired \$33.0 million principal amount of the October 1999 Senior Notes through open market purchases. During the year ended December 31, 2005, the Company exchanged 5,165,175 shares of the Company's common stock for the extinguishment of \$8.6 million in principal amount of these senior notes. During the quarter ended March 31, 2006, the Company exchanged 1,825,000 shares of the Company's common stock for the extinguishment of \$2.5 million in principal amount of these senior notes.

### *Leased Fiber Capacity*

Beginning September 30, 2001, the Company accepted delivery of fiber optic capacity on an IRU basis from Southern Cross Cables Limited ("SCCL"). The Company and SCCL entered into an arrangement financing the capacity purchase. During the three months ended December 31, 2001, the Company renegotiated the payment terms with SCCL. Under the new terms, the payments for each capacity segment will be made over a five-year term ending in April 2008, which added two years to the original three-year term. The effective interest rate on current borrowings is 7.4%. The Company further agreed to purchase \$12.2 million of additional fiber optic capacity from SCCL under the IRU agreement. The Company has fulfilled the total purchase obligation and

## [Table of Contents](#)

made additional purchases of \$3.8 million in 2004. At March 31, 2006 and December 31, 2005, the Company had a liability recorded under this agreement in the amount of \$9.1 million and \$10.7 million, respectively.

In December 2000, the Company entered into a financing arrangement to purchase fiber optic capacity in Australia for 51.1 million AUD (\$28.5 million at December 31, 2000) from Optus Networks Pty. Limited. As of December 31, 2001, the Company had fulfilled the total purchase obligation. The Company signed a promissory note payable over a four-year term ending in April 2005 bearing interest at a rate of 14.31%. During the three months ended June 30, 2003, the Company renegotiated the payment terms extending the payment schedule through March 2007, and lowering the interest rate to 10.2%. At March 31, 2006 and December 31, 2005, the Company had a liability recorded in the amount of \$7.1 million (10.1 million AUD) and \$9.0 million (12.4 million AUD), respectively.

### *Equipment Financing and Other Long-Term Obligations*

In November 2005, Primus Australia entered into a financing arrangement with Alleasing Finance Australia United for network equipment. Payments will be made over a five-year term ending October 2010. The effective interest rate on the current borrowing is 9.3%. At March 31, 2006 and December 31, 2005, the Company had a liability recorded under this agreement in the amount \$5.2 million (7.3 million AUD) and \$6.1 million (8.4 million AUD), respectively.

In April 2004, Primus Canada entered into a loan agreement with a Canadian financial institution. The agreement provided for a \$34.6 million (42 million CAD) two-year non-revolving term loan credit facility, bearing an interest rate of 7.75%. The agreement allows the proceeds to be used for general corporate purposes of the Company and is secured by the assets of Primus Canada's operations. In October 2004, Primus Canada signed an amendment to the April 2004 loan agreement that extended the maturity date one year to April 2007. In January 2006, Primus Canada entered into an Amended and Restated Loan Agreement that extended the maturity date one year to April 2008. The agreement is now a four-year non-revolving term loan credit facility bearing an interest rate of 7.75%. The new agreement reduced the maximum loan balance from \$36.6 million (42 million CAD) to \$27.9 million (32 million CAD) and established quarterly principal payments of \$0.9 million (1 million CAD) commencing in April 2007. In February 2006, the Company drew the remaining \$14.8 million (17 million CAD) available under the amended loan facility. At March 31, 2006 and December 31, 2005, the Company had an outstanding liability of \$27.4 million (32 million CAD) and \$12.8 million (15.0 million CAD), respectively. An affiliate of Primus Canada has an additional loan facility agreement with the Canadian financial institution and had a liability under this facility of \$2.6 million (3.0 million CAD) and \$2.6 million (3.0 million CAD) at March 31, 2006 and December 31, 2005, respectively.

## **5. DERIVATIVES**

The Step Up Convertible Subordinated Debentures, 2000 Convertible Subordinated Debentures and the 2003 Convertible Senior Notes each contain an embedded derivative that requires separate valuation. The Company determined the fair value of the embedded conversion features within the Step Up Convertible Subordinated Debentures and the 2003 Convertible Senior Notes at the time of issuance to be \$11.5 million and \$4.2 million, respectively. The Company determined that the embedded conversion feature within the 2000 Convertible Subordinated Debentures had no value. At March 31, 2006, the Company determined the fair value of the embedded conversion features within the Step Up Convertible Subordinated Debentures and the 2003 Convertible Senior Notes to be \$9.7 million and \$3.4 million, respectively. The Company determined that the embedded conversion feature within the 2000 Convertible Subordinated Debentures still had no value. The change in fair value of \$2.5 million was recorded as other income for the three months ended March 31, 2006.

## [Table of Contents](#)

### 6. COMMITMENTS AND CONTINGENCIES

Future minimum lease payments under capital leases and leased fiber capacity financing (“Vendor Financing”), purchase obligations and non-cancelable operating leases as of March 31, 2006 are as follows (in thousands):

<u>Year Ending December 31,</u>	<u>Vendor Financing</u>	<u>Purchase Obligations</u>	<u>Operating Leases</u>
2006 (as of March 31, 2006)	\$12,060	\$ 4,900	\$ 11,190
2007	6,608	300	12,212
2008	3,220	—	8,644
2009	1,524	—	6,274
2010	2,110	—	4,176
Thereafter	—	—	4,502
Total minimum lease payments	25,522	5,200	46,998
Less: Amount representing interest	(2,609)	—	—
	<u>\$22,913</u>	<u>\$ 5,200</u>	<u>\$46,998</u>

The Company has contractual obligations to utilize an external vendor for certain back-office support functions and to utilize network facilities from certain carriers with terms greater than one year. The Company does not purchase or commit to purchase quantities in excess of normal usage or amounts that cannot be used within the contract term or at rates below or above market value. The Company made purchases under purchase commitments of \$3.7 million and \$7.9 million for the three months ended March 31, 2006 and 2005, respectively.

Rent expense under operating leases was \$4.4 million and \$5.0 million for the three months ended March 31, 2006 and 2005, respectively.

#### *Litigation*

The Company is subject to claims and legal proceedings that arise in the ordinary course of its business. Each of these matters is subject to various uncertainties, and it is possible that some of these matters may be decided unfavorably to the Company. The Company believes that any aggregate liability that may result from the resolution of these matters will not have a material adverse effect on the Company’s consolidated financial position, results of operations or cash flows.

### 7. STOCK-BASED COMPENSATION

In December 1998, the Company established the 1998 Restricted Stock Plan (the “Restricted Plan”) to facilitate the grant of restricted stock to selected individuals (excluding executive officers and directors of the Company) who contribute to the development and success of the Company. The total number of shares of common stock that may be granted under the Restricted Plan is 750,000. The Company did not issue any restricted stock under the Restricted Plan for the three months ended March 31, 2006 and 2005. During the year ended December 31, 2004, the Company cancelled 494 shares of restricted stock (which were issued prior to 2001) due to the termination of certain employees and agents, respectively. As of March 31, 2006, of the remaining issued shares, none are considered restricted.

The Company sponsors an employee stock option plan (the “Equity Incentive Plan”). The total number of shares of common stock authorized for issuance under the Equity Incentive Plan is 13,000,000. Under the Equity Incentive Plan, awards may be granted to key employees of the Company and its subsidiaries in the form of Incentive Stock Options or Nonqualified Stock Options. The Equity Incentive Plan allows the granting of options at an exercise price of not less than 100% of the stock’s fair value at the date of grant. The options vest over a period of up to three years, and no option will be exercisable more than ten years from the date it is granted. On

## [Table of Contents](#)

June 16, 2004, the stockholders of the Company approved amendments to the Equity Incentive Plan, including (i) renaming the employee stock option plan the “Equity Incentive Plan”; (ii) expanding the forms of awards permitted to be granted, including stock appreciation rights, restricted stock awards, stock units and other equity securities, and authorizing a tax deferral feature for executive officers; (iii) prohibiting the repricing of stock options in the future without stockholder approval; and (iv) requiring three-year vesting of restricted stock and stock unit awards, unless accelerated following the first anniversary of the award due to the satisfaction of predetermined performance conditions.

The Company sponsors a Director Stock Option Plan (the “Director Plan”) for non-employee directors. Under the Director Plan, an option is granted to each qualifying non-employee director to purchase 45,000 shares of common stock, which vests in one-third increments as of the grant date and the first and second anniversaries of the grant date, over a two-year period. The option price per share is the fair market value of a share of common stock on the date the option is granted. No option will be exercisable more than five years from the date of grant. On June 16, 2004, the stockholders of the Company approved amendments to the Director Plan to (i) increase the number of shares of common stock issuable pursuant to awards under the Director Plan by 300,000 to a total of 900,000; and (ii) authorize the issuance of restricted stock (in lieu of cash compensation at the discretion of individual Directors).

On December 21, 2005, the Company accelerated the vesting of certain unvested stock options previously awarded under the Company’s Equity Incentive Plan and Director Plan. The Company took this action because the future costs to be recognized if this action were not taken were disproportionate to the employee retention value of the stock options. As a result of this action, stock options to purchase up to 1.5 million shares of common stock, which would otherwise have vested over the next three years, became exercisable effective December 21, 2005. These stock options have exercise prices ranging from \$1.61 to \$6.30 per share. Based upon the closing stock price for the Company’s common stock of \$0.82 per share on December 21, 2005, all of these stock options were “under water” or “out-of-the-money.” Of the stock options whose vesting was accelerated, 0.6 million stock options were held by executive officers and 30,000 stock options were held by non-employee directors. Outstanding unvested stock options to purchase 1.5 million shares of the Company’s common stock, with per share exercise prices ranging from \$0.62 to \$0.92, were not accelerated.

A summary of stock option activity during the three months ended March 31 is as follows:

	2006		2005	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Options outstanding—Beginning of quarter	9,316,005	\$ 2.36	8,606,888	\$ 2.92
Granted	627,500	\$ 0.79	10,000	\$ 1.80
Exercised	—	\$ —	(34,250)	\$ 1.57
Forfeitures	(1,193,831)	\$ 2.23	(113,502)	\$ 8.62
Outstanding—end of quarter	<u>8,749,674</u>	\$ 2.26	<u>8,469,136</u>	\$ 2.85
Eligible for exercise—end of quarter	6,764,674		5,887,766	

## [Table of Contents](#)

The following table summarizes information about stock options outstanding at March 31, 2006:

Range of Option Prices	Options Outstanding			Intrinsic Value	Options Exercisable		
	Total Outstanding	Weighted Average Remaining Life in Years	Weighted Average Outstanding Price		Total Exercisable	Weighted Average Exercise Price	Intrinsic Value
\$0.54 to \$0.76	130,001	4.92	\$ 0.64	\$ 16,900	128,001	\$ 0.64	\$ 16,640
\$0.77	500,000	9.84	\$ 0.77	—	—	\$ —	—
\$0.79 to \$0.88	192,500	8.48	\$ 0.86	—	15,000	\$ 0.79	—
\$0.90	896,139	5.02	\$ 0.90	—	896,139	\$ 0.90	—
\$0.92	1,305,500	9.61	\$ 0.92	—	—	\$ —	—
\$0.93 to \$1.61	54,500	8.38	\$ 1.27	—	54,500	\$ 1.27	—
\$1.65	1,828,735	6.72	\$ 1.65	—	1,828,735	\$ 1.65	—
\$1.80 to \$2.38	2,057,400	6.59	\$ 1.97	—	2,057,400	\$ 1.97	—
\$3.03 to \$6.30	1,736,499	8.17	\$ 5.12	—	1,736,499	\$ 5.12	—
\$12.31 to \$17.44	24,850	3.42	\$ 14.39	—	24,850	\$ 14.39	—
\$31.94 to \$33.38	23,550	4.09	\$ 33.38	—	23,550	\$ 33.38	—
	<u>8,749,674</u>			<u>\$ 16,900</u>	<u>6,764,674</u>		<u>\$ 16,640</u>

### 8. GAIN OR LOSS ON EARLY EXTINGUISHMENT OF DEBT

In March 2006, the Company exchanged \$27.4 million principal amount of the Company's 2000 Convertible Subordinated Debentures for \$27.5 million principal amount of the Company's 2006 Step Up Convertible Subordinated Debentures resulting in a gain on early extinguishment of debt of \$1.5 million including the write-off of related deferred financing costs. In January 2006, the Company exchanged 1,825,000 shares of the Company's common stock for the extinguishment of \$2.5 million in principal amount of the October 1999 Senior Notes resulting in a \$1.2 million gain on early extinguishment of debt including the write-off of related deferred financing costs.

### 9. OPERATING SEGMENT AND RELATED INFORMATION

The Company has four reportable operating segments based on management's organization of the enterprise into geographic areas—United States and Other, Canada, Europe and Asia-Pacific. The Company evaluates the performance of its segments and allocates resources to them based upon net revenue and income (loss) from operations. The accounting policies of the segments are the same as those described in the summary of significant accounting policies. Net revenue by reportable segment is reported on the basis of where services are provided. The Company has no single customer representing greater than 10% of its revenues. Operations and assets of the United States and Other segment include shared corporate functions and assets, which the Company does not allocate to its other geographic segments for management reporting purposes.

[Table of Contents](#)

Summary information with respect to the Company's segments is as follows (in thousands):

	Three months ended	
	March 31,	
	2006	2005
<b>Net Revenue</b>		
United States and Other		
<i>United States</i>	\$ 47,629	\$ 54,910
<i>Other</i>	987	740
Total United States and Other	<u>48,616</u>	<u>55,650</u>
Canada		
<i>Canada</i>	70,546	62,996
Total Canada	<u>70,546</u>	<u>62,996</u>
Europe		
<i>United Kingdom</i>	22,720	45,328
<i>Germany</i>	11,511	12,418
<i>Netherlands</i>	19,270	16,355
<i>Other</i>	16,513	22,664
Total Europe	<u>70,014</u>	<u>96,765</u>
Asia-Pacific		
<i>Australia</i>	78,209	92,522
<i>Other</i>	4,994	5,785
Total Asia-Pacific	<u>83,203</u>	<u>98,307</u>
Total	<u>\$272,379</u>	<u>\$313,718</u>
<b>Income (Loss) from Operations</b>		
United States and Other	\$ (8,123)	\$ (18,085)
Canada	8,539	6,523
Europe	(5,534)	(6,652)
Asia-Pacific	1,036	1,341
Total	<u>\$ (4,082)</u>	<u>\$ (16,873)</u>
<b>Capital Expenditures</b>		
United States and Other	\$ 875	\$ 3,609
Canada	4,683	2,505
Europe	464	1,491
Asia-Pacific	3,366	6,629
Total	<u>\$ 9,388</u>	<u>\$ 14,234</u>

## [Table of Contents](#)

The above capital expenditures exclude assets acquired in business combinations and under terms of capital lease and vendor financing obligations.

	<u>March 31,</u> <u>2006</u>	<u>December 31,</u> <u>2005</u>
<b>Assets</b>		
United States and Other		
<i>United States</i>	\$ 131,400	\$ 134,360
<i>Other</i>	7,663	7,226
Total United States and Other	<u>139,063</u>	<u>141,586</u>
Canada		
<i>Canada</i>	159,861	157,155
Total Canada	<u>159,861</u>	<u>157,155</u>
Europe		
<i>United Kingdom</i>	33,718	35,685
<i>Germany</i>	13,930	13,374
<i>Netherlands</i>	10,178	13,379
<i>Other</i>	53,279	57,019
Total Europe	<u>111,105</u>	<u>119,457</u>
Asia-Pacific		
<i>Australia</i>	191,443	200,148
<i>Other</i>	22,862	22,743
Total Asia-Pacific	<u>214,305</u>	<u>222,891</u>
Total	<u>\$ 624,334</u>	<u>\$ 641,089</u>

The Company offers three main products—voice, data/Internet and VOIP in all of our segments. Summary net revenue information with respect to the Company's products is as follows (in thousands):

	<u>Three months ended</u> <u>March 31,</u>	
	<u>2006</u>	<u>2005</u>
Voice	\$ 197,620	\$ 244,192
Data/Internet	45,329	47,041
VOIP	29,430	22,485
Total	<u>\$ 272,379</u>	<u>\$ 313,718</u>

## **10. BASIC AND DILUTED INCOME (LOSS) PER COMMON SHARE**

Basic income (loss) per common share is calculated by dividing income (loss) attributable to common stockholders by the weighted average common shares outstanding during the period.

Diluted income per common share adjusts basic income per common share for the effects of potentially dilutive common share equivalents. Potentially dilutive common shares primarily include the dilutive effects of common shares issuable under the Company's stock option compensation plans computed using the treasury stock method and the dilutive effects of shares issuable upon conversion of its 2003 Convertible Senior Notes, 2000 Convertible Subordinated Debentures and the Step Up Convertible Subordinated Debentures.

## [Table of Contents](#)

The Company had no dilutive common share equivalents during the three months ended March 31, 2006 and the three months ended March 31, 2005. For the three months ended March 31, 2006, the following could potentially dilute income per common share in the future but were excluded from the calculation of diluted loss per common share due to their antidilutive effects:

- 8.7 million shares issuable under the Company's stock option compensation plans,
- 14.2 million shares issuable upon conversion of the 2003 Convertible Senior Notes,
- 0.5 million shares issuable upon the conversion of the 2000 Convertible Subordinated Debentures, and
- 23.2 million shares issuable upon the conversion of the Step Up Convertible Subordinated Debentures.

For the three months ended March 31, 2005, the following could potentially dilute income per common share in the future but were excluded from the calculation of diluted loss per common share due to their antidilutive effects:

- 8.5 million shares issuable under the Company's stock option compensation plans,
- 14.2 million shares issuable upon conversion of the 2003 Convertible Senior Notes, and
- 1.3 million shares issuable upon the conversion of the 2000 Convertible Subordinated Debentures.

### **11. GUARANTOR/NON-GUARANTOR CONDENSED CONSOLIDATED FINANCIAL INFORMATION**

PTHI's 2004 Senior Notes are fully and unconditionally guaranteed by Primus Telecommunications Group, Incorporated ("PTGI"). Accordingly, the following consolidating condensed financial information as of March 31, 2006 and December 31, 2005, and for the three-month periods ended March 31, 2006 and March 31, 2005 are included for (a) PTGI on a stand-alone basis; (b) PTHI and its subsidiaries; and (c) PTGI on a consolidated basis.

Investments in subsidiaries are accounted for using the equity method for purposes of the consolidating presentation. The principal elimination entries eliminate investments in subsidiaries, intercompany balances and intercompany transactions.

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**  
**CONSOLIDATING CONDENSED STATEMENT OF OPERATIONS**  
(in thousands)

	For the Three Months Ended March 31, 2006			
	<u>PTGI</u>	<u>PTHI</u>	<u>Eliminations</u>	<u>Consolidated</u>
NET REVENUE	\$ —	\$ 272,379	\$ —	\$ 272,379
OPERATING EXPENSES				
Cost of revenue (exclusive of depreciation included below)	—	180,247	—	180,247
Selling, general and administrative	2,139	75,130	—	77,269
Depreciation and amortization	—	17,909	—	17,909
Loss on sale or disposal of assets		1,036	—	1,036
Total operating expenses	<u>2,139</u>	<u>274,322</u>	<u>—</u>	<u>276,461</u>
LOSS FROM OPERATIONS	(2,139)	(1,943)	—	(4,082)
INTEREST EXPENSE	(4,585)	(9,094)	—	(13,679)
ACCRETION ON DEBT DISCOUNT	(392)	—	—	(392)
CHANGE IN FAIR VALUE OF DERIVATIVES EMBEDDED WITHIN CONVERTIBLE DEBT	2,523	—	—	2,523
GAIN (LOSS) ON EARLY EXTINGUISHMENT OF DEBT	2,728	(115)	—	2,613
INTEREST AND OTHER INCOME	30	538	—	568
FOREIGN CURRENCY TRANSACTION GAIN (LOSS)	3,010	(4,977)	—	(1,967)
INTERCOMPANY INTEREST	1,058	(1,058)	—	—
EQUITY IN NET LOSS OF SUBSIDIARIES	(17,825)	—	17,825	—
LOSS BEFORE INCOME TAXES	<u>(15,592)</u>	<u>(16,649)</u>	<u>17,825</u>	<u>(14,416)</u>
INCOME TAX EXPENSE	(106)	(1,176)	—	(1,282)
NET LOSS	<u>\$ (15,698)</u>	<u>\$ (17,825)</u>	<u>\$ 17,825</u>	<u>\$ (15,698)</u>

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**  
**CONSOLIDATING CONDENSED STATEMENT OF OPERATIONS**  
(in thousands)

	For the Three Months Ended March 31, 2005			
	<u>PTGI</u>	<u>PTHI</u>	<u>Eliminations</u>	<u>Consolidated</u>
NET REVENUE	\$ —	\$313,718	\$ —	\$ 313,718
OPERATING EXPENSES				
Cost of revenue (exclusive of depreciation included below)	—	202,095	—	202,095
Selling, general and administrative	2,020	103,513	—	105,533
Depreciation and amortization	—	22,963	—	22,963
Total operating expenses	<u>2,020</u>	<u>328,571</u>	<u>—</u>	<u>330,591</u>
LOSS FROM OPERATIONS	(2,020)	(14,853)	—	(16,873)
INTEREST EXPENSE	(5,146)	(7,296)	—	(12,442)
EQUITY INVESTMENT LOSS	—	(281)	—	(281)
INTEREST AND OTHER INCOME	31	545	—	576
FOREIGN CURRENCY TRANSACTION LOSS	(137)	(2,998)	—	(3,135)
INTERCOMPANY INTEREST INCOME (EXPENSE)	10,652	(10,652)	—	—
EQUITY IN NET LOSS OF SUBSIDIARIES	<u>(36,942)</u>	<u>—</u>	<u>36,942</u>	<u>—</u>
LOSS BEFORE INCOME TAXES	(33,562)	(35,535)	36,942	(32,155)
INCOME TAX EXPENSE	<u>(1,065)</u>	<u>(1,407)</u>	<u>—</u>	<u>(2,472)</u>
NET LOSS	<u>\$ (34,627)</u>	<u>\$ (36,942)</u>	<u>\$ 36,942</u>	<u>\$ (34,627)</u>

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**  
**CONSOLIDATING CONDENSED BALANCE SHEET**  
(in thousands)

	March 31, 2006			Consolidated
	PTGI	PTHI	Eliminations	
<b>ASSETS</b>				
<b>CURRENT ASSETS:</b>				
Cash and cash equivalents	\$ 2,550	\$ 56,161	\$ —	\$ 58,711
Accounts receivable	—	126,096	—	126,096
Prepaid expenses and other current assets	1,136	28,088	—	29,224
Total current assets	<u>3,686</u>	<u>210,345</u>	<u>—</u>	<u>214,031</u>
INTERCOMPANY RECEIVABLES	—	186,377	(186,377)	—
INVESTMENTS IN SUBSIDIARIES	264,622	—	(264,622)	—
RESTRICTED CASH	—	9,103	—	9,103
PROPERTY AND EQUIPMENT—Net	—	275,899	—	275,899
GOODWILL	—	85,778	—	85,778
OTHER INTANGIBLE ASSETS—Net	—	9,624	—	9,624
OTHER ASSETS	4,289	25,610	—	29,899
TOTAL ASSETS	<u>\$ 272,597</u>	<u>\$ 802,736</u>	<u>\$ (450,999)</u>	<u>\$ 624,334</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>				
<b>CURRENT LIABILITIES:</b>				
Accounts payable	\$ 1,208	\$ 78,416	\$ —	\$ 79,624
Accrued interconnection costs	—	57,436	—	57,436
Deferred revenue	—	28,234	—	28,234
Accrued expenses and other current liabilities	482	37,757	—	38,239
Accrued income taxes	1,856	15,560	—	17,416
Accrued interest	4,830	4,001	—	8,831
Derivatives embedded within convertible debt, at estimated fair value	13,140	—	—	13,140
Current portion of long-term obligations	—	15,281	—	15,281
Total current liabilities	<u>21,516</u>	<u>236,685</u>	<u>—</u>	<u>258,201</u>
INTERCOMPANY PAYABLES	186,377	—	(186,377)	—
LONG-TERM OBLIGATIONS (net of discount of \$16,985)	236,758	373,018	—	609,776
OTHER LIABILITIES	—	2,861	—	2,861
Total liabilities	<u>444,651</u>	<u>612,564</u>	<u>(186,377)</u>	<u>870,838</u>
<b>COMMITMENTS AND CONTINGENCIES</b>				
<b>STOCKHOLDERS' EQUITY (DEFICIT):</b>				
Common stock	1,138	—	—	1,138
Additional paid-in capital	692,544	1,161,937	(1,161,937)	692,544
Accumulated deficit	(865,736)	(897,315)	897,315	(865,736)
Accumulated other comprehensive loss	—	(74,450)	—	(74,450)
Total stockholders' equity (deficit)	<u>(172,054)</u>	<u>190,172</u>	<u>(264,622)</u>	<u>(246,504)</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)	<u>\$ 272,597</u>	<u>\$ 802,736</u>	<u>\$ (450,999)</u>	<u>\$ 624,334</u>

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**  
**CONSOLIDATING CONDENSED BALANCE SHEET**  
(in thousands)

	December 31, 2005			
	PTGI	PTHI	Eliminations	Consolidated
<b>ASSETS</b>				
<b>CURRENT ASSETS:</b>				
Cash and cash equivalents	\$ 1,255	\$ 41,744	\$ —	\$ 42,999
Accounts receivable	—	141,909	—	141,909
Prepaid expenses and other current assets	1,596	30,309	—	31,905
Total current assets	2,851	213,962	—	216,813
INTERCOMPANY RECEIVABLES	—	187,999	(187,999)	—
INVESTMENTS IN SUBSIDIARIES	282,447	—	(282,447)	—
RESTRICTED CASH	—	10,619	—	10,619
PROPERTY AND EQUIPMENT—Net	—	285,881	—	285,881
GOODWILL	—	85,745	—	85,745
OTHER INTANGIBLE ASSETS—Net	—	11,392	—	11,392
OTHER ASSETS	4,738	25,901	—	30,639
<b>TOTAL ASSETS</b>	<b>\$ 290,036</b>	<b>\$ 821,499</b>	<b>\$ (470,446)</b>	<b>\$ 641,089</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>				
<b>CURRENT LIABILITIES:</b>				
Accounts payable	\$ 2,275	\$ 81,666	\$ —	\$ 83,941
Accrued interconnection costs	—	64,333	—	64,333
Deferred revenue	—	30,037	—	30,037
Accrued expenses and other current liabilities	62	31,338	—	31,400
Accrued income taxes	1,770	14,569	—	16,339
Accrued interest	4,540	8,728	—	13,268
Current portion of long-term obligations	—	16,092	—	16,092
Total current liabilities	8,647	246,763	—	255,410
INTERCOMPANY PAYABLES	187,999	—	(187,999)	—
LONG-TERM OBLIGATIONS	256,179	362,941	—	619,120
OTHER LIABILITIES	—	2,893	—	2,893
Total liabilities	452,825	612,597	(187,999)	877,423
<b>COMMITMENTS AND CONTINGENCIES</b>				
<b>STOCKHOLDERS' EQUITY (DEFICIT):</b>				
Common stock	1,053	—	—	1,053
Additional paid-in capital	686,196	1,161,937	(1,161,937)	686,196
Accumulated deficit	(850,038)	(879,490)	879,490	(850,038)
Accumulated other comprehensive loss	—	(73,545)	—	(73,545)
Total stockholders' equity (deficit)	(162,789)	208,902	(282,447)	(236,334)
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>	<b>\$ 290,036</b>	<b>\$ 821,499</b>	<b>\$ (470,446)</b>	<b>\$ 641,089</b>

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**  
**CONSOLIDATING CONDENSED STATEMENT OF CASH FLOWS**  
(in thousands)

	For the Three Months Ended March 31, 2006			
	PTGI	PTHI	Eliminations	Consolidated
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>				
Net loss	\$(15,698)	\$(17,825)	\$ 17,825	\$ (15,698)
Adjustments to reconcile net loss to net cash provided by operating activities:				
Provision for doubtful accounts receivable	—	3,943	—	3,943
Stock compensation expense	—	113	—	113
Depreciation and amortization	—	17,909	—	17,909
Loss on sale or disposal of assets	—	1,036	—	1,036
Accretion of debt discount	392	—	—	392
Equity in net loss of subsidiary	17,825	—	(17,825)	—
Change in estimated fair value of embedded derivatives	(2,523)	—	—	(2,523)
(Gain) loss on early extinguishment of debt	(2,728)	115	—	(2,613)
Minority interest share of loss	—	(101)	—	(101)
Unrealized foreign currency transaction (gain) loss on intercompany and foreign debt	(2,970)	4,336	—	1,366
Changes in assets and liabilities, net of acquisitions:				
Decrease in accounts receivable	—	11,784	—	11,784
Decrease in prepaid expenses and other current assets	461	2,215	—	2,676
(Increase) decrease in other assets	290	(100)	—	190
(Increase) decrease in intercompany balance	1,461	(1,461)	—	—
Decrease in accounts payable	(1,067)	(3,367)	—	(4,434)
Decrease in accrued interconnection costs	—	(6,873)	—	(6,873)
Increase, net, in deferred revenue, accrued expenses, other current liabilities, accrued income taxes and other liabilities	503	5,704	—	6,207
Increase (decrease) in accrued interest	379	(4,727)	—	(4,348)
Net cash provided by (used in) operating activities	<u>(3,675)</u>	<u>12,701</u>	<u>—</u>	<u>9,026</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>				
Purchase of property and equipment	—	(9,388)	—	(9,388)
Cash used for business acquisitions, net of cash acquired	—	(62)	—	(62)
Decrease in restricted cash	—	1,349	—	1,349
Net cash used in investing activities	<u>—</u>	<u>(8,101)</u>	<u>—</u>	<u>(8,101)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>				
Proceeds from issuance of long-term obligations	—	14,790	—	14,790
Principal payments on capital leases, vendor financing and other long-term obligations	—	(4,591)	—	(4,591)
Proceeds from sale of common stock	4,970	—	—	4,970
Net cash provided by financing activities	<u>4,970</u>	<u>10,199</u>	<u>—</u>	<u>15,169</u>
EFFECTS OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	—	(382)	—	(382)
NET CHANGE IN CASH AND CASH EQUIVALENTS	1,295	14,417	—	15,712
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	1,255	41,744	—	42,999
CASH AND CASH EQUIVALENTS, END OF PERIOD	<u>\$ 2,550</u>	<u>\$ 56,161</u>	<u>\$ —</u>	<u>\$ 58,711</u>

**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**  
**CONSOLIDATING CONDENSED STATEMENT OF CASH FLOWS**  
(in thousands)

	For the Three Months Ended March 31, 2005			
	PTGI	PTHI	Eliminations	Consolidated
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>				
Net loss	\$(34,627)	\$(36,942)	\$ 36,942	\$ (34,627)
Adjustments to reconcile net loss to net cash provided by operating activities:				
Provision for doubtful accounts receivable	—	5,986	—	5,986
Depreciation and amortization	—	22,963	—	22,963
Equity in net income of subsidiary	36,942	—	(36,942)	—
Equity investment loss	—	281	—	281
Minority interest share of loss	—	(123)	—	(123)
Unrealized foreign currency transaction loss on intercompany and foreign debt	170	1,263	—	1,433
Changes in assets and liabilities, net of acquisitions:				
Decrease in accounts receivable	—	12,459	—	12,459
Increase in prepaid expenses and other current assets	(74)	1,434	—	1,360
Decrease in other assets	310	307	—	617
(Increase) decrease in intercompany balance	(1,515)	1,515	—	—
Decrease in accounts payable	(143)	(11,806)	—	(11,949)
Decrease in accrued interconnection costs	—	(7,329)	—	(7,329)
Decrease in accrued expenses, other current liabilities, accrued income taxes and other liabilities	(32)	(1,687)	—	(1,719)
Increase (decrease) in accrued interest	431	(3,712)	—	(3,281)
Net cash provided by (used in) operating activities	<u>1,462</u>	<u>(15,391)</u>	<u>—</u>	<u>(13,929)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>				
Purchase of property and equipment	—	(14,234)	—	(14,234)
Cash used for business acquisitions, net of cash acquired	—	(165)	—	(165)
Decrease in restricted cash	—	3,640	—	3,640
Net cash used in investing activities	<u>—</u>	<u>(10,759)</u>	<u>—</u>	<u>(10,759)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>				
Proceeds from issuance of long-term obligations, net	—	97,000	—	97,000
Principal payments on capital leases, vendor financing and other long-term obligations	—	(5,310)	—	(5,310)
Proceeds from sale of common stock	122	—	—	122
Net cash provided by financing activities	<u>122</u>	<u>91,690</u>	<u>—</u>	<u>91,812</u>
EFFECTS OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	<u>—</u>	<u>(508)</u>	<u>—</u>	<u>(508)</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	1,584	65,032	—	66,616
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	1,967	47,701	—	49,668
CASH AND CASH EQUIVALENTS, END OF PERIOD	<u>\$ 3,551</u>	<u>\$112,733</u>	<u>\$ —</u>	<u>\$ 116,284</u>

## 12. SUBSEQUENT EVENT

In May 2006, the Company entered into a Share Purchase Agreement (“SPA”) with Videsh Sanchar Nigam Limited (“VSNL”), a leading international telecommunications company and member of the TATA Group, whereby VSNL will purchase 100% of the stock of Direct Internet Limited (“DIL”), whose wholly-owned subsidiary, Primus Telecommunications India Limited (“PTIL”), is primarily engaged in providing fixed broadband wireless internet services to enterprise and retail customers in India. The Company owns approximately 85% of the stock of DIL through an indirect wholly-owned subsidiary. The remaining approximately 15% of the stock of DIL is owned by the manager of DIL and PTIL, who had founded the predecessor companies. The purchase consideration is approximately \$16.7 million, as may be adjusted to reflect cash balances in DIL at closing. The Company expects to receive approximately \$14.4 million in net proceeds from the transaction, before any closing adjustments. Consummation of the transaction is subject to a number of conditions precedent, which conditions are expected to be satisfied over the next few weeks. Under the SPA, the Company agrees to certain non-compete provisions regarding the business of DIL and PTIL and is a party to the SPA for the purpose of guaranteeing indemnity obligations of the Company’s subsidiary selling the stock of DIL. The net assets of DIL are approximately \$6.6 million at March 31, 2006. For the three months ended March 31, 2006, DIL recorded revenue and income from operations of \$2.8 million and \$0.6 million, respectively. For the year ended December 31, 2005, DIL recorded revenue and income from operations of \$10.8 million and \$2.3 million, respectively.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Introduction

We are an integrated telecommunications services provider offering a portfolio of international and domestic voice, wireless, Internet, voice-over-Internet protocol (VOIP), data and hosting services to business and residential retail customers and other carriers located primarily in the United States, Australia, Canada, the United Kingdom and western Europe. Our focus is to service the demand for high quality, competitively priced communications services that is being driven by the globalization of the world's economies, the worldwide trend toward telecommunications deregulation and the growth of broadband, Internet, VOIP, wireless and data traffic.

### Recent Product Initiatives Overview

We have selectively targeted opportunities to participate in major growth areas for telecommunications—local, wireless, broadband, and VOIP—which we call our new initiatives or new strategic initiatives. These initiatives have been accelerated in response to competitive developments described under “—Recent Competitive Developments; Our Four-Pronged Action Plan.” Our approach in these areas has common elements: focus on bundling services to end-user customers; leverage our existing global voice, data and Internet network; and utilize established distribution channels and back-office systems. We have continued to devote substantial resources in 2006 to our new strategic initiatives.

We believe the local services market is a major opportunity for revenue growth for us. During the third quarter of 2004, we began offering local line service in Canada on a resale basis. We bundle these services with our other product offerings of long distance voice and Internet access, in competition with incumbent local exchange carriers (ILECs) and cable companies. Our Canadian subsidiary posted record net revenues of \$71 million in the first quarter 2006. The Canadian residential local telephone offering remained flat at approximately 73,000 lines in service. Local line growth was impeded by the conscious slowing of new customer acquisitions until our DSLAM network is ready to carry local line and DSL traffic on-net at substantial improvements to margin versus an off-net customer. Approximately 90% of new local customers in Canada add a bundled long distance offering with average monthly revenue of \$36 (42 CAD) as compared to \$10 (12 CAD) for a stand-alone long distance customer. In Canada, we believe the ability to bundle local services with our core long distance service presents future growth opportunities for us. During the fourth quarter 2005, we launched an important new initiative in Canada—the build-out of a digital subscriber line (DSL) infrastructure—to position us for profitable growth in the local and broadband markets and to enhance product bundling opportunities. As of March 31, 2006, 30 nodes have been installed with a goal of completing our build to 66 nodes during the second quarter 2006.

In 2004 we began the process of building our own DSL network infrastructure in Australia in order to provide voice and broadband Internet services to residential customers on such network. The initial build-out of our Australian DSL infrastructure is virtually complete with 180 nodes installed. In Australia, we now have over 136,000 DSL customers. Migration of existing resale local and broadband customers to our network began in the second quarter 2005 and has now reached approximately 65,000 services on-net. Most new Australian broadband customers sign a two-year contract and approximately 67% also take a bundled local and long distance voice package. Australian residential customers taking a bundled broadband solution now generate approximately \$68 (95 Australian dollars (AUD)) per month in revenue.

The target customers for our retail VOIP products will ultimately be anyone who has a broadband connection anywhere in the world. We have been in the carrier VOIP market now for several years and carried over one billion minutes of international voice traffic in 2005 over the public Internet. In January 2004, we launched our retail VOIP TalkBroadband® service in Canada. In June 2004, we launched our retail LINGO product in the United States, which offers unlimited calling plans including destinations in Western Europe and certain countries in Asia, unlimited calling between two LINGO subscribers and the issuance of phone numbers

## [Table of Contents](#)

that are local for calls originating in certain foreign countries. We have recently launched VOIP services in Australia, Japan and Brazil. Global retail VOIP services have grown to approximately 109,000 customers. For our LINGO product in the United States, growth slowed significantly since the second half of 2005 as we moderated our investment in LINGO due to financial resource limitations and the disruption in marketing activities raised by the emergency 911 regulations. LINGO customers generate approximately \$29 in average monthly revenues. As a result of reduced selling, general and administrative (SG&A) expenses including a lower level of marketing spend, we have succeeded in improving the results of our LINGO operations while continuing to grow the customer base at a modest pace.

Based on first quarter 2006 results of \$31 million of net revenue, our new initiatives exceed an aggregate revenue run rate of \$120 million annually.

It should be recognized that our marketing efforts across our broadband and local initiatives initially increase near-term pressure on profitability and cash flow due to migration and installation charges imposed by the incumbent carriers for each customer transferred to our network. The relative impact of such fees, which currently range between \$40 per customer in Canada and \$110 per customer in Australia, should lessen as the rate of new customer additions becomes a lower percentage of the growing customer base. In the three months ended March 31, 2006, we incurred \$3 million in such fees, and in 2005, we incurred \$11 million.

We believe that progress to date in transforming the Company and growing our broadband, local, and VOIP businesses has not only strengthened the Company, but has enhanced the competitive positioning and the franchise values of our major operating subsidiaries in Australia and Canada. We have also focused on our European and United States operations, and significant progress has already been made in eliminating low-margin services and associated costs in reducing SG&A expenses and in tightening our focus on areas of profitable growth. We expect further improvement in the second quarter 2006.

### **Four-Pronged Action Plan**

Our fundamental challenge continues to be generating sufficient sales volume from new initiatives in broadband, local, wireless and VOIP services to offset the declining contribution from our core long distance voice and dial-up Internet service provider (ISP) businesses. To address this challenge, we have continued progress on our four-pronged action plan (“Action Plan”): first, to continue to drive strong revenue growth from the new initiatives in the broadband, local, wireless and VOIP businesses and to concentrate resources on the most promising initiatives (discussed within “Recent Product Initiatives Overview”); second, to enhance margin by increasing scale on the new initiatives and by investing in broadband infrastructure in high density locations as well as migrating customers onto our network (discussed within “Recent Product Initiatives Overview”); third, to continue cost cutting and cost management programs partially to offset margin erosion caused by the continued decline of our high-margin core retail revenues; and fourth, to strengthen the balance sheet through potential deleveraging and equity capital infusion on a prudent basis. During the first quarter, progress was made on each element of the Action Plan.

Our operating results continue to reflect increased competition from product bundling in virtually all of our markets; product substitution (e.g., wireless for fixed line; broadband for dial-up Internet); declining usage patterns for traditional fixed line voice services as use of wireless, e-mail and instant messaging services expands; and continued competitive pricing pressures. As a result, our revenue growth and profitability have been strongly challenged by a changing industry environment, and this has caused variability in our operating results, as described below. In the past several quarters, we experienced pricing pressure on our core long distance services, reduced margins on our resale of DSL in Australia and significant churn in our dial-up ISP products in Australia, and reduced pricing on long distance offerings to encourage customers to subscribe to bundled local, wireless and broadband services. However, in Canada we have recently experienced a reduction of competitive pressures as incumbent providers are retracting low rate offers for long distance voice services.

## [Table of Contents](#)

Our first quarter 2006 operating results as compared to fourth quarter 2005 reflect \$12 million in net revenue declines in our prepaid services business. We have adjusted the cost structure and pricing of our European prepaid services offering and, effective in the second quarter 2006, will further modify the operation to include a wholesale business model, whereby we will offer our prepaid services platform and infrastructure on a managed basis along with wholesale minute terminations. The wholesale model will result in reduced revenue and corresponding SG&A levels and improved results as compared to the first quarter 2006. As a result of the planned restructuring of the European prepaid services business in the second quarter 2006, we expect to take a non-cash charge of \$3 million to \$5 million in the second quarter for assets that will have no future alternative use in a wholesale model.

Another important element of our Action Plan is the reduction of costs to offset partially the decline in core long-distance voice and dial-up ISP revenues. Selling, general and administrative (SG&A) expenses declined an additional \$7 million as compared to a \$10 million decline in the prior quarter, and further cost reductions will be pursued.

The fourth element of our Action Plan is to strengthen the balance sheet through deleveraging and capital infusion. In the first quarter 2006, we exchanged \$27.4 million principal amount of our 2000 Convertible Subordinated Debentures for \$27.5 million principal amount of our step up convertible subordinated debentures due 2009 ("Step Up Convertible Subordinated Debentures"). Also, we exchanged \$2.5 million principal amount of our 12.75% senior notes due 2009 (the "October 1999 Senior Notes") for 1.8 million shares of our common stock. Additionally, \$5 million of newly issued common stock was sold to a private investor.

### **Overview of Operations**

Generally, we price our services competitively with the major carriers and service providers operating in our principal service regions. We seek to generate net revenue through sales and marketing efforts focused on customers with significant communications needs (international and domestic voice, wireless, VOIP, high speed and dial-up Internet and data), including small- and medium-sized enterprises (SMEs), multinational corporations, residential customers, and other telecommunications carriers and resellers and through acquisitions.

Prices in the long distance industry continue to decline, and as competition continues to increase in each of the service segments and each of the product lines, we believe that prices are likely to continue to decrease. Long distance minutes of use per customer also continue to decline as more customers are using wireless phones and the Internet as alternatives to the use of wireline phones. Also, product substitution (e.g., wireless/Internet for fixed line voice; broadband for dial-up ISP services) has resulted in revenue declines in our core long distance voice and dial-up ISP businesses. Additionally, we believe that because deregulatory influences have begun to affect telecommunications markets outside the United States, the deregulatory trend will result in greater competition from the existing wireline and wireless competitors and from new entrants, such as cable companies and VOIP companies, which could continue to affect adversely our net revenue per minute.

As the portion of traffic transmitted over leased or owned facilities increases, cost of revenue increasingly is comprised of fixed costs. In order to manage such costs, we pursue a flexible approach with respect to the expansion of our network capacity. In most instances, we initially obtain transmission capacity on a variable-cost, per-minute leased basis, then acquire additional capacity on a fixed-cost basis when traffic volume makes such a commitment cost-effective, and ultimately purchase and operate our own facilities when traffic levels justify such investment. We also seek to lower the cost of revenue through:

- optimizing the cost of traffic by using the least expensive cost routing;
- negotiating lower variable usage based costs with domestic and foreign service providers and negotiating additional and lower cost foreign carrier agreements with the foreign incumbent carriers and others;
- continuing to expand the capacity of our network when traffic volumes justify such investment; and
- increasing use of the public Internet.

## [Table of Contents](#)

Overall carrier revenue accounted for 20% of total net revenue for the three months ended March 31, 2006 and for the year ended December 31, 2005. The provision of carrier services also allows us to connect our network to all major carriers, which enables us to provide global coverage. Our overall margin may fluctuate based on the relative volumes of international versus domestic long distance services; carrier services versus business and residential long distance services; prepaid services versus traditional post-paid voice services; Internet, VOIP and data services versus fixed line voice services; the amount of services that are resold; and the proportion of traffic carried on our network versus resale of other carriers' services. Increased pressure will occur on our margin from customer set-up fees as we accelerate customer additions with our new product initiatives. For example, we pay a charge to transfer a new local customer in Canada, and charges to migrate DSL and local customers in Australia. However, migrating customers to our own networks, such as the DSL networks being constructed in Australia and Canada, enable us to increase our margin on such services as compared to resale of services using other carriers' networks.

Selling, general and administrative expenses are comprised primarily of salaries and benefits, commissions, occupancy costs, sales and marketing expenses, advertising, professional fees, and administrative costs. All selling, general and administrative expenses are expensed when incurred.

We plan to reduce debt through regularly scheduled principal payments and may pursue opportunistic means to reduce debt, including further exchanges of common stock for debt.

### **Foreign Currency**

Foreign currency can have a major impact on our financial results. Currently in excess of 80% of our net revenue is derived from sales and operations outside the United States. The reporting currency for our consolidated financial statements is the USD. The local currency of each country is the functional currency for each of our respective entities operating in that country. In the future, we expect to continue to derive the majority of our net revenue and incur a significant portion of our operating costs from outside the United States, and therefore changes in exchange rates have had and may continue to have a significant, and potentially adverse, effect on our results of operations. Our primary risk of loss regarding foreign currency exchange rate risk is caused primarily by fluctuations in the following exchange rates: USD/CAD, USD/AUD, USD/British pound (GBP), and USD/Euro (EUR). Due to the large percentage of our revenue derived outside of the United States, changes in the USD relative to one or more of the foregoing currencies could have an adverse impact on our future results of operations. We have agreements with certain subsidiaries for repayment of a portion of the investments and advances made to these subsidiaries. As we anticipate repayment in the foreseeable future, we recognize the unrealized gains and losses in foreign currency transaction gain (loss) on the consolidated statements of operations. We historically have not engaged in hedging transactions. However, the exposure of our income from operations to fluctuations in foreign currency exchange rates is reduced in part because a majority of the costs that we incur in connection with our foreign operations are also denominated in local currencies.

We are exposed to financial statement gains and losses as a result of translating the operating results and financial position of our international subsidiaries. We translate the local currency statements of operations of our foreign subsidiaries into USD using the average exchange rate during the reporting period. Changes in foreign exchange rates affect the reported profits and losses and cash flows and may distort comparisons from year to year. By way of example, when the USD strengthens compared to the EUR, there could be a negative or positive effect on the reported results for Europe, depending upon whether Europe is operating profitably or at a loss. It takes more profits in EUR to generate the same amount of profits in USD and a greater loss in EUR to generate the same amount of loss in USD. The opposite is also true. For instance, when the USD weakens there is a positive effect on reported profits and a negative effect on reported losses for Europe.

## [Table of Contents](#)

In the three months ended March 31, 2006, as compared to the three months ended March 31, 2005, the USD was weaker on average as compared to the CAD and stronger on average as compared to the AUD, GBP and EUR. The following tables demonstrate the impact of currency fluctuations on our net revenue for the three months ended March 31, 2006 and 2005 (in thousands, except percentages):

### Net Revenue by Location—in USD

	For the three months ended		Variance	Variance %
	March 31, 2006	March 31, 2005		
Canada	\$ 70,546	\$ 62,996	\$ 7,550	12%
Australia	\$ 78,209	\$ 92,522	\$ (14,313)	(15)%
United Kingdom	\$ 22,720	\$ 45,328	\$ (22,608)	(50)%
Europe*	\$ 45,609	\$ 46,549	\$ (940)	(2)%

### Net Revenue by Location—in Local Currencies

	For the three months ended		Variance	Variance %
	March 31, 2006	March 31, 2005		
Canada (in CAD)	81,481	77,251	4,230	5%
Australia (in AUD)	105,830	119,098	(13,268)	(11)%
United Kingdom (in GBP)	12,963	23,991	(11,028)	(46)%
Europe* (in EUR)	37,942	35,508	2,434	7%

\* Europe includes only subsidiaries whose functional currency is the Euro dollar.

### Critical Accounting Policies

See “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our Form 10-K for the year ended December 31, 2005 for a detailed discussion of our critical accounting policies. These policies include revenue recognition, determining our allowance for doubtful accounts receivable, accounting for cost of revenue, valuation of long-lived assets and accounting for income taxes. No significant changes in our critical accounting policies have occurred since December 31, 2005.

### Shared-Based Compensation Expense

Effective January 1, 2006, we adopted Statement of Financial Accounting Standards (SFAS) No. 123(R), “Share-Based Payment,” utilizing the modified prospective method. The revised standard required us to begin to recognize compensation cost for unvested common stock options granted to our employees which were outstanding as of January 1, 2006. This requirement to recognize expense on these unvested grants is immaterial to us as we had accelerated the vesting of certain unvested stock options.

On December 21, 2005, we accelerated the vesting of certain unvested stock options previously awarded under the our Equity Incentive Plan and Director Plan. We took this action because the future costs to be recognized if this action were not taken were disproportionate to the employee retention value of the stock options. As a result of this action, stock options to purchase up to 1.5 million shares of common stock, which would otherwise have vested over the next three years, became exercisable effective December 21, 2005. These stock options have exercise prices ranging from \$1.61 to \$6.30 per share. Based upon the closing stock price for the our common stock of \$0.82 per share on December 21, 2005, all of these stock options were “under water” or “out-of-the-money.” Of the stock options whose vesting is being accelerated, 0.6 million stock options are held by executive officers and 30,000 stock options are held by non-employee directors. Outstanding unvested stock options to purchase 1.5 million shares of the our common stock, with per share exercise prices ranging from \$0.62 to \$0.92, were not accelerated.

As of March 31, 2006, we had 2.0 million unvested awards outstanding, of which \$1.0 million of compensation expense will be recognized over the weighted average remaining vesting period of 2.7 years.

**Results of Operations**

*Results of operations for the three months ended March 31, 2006 as compared to the three months ended March 31, 2005*

Net revenue decreased \$41.3 million or 13.2% to \$272.4 million for the three months ended March 31, 2006 from \$313.7 million for the three months ended March 31, 2005 for the reasons described below. Our data/Internet and VOIP revenue contributed \$45.3 million and \$29.4 million, respectively, for the three months ended March 31, 2006, as compared to \$47.0 million and \$22.5 million, respectively, for the three months ended March 31, 2005. The year-over-year decline in data/Internet net revenue is primarily attributed to the decline in dial-up ISP revenue in Australia.

United States and Other: United States and Other net revenue decreased \$7.1 million or 12.7% to \$48.6 million for the three months ended March 31, 2006 from \$55.7 million for the three months ended March 31, 2005. The decrease is primarily attributed to a decrease of \$8.0 million in retail voice services (including declines in residential and small business voice services, prepaid services, and wireless), a decrease of \$1.0 million in carrier services and a \$1.0 million decrease in Internet services. These decreases were partially offset by an increase of \$2.8 million in retail VOIP.

Canada: Canada net revenue increased \$7.5 million or 11.9% to \$70.5 million for the three months ended March 31, 2006 from \$63.0 million for the three months ended March 31, 2005. The increase is primarily attributed to an increase of \$7.1 million in initiatives which include local, VOIP and wireless services, a \$2.4 million increase in prepaid services, and a \$0.5 million increase in Internet services. These increases were partially offset by a decrease of \$2.7 million in retail voice services. The strengthening of CAD against the USD accounted for a \$3.9 million increase to revenue, which is included in the services explanation above, and which reflects changes in the exchange rates for the three months ended March 31, 2006 as compared to the three months ended March 31, 2005.

The following table reflects net revenue for each major country in North America (in thousands, except percentages):

Revenue by Country—in USD

	For the three months ended		Year-over-Year	
	March 31, 2006 Net Revenue	March 31, 2005 Net Revenue	Variance	Variance %
United States	\$ 47,629	\$ 54,910	\$(7,281)	(13)%
Canada	\$ 70,546	\$ 62,996	\$ 7,550	12%
Other	\$ 987	\$ 740	\$ 247	33%

Europe: European net revenue decreased \$26.8 million or 27.7% to \$70.0 million for the three months ended March 31, 2006 from \$96.8 million for the three months ended March 31, 2005. The decrease is primarily attributable to an \$18.5 million decrease in prepaid services (including decreases of \$20.0 million in the UK and \$1.7 million in Sweden, offset by an increase of \$3.3 million in Netherlands), a \$5.1 million decrease in carrier services, and a decrease of \$3.9 million in retail voice services. These decreases were partially offset by an increase of \$0.7 million in wireless services. The European prepaid services business declined primarily in the UK due to a UK court decision regarding the application of VAT which favored our competitors and made PRIMUS' products uncompetitive from a pricing standpoint. As of the first half of 2005, we no longer operate a prepaid service business in the UK, but rather are a support service provider through a wholesale relationship. During the second quarter 2005 we launched prepaid services operations in new geographic markets. The weakening of the European currencies against the USD accounted for a \$7.5 million decrease to revenue, which is included in the services explanation above, when comparing the exchange rates for the three months ended

## [Table of Contents](#)

March 31, 2006 as compared to the three months ended March 31, 2005. The following table reflects net revenue for each major country in Europe (in thousands, except percentages):

### Revenue by Country—in USD

	For the three months ended March 31, 2006		For the three months ended March 31, 2005		Year-over-Year	
	Net Revenue	% of Europe	Net Revenue	% of Europe	Variance	Variance %
United Kingdom	\$ 22,720	32%	\$ 45,328	47%	\$(22,608)	(50)%
Netherlands	19,270	28%	16,355	17%	2,915	18%
Germany	11,511	16%	12,419	13%	(908)	(7)%
Spain	4,852	7%	4,949	5%	(97)	(2)%
Other	11,661	17%	17,714	18%	(6,053)	(34)%
Europe Total	<u>\$ 70,014</u>	<u>100%</u>	<u>\$ 96,765</u>	<u>100%</u>	<u>\$(26,751)</u>	<u>(28)%</u>

Asia-Pacific: Asia-Pacific net revenue decreased \$15.1 million or 15.4% to \$83.2 million for the three months ended March 31, 2006 from \$98.3 million for the three months ended March 31, 2005. The decrease is primarily attributable to a \$9.7 million decrease in residential voice services, a \$6.6 million decrease in dial-up Internet services, a \$1.1 million decrease in business voice services, and a \$0.7 million decrease in prepaid services, partially offset by a \$3.2 million increase in Australia DSL services. The weakening of the AUD against the USD accounted for a \$4.5 million decrease to revenue, which is included in the services explanation above, which reflects changes in the exchange rates for the three months ended March 31, 2006 as compared to the three months ended March 31, 2005. The following table reflects net revenue for each major country in Asia-Pacific (in thousands, except percentages):

### Revenue by Country—in USD

	For the three months ended March 31, 2006		For the three months ended March 31, 2005		Year-over-Year	
	Net Revenue	% of Asia-Pacific	Net Revenue	% of Asia-Pacific	Variance	Variance %
Australia	\$ 78,209	94%	\$ 92,522	94%	\$(14,313)	(15)%
India	2,847	3%	2,731	3%	116	4%
Japan	2,147	3%	3,054	3%	(907)	(30)%
Asia-Pacific Total	<u>\$ 83,203</u>	<u>100%</u>	<u>\$ 98,307</u>	<u>100%</u>	<u>\$(15,104)</u>	<u>(15)%</u>

Cost of revenue (exclusive of depreciation) decreased \$21.9 million to \$180.2 million, or 66.2% of net revenue, for the three months ended March 31, 2006 from \$202.1 million, or 64.4% of net revenue, for the three months ended March 31, 2005. We continue to experience a shift from higher margin core long distance and dial-up Internet revenues to new product sets that include bundled services and lower margin prepaid and resold services.

United States and Other: United States and Other cost of revenue decreased \$1.9 million primarily due to a decrease of \$2.6 million in retail voice services and a decrease of \$1.2 million in prepaid services. These decreases were partially offset by an increase of \$1.9 million in VOIP services.

Canada: Canada cost of revenue increased \$6.3 million primarily due to an increase of \$4.2 million in new initiatives, which include local, VOIP and wireless services, \$0.9 million in retail voice services, \$0.7 million in internet services, and \$0.4 million in prepaid services. The strengthening of the CAD against the USD accounted for a \$1.7 million increase to cost of revenue, which is included in the services explanation above, and which reflects changes in the exchange rates for the three months ended March 31, 2006 as compared to the three months ended March 31, 2005.

## [Table of Contents](#)

Europe: European cost of revenue decreased by \$18.6 million. The decrease is primarily attributable to a \$9.3 million decrease in prepaid services (including decreases of \$12.1 million in the UK and \$1.6 million in Sweden, offset by an increase of \$4.4 million in Netherlands), a decrease of \$4.8 million in carrier services (including decreases of \$2.2 million in the UK and \$1.8 million in Italy), a decrease of \$3.7 million in wireless services due to the wireless inventory write-down during the 2005 period, and a decrease of \$0.7 million in retail voice services. The weakening of the European currencies against the USD accounted for a \$5.8 million decrease to cost of revenue, which is included in the services explanation above, and which reflects changes in the exchange rates for the three months ended March 31, 2006 as compared to the three months ended March 31, 2005.

Asia-Pacific: Asia-Pacific cost of revenue decreased \$7.7 million primarily due to a decrease of \$5.6 million in residential voice services (which includes \$1.5 million in additional line rental charges from Telstra), a decrease of \$3.7 million of Internet services, a decrease of \$1.5 million in business services, and a decrease of \$0.5 million for carrier and prepaid services. The decrease was partially offset by an increase of \$3.4 million in DSL services. Weakening of the AUD against the USD accounted for a \$2.9 million decrease to cost of revenue, which is included in the services explanation above, and which reflects changes in the exchange rates for the three months ended March 31, 2006 as compared to the three months ended March 31, 2005.

*Selling, general and administrative expenses* decreased \$28.2 million to \$77.3 million, or 28.4% of net revenue, for the three months ended March 31, 2006 from \$105.5 million, or 33.6% of net revenue, for the three months ended March 31, 2005. The decrease in selling, general and administrative expenses is attributable to a decrease of \$8.9 million in sales and marketing expenses primarily in prepaid services agent commissions and promotions, a \$7.7 million decrease in salaries and benefits due to cost cutting/staff reduction efforts, a decrease of \$6.7 million in advertising expenses, a decrease of \$2.7 million in general and administrative expenses, a decrease of \$1.3 million in professional fees, a decrease of \$0.4 million in occupancy, and a decrease of \$0.4 million in travel and entertainment.

United States and Other: United States and Other selling, general and administrative expenses decreased \$13.0 million to \$16.6 million for three months ended March 31, 2006 from \$29.6 million for the three months ended March 31, 2005. The decrease is attributable to a decrease of \$4.6 million in advertising, a decrease of \$3.8 million due to cost cutting/staff reduction effort, a decrease of \$2.1 million in sales and marketing expense (primarily due to a \$1.2 million decrease in agent commissions and a \$1.1 million decrease in promotions), a decrease of \$1.2 million in professional fees, a decrease of \$0.9 million for general and administrative expenses, and a decrease of \$0.3 million in occupancy.

Canada: Canada selling, general and administrative expense decreased \$0.5 million to \$23.7 million for three months ended March 31, 2006 from \$24.2 million for the three months ended March 31, 2005. The decrease is attributable to a decrease of \$0.7 million in sales and marketing expenses.

Europe: Europe selling, general and administrative expense decreased \$8.6 million to \$16.2 million for the three months ended March 31, 2006 from \$24.8 million for the three months ended March 31, 2005. The decrease is attributable to a decrease of \$6.3 million in sales and marketing expense primarily in prepaid services agent commissions, a decrease of \$0.7 million in salaries and benefits, a decrease of \$0.6 million in general and administrative expenses, and a decrease of \$0.4 million in travel and entertainment.

Asia-Pacific: Asia-Pacific selling, general and administrative expense decreased \$6.0 million to \$20.9 million for the three months ended March 31, 2006 from \$26.9 million for the three months ended March 31, 2005. The decrease is attributable to a decrease of \$3.0 million in salaries and benefits, a decrease of \$1.8 million in advertising expenses, and a decrease of \$1.1 million in general and administrative expenses.

*Depreciation and amortization expense* decreased \$5.1 million to \$17.9 million for the three months ended March 31, 2006 from \$23.0 million for the three months ended March 31, 2005. The decrease consists of a decrease in depreciation expense of \$2.2 million as assets become fully depreciated and a decrease in amortization expense of \$2.8 million.

## [Table of Contents](#)

*Interest expense* increased \$1.7 million to \$14.1 million for the three months ended March 31, 2006 from \$12.4 million for the three months ended March 31, 2005. The \$1.7 million increase is a result of a \$2.7 million increase from our capital leases, Senior Secured Term Loan Facility and the 2006 Step Up Convertible Subordinated Debentures, offset by a \$1.1 million decrease resulting from reductions in our October 1999 Senior Notes and 2000 Convertible Subordinated Debentures and decreases in other interest.

*Change in Fair Value of Derivatives Embedded within Convertible Debt* was a gain of \$2.5 million for the three months ended March 31, 2006. Our Step Up Convertible Subordinated Debentures, 2000 Convertible Subordinated Debentures and 2003 Convertible Senior Notes contain embedded derivatives that require bifurcation from the debt host. We recognize these embedded derivatives as a current liability in our balance sheet, measure them at their estimated fair value and recognize changes in the estimated fair value of the derivative instruments in earnings. We estimated that the embedded derivatives had a March 31, 2006 estimated fair value of \$13.1 million and at issuance of the Step Up Convertible Subordinated Debentures, an estimated fair value of \$15.7 million. The embedded derivatives derive their value primarily based on changes in the price and volatility of our common stock. The estimated fair value of the embedded derivatives increases as the price of our common stock increases and decreases as the price of our common stock decreases. The closing price of our common stock decreased to \$0.77 on March 31, 2006 from \$0.88 as of February 27, 2006, causing the overall value of the derivative instrument to decline. As a result, during the three months ended March 31, 2006, we recognized a gain of \$2.5 million from the change in estimated fair value of the embedded derivatives. Over the life of the Step Up Convertible Subordinated Debentures, given the historical volatility of our common stock, changes in the estimated fair value of the embedded derivatives are expected to have a material effect on our results of operations. See “Quantitative and Qualitative Disclosures about Market Risk.” Furthermore, we have estimated the fair value of these embedded derivatives using a theoretical model based on the historical volatility of our common stock of (98% as of March 31, 2006) over the past 42 months.

*Gain on early extinguishment of debt* was \$2.6 million for the three months ended March 31, 2006. In March 2006, we exchanged \$27.4 million principal amount of our 2000 Convertible Subordinated Debentures for \$27.5 million principal amount of our 2006 Step Up Convertible Subordinated Debentures resulting in a gain on early extinguishment of debt of \$1.5 million including the write-off of related deferred financing costs. In January 2006, we exchanged 1,825,000 shares of our common stock for the extinguishment of \$2.5 million in principal amount of the October 1999 Senior Notes resulting in a \$1.2 million gain on early extinguishment of debt including the write-off of related deferred financing costs.

*Foreign currency transaction loss* was a loss of (\$2.0) million for the three months ended March 31, 2006 as compared to a loss of (\$3.1) million for the three months ended March 31, 2005. This loss is attributable to the impact of foreign currency exchange rate changes on intercompany debt balances and on receivables and payables denominated in a currency other than the subsidiaries’ functional currency.

*Income tax expense* decreased to \$1.3 million for the three months ended March 31, 2006 from \$2.5 million for the three months ended March 31, 2005. The expense for both periods primarily consists of foreign withholding tax on intercompany interest and royalty fees owed to our United States subsidiary by our Canadian and Australian subsidiaries.

## **Liquidity and Capital Resources**

### ***Changes in Cash Flows***

Our principal liquidity requirements arise from cash used in operating activities, purchases of network equipment including switches, related transmission equipment and capacity, DSL network build-out, development of back-office systems, interest and principal payments on outstanding debt and other obligations, and acquisitions. We have financed our growth and operations to date through public offerings and private placements of debt and equity securities, vendor financing, capital lease financing and other financing arrangements.

## [Table of Contents](#)

Net cash provided by operating activities was \$9.0 million for three months ended March 31, 2006 as compared to net cash used in operating activities of \$13.9 million for the three months ended March 31, 2005. For the three months ended March 31, 2006, operations provided \$3.8 million of cash. In addition, cash was increased by reductions in accounts receivable of \$11.8 million, increases in deferred revenue, accrued expenses, accrued income taxes and other liabilities of \$6.2 million and reductions in prepaid expenses and other current assets of \$2.7 million. During three months ended March 31, 2006 we used \$11.3 million to reduce accounts payable and accrued interconnections costs and accrued interest was reduced by \$4.3 million. For the three months ended March 31, 2005, operations used \$4.1 million of cash. We used \$21.0 million to reduce our accounts payable, accrued interconnection costs, deferred revenue, accrued expenses, accrued income taxes and other liabilities, and accrued interest was reduced by \$3.3 million. During the three months ended March 31, 2005 cash was increased through a decrease in accounts receivable of \$12.5 million and partially offset by an increase in prepaid expenses and other current assets of \$1.4 million.

Net cash used by investing activities was \$8.1 million for the three months ended March 31, 2006 compared to \$10.8 million for the three months ended March 31, 2005. Net cash used by investing activities during the three months ended March 31, 2006 included \$9.4 million of capital expenditures primarily for additions to our DSL networks in Australia and Canada and back office support systems, offset by a \$1.3 million decrease in restricted cash. Net cash used by investing activities during the three months ended March 31, 2005 included \$14.2 million of capital expenditures primarily for additions to our global network, especially the Australian DSL network, and back office support systems, offset by a \$3.6 million reduction in restricted cash.

Net cash provided by financing activities was \$15.2 million for the three months ended March 31, 2006 as compared to net cash provided by financing activities of \$91.8 million for the three months ended March 31, 2005. During the three months ended March 31, 2006, net cash provided by financing activities consisted of \$14.8 million from the issuance of \$15.0 million through an amended and restated loan facility with a Canadian financial institution, net of \$0.2 million in financing costs, \$5.0 million from the sale of 6.7 million shares of our common stock pursuant to a subscription agreement with an existing stockholder, partially offset by an increase of \$4.5 million of principal payments on capital leases, leased fiber capacity, financing facilities and other long-term obligations. During the three months ended March 31, 2005, cash provided by financing activities consisted of \$97.0 million primarily from the issuance of our \$100 million senior secured term loan facility, net of \$3.0 million in financing costs, slightly offset by \$5.3 million of principal payments on capital leases, leased fiber capacity, financing facilities and other long-term obligations.

### ***Short- and Long-Term Liquidity Considerations and Risks***

We believe that our existing cash and cash equivalents will be sufficient to fund our debt service requirements, the repayment of the 2000 Convertible Subordinated Debentures and other fixed obligations (such as capital leases, vendor financing and other long-term obligations), and other cash needs for our operations for the next twelve months, if we realize timely sufficient benefit from the actions detailed below.

As of December 31, 2005, we had \$50.1 million of our 2000 Convertible Subordinated Debentures outstanding. So far in 2006, we have exchanged \$27.4 million of our 2000 Convertible Subordinated Debentures due February 2007 for Step Up Convertible Subordinated Debentures due in August 2009. Although we may conclude similar or other transactions for the remaining \$22.7 million, there can be no assurance that such transactions will be completed. If no further transactions are completed, the remaining \$22.7 million will be due on February 15, 2007. Our ability to repay the maturing \$22.7 million of 2000 Convertible Subordinated Debentures on February 15, 2007, along with the ability to meet the cash needs for our operations, will be dependent on our timely ability to realize sufficient benefit from the following actions: improved operating performance, continued cost reduction efforts, moderation of capital expenditures, potential debt financing alternatives, potential future sales of equity, certain opportunistic asset sales, and interest expense savings from balance sheet deleveraging.

## Table of Contents

In January 2006, we exchanged \$2.5 million principal amount of our 12.75% senior notes due 2009 (the “October 1999 Senior Notes”) for 1.8 million shares of our common stock. These actions are somewhat offset in January 2006 by our wholly owned Canadian subsidiary entering into an Amended and Restated Loan Agreement (the “Amended Agreement”) related to its existing secured non-revolving term loan facility with a Canadian financial institution. The Amended Agreement, among other things, extended the maturity date to April 2008. On February 1, 2006 the Company drew the remaining \$15 million available under the loan facility. We will continue to reduce debt through regularly scheduled principal payments and may pursue opportunistic means to reduce debt, including further exchanges of our common stock for debt. Additionally, \$5 million of newly issued common stock was sold to a private investor.

We will continue to have significant debt service obligations during the next year and on a long-term basis. However, there can be no assurance that changes in assumptions or conditions, including those referenced under “Special Note Regarding Forward-Looking Statements” will not adversely affect our financial condition or short-term or long-term liquidity.

As of March 31, 2006, we have \$5.2 million in future minimum purchase obligations, \$47.0 million in future operating lease payments and \$625.1 million of indebtedness. Payments of principal and interest are due as follows:

Year Ending December 31,	Vendor Financing	Senior Secured Term Loan Facility (1)	Financing Facility and Other	Senior Notes	Convertible Senior Notes	Step-Up Convertible Subordinated Debentures	Convertible Subordinate Debentures	Purchase Obligations	Operating Leases	Total
2006 (as of March 31, 2006)	\$ 12,060	\$ 9,349	\$ 2,374	\$ 18,524	\$ 2,475	\$ 764	\$ 653	\$ 4,900	\$ 11,190	\$ 62,289
2007	6,608	12,363	2,911	27,924	4,950	1,820	23,355	300	12,212	92,443
2008	3,220	12,247	30,656	27,924	4,950	2,095	—	—	8,644	89,736
2009	1,524	12,131	32	99,484	4,950	29,679	—	—	6,274	154,074
2010	2,110	12,015	32	18,800	136,950	—	—	—	4,176	174,083
Thereafter	—	94,250	135	300,800	—	—	—	—	4,502	399,687
Total Minimum Principal & Interest Payments	25,522	152,355	36,140	493,456	154,275	34,358	24,008	5,200	46,998	972,312
Less: Amount Representing Interest	(2,609)	(53,355)	(4,754)	(186,896)	(22,275)	(6,877)	(1,306)	—	—	(278,072)
	22,913	99,000	31,386	306,560	132,000	27,481	22,702	5,200	46,998	694,240
Less: Amount Representing Discount	—	—	—	—	(4,107)	(12,878)	—	—	—	(16,985)
	<u>\$ 22,913</u>	<u>\$ 99,000</u>	<u>\$ 31,386</u>	<u>\$ 306,560</u>	<u>\$ 127,893</u>	<u>\$ 14,603</u>	<u>\$ 22,702</u>	<u>\$ 5,200</u>	<u>\$ 46,998</u>	<u>\$ 677,255</u>

(1) For the purpose of preparation of this table, we have assumed the interest rate of the \$100 million Senior Secured Term Loan Facility to be 11.6%.

We have contractual obligations to utilize an external vendor for certain back-office support functions and to utilize network facilities from certain carriers with terms greater than one year. We generally do not purchase or commit to purchase quantities in excess of normal usage or amounts that cannot be used within the contract term. We have minimum annual purchase obligations of \$4.9 million and \$0.3 million remaining in 2006 and 2007, respectively.

The indentures governing the senior notes, convertible senior notes, step up convertible subordinated debentures, convertible subordinated debentures, and the senior secured term loan facility, as well as other credit arrangements, contain certain financial and other covenants which, among other things, will restrict our ability to incur further indebtedness and make certain payments, including the payment of dividends and repurchase of subordinated debt and certain debt issued by our subsidiaries. We were in compliance with the above covenants at March 31, 2006.

## [Table of Contents](#)

From time to time, we consider the feasibility and timing of transactions that could raise capital for additional liquidity, debt reduction, refinancing of existing indebtedness and for additional working capital and growth opportunities. There can be no assurance we will be successful in any of these efforts to obtain any such financing on acceptable terms or at all. If we are successful in raising additional financing, securities comprising a significant percentage of our diluted capital may be issued in connection with the completion of such transactions. Additionally, if our plans or assumptions change or prove inaccurate, including those with respect to our debt levels, competitive developments, developments affecting our network or new product initiatives, services, operations or cash from operating activities, if we consummate additional investments or acquisitions, if we experience unexpected costs or competitive pressures or if existing cash and any other borrowings prove to be insufficient, we may need to obtain such financing and/or relief sooner than expected. In such circumstances, there can be no assurance we will be successful in these efforts to obtain new capital at acceptable terms.

In light of the foregoing, we and/or our subsidiaries will evaluate and determine on a continuing basis, depending on market conditions and the outcome of events described herein under “Special Note Regarding Forward-Looking Statements,” the most efficient use of our capital and resources, including investment in our network, systems and new product initiatives, purchasing, refinancing, exchanging, tendering for or retiring certain of our outstanding debt securities in privately negotiated transactions, open market transactions or by other direct or indirect means to the extent permitted by our existing covenants.

### **New Accounting Pronouncements**

In February 2006, the FASB issued SFAS No. 155, “Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140.” SFAS No. 155 clarifies certain issues relating to embedded derivatives and beneficial interests in securitized financial assets. The provisions of SFAS No. 155 are effective for all financial instruments acquired or issued after fiscal years beginning after September 15, 2006. We are currently assessing the impact that the adoption of SFAS 155 will have on our results of operations and financial position.

### **Special Note Regarding Forward Looking Statements**

Certain statements in this Quarterly Report on Form 10-Q and elsewhere constitute “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Such statements are based on current expectations, and are not strictly historical statements. Forward-looking statements include, without limitation, statements set forth in this document and elsewhere regarding, among other things:

- expectations of future growth, creation of shareholder value, revenue, foreign revenue contributions and net income, as well as income from operations, margins, earnings per share, cash flow and cash sufficiency levels, working capital, network development, customer migration and related costs, spending on and success with new product initiatives, including the development of broadband Internet, VOIP, wireless and local services, traffic development, capital expenditures, selling, general and administrative expenses, income tax expense, goodwill impairment charges, service introductions and cash requirements;
- increased competitive pressures, declining usage patterns, and our new product initiatives, bundled service offerings and DSL network build-out, the pace and cost of customer migration onto our networks, the effectiveness and profitability of new initiatives and prepaid services offerings;
- financing, refinancing, de-levering and/or debt repurchase, restructuring, exchange or tender plans or initiatives, and potential dilution of existing equity holders from such initiatives;
- liquidity and debt service forecasts;
- assumptions regarding currency exchange rates;
- timing, extent and effectiveness of cost reduction initiatives and management’s ability to moderate or control discretionary spending;

## [Table of Contents](#)

- management’s plans, goals, expectations, guidance, objectives, strategies, and timing for future operations, acquisitions, product plans, performance and results; and
- management’s assessment of market factors and competitive developments, including pricing actions and regulatory rulings.

Factors and risks that could cause actual results or circumstances to differ materially from those set forth or contemplated in forward-looking statements include those set forth in “Item 1A—Risk Factors” as well as, without limitation:

- changes in business conditions causing changes in the business direction and strategy by management;
- accelerated competitive pricing and bundling pressures in the markets in which we operate;
- risks, delays and costs in seeking to restructure and reestablish our prepaid services business managed from Europe in pre-existing and new markets;
- accelerated decrease in minutes of use on wireline phones;
- fluctuations in the exchange rates of currencies, particularly of the USD relative to foreign currencies of the countries where we conduct our foreign operations;
- adverse interest rate developments affecting our variable interest rate debt;
- difficulty in maintaining or increasing customer revenues and margins through our new product initiatives and bundled service offerings, and difficulties, costs and delays in constructing and operating a proposed DSL networks in Australia and Canada, and migrating broadband and local customers to such networks;
- inadequate financial resources to promote and to market the new product initiatives;
- fluctuations in prevailing trade credit terms or revenues due to the adverse impact of, among other things, further telecommunications carrier bankruptcies or adverse bankruptcy related developments affecting our large carrier customers;
- the possible inability to raise additional capital when needed, on attractive terms, or at all;
- the inability to reduce, repurchase, exchange, tender for or restructure debt significantly, or in amounts sufficient to conduct regular ongoing operations;
- inadequate amount of remaining authorized capital stock to issue and reserve shares in connection with potential debt and equity transactions and the inability to obtain requisite shareholder approval to increase authorized capital stock either directly or through a reverse stock split;
- potential delisting of our common stock from NASDAQ which may impair our ability to raise capital;
- further changes in the telecommunications or Internet industry, including rapid technological changes, regulatory and pricing changes in our principal markets and the nature and degree of competitive pressure that we may face;
- adverse tax or regulatory rulings from applicable authorities;
- broadband, DSL, Internet, wireless, VOIP and local and long distance voice telecommunications competition;
- changes in financial, capital market and economic conditions, including the potential adverse impact arising out of or as a consequence of our external auditor’s opinion which included a matter of emphasis paragraph for a going concern;
- changes in service offerings or business strategies, including the need to modify business models if performance is below expectations;
- difficulty in retaining existing long distance wireline and dial-up ISP customers;
- difficulty in migrating or retaining customers associated with acquisitions of customer bases, or integrating other assets;

## Table of Contents

- difficulty in selling new services in the marketplace;
- difficulty in providing broadband, DSL, local, VOIP or wireless services;
- changes in the regulatory schemes or requirements and regulatory enforcement in the markets in which we operate;
- restrictions on our ability to follow certain strategies or complete certain transactions as a result of our inexperience with new product initiatives, or limitations imposed by our capital structure or debt covenants;
- risks associated with our limited DSL, Internet, VOIP, Web hosting and wireless experience and expertise, including cost effectively utilizing new marketing channels such as interactive marketing utilizing the Internet;
- entry into developing markets;
- aggregate margin contribution from the new initiatives are not sufficient in amount or timing to offset the margin decline in our long distance voice and dial-up ISP businesses;
- the possible inability to hire and/or retain qualified executive management, sales, technical and other personnel, and to change in size;
- risks associated with international operations;
- dependence on effective information systems;
- dependence on third parties for access to their networks to enable us to expand and manage our global network and operations and to offer broadband, DSL, local, VOIP and wireless services, including dependence upon the cooperation of incumbent carriers relating to the migration of customers;
- dependence on the implementation and performance of our global standard asynchronous transfer mode and Internet-based protocol (ATM+IP) communications network;
- adverse regulatory rulings or actions affecting our operations, including the imposition of obligations upon VOIP providers to provide enhanced 911 (E911) services and restricting access to broadband networks owned and operated by others;
- the potential elimination or limitation of a substantial amount or all of our United States or foreign operating loss carryforwards due to significant issuances of equity securities, changes in ownership or other circumstances, which carryforwards would otherwise be available to reduce future taxable income; and
- the outbreak or escalation of hostilities or terrorist acts and adverse geopolitical developments.

As such, actual results or circumstances may vary materially from such forward-looking statements or expectations. Readers are also cautioned not to place undue reliance on these forward-looking statements which speak only as of the date these statements were made. We are not necessarily obligated to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our primary market risk exposures relate to changes in foreign currency exchange rates, valuations of derivatives and to changes in interest rates.

Foreign currency can have a major impact on our financial results. Currently in excess of 80% of our net revenue is derived from sales and operations outside the United States. The reporting currency for our consolidated financial statements is the USD. The local currency of each country is the functional currency for each of our respective entities operating in that country. In the future, we expect to continue to derive the majority of our net revenue and incur a significant portion of our operating costs from outside the United States,

## [Table of Contents](#)

and therefore changes in exchange rates have had and may continue to have a significant, and potentially adverse, effect on our results of operations. Our primary risk of loss regarding foreign currency exchange rate risk is caused primarily by fluctuations in the following exchange rates: USD/CAD, USD/AUD, USD/British pound (GBP), and USD/Euro (EUR). Due to the large percentage of our revenue derived outside of the United States, changes in the USD relative to one or more of the foregoing currencies could have an adverse impact on our future results of operations. We have agreements with certain subsidiaries for repayment of a portion of the investments and advances made to these subsidiaries. As we anticipate repayment in the foreseeable future, we recognize the unrealized gains and losses in foreign currency transaction gain (loss) on the consolidated statements of operations. We historically have not engaged in hedging transactions. However, the exposure of our income from operations to fluctuations in foreign currency exchange rates is reduced in part because a majority of the costs that we incur in connection with our foreign operations are also denominated in local currencies.

We are exposed to financial statement gains and losses as a result of translating the operating results and financial position of our international subsidiaries. We translate the local currency statements of operations of our foreign subsidiaries into USD using the average exchange rate during the reporting period. Changes in foreign exchange rates affect the reported profits and losses and cash flows and may distort comparisons from year to year. By way of example, when the USD strengthens compared to the EUR, there could be a negative or positive effect on the reported results for Europe, depending upon whether Europe is operating profitably or at a loss. It takes more profits in EUR to generate the same amount of profits in USD and a greater loss in EUR to generate the same amount of loss in USD. The opposite is also true. For instance, when the USD weakens there is a positive effect on reported profits and a negative effect on reported losses for Europe.

In the three months ended March 31, 2006, as compared to the three months ended March 31, 2005, the USD was weaker on average as compared to the CAD and stronger on average as compared to the AUD, GBP and EUR. As a result, our revenue of the subsidiaries whose local currency is AUD, CAD, GBP and EUR increased (decreased) (11)%, 5%, (46)% and 7% in local currency compared to the three months ended March 31, 2005, but increased (decreased) (15)%, 12%, (50)% and (2)% in USD, respectively.

*Interest rates*—The majority of our long-term debt obligations are at fixed interest rates at March 31, 2006. In February 2005, we obtained a \$100 million senior secured loan facility, which has a variable interest rate feature. We are exposed to interest rate risk as additional financing may be required. Our primary exposure to market risk stems from fluctuations in interest rates. We do not currently anticipate entering into interest rate swaps and/or similar instruments.

The interest rate sensitivity table below summarizes our market risks associated with fluctuations in interest rates as of March 31, 2006 in USD, which is our reporting currency. The table presents principal cash flows and related weighted average interest rates by year of expected maturity for our senior notes, convertible senior notes, convertible subordinated debentures, leased fiber capacity, and other long-term obligations in effect at March 31, 2006. In the case of the convertible senior notes and convertible subordinated debentures the table excludes the potential exercise of the relevant redemption and conversion features and excludes an aggregate debt discount of \$17.0 million.

	Year of Maturity					Total	Fair Value	
	2006	2007	2008	2009	2010			Thereafter
				(in thousands, except percentages)				
Fixed Rate	\$ 11,539	\$ 29,189	\$ 32,826	\$ 100,351	\$ 134,013	\$ 235,124	\$ 543,042	\$ 358,427
Average Interest Rate	9%	6%	8%	11%	4%	8%	7%	
Variable Rate	\$ 750	\$ 1,000	\$ 1,000	\$ 1,000	\$ 1,000	\$ 94,250	\$ 99,000	\$ 99,000
Average Interest Rate	12%	12%	12%	12%	12%	12%	12%	

## [Table of Contents](#)

We have not entered into any financial instruments for trading purposes. However, the estimated fair value of the derivatives embedded within our Step Up Convertible Subordinated Debentures and 2003 Senior Notes creates a market risk exposure resulting from changes in the price of our common stock and remaining terms of the notes. These embedded derivatives derive their value primarily based on the price and volatility of our common stock; however, we do not expect significant changes in the near term in the historical volatility of our common stock used to calculate the estimated fair value of the embedded derivatives. For the three months ended March 31, 2006, the Company recognized a gain of \$2.5 million resulting from changes in the fair value of the derivative instruments. Other factors being equal, as of March 31, 2006, the table below provides information about the estimated fair value of the derivatives embedded within our convertible debt (in thousands) and the effect that changes in the price of our common stock could potentially have on the estimated fair value of the embedded derivatives:

<u>Price per Share of Common Stock</u>	<u>Estimated Fair Value of Embedded Derivatives</u>
\$0.77 (stock price at March 31, 2006)	\$ 13,140
\$0.60	\$ 9,899
\$1.00	\$ 19,871
\$1.20	\$ 25,263
\$1.40	\$ 30,846
\$1.60	\$ 36,585

As noted above, the estimated fair value of the embedded derivatives increases as the price of our common stock increases. These changes in estimated fair value will affect our results of operations but will not impact our cash flows.

#### **ITEM 4. CONTROLS AND PROCEDURES**

Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation, our principal executive officer and our principal financial officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective. Disclosure controls and procedures mean our controls and other procedures that are designed to ensure that information required to be disclosed by us in our reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in our reports that we file or submit under the Securities Exchange Act of 1934 is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

There have been no changes in our internal control over financial reporting or in other factors that could significantly affect internal controls over financial reporting, that occurred during the quarter ended March 31, 2006, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

We are subject to claims and legal proceedings that arise in the ordinary course of its business. Each of these matters is subject to various uncertainties, and it is possible that some of these matters may be decided unfavorably to us. We believe that any aggregate liability that may result from the resolution of these matters will not have a material adverse effect on our consolidated financial position, results of operations or cash flows.

### ITEM 1A. RISK FACTORS

A wide range of factors could materially affect our performance. In addition to factors affecting specific business operations and the financial results of those operations identified elsewhere in this report, the following factors, among others, could adversely affect our operations:

*The unqualified opinion with a matter of emphasis regarding our ability to continue as a going concern from our independent registered public accounting firm in connection with the filing of our Form 10-K for the year ended December 31, 2005, could adversely affect our operations by potentially increasing our immediate need for additional capital and disrupting supplier relationships.*

Our independent registered public accounting firm has included in their report concerning our consolidated financial statements for 2005 an explanatory paragraph that our recurring losses from operations, the maturity of \$22.7 million of the 2000 Convertible Subordinated Debentures due February 15, 2007, negative working capital, and stockholders' deficit raise substantial doubt about our ability to continue as a going concern. The reaction to this opinion may adversely affect our ability to manage our accounts payable and potentially cause some suppliers to deal with us on a cash-on-delivery or prepaid basis only or to terminate the supplier relationship. If this were to occur, this would adversely affect our operations by increasing our immediate need for additional capital.

*If competitive pressures continue or intensify and/or the success of our new initiatives is not adequate in amount or timing to offset the decline in results from our core businesses, we may not be able to service our debt or other obligations.*

We believe that our existing cash and cash equivalents, future sales of equity, internally generated funds from operating activities, continued cost reduction efforts, our ability to moderate capital expenditures, combined with existing and potential debt financing alternatives and potential proceeds from opportunistic asset sales and interest savings from balance sheet deleveraging should be sufficient to fund our debt service requirements and other fixed obligations (such as capital leases, vendor financing and other long-term obligations), resolution of vendor disputes, and other cash needs for our operations through at least 2006. However, there are substantial risks, uncertainties and changes that could cause actual results to differ from our current belief, particularly as aggressive pricing and bundling strategies by certain incumbent carriers and ILECs have intensified competitive pressures in the markets where we operate, and/or if we have insufficient financial resources to market our services. The aggregate anticipated margin contribution from our new initiatives may not be adequate in amount or timing to offset the declines in margin from our core business. In addition, regulatory decisions could have a material adverse impact on our operations and outlook. See also information regarding our 2000 Convertible Subordinated Debentures due February 15, 2007 and other information under "Item 2—MD&A—Liquidity and Capital Resources—Short- and Long-Term Liquidity Considerations and Risks" and in these Risk Factors. If adverse events referenced therein were to occur, we may not be able to service our debt or other obligations and could, among other things, be required to seek protection under the bankruptcy laws of the United States or other similar laws in other countries.

*Our high level of debt may adversely affect our financial and operating flexibility.*

We currently have substantial indebtedness and anticipate that we and our subsidiaries may incur additional indebtedness in the future. The level and/or terms of our indebtedness (1) could make it difficult for us to make

## [Table of Contents](#)

required payments of principal and interest on our outstanding debt; (2) could limit our ability to obtain any necessary financing in the future for working capital, capital expenditures, debt service requirements or other purposes; (3) requires that a substantial portion of our cash flow, if any, be dedicated to the payment of principal and interest on outstanding indebtedness and other obligations and, accordingly, such cash flow will not be available for use in our business; (4) could limit our flexibility in planning for, or reacting to, changes in our business; (5) results in our being more highly leveraged than many of our competitors, which places us at a competitive disadvantage; (6) will make us more vulnerable in the event of a downturn in our business; and (7) could limit our ability to sell assets partially or fund our operations due to covenant restrictions.

*If we do not have sufficient authorized shares, we will be limited in our ability to reserve adequate shares for our existing instruments and our ability to issue equity and to deleverage our balance sheet further.*

Our First Amended and Restated Certificate of Incorporation, as amended, currently authorizes the issuance of up to 150,000,000 shares of Common Stock and 2,455,000 shares of preferred stock. As of March 31, 2006 we had 113,787,301 shares of Common Stock issued and outstanding and no shares of preferred stock issued and outstanding. In order to provide us the flexibility to raise equity and to deleverage the balance sheet further, or even to have sufficient shares for the existing financial instruments, we need to increase the authorized number of shares. We currently have an outstanding definitive proxy proposing a 1 for 10 reverse stock split and an increase of the number of authorized shares from 150,000,000 to 300,000,000. Both proposals would provide the Company sufficient flexibility in regards to having enough common stock available for future needs, and they are alternative proposals in that only one would be made effective, if at all. The proposal for the reverse stock split, however, seeks to also address another concern—the potential NASDAQ delisting if our common stock does not maintain a minimum \$1 per share trading level for the required period (see the immediately following risk factor).

*If we are delisted from the Nasdaq National Market and/or Nasdaq Capital Market, it could result in a more limited public market for our common stock.*

On June 17, 2005, we received a notice of potential delisting of our common stock from Nasdaq National Market due to the fact that our common stock had not met the minimum prescribed trading prices for continued listing on the Nasdaq National Market. On December 13, 2005, we received a Staff Determination Letter from the Nasdaq National Market that our common stock was subject to delisting from the Nasdaq National Market for failing to meet the minimum bid requirement. On December 20, 2005, the Company requested a hearing that was held on January 12, 2006 before the Nasdaq Listings Qualification Panel (the “Panel”). The delisting of our common stock was stayed pending the outcome of the hearing. On February 14, 2006, the Company received the Panel’s determination to continue the listing of the Company’s common stock on the Nasdaq National Market conditioned upon the following exception: on or before March 10, 2006, the Company must have evidenced a closing bid price of at least \$1.00 per share for a minimum of ten consecutive trading days. The Panel also noted that the Company meets the listing standards for inclusion in the Nasdaq Capital Market, and that a transfer to that market would provide the Company with an additional 180 days (from December 13, 2005) to comply with the minimum bid price rule. In order to meet the minimum bid price rule, we may take certain steps to increase the minimum bid of our common stock, including, subject to appropriate authorizations and approvals, effecting a reverse split of our common stock. On February 7, 2006, the Company applied for listing on the Nasdaq Capital Market to be effective March 14, 2006. Effective March 14, 2006, the Company’s common stock trades on the Nasdaq Capital Market. If we do not meet the minimum bid price rule by June 12, 2006, however, our common stock would be delisted from trading on the Nasdaq Capital Market and could trade on the OTC Bulletin Board. The OTC Bulletin Board is a substantially less liquid market than the Nasdaq National Market or Capital Market. As a result, if our common stock is delisted from the Nasdaq markets or if we effect a reverse split of our common stock (see immediately preceding risk factor), our stockholders may have greater difficulty disposing of their shares in acceptable amounts and at acceptable prices and we may have greater difficulty issuing equity securities or securities convertible into common stock in such circumstances. If delisted, we cannot assure you when, if ever, our common stock would once again be eligible for listing on either the Nasdaq National Market or Capital Market.

## [Table of Contents](#)

*Given our limited experience in delivering our new product initiatives and in providing bundled local, wireless, broadband, DSL, Internet, data and VOIP services, we may not be able to operate successfully or expand these parts of our business.*

During 2004, we accelerated initiatives to provide wireless, broadband, VOIP and local wireline services in certain markets where we operate. During the third quarter of 2004 we accelerated initiatives to become an integrated wireline, wireless and broadband service provider in order to counter competitive pricing pressures initiated by large incumbent providers in certain of the principal markets where we operate and to stem the loss of certain of our wireline and dial-up ISP customers to our competitors' bundled wireless, wireline and broadband service offerings. Our experience in providing these new products in certain markets and in providing these bundled service offerings is limited. Our primary competitors include incumbent telecommunications providers, cable companies and other ISPs that have a significant national or international presence. Many of these operators have substantially greater resources, capital and operational experience than we do. We also expect that we will experience increased competition from traditional telecommunications carriers and cable companies and other new entrants that expand into the market for broadband, VOIP, Internet services and traditional voice services, and regulatory developments may impair our ability to compete. Therefore, future operations involving these individual or bundled services may not succeed in this new competitive environment, and we may not be able to expand successfully; may experience margin pressure; may face quarterly revenue and operating results variability; may have limited resources to develop and to market the new services; and have heightened difficulty in establishing future revenues or results. As a result, there can be no assurance that we will reverse recent revenue declines or maintain or increase revenues or be able to generate income from operations or net income in the future or on any predictable or timely basis.

*We may be exposed to significant liability resulting from our noncompliance with FCC directives regarding enhanced 911 (E911) services.*

In June 2005, the FCC adopted new rules requiring VOIP providers interconnected to the public switched telephone network (PSTN) to provide E911 service in a manner similar to traditional wireline carriers by November 2005. LINGO, our subsidiary which sells VOIP services, was unable to meet this deadline for all of its customers. As of February 28, 2006, approximately 35% of our LINGO customers were without E911 service. We have sought a waiver from the FCC asking for an additional nine months to complete deploying our E911 service, but the FCC has not yet addressed our waiver petition. We also are participating in a legal challenge to these rules pending before the U.S. Court of Appeals for the District of Columbia Circuit.

LINGO's current services are more limited than the 911 services offered by traditional wireline telephone companies. These limitations may cause significant delays, or even failures, in callers' receipt of the emergency assistance they need. We have notified our customers of the differences between our Emergency Calling Service and E911 services and those available through traditional telephony providers and have received affirmative acknowledgement from substantially all of our customers. Nevertheless, injured customers may attempt to hold us responsible for any loss, damage, personal injury or death suffered as a result of our failure to comply with the FCC mandated E911 service. Our resulting liability could be significant, although the likelihood is remote.

In addition, if and to the extent that we are determined to be out of compliance with the FCC order regarding E911 services we may be subject to fines or penalties or injunctions prohibiting LINGO from providing service in some markets.

*We are substantially smaller than our major competitors, whose marketing and pricing decisions, and relative size advantage, could adversely affect our ability to attract and retain customers and are likely to continue to cause significant pricing pressures that could adversely affect our net revenues, results of operations and financial condition.*

The long distance telecommunications, Internet, broadband, DSL, data and wireless industry is significantly influenced by the marketing and pricing decisions of the larger long distance industry, Internet access, broadband, DSL and wireless business participants. Prices in the long distance industry have continued to decline

## [Table of Contents](#)

in recent years, and as competition continues to increase within each of our service segments and each of our product lines, we believe that prices are likely to continue to decrease. Our competitors in our core markets include, among others: Sprint, the regional bell operating companies (RBOCs) and the major wireless carriers in the United States; Telstra, SingTel Optus and Telecom New Zealand in Australia; Telus, BCE, Allstream (formerly AT&T Canada) and the major wireless and cable companies in Canada; and BT, Cable & Wireless United Kingdom, Colt Telecom, Energis and the major wireless carriers in the United Kingdom. Customers frequently change long distance, wireless and broadband providers, and ISPs in response to the offering of lower rates or promotional incentives, increasingly as a result of bundling of various services by competitors. Moreover, competitors' VOIP and broadband product rollouts have added further customer choice and pricing pressure. As a result, generally, customers can switch carriers and service offerings at any time. Competition in all of our markets is likely to remain intense, or even increase in intensity and, as deregulatory influences are experienced in markets outside the United States, competition in non-United States markets is becoming similar to the intense competition in the United States. Many of our competitors are significantly larger than we are and have substantially greater financial, technical and marketing resources, larger networks, a broader portfolio of service offerings, greater control over network and transmission lines, stronger name recognition and customer loyalty, long-standing relationships with our target customers, and lower debt leverage ratios. As a result, our ability to attract and retain customers may be adversely affected. Many of our competitors enjoy economies of scale that result in low cost structures for transmission and related costs that could cause significant pricing pressures within the industry. Several long distance carriers in the United States, Canada and Australia and the major wireless carriers and cable companies, have introduced pricing and product bundling strategies that provide for fixed, low rates for calls. This strategy of our competitors could have a material adverse effect on our net revenue per minute, results of operations and financial condition if our pricing, set to remain competitive, is not offset by similar declines in our costs. Many companies emerging out of bankruptcy might benefit from a lower cost structure and might apply pricing pressure within the industry to gain market share. We compete on the basis of price, particularly with respect to our sales to other carriers, and also on the basis of customer service and our ability to provide a variety of telecommunications products and services. If such price pressures and bundling strategies intensify, we may not be able to compete successfully in the future, may face quarterly revenue and operating results variability, and may have heightened difficulty in estimating future revenues or results.

*Our repositioning in the market place places a significant strain on our resources, and if not managed effectively, could result in operational inefficiencies and other difficulties.*

Our repositioning in the market place may place a significant strain on our management, operational and financial resources, and increase demand on our systems and controls. To manage this change effectively, we must continue to implement and improve our operational and financial systems and controls, invest in critical network infrastructure to maintain or improve our service quality levels, purchase and utilize other transmission facilities, and expand, train and manage our employee base. If we inaccurately forecast the movement of traffic onto our network, we could have insufficient or excessive transmission facilities and disproportionate fixed expenses. As we proceed with our development, operational difficulties could arise from additional demand placed on customer provisioning and support, billing and management information systems, product delivery and fulfillment, on our support, sales and marketing and administrative resources and on our network infrastructure. For instance, we may encounter delays or cost-overruns or suffer other adverse consequences in implementing new systems when required. In addition, our operating and financial control systems and infrastructure could be inadequate to ensure timely and accurate financial reporting.

*We have experienced significant historical, and may experience significant future, operating losses and net losses which may hinder our ability to meet our debt service or working capital requirements.*

As of December 31, 2005, we had an accumulated deficit of \$(850.0) million. We incurred net losses of \$(63.6) million in 1998, \$(112.7) million in 1999, \$(174.7) million in 2000, \$(306.2) million in 2001, \$(34.6) million in 2002, \$(10.6) million in 2004 and \$(154.4) million in 2005. During the year ended December 31, 2003, we recognized net income of \$54.8 million, of which \$39.4 million is the positive impact of foreign

## [Table of Contents](#)

currency transaction gains. We cannot assure you that we will recognize net income, or reverse net revenue declines in future periods. If we cannot generate net income or operating profitability, we may not be able to meet our debt service or working capital requirements.

*Integration of acquisitions ultimately may not provide the benefits originally anticipated by management and may distract the attention of our personnel from the operation of our business.*

We strive to increase the volume of voice and data traffic that we carry over our existing global network in order to reduce transmission costs and other operating costs as a percentage of net revenue, improve margins, improve service quality and enhance our ability to introduce new products and services. We may pursue acquisitions in the future to further our strategic objectives. Acquisitions of businesses and customer lists, a key element of our historical growth strategy, involve operational risks, including the possibility that an acquisition does not ultimately provide the benefits originally anticipated by management. Moreover, there can be no assurance that we will be successful in identifying attractive acquisition candidates, completing and financing additional acquisitions on favorable terms, or integrating the acquired business or assets into our own. There may be difficulty in migrating the customer base and in integrating the service offerings, distribution channels and networks gained through acquisitions with our own. Successful integration of operations and technologies requires the dedication of management and other personnel, which may distract their attention from the day-to-day business, the development or acquisition of new technologies, and the pursuit of other business acquisition opportunities, and there can be no assurance that successful integration will occur in light of these factors.

*We experience intense domestic and international competition which may adversely affect our results of operations and financial condition.*

The local and long distance telecommunications, data, broadband, Internet, VOIP and wireless industries are intensely competitive with relatively limited barriers to entry in the more deregulated countries in which we operate and with numerous entities competing for the same customers. Recent and pending deregulation in various countries may encourage new entrants to compete, including ISPs, wireless companies, cable television companies, who would offer voice, broadband, Internet access and television, and electric power utilities who would offer voice and broadband Internet access. For example, the United States and many other countries have committed to open their telecommunications markets to competition pursuant to an agreement under the World Trade Organization which began on January 1, 1998. Further, in the United States, as certain conditions have been met under the Telecommunications Act of 1996, the RBOCs have been allowed to enter the long distance market, and other long distance carriers have been allowed to enter the local telephone services market (although recent judicial and regulatory developments have diminished the attractiveness of this opportunity), and many entities, including cable television companies and utilities, have been allowed to enter both the local service and long distance telecommunications markets. Moreover, the rapid enhancement of VOIP technology may result in increasing levels of traditional domestic and international voice long distance traffic being transmitted over the Internet, as opposed to traditional telecommunication networks such as ours. Currently, there are significant capital investment savings and cost savings associated with carrying voice traffic employing VOIP technology, as compared to carrying calls over traditional networks. Thus, there exists the possibility that the price of traditional long distance voice services will decrease in order to be competitive with VOIP. Additionally, competition is expected to be intense to switch customers to VOIP product offerings, as is evidenced by numerous recent market announcements in the United States and internationally from industry leaders and competitive carriers concerning significant VOIP initiatives. Our ability effectively to retain our existing customer base and generate new customers, either through our network or our own VOIP offerings, may be adversely affected by accelerated competition arising as a result of VOIP initiatives, as well as regulatory developments that may impede our ability to compete, such as restrictions on access to broadband networks owned and operated by others and the requirements to provide E911 services. As competition intensifies as a result of deregulatory, market or technological developments, our results of operations and financial condition could be adversely affected.

## [Table of Contents](#)

*If the fair value of our long-lived assets is determined to be less than its carrying value, any resulting impairment charge could have a material adverse impact on our results of operations and financial condition.*

We assess the recoverability of our long-lived assets to be held and used whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. Our judgments regarding the existence of impairment indicators are based on expected operational performance, market conditions, legal factors and future plans. If we conclude that a triggering event for impairment has occurred, we will compare the carrying value of the assets with the undiscounted cash flows expected to be derived from the usage of the asset. If there is a shortfall and the fair value of the asset is less than its carrying value, we will record an impairment charge for the excess carrying value over fair value. We estimate fair value using a discounted cash flow model. Any resulting impairment charge could have a material adverse impact on our financial condition and results of operations.

*A deterioration in our relationships with facilities-based carriers could have a material adverse effect upon our business.*

We primarily connect our customers' telephone calls and data/Internet needs through transmission lines that we lease under a variety of arrangements with other facilities-based long distance carriers. Many of these carriers are, or may become, our competitors. Our ability to maintain and expand our business depends on our ability to maintain favorable relationships with the facilities-based carriers from which we lease transmission lines. If our relationship with one or more of these carriers were to deteriorate or terminate, it could have a material adverse effect upon our cost structure, service quality, network diversity, results of operations and financial condition.

*Uncertainties and risks associated with international markets could adversely impact our international operations.*

We have significant international operations and, as of December 31, 2005, derive more than 80% of our revenues by providing services outside of the United States. In international markets, we are smaller than the principal or incumbent telecommunications carrier that operates in each of the foreign jurisdictions where we operate. In these markets, incumbent carriers are likely to control access to, and pricing of, the local networks; enjoy better brand recognition and brand and customer loyalty; generally offer a wider range of product and services; and have significant operational economies of scale, including a larger backbone network and more correspondent agreements. Moreover, the incumbent carrier may take many months to allow competitors, including us, to interconnect to its switches within its territory, and we are dependent upon their cooperation in migrating customers onto our network. There can be no assurance that we will be able to obtain the permits and operating licenses required for us to operate; obtain access to local transmission facilities on economically acceptable terms; or market services in international markets. In addition, operating in international markets generally involves additional risks, including unexpected changes in regulatory requirements, taxes, tariffs, customs, duties and other trade barriers, difficulties in staffing and managing foreign operations, problems in collecting accounts receivable, political risks, fluctuations in currency exchange rates, restrictions associated with the repatriation of funds, technology export and import restrictions, and seasonal reductions in business activity. Our ability to operate and grow our international operations successfully could be adversely impacted by these risks and uncertainties particularly in light of the fact that we derive such a large percentage of our revenues from outside of the United States.

*Because a significant portion of our business is conducted outside the United States, fluctuations in foreign currency exchange rates could adversely affect our results of operations.*

A significant portion of our net revenue is derived from sales and operations outside the United States. The reporting currency for our consolidated financial statements is the United States dollar (USD). The local currency of each country is the functional currency for each of our respective entities operating in that country. In the future, we expect to continue to derive a significant portion of our net revenue and incur a significant portion of our operating costs outside the United States, and changes in exchange rates have had and may have a significant, and potentially adverse, effect on our results of operations. Our primary risk of loss regarding foreign currency

## [Table of Contents](#)

exchange rate risk is caused by fluctuations in the following exchange rates: USD/AUD, USD/CAD, USD/GBP, and USD/EUR. See “Quantitative and Qualitative Disclosures about Market Risk.” Due to the large percentage of our operations conducted outside of the United States, strengthening or weakening of the USD relative to one or more of the foregoing currencies could have an adverse impact on future results of operations. We historically have not engaged in hedging transactions and do not currently contemplate engaging in hedging transactions to mitigate foreign exchange risks. In addition, the operations of affiliates and subsidiaries in foreign countries have been funded with investments and other advances denominated in foreign currencies. Historically, such investments and advances have been long-term in nature, and we accounted for any adjustments resulting from currency translation as a charge or credit to accumulated other comprehensive loss within the stockholders’ deficit section of our consolidated balance sheets. In 2002, agreements with certain subsidiaries were put in place for repayment of a portion of the investments and advances made to those subsidiaries. As we anticipate repayment in the foreseeable future of these amounts, we recognize the unrealized gains and losses in foreign currency transaction gain (loss) on the consolidated statements of operations, and depending upon changes in future currency rates, such gains or losses could have a significant, and potentially adverse, effect on our results of operations.

*The telecommunications industry is rapidly changing, and if we are not able to adjust our strategy and resources effectively in the future to meet changing market conditions, we may not be able to compete effectively.*

The telecommunications industry is changing rapidly due to deregulation, privatization, consolidation, technological improvements, availability of alternative services such as wireless, broadband, DSL, Internet, VOIP, and wireless DSL through use of the fixed wireless spectrum, and the globalization of the world’s economies. In addition, alternative services to traditional fixed wireline services, such as wireless, broadband, Internet and VOIP services, are a substantial competitive threat. If we do not adjust our contemplated plan of development to meet changing market conditions and if we do not have adequate resources, we may not be able to compete effectively. The telecommunications industry is marked by the introduction of new product and service offerings and technological improvements. Achieving successful financial results will depend on our ability to anticipate, assess and adapt to rapid technological changes, and offer, on a timely and cost-effective basis, services including the bundling of multiple services, that meet evolving industry standards. If we do not anticipate, assess or adapt to such technological changes at a competitive price, maintain competitive services or obtain new technologies on a timely basis or on satisfactory terms, our financial results may be materially and adversely affected.

*If we are not able to operate a cost-effective network, we may not be able to successfully grow our business.*

Our long-term success depends on our ability to design, implement, operate, manage and maintain a reliable and cost-effective network. In addition, we rely on third parties to enable us to expand and manage our global network and to provide local, broadband Internet and wireless services. If we fail to generate additional traffic on our network, if we experience technical or logistical impediments to our ability to develop necessary network (such as our DSL networks in Australia and Canada) or to migrate traffic and customers onto our network, or if we experience difficulties with our third-party providers, we may not achieve desired economies of scale or otherwise be successful in growing our business.

*If we are not able to use and protect our intellectual property domestically and internationally, it could have a material adverse effect on our business.*

Our ability to compete depends, in part, on our ability to use intellectual property in the United States and internationally. We rely on a combination of trade secrets, trademarks and licenses to protect our intellectual property. We are also subject to the risks of claims and litigation alleging infringement of the intellectual property rights of others. The telecommunications industry is subject to frequent litigation regarding patent and other intellectual property rights. We rely upon certain technology, including hardware and software, licensed from third parties. There can be no assurance that the technology licensed by us will continue to provide competitive features and functionality or that licenses for technology currently used by us or other technology

## [Table of Contents](#)

that we may seek to license in the future will be available to us on commercially reasonable terms or at all. Although our existing intellectual property are on standard commercial terms made generally available by the companies providing the licenses and, individually, their costs and terms are not material to our business, the loss of, or our inability to maintain existing licenses, could result in shipment delays or reductions until equivalent technology or suitable alternative products could be developed, identified, licensed and integrated. Such delays or reductions in the aggregate could harm our business.

*The loss of our key personnel could have a material adverse effect on our business.*

The loss of the services of K. Paul Singh, our Chairman and Chief Executive Officer, or the services of our other key personnel, or our inability to attract and retain additional key management, technical and sales personnel, could have a material adverse effect upon us.

*We are subject to potential adverse effects of regulation which may have a material adverse impact on our competitive position, growth and financial performance.*

Our operations are subject to constantly changing regulation. There can be no assurance that future regulatory changes will not have a material adverse effect on us, or that regulators or third parties will not raise material issues with regard to our compliance or noncompliance with applicable regulations, any of which could have a material adverse effect upon us. As a multinational telecommunications company, we are subject to varying degrees of regulation in each of the jurisdictions in which we provide our services. Local laws and regulations, and the interpretation of such laws and regulations, differ significantly among the jurisdictions in which we operate. Enforcement and interpretations of these laws and regulations can be unpredictable and are often subject to the informal views of government officials. Recent widespread regulatory changes in the United Kingdom and potential future regulatory, judicial, legislative and government policy changes in other jurisdictions where we operate could have a material adverse effect on us. Domestic or international regulators or third parties may raise material issues with regard to our compliance or noncompliance with applicable regulations, and therefore may have a material adverse impact on our competitive position, growth and financial performance. Regulatory considerations that affect or limit our business include (1) United States common carrier requirements not to discriminate unreasonably among customers and to charge just and reasonable rates; (2) general uncertainty regarding the future regulatory classification of and taxation of VOIP telephony, the need to provide emergency calling services in a manner required by the FCC that is not yet available commercially on a nationwide basis and the ability to access broadband networks owned and operated by others; if regulators decide that VOIP is a regulated telecommunications service, our VOIP services may be subject to burdensome regulatory requirements and fees, we may be obligated to pay carriers additional interconnection fees and operating costs may increase; (3) general changes in access charges, universal service and regulatory fee payments would affect our cost of providing long distance services; (4) the ultimate regulatory resolution regarding efforts by Telstra in Australia to increase prices and charges; and (5) general changes in access charges and contribution payments could adversely affect our cost of providing long distance, wireless, broadband, VOIP, local and other services. Any adverse developments implicating the foregoing could materially adversely affect our business, financial condition, result of operations and prospects.

*Natural disasters may affect the markets in which we operate, our operations and our profitability.*

Many of the geographic areas where we conduct our business may be affected by natural disasters, including hurricanes and tropical storms. Hurricanes, tropical storms and other natural disasters could have a material adverse effect on the business by damaging the network facilities or curtailing voice or data traffic as a result of the effects of such events, such as destruction of homes and businesses.

*Terrorist attacks and other acts of violence or war may affect the markets in which we operate, our operations and our profitability.*

We are a United States-based corporation with significant international operations. Terrorist attacks, such as the attacks that occurred in New York City and Washington, D.C. on September 11, 2001, and subsequent

## [Table of Contents](#)

worldwide terrorist actions, including apparent action against companies operating abroad, may negatively affect our operations. We cannot assure you that there will not be further terrorist attacks that affect our employees, network facilities or support systems, either in the United States or in any of the other countries in which we operate. Certain losses resulting from these types of events are uninsurable and others are not likely to be covered by our insurance. Terrorist attacks may directly impact our business operations through damage or harm to our employees, network facilities or support systems, increased security costs or the general curtailment of voice or data traffic. Any of these events could result in increased volatility in or damage to our business and the United States and worldwide financial markets and economies.

*A small group of our stockholders could exercise influence over our affairs.*

As of February 28, 2006, funds affiliated with American International Group, Incorporated (AIG Entities) beneficially owned 15% of our outstanding common stock, which was acquired through the conversion of their Series C Preferred Stock. As a result of such share ownership, these holders can exercise influence over our affairs through the provisions of a certain Governance Agreement between such holders and us, dated November 4, 2003, that provide for their right to nominate a candidate for election by our stockholders to our board of directors and nominate one non-voting board observer, in each case subject to the maintenance of certain minimum ownership levels of our common stock and our board's right to exercise its fiduciary duties.

In addition, these holders' significant ownership levels could have an influence on: amendments to our certificate of incorporation; other fundamental corporate transactions such as mergers and asset sales; and the general direction of our business and affairs.

Also, the applicable triggering provisions of our rights agreement with StockTrans, Inc., as Rights Agent, dated December 23, 1998 (as amended, the "Rights Agreement") contain exceptions with respect to the acquisition of beneficial ownership of our shares by such holders and the other former holders of Series C Preferred Stock. As a result, such holders could gain additional control over our affairs without triggering the provisions of the Rights Agreement.

Finally, other stockholders that acquire a significant portion of our common stock, either in the market or in future issuances by us, could potentially exercise influence over our affairs.

*Significant future sales of our common stock in the public market could adversely affect the market price of our common stock and could impair our ability to raise funds in additional stock offerings.*

Significant future sales of our common stock in the public market, including in particular the shares offered under the Common Stock Resale Registration Statement (defined below) and the Note Registration Statement (defined below) and shares issuable upon conversion of the 2009 Debentures, could lower our stock price and impair our ability to raise funds in new stock offerings. Of 22.6 million shares of our common stock originally issued upon conversion of our Series C Preferred stock (the "Series C Registered Securities") in November 2003, which were registered for resale under an effective registration statement (the "Common Stock Resale Registration Statement") under the Securities Act, 16.5 million shares were, as of February 23, 2006, held by a group of affiliated holders. These shares, in general, may be freely resold under the Securities Act pursuant to the Common Stock Resale Registration Statement. The holders of the 2010 Notes have a registration statement that has been declared effective under the Securities Act (the "Note Registration Statement") covering these notes and the 14.2 million shares of common stock issuable upon conversion of these notes, and the 23.2 million shares of common stock issuable upon conversion of the outstanding 2009 Debentures will be unrestricted and freely transferable under the Securities Act. Sales of a substantial amount of this common stock in the public market, or the perception that these sales may occur, could create selling pressure on our common stock and adversely affect the market price of our common stock prevailing from time to time in the public market and could impair our ability to raise funds in additional stock offerings.

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[Table of Contents](#)

**ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS**

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

(a) Exhibits (see index on page 53)



**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description</b>
3.1	First amended and Restated Certificate of Incorporation of Primus; Incorporated by reference to Exhibit 3.1 of the Registration Statement on Form S-8, No. 333-56557.
3.2	Certificate of Amendment to First Amended and Restated Certificate of Incorporation of Primus; Incorporated by reference to Exhibit 3.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 2004.
3.3	Amended and Restated Bylaws of Primus; Incorporated by reference to Exhibit 3.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 2002.
4.1	Indenture, dated February 27, 2006, between the Company and U.S. Bank National Association, as Trustee, concerning the Step Up Convertible Subordinated Debentures due 2009, including therein the form of the debentures; Incorporated by reference to Exhibit 4.1 to the Company's current report on Form 8-K file on March 2, 2006.
10.1	Second amended and restated Loan agreement, dated as of January 31, 2006 between the Manufactures Life Insurance Company and Primus Telecommunications Canada Inc. and 3082833 Nova Scotia Company; Incorporated by reference to the Company's current report on Form 8-K dated February 3, 2006.
10.2	Form of Subscription Agreement, pursuant to the Company's Registration Statement on Form S-3 (File No. 333-110241), as supplemented by the Prospectus Supplement dated March 13, 2006; Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K dated March 15, 2006.
31	Certifications.
32	Certification.*

\* This certification is being "furnished" and will not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act (15 U.S.C. 78r) and will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that the registrant specifically incorporates it by reference.





**CERTIFICATION**

Pursuant to Section 906 of the Public Company Accounting Reform and Investor Protection Act of 2002 (18 U.S.C. § 1350, as adopted), K. Paul Singh, the Chief Executive Officer of Primus Telecommunications Group, Incorporated (the "Company"), and Thomas R. Kloster, the Chief Financial Officer of the Company, each hereby certifies that, to the best of his knowledge:

1. The Company's Quarterly Report on Form 10-Q for the period ended March 31, 2006, to which this Certification is attached as Exhibit 32 (the "Periodic Report"), fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and

2. The information contained in the Periodic Report fairly presents, in all material respects, the financial condition of the Company at the end of the period covered by the Periodic Report and results of operations of the Company for the period covered by the Periodic Report.

Dated: May 10, 2006

/s/ K. PAUL SINGH

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**K. Paul Singh**  
Chairman, President and Chief Executive Officer  
(Principal Executive Officer) and Director

/s/ THOMAS R. KLOSTER

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**Thomas R. Kloster**  
Senior Vice President and Chief Financial Officer  
(Principal Financial Officer)