INFONET SERVICES CORP
Form 10-Q
November 10, 2003

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 26, 2003

OR

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

For the transition period from __________ to __________

Commission file number 1-15475

INFONET SERVICES CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**95-4148675**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

2160 East Grand Avenue, El Segundo, California

(Address of principal executive offices)

90245-1022

(Zip Code)

(310) 335-2600

(Registrant s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed under Sections 12, 13 or 15(d) of the Securities Exchange of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes ¨ No ¨

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

As of November 5, 2003, the registrant had the following number of shares outstanding:

Class A common stock: 161,403,358

Class B common stock: 301,650,470

INFONET SERVICES CORPORATION

FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 26, 2003

PART I FINANCIAL INFORMATION

ITEM 1. *FINANCIAL STATEMENTS*

INFONET SERVICES CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In Thousands, Except per Share Amounts)

	March 31, 2003	September 30, 2003
		(Unaudited)
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 146,730	$ 116,477
Short-term investments	282,249	286,595
Accounts receivable, net	139,981	133,147
Deferred income taxes	1,266	1,636
Prepaid expenses	24,243	26,053
Other current assets	22,576	23,043
Total current assets	617,045	586,951
Property, Equipment And Communication Lines, Net	423,524	417,191
Intangible And Other Assets, Net	54,158	57,610
Total Assets	$ 1,094,727	$ 1,061,752
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Current portion of capital lease obligations	$ 2,151	$ 1,535
Accounts payable	41,103	32,943
Network communications	26,812	33,865
Accrued salaries and related benefits	24,914	18,181
Income taxes payable	9,894	9,980
Advance billings	25,837	31,546
Deferred installation revenues	11,493	12,516
Other accrued expenses	27,425	28,615
Total current liabilities	169,629	169,181
Deferred Revenue	17,358	19,289

Deferred Compensation	19,369	19,523
Capital Lease Obligations, Less Current Portion	4,081	3,385
Minority Interest	1,612	1,312
Commitments and Contingencies		
Stockholders Equity:		
Class A common stock, $0.01 par value per share:		
400,000 shares authorized; 364,160 shares issued; 161,403 shares outstanding; and 202,757 shares held in treasury	66,078	66,078
Class B common stock $0.01 par value per share:		
600,000 shares authorized; 311,577 and 312,340 shares issued as of March 31, 2003 and September 30, 2003; 304,192 and 302,147 shares outstanding as of March 31, 2003 and September 30, 2003; 7,385 and 10,193 shares held in treasury as of March 31, 2003 and September 30, 2003	1,190,002	1,196,137
Treasury stock, at cost, 210,142 and 212,950 shares as of March 31, 2003 and September 30, 2003	(136,017)	(140,501)
Notes receivable from issuance of common stock	(8,736)	(8,911)
Accumulated deficit	(225,753)	(262,738)
Accumulated other comprehensive loss	(2,896)	(1,003)
Total stockholders equity	882,678	849,062
Total Liabilities and Stockholders Equity	$ 1,094,727	$ 1,061,752

See accompanying notes to consolidated financial statements.

INFONET SERVICES CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(In Thousands, Except per Share Amounts)

(Unaudited)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2002	**2003**	**2002**	**2003**
Revenues, Net	$ 142,815	$ 151,282	$ 290,122	$ 300,345
Operating Costs and Expenses:				
Communication services costs	24,622	25,628	53,822	47,141
Integration and provisioning costs	40,060	52,071	79,207	106,262
Bandwidth and related costs	25,991	26,042	92,900	52,740
Network operations	27,444	30,415	53,748	61,081
Selling, general and administrative	37,278	34,596	77,651	70,161
Total operating costs and expenses	155,395	168,752	357,328	337,385
Operating Loss	(12,580)	(17,470)	(67,206)	(37,040)
Other Income (Expense):				
Interest income	3,601	2,173	7,923	4,305
Interest expense	(2,174)	(202)	(4,443)	(328)
Equity in loss of unconsolidated affiliates	(878)	(808)	(982)	(1,547)
Other, net	33	(141)	3,153	(1,074)
Total other income, net	582	1,022	5,651	1,356
Loss Before (Credit) Provision For Income Taxes and Minority Interest	(11,998)	(16,448)	(61,555)	(35,684)
(Credit) Provision For Income Taxes	(5,985)	655	(19,189)	1,299
Loss Before Minority Interest	(6,013)	(17,103)	(42,366)	(36,983)
Minority Interest	204	84	271	2
Net Loss	(6,217)	(17,187)	(42,637)	(36,985)
Other Comprehensive Income (Loss):				
Foreign currency translation adjustments	285	242	3,960	2,857
Unrealized gains on securities, net of income tax in 2002	538	(905)	828	(964)
Unrealized loss on derivative instruments, net of income tax in 2002	(928)		(1,721)	
Total other comprehensive income (loss), net	(105)	(663)	3,067	1,893
Comprehensive Loss	$ (6,322)	$ (17,850)	$ (39,570)	$ (35,092)

Basic and Diluted Loss Per Common Share	$ (0.01)	$ (0.04)	$ (0.09)	$ (0.08)
Basic Weighted Average Number of Common Shares Outstanding	469,496	464,096	469,381	464,356
Diluted Weighted Average Number of Common Shares Outstanding	469,496	464,096	469,381	464,356

See accompanying notes to consolidated financial statements.

INFONET SERVICES CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Thousands)

(Unaudited)

	Six Months Ended September 30,	
	2002	**2003**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (42,637)	$ (36,985)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	38,840	38,492
Amortization of debt acquisition costs	375	
Equity in loss of unconsolidated affiliates	982	1,547
Write-off of communication lines	40,757	
Stock-based compensation charge	7,001	5,288
(Gain) loss on disposal of property, equipment and communication lines	(139)	817
Premium amortization on marketable securities	2,758	2,453
Realized gain on marketable securities	(1,426)	(158)
Deferred income taxes	(20,493)	(370)
Minority interest	271	2
Changes in operating assets and liabilities:		
Accounts receivable, net	28,453	8,604
Prepaid expenses	(1,386)	(1,473)
Other current assets	7,502	894
Accounts payable	(17,875)	(6,676)
Network communications	(6,492)	5,499
Accrued salaries and related benefits	(2,711)	(7,223)
Income taxes payable	(271)	(98)
Advance billings	(4,792)	5,707
Other accrued expenses	4,714	3,514
Deferred revenue	48	(224)
Deferred compensation	313	(1,144)
Purchases of trading securities	(4,863)	(6,779)
Proceeds from sales of trading securities	4,378	5,929
Other operating activities	312	(455)
Net cash provided by operating activities	33,619	17,161
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property, equipment and communication lines	(21,588)	(32,724)
Proceeds from sale of property, equipment and communication lines	129	268
Purchases of securities available-for-sale	(170,159)	(135,593)
Proceeds from sales of securities available-for-sale	156,519	106,790
Maturities of securities available-for-sale	59,250	21,198
Investments in unconsolidated affiliates	(9,000)	(4,031)

Net cash provided by (used in) investing activities	15,151	(44,092)

(Table continued on following page)

INFONET SERVICES CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(In Thousands)

(Unaudited)

	Six Months Ended September 30,	
	2002	**2003**
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of long-term obligations	$ (6,433)	$
Repayments of capital lease obligations	(1,367)	(1,312)
Purchases of treasury stock	(5,310)	(4,375)
Net proceeds from issuance of common stock	1,052	847
Distribution to minority interest		(302)
Repayments of notes receivable from issuance of common stock	70	
Net cash used in financing activities	(11,988)	(5,142)
Effect of Exchange Rate Changes on Cash and Cash Equivalents	2,375	1,820
Net Increase (Decrease) in Cash and Cash Equivalents	39,157	(30,253)
Cash and Cash Equivalents, Beginning of Period	147,180	146,730
Cash and Cash Equivalents, End of Period	$ 186,337	$ 116,477
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Income taxes	$ 1,251	$ 1,204
Interest	$ 3,880	$ 343
SUPPLEMENTAL NONCASH INVESTING AND FINANCING ACTIVITIES:		
Acquisitions of communication lines accrued but not yet paid	$ 2,928	$ 2,689
Acquisitions of equipment accrued but not yet paid	$ 1,854	$ 198

See accompanying notes to consolidated financial statements.

INFONET SERVICES CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Basis of Presentation

In the opinion of management, the accompanying unaudited financial statements of Infonet Services Corporation and subsidiaries (the Company) have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Regulation S-X promulgated under the Securities Exchange Act of 1934. Correspondingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. All normal, recurring adjustments considered necessary for a fair presentation have been included. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. Actual results may differ from these estimates. The financial statements should be read in conjunction with the financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended March 28, 2003 filed with the Securities and Exchange Commission on June 26, 2003. Certain items have been reclassified to conform with the current period presentation. The results of operations for the three and six months ended September 30, 2003 are not necessarily indicative of the results that may be expected for the fiscal year ending April 2, 2004.

The Company s fiscal year is the 52- or 53-week period ending on the Friday nearest to March 31. For simplicity of presentation, the Company has described the 52-week period ended March 28, 2003 as the year ended March 31, 2003, and the 13- and the 26-week periods ended September 27, 2002 and September 26, 2003 as the three and six months ended September 30, 2002 and September 30, 2003, respectively.

Note 2. New Accounting Pronouncements

Statement of Financial Accounting Standards (SFAS) No. 143 Accounting for Asset Retirement Obligations , which became effective for the Company on April 1, 2003, addresses the obligations and asset retirement costs associated with the retirement of tangible long-lived assets. It requires that the fair value of the liability for an asset retirement obligation be recorded when incurred instead of over the life of the asset. The asset retirement costs must be capitalized as part of the carrying value of the long-lived asset. If the liability is settled for an amount other than the recorded balance, either a gain or loss will be recognized at settlement. The adoption of SFAS No. 143 did not have a material effect on the Company s consolidated financial position or results of operations.

In November 2002, the Emerging Issues Task Force (EITF) reached a consensus on Issue No. 00-21, Revenue Arrangements with Multiple Deliverables . EITF Issue No. 00-21 addresses certain aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities and how arrangement considerations should be measured and allocated to the separate units of accounting in the arrangement. The provisions of EITF Issue No. 00-21 apply to revenue arrangements entered into during fiscal periods beginning after June 15, 2003. The adoption of EITF Issue No. 00-21 did not have a material effect on the Company s consolidated financial position or results of operations.

In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation No. 46, Consolidation of Variable Interest Entities . The interpretation clarifies the application of Accounting Research Bulletin No. 51, Consolidated Financial Statements , to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. This interpretation applies immediately to variable interest entities created after January 31, 2003 and variable interest entities in which a company obtains an interest after January 31, 2003. For variable interest entities in which a company obtained an interest before February 1, 2003, the interpretation applies to the fiscal periods ending after

INFONET SERVICES CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 15, 2003. Adoption of this interpretation is not expected to have a material effect on the Company s consolidated financial position or results of operations.

In April 2003, the FASB issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities . SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities . This statement is effective for contracts entered into or modified after June 30, 2003. The adoption of SFAS No. 149 did not have a material effect on the Company s consolidated financial position or results of operations.

In May 2003, the EITF reached a consensus on Issue No. 01-08, Determining Whether an Arrangement Contains a Lease . EITF Issue No. 01-08 provides guidance on how to determine whether an arrangement contains a lease that is within the scope of SFAS No. 13, Accounting for Leases . The guidance in EITF Issue No. 01-08 is based on whether the arrangement conveys to the purchaser (lessee) the right to use a specific asset. Issue No. 01-08 is effective for arrangements entered into or modified during fiscal periods beginning after May 28, 2003. The adoption of EITF Issue No. 01-08 did not have a material effect on the Company s consolidated financial position or results of operations.

Note 3. Stock Incentive Plans

The Company issues stock options and other stock-based awards to employees and directors. The Company accounts for those plans under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees , and related interpretations. In accordance with SFAS No. 123, Accounting for Stock-Based Compensation , as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure , the following pro forma net income and earnings per share information is presented as if the Company accounted for stock-based compensation awarded under the stock incentive plans using the fair value method. Under the fair value method, the estimated fair value of stock incentive awards is charged against income on a straight-line basis over the vesting period.

	Three Months Ended September 30,		Six Months Ended September 30,	
	2002	**2003**	**2002**	**2003**
	(In thousands, except per share amounts)			
Net loss, as reported	$ (6,217)	$ (17,187)	$ (42,637)	$ (36,985)
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects in 2002	3,046	2,509	6,473	5,288
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects in 2002	(8,695)	(10,802)	(17,588)	(21,648)
Pro forma net loss	$ (11,866)	$ (25,480)	$ (53,752)	$ (53,345)
Loss per share:				

Basic and diluted, as reported	$ (0.01)	$ (0.04)	$ (0.09)	$ (0.08)
Basic and diluted, pro forma	$ (0.03)	$ (0.05)	$ (0.11)	$ (0.11)

During May 2003, the Company s board of directors adopted, subject to stockholder approval, the amended and restated Infonet Services Corporation 2000 Employee Stock Purchase Plan (the Amended ESPP) to be effective January 1, 2004. The Amended ESPP was approved by the Company s stockholders on August 19,

INFONET SERVICES CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2003. The Amended ESPP, among other things, increases the number of shares of Class B common stock reserved for issuance under the Company s existing 2000 Employee Stock Purchase Plan from 2,000,000 to 4,000,000.

During May 2003, the Company s board of directors adopted the 2003 Incentive Award Plan of Infonet Services Corporation (the 2003 Plan), subject to stockholder approval. The 2003 Plan was approved by the Company s stockholders on August 19, 2003, and will serve as a successor to the Company s 1998 Stock Option Plan, 1999 Stock Option Plan and 2000 Omnibus Stock Plan (the Prior Plans). The aggregate number of shares of Class B common stock subject to options, stock purchase rights, stock appreciation rights, and other awards under the 2003 Plan is equal to 20,000,000, plus the number of shares of Class B common stock that remain available for the grant of options or other awards under the Prior Plans, together with any additional shares of Class B common stock that may become available for issuance under the Prior Plans as a result of the reserved share replenishment provisions of those plans or as a result of stock options under those plans expiring or otherwise becoming unexercisable.

During January 2002, the Company extended an offer to most of its non-director employees to exchange outstanding options to purchase shares of the Company s Class B common stock with an exercise price of $13.00 or higher granted under the Infonet Services Corporation 1999 Stock Option Plan and 2000 Omnibus Stock Plan for new options (the New Options) to be granted under the same plans. On February 14, 2002, approximately 6,352,000 options were cancelled pursuant to the offer to exchange. On August 20, 2002, which was at least six months and one day from the date the Company accepted the outstanding options for exchange and cancelled the options, approximately 6,292,000 New Options were issued under the same plans at an exercise price of $2.26 per share.

Note 4. Reclassifications

Certain reclassifications have been made to the prior year financial statements to conform with the current period presentation. The Company also has reclassified its expense categories as previously reported for the three and six months ended September 30, 2002 as follows (in thousands):

	Three Months Ended September 30, 2002				
	Country Representative Compensation	Bandwidth and Related Costs	Network Operations	Selling, General and Administrative	Total New Classification
Communication services costs	$ 21,201(a)	$	$	$ 3,421(b)	$ 24,622
Integration and provisioning costs	8,566(c)	1,688(d)	(479)	30,285(e)	40,060
Bandwidth and related costs		25,991			25,991
Network operations			27,444		27,444
Selling, general and administrative				37,278	37,278
Total Prior Classification	$ 29,767	$ 27,679	$ 26,965	$ 70,984	$ 155,395

INFONET SERVICES CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Six Months Ended September 30, 2002				
	Country Representative Compensation	Bandwidth and Related Costs	Network Operations	Selling, General and Administrative	Total New Classification
Communication services costs	$ 47,606(a)	$	$	$ 6,216(b)	$ 53,822
Integration and provisioning costs	20,376(c)	3,918(d)	(250)	55,163(e)	79,207
Bandwidth and related costs		92,900			92,900
Network operations			53,748		53,748
Selling, general and administrative				77,651	77,651
Total Prior Classification	$ 67,982	$ 96,818	$ 53,498	$ 139,030	$ 357,328

Notes (a) through (e) are used in the following paragraphs to describe each of the expense reclassifications.

Communication Services Costs

Communication services costs, including both country representative compensation and support compensation, consist of costs associated with Network Services, Application Services and Other Communication Services revenues. The country representative compensation was previously reported in the country representative compensation category (reference (a) in reclassification tables above). The support compensation expense was previously reported in the selling, general and administrative category (reference (b) in reclassification tables above).

Integration and Provisioning Costs

The Company s integration and provisioning costs include expenses related to Global Connect revenues, or the provisioning of the last mile whereby the Company installs and manages leased lines and customer premise equipment at the client s site to enable the client to access The World Network and use the Company s Network Services. These expenses are paid in the form of country representative compensation and support compensation to country representatives as well as local access costs paid directly to local telecom service providers. Integration and provisioning costs also include the amortization of installation expenses over the life of the client contract. The country representative compensation was previously reported in the country representative compensation category (reference (c) in reclassification tables above). The support compensation expense was previously reported in the selling, general and administrative category (reference (e) in reclassification tables above). The local access costs, incurred by consolidated country representatives for provisioning the last mile services for the client, were previously reported in the bandwidth and related costs category (reference (d) in reclassification tables above).

Note 5. Derivative Financial Instruments

Under the terms of its $250,000,000 Senior Secured Credit Facility, which was terminated in December 2002, the Company was required to enter into hedge agreements to provide that at least 50% of the outstanding term loans would be subject to fixed interest rates. The Company entered into interest swap agreements to fix the interest rates and mitigate interest rate risk. In connection with the mortgage agreement related to the purchase of the Company s headquarters facility, which was repaid in March 2003, the Company entered into an interest rate swap to fix the interest rate over the remaining life of the mortgage agreement and mitigate interest rate risk. The Company designated the swaps as cash flow hedges pursuant to SFAS No. 133, as amended.

INFONET SERVICES CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the six months ended September 30, 2002, the change in fair market value of cash flow hedges resulted in a pre-tax charge to Other Comprehensive Income (OCI) of approximately $2.8 million (approximately $1.7 million, net of tax). In conjunction with the repayment of the indebtedness under the Senior Secured Credit Facility and termination thereof on December 20, 2002, the interest rate swap agreements were terminated. In conjunction with the repayment of the mortgage indebtedness on March 21, 2003, the interest rate swap agreement was terminated.

Note 6. Property, Equipment and Communication Lines

Property, equipment and communication lines consist of the following (in thousands):

	March 31, 2003	September 30, 2003
Communications, computer and related equipment	$ 286,154	$ 310,314
Communication lines	302,980	305,240
Land, buildings and leasehold improvements	77,851	78,631
Furniture and other equipment	19,449	20,154
	686,434	714,339
Less accumulated depreciation and amortization	262,910	297,148
Property, equipment and communication lines, net	$ 423,524	$ 417,191

Communication lines consist of purchased bandwidth. Under the purchased bandwidth arrangements, the Company s rights to use the communication lines range from 10 to 25 years.

The Company had purchased bandwidth with a net book value of approximately $40.8 million as of June 30, 2002 from a network service provider and its affiliates, each of which was in bankruptcy proceedings as of June 30, 2002. These service providers subsequently shut down operations and, as a result, the services they were providing for the Company under the purchased bandwidth agreements were disrupted. The Company determined that the service disruption was permanent and concluded to write-off the net book value of the purchased bandwidth at June 30, 2002. This write-off resulted in a charge to the Company s results of operations of approximately $40.8 million which is included in bandwidth and related costs in the consolidated statement of operations for the six months ended September 30, 2002.

Note 7. Intangible and Other Assets

Intangible and other assets consist of the following (in thousands):

	March 31, 2003	September 30, 2003
SERP minimum pension liability	$ 2,030	$ 2,030
Pension minimum liability	18	18
IDIP assets	6,413	8,560
Deferred installation costs	15,912	17,993
Unconsolidated investments in affiliates	19,364	19,795
Goodwill	1,468	1,468
Intangible assets, net	3,162	2,501
Employee loans and interest receivable	2,026	1,435
Other	3,765	3,810
Intangible and other assets, net	$ 54,158	$ 57,610

INFONET SERVICES CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For the six months ended September 30, 2003, no intangibles were acquired, impaired or disposed. Intangibles consisted of the following (in thousands):

		March 31, 2003			September 30, 2003		
	Weighted Average Lives	Gross Carrying Amount	Accumulated Amortization	Intangible Assets, Net	Gross Carrying Amount	Accumulated Amortization	Intangible Assets, Net
Purchased technology	5	$ 6,600	$ (3,520)	$ 3,080	$ 6,600	$ (4,180)	$ 2,420
Other	5-20	1,681	(1,599)	82	1,681	(1,600)	81
		$ 8,281	$ (5,119)	$ 3,162	$ 8,281	$ (5,780)	$ 2,501

Amortization expense for the six months ended September 30, 2003 was approximately $661,000. At September 30, 2003, estimated future amortization expense is as follows: approximately $663,000 for the remaining six months of fiscal year 2004 and approximately $1.3 million, $446,000, $6,000, $6,000, $6,000 and $46,000 for fiscal years 2005, 2006, 2007, 2008, 2009 and thereafter, respectively.

Note 8. Earnings (Loss) Per Share

Basic earnings (loss) per common share is computed by dividing net income (loss) by the weighted average number of shares outstanding during the periods presented. Diluted earnings (loss) per common share is computed based on the weighted average number of shares outstanding plus the dilutive effect of potential common stock.

At September 30, 2002 and 2003, the types of potential common stock were stock options and purchase rights. The inclusion of potential common stock had an antidilutive effect on the reported loss per share for the three and six months ended September 30, 2002 and 2003. Consequently, reported basic and diluted earnings per share are the same amount for the three and six months ended September 30, 2002 and 2003. Options to purchase approximately 26.8 million and approximately 30.4 million shares of common stock were outstanding at September 30, 2002 and 2003, respectively, but were not included in the computation of diluted earnings per share because to do so would have been antidilutive.

Note 9. Income Taxes

In the quarter ended March 31, 2003, the Company recorded a non-cash charge to establish a valuation allowance against its entire net U.S. deferred income tax assets. The valuation allowance was recorded in accordance with the provisions of SFAS No. 109, Accounting for Income Taxes due to the lack of evidence, within the meaning of SFAS No. 109, of the existence of sufficient future taxable income needed to realize the deferred income tax assets. The Company also announced that until appropriate levels of profitability were reached, it would not recognize any domestic income tax benefits in its future results of operations. In the three and six months ended in September 30, 2003 the Company did not record income tax benefits resulting from its U.S. losses. The tax provision that was recorded is comprised of foreign subsidiary income taxes, foreign withholding taxes and state income taxes in jurisdictions that do not permit consolidated tax filings.

At September 30, 2003 the gross amount of the Company s net deferred income tax assets was $195.2 million. The valuation reserve recorded against those net deferred income tax assets was $193.6 million. The $1.6 million residual is comprised of foreign net deferred income tax assets.

INFONET SERVICES CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 10. Segment Information

The Company conducts business in two operating segments: country representatives or Direct Sales Channels (Direct) and Alternate Sales Channels (Alternate). Both of these segments generate revenues by providing the Company s customers with a complete global networking solution.

The Company has organized its operating segments around differences in distribution channels used to deliver its services to clients. These segments are managed and evaluated separately because each segment possesses different economic characteristics requiring different marketing strategies.

The accounting policies adopted for each segment are the same as those described in the summary of significant accounting policies in the Company s Annual Report on Form 10-K. The Company s management evaluates performance based on operating contribution, where segment revenues are reduced by those costs that are allocable to the segments. Costs relating to operating the Company s core network, and non-allocable general, administrative, marketing and overhead costs, including income tax expense, are not charged to the segments. Accordingly, neither assets related to the core network, nor their associated depreciation expense are allocated to the segments.

The Company accounts for intersegment transactions on the same terms and conditions as if the transactions were with third parties. Intersegment revenues are not material to any segment.

Summarized financial information concerning the Company s reportable segments is shown in the following table (in thousands).

	Three Months Ended September 30,		**Six Months Ended September 30,**	
	2002	**2003**	**2002**	**2003**
Reportable segments:				
Revenues:				
Direct	$ 115,573	$ 133,203	$ 229,510	$ 265,502
Alternate	27,242	18,079	60,612	34,843
Total	$ 142,815	$ 151,282	$ 290,122	$ 300,345
Operating contributions:				
Direct	$ 45,379	$ 46,752	$ 90,275	$ 92,220
Alternate	8,230	8,060	15,398	15,868

Total	$ 53,609	$ 54,812	$ 105,673	$ 108,088

	September 30,	
	2002	2003
Total Assets:		
Direct	$ 103,329	$ 138,108
Alternate	18,306	14,021
Total	$ 121,635	$ 152,129

INFONET SERVICES CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2002	2003	2002	2003
Reconciliations:				
Operating contribution from reportable segments	$ 53,609	$ 54,812	$ 105,673	$ 108,088
Core network, overhead and other non-allocable costs	(65,607)	(71,260)	(167,228)	(143,772)
Loss before credit for income taxes and minority interest	$ (11,998)	$ (16,448)	$ (61,555)	$ (35,684)

	September 30,	
	2002	2003
Total assets of reportable segments	$ 121,635	$ 152,129
Core network, corporate and other non-allocable assets	1,223,039	909,623
Total assets	$ 1,344,674	$ 1,061,752

Note 11. Related-Party Transactions

Related parties consist of the Company s stockholders and its affiliates as well as non-consolidated country representative organizations in which the Company holds greater than a 20% but less than a 50% ownership interest, country representative organizations owned directly or indirectly by the Company s stockholders, and the affiliates of the Company s stockholders.

Related party transactions for the periods presented comprise the following (in thousands):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2002	2003	2002	2003
Revenues: (From services sold to the following related parties)				
AUCS Communications Services N.V. (The Netherlands)	$ 7,052	$	$ 14,030	$
Infonet Telecom AS (Norway)	2,149	1,859	3,738	3,585

Infonet Thailand Ltd. (Thailand)	47	114	85	156
KDDI Corporation (Japan)	8,939	9,407	17,397	17,970
KPN Telecom B.V. (The Netherlands)	13,964	17,448	27,942	34,192
Swisscom AG (Switzerland)	9,688	9,878	19,738	19,831
Telefonica International Holdings B.V. (Spain)	2,432	2,053	4,793	4,334
TeliaSonera A.B. (Sweden)	8,405	12,668	17,128	25,659
Telstra Corporation Limited (Australia)	6,296	6,385	12,834	12,264

INFONET SERVICES CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Operating Costs and Expenses: (Includes procurement of the following services from the related parties)

Communication Services Costs

	Three Months Ended September 30,		Six Months Ended September 30,	
	2002	2003	2002	2003
AUCS Communications Services N.V. (The Netherlands)	$ 6,006	$	$ 15,076	$
Infonet Telecom AS (Norway)	285	459	639	749
Infonet Thailand Ltd. (Thailand)	614	68	648	104
KDDI Corporation (Japan)	2,594	2,631	5,177	5,665
KPN Telecom B.V. (The Netherlands)	2,194	5,007	4,446	9,066
Swisscom AG (Switzerland)	1,944	2,134	3,682	3,882
Telefonica International Holdings B.V. (Spain)	478	650	1,155	1,327
TeliaSonera A.B. (Sweden)	1,035	3,691	1,928	6,747
Telstra Corporation Limited (Australia)	1,761	1,612	3,733	3,069

Integration and Provisioning Costs

	Three Months Ended September 30,		Six Months Ended September 30,	
	2002	2003	2002	2003
AUCS Communications Services N.V. (The Netherlands)	$ 2,203	$	$ 5,959	$
Infonet Telecom AS (Norway)	411	535	813	1,076
Infonet Thailand Ltd. (Thailand)	122	291	380	1,157
KDDI Corporation (Japan)	1,759	2,602	3,396	4,107
KPN Telecom B.V. (The Netherlands)	1,984	4,002	3,301	7,464
Swisscom AG (Switzerland)	2,942	3,624	5,299	7,059
Telefonica International Holdings B.V. (Spain)	917	1,342	1,196	2,668
TeliaSonera A.B. (Sweden)	1,999	2,608	3,647	5,128
Telstra Corporation Limited (Australia)	1,329	1,754	2,287	3,299

Bandwidth and Related Costs

	Three Months Ended September 30,		Six Months Ended September 30,	
	2002	2003	2002	2003
AUCS Communications Services N.V. (The Netherlands)	$	$	$	$
Infonet Telecom AS (Norway)		35	87	35
Infonet Thailand Ltd. (Thailand)	224	181	423	321
KDDI Corporation (Japan)	586	407	1,154	743
KPN Telecom B.V. (The Netherlands)	669	440	2,700	1,024
Swisscom AG (Switzerland)	271	550	597	958
Telefonica International Holdings B.V. (Spain)	7	304	179	438
Teliasonera A.B. (Sweden)	756	852	1,401	1,654
Telstra Corporation Limited (Australia)	(21)	34	58	34

INFONET SERVICES CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Network Operations

	Three Months Ended September 30,		Six Months Ended September 30,	
	2002	**2003**	**2002**	**2003**
AUCS Communications Services N.V. (The Netherlands)	$	$	$	$