CINCINNATI BELL INC
Form 10-Q/A
June 28, 2004

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q/A

Amendment No. 1

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

For the quarterly period ended June 30, 2003

OR

o 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 1-8519

CINCINNATI BELL INC.

Incorporated under the laws of the State of Ohio

201 East Fourth Street, Cincinnati, Ohio 45202

I.R.S. Employer Identification Number 31-1056105

Telephone - Area Code (513) 397-9900

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 o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes x Noo

At July 31, 2003, there were 218,962,535 common shares outstanding.

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EXPLANATORY NOTE

Pursuant to this amended Quarterly Report on Form 10-Q/A, the registrant amends Item 1. Financial Statements , Item 2. Management s Discussion and Analysis of Financial Condition And Results of Operations and Item 4. Controls and Procedures of Part I Financial Information of its Quarterly Report on Form 10-Q as filed with the Securities and Exchange Commission on August 14, 2003 for the quarter ended June 30, 2003. The amendment is related to the restatement of previously reported results. The Audit Committee of the Company s Board of Directors completed an investigation into the allegations contained in an amended class action securities lawsuit filed in December 2003. These allegations relate primarily to the manner in which the Company recognized revenue, and wrote down assets, with respect to its former broadband business. In connection with that investigation, adjustments have been identified related to the manner that the Company recorded a particular broadband network construction agreement entered into in 2000. These adjustments related to the timing of revenue recognition resulting from the inappropriate inclusion of certain costs that had not been fully incurred and use of estimates regarding the extent to which the construction contract had been completed. The Company has restated its financial statements to reflect the revised accounting for this contract. In investigating plaintiffs other allegations, the Audit Committee did not identify any information that warranted any modification or change to the Company s financial statements.

In connection with the restatement, the Company made an adjustment that was previously identified but deemed to be immaterial and was recorded in the period management identified the error. The impact of the 2002 adjustments was to decrease cost of services and products by $0.6 million in the Local segment in the first quarter of 2002 and increase cost of services and products by $0.6 million in the second quarter of 2002, with no impact on the full year results.

This amendment does not amend any other Items except those indicated above and does not update any of the disclosures contained in the Quarterly Report as previously filed except for certain amounts which have been reclassified to conform to the current classifications. All other information is as of the date of original filing and included for convenience.

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PART I. Financial Information

PART II. Other Information

Form 10-Q/A Part I — Cincinnati Bell Inc.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
(Dollars in Millions, Except Per Common Share Amounts)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
	(Restated)	(Restated)	(Restated)	
Revenue	$ 450.6	$ 556.2	$ 931.3	$ 1,099.0
Costs, Expenses, Gains and Losses				
Cost of services and products (excluding depreciation of $31.5, $100.6, $64.5 and $194.8 included below)	209.8	270.4	428.7	536.5
Selling, general and administrative	109.5	128.3	230.2	257.4
Depreciation	39.6	115.8	81.0	231.0
Amortization	0.1	6.4	0.3	12.8
Restructuring	(3.4)		(3.4)	16.5
Asset impairments and other	(1.1)		(0.8)	
Gain on sale of broadband assets	(299.0)		(299.0)	
Total operating costs, expenses, gains and losses	55.5	520.9	437.0	1,054.2
Operating Income	395.1	35.3	494.3	44.8
Minority interest expense	15.8	14.8	29.9	29.0
Interest expense and other financing costs	61.3	38.9	106.6	77.2
Other expense (income), net	(0.4)	0.4	(0.5)	(0.8)
Income (loss) from continuing operations before income taxes, discontinued operations and cumulative effect of changes in accounting principles	318.4	(18.8)	358.3	(60.6)
Income tax expense (benefit)	(2.0)	0.1		(8.8)
Income (loss) from continuing operations before discontinued operations and cumulative effect of changes in accounting principles	320.4	(18.9)	358.3	(51.8)
Income (loss) from discontinued operations, net of taxes of $(0.1) and $119.7, respectively		(0.2)		217.6
Income (loss) before cumulative effect of changes in accounting principles	320.4	(19.1)	358.3	165.8

Cumulative effect of changes in accounting principles, net of taxes of $47.6 and $5.8, respectively			85.9	(2,008.7)
Net Income (Loss)	320.4	(19.1)	444.2	(1,842.9)
Preferred stock dividends	2.6	2.6	5.2	5.2
Net Income (Loss) Applicable to Common Shareowners	$ 317.8	$ (21.7)	$ 439.0	$(1,848.1)
Net Income (Loss)	$ 320.4	$ (19.1)	$ 444.2	$(1,842.9)
Other comprehensive income (loss), net of tax:				
Unrealized gain (loss) on interest rate swaps	1.4	(1.7)	3.2	1.1
Comprehensive Income (Loss)	$ 321.8	$ (20.8)	$ 447.4	$(1,841.8)
Basic Earnings (Loss) Per Common Share				
Income (loss) from continuing operations	$ 1.45	$ (0.10)	$ 1.62	$ (0.27)
Income from discontinued operations, net of taxes				1.00
Cumulative effect of changes in accounting principles, net of taxes			0.39	(9.20)
Net Earnings (Loss) per Common Share	$ 1.45	$ (0.10)	$ 2.01	$ (8.47)
Diluted Earnings (Loss) Per Common Share				
Income (loss) from continuing operations	$ 1.33	$ (0.10)	$ 1.55	$ (0.27)
Income from discontinued operations, net of taxes				1.00
Cumulative effect of changes in accounting principles, net of taxes			0.35	(9.20)
Net Earnings (Loss) per Common Share	$ 1.33	$ (0.10)	$ 1.90	$ (8.47)
Weighted Average Common Shares Outstanding (millions)				
Basic	218.9	218.4	218.9	218.3
Diluted	249.1	218.4	244.9	218.3

The accompanying notes are an integral part of the financial statements.

Form 10-Q/A Part I | Cincinnati Bell Inc.

CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in Millions, Except Per Share Amounts)
(Unaudited)

	June 30, 2003	December 31, 2002
	(Restated)	
Assets		
Current assets		
Cash and cash equivalents	$ 30.1	$ 44.9
Restricted Cash		7.0
Receivables, net of allowances of $23.5 and $53.0	156.0	240.1
Materials and supplies	33.6	32.2
Deferred income tax benefits	4.1	46.8
Prepaid expenses and other current assets	28.5	23.8
Assets held for sale	12.3	
Total current assets	264.6	394.8
Property, plant and equipment, net of accumulated depreciation of $1,579.1 and $1,659.8	925.9	867.9
Goodwill, net of accumulated amortization of $3.3 and $3.3	40.9	40.9
Other intangibles, net	47.5	47.8
Other noncurrent assets	121.8	101.2
Total assets	$ 1,400.7	$ 1,452.6
Liabilities and Shareowners Deficit		
Current liabilities		
Short-term debt	$ 249.0	$ 203.7
Accounts payable	80.3	129.4
Current portion of unearned revenue and customer deposits	40.3	118.9
Accrued taxes	69.4	84.4
Accrued restructuring	28.4	41.1
Dividends payable	55.6	30.9
Other current liabilities	115.4	141.2
Total current liabilities	638.4	749.6
Long-term debt, less current portion	2,194.8	2,354.7
Unearned revenue, less current portion	12.6	306.0
Deferred income tax liabilities	88.0	72.7
Accrued pension and postretirement benefits	70.0	64.9

Other noncurrent liabilities	57.1	59.6
Total liabilities	3,060.9	3,607.5
Minority interest	449.2	443.9
Commitments and contingencies		
Shareowners Deficit		
6¾% Cumulative Convertible Preferred Stock, 2,357,299 shares of all classes of preferred stock authorized; 155,250 shares (3,105,000 depository shares) issued and outstanding at June 30, 2003 and December 31, 2002	129.4	129.4
Common shares, $.01 par value; 480,000,000 shares authorized; 226,688,355 and 226,598,844 shares issued; 218,815,304 and 218,690,375 outstanding at June 30, 2003 and December 31, 2002	2.3	2.3
Additional paid-in capital	2,407.1	2,365.1
Accumulated deficit	(4,491.9)	(4,936.1)
Accumulated other comprehensive loss	(10.7)	(13.8)
Common shares in treasury, at cost: 7,873,051 and 7,908,469 shares at June 30, 2003 and December 31, 2002	(145.6)	(145.7)
Total shareowners deficit	(2,109.4)	(2,598.8)
Total liabilities and shareowners deficit	$ 1,400.7	$ 1,452.6

The accompanying notes are an integral part of the financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Millions)
(Unaudited)

	Six Months Ended June 30,	
	2003	2002
	(Restated)	
Cash Flows from Operating Activities		
Net income (loss)	$ 444.2	$(1,842.9)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Cumulative effect of changes in accounting principles, net of tax	(85.9)	2,008.7
Gain on sale of broadband assets	(299.0)	
Gain on sale of discontinued operations		(211.8)
Depreciation	81.0	231.0
Amortization	0.3	12.8
Asset impairments	0.4	
Provision for loss on receivables	16.7	24.9
Noncash interest expense	36.9	20.5
Minority interest expense	29.9	29.0
Deferred income tax benefit	(0.2)	(9.5)
Tax benefits from employee stock option plans	0.2	0.7
Other, net	2.0	(0.4)
Changes in operating assets and liabilities:		
Decrease (increase) in receivables	6.2	(26.2)
Increase in prepaid expenses and other current assets	(12.8)	(2.6)
Decrease in accounts payable	(11.2)	(43.2)
Decrease in accrued and other current liabilities	(34.1)	(74.5)
Decrease in unearned revenue	(47.5)	(85.0)
Decrease (increase) in other assets and liabilities, net	(3.6)	1.2
Net cash used in discontinued operations		(9.5)
Net cash provided by operating activities	123.5	23.2
Cash Flows from Investing Activities		
Capital expenditures	(57.5)	(99.7)
Proceeds from sale of investments		23.3
Proceeds from sale of broadband assets	62.2	
Proceeds from sale of discontinued operations		345.0
Other, net	(0.5)	

Net cash provided by investing activities	4.2	268.6
Cash Flows from Financing Activities		
Issuance of long-term debt	350.0	95.0
Repayment of long-term debt	(438.6)	(352.6)
Short-term repayments, net	(2.7)	(4.8)
Debt issuance costs	(47.3)	(6.7)
Issuance of common shares - exercise of stock options	1.3	0.6
Minority interest and preferred stock dividends paid	(5.2)	(29.9)
Net cash used in financing activities	(142.5)	(298.4)
Net decrease in cash and cash equivalents	(14.8)	(6.6)
Cash and cash equivalents at beginning of period	44.9	30.0
Cash and cash equivalents at end of period	$ 30.1	$ 23.4

The accompanying notes are an integral part of the financial statements.

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Form 10-Q/A Part I Cincinnati Bell Inc.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Description of Business, Liquidity and Accounting Policies

Description of Business Cincinnati Bell Inc. (the Company), f/k/a Broadwing Inc., provides diversified telecommunications services through businesses in four segments: Local, Wireless, Other and Broadband. During the first quarter of 2002, the Company sold substantially all of the assets of Cincinnati Bell Directory (CBD), which was previously reported in the Other segment.

On February 22, 2003, certain BRCOM (f/k/a as Broadwing Communications Inc.) subsidiaries entered into a definitive agreement to sell substantially all of the assets of its broadband business for approximately $129.3 million in cash, subject to certain purchase price adjustments, and the assumption of certain liabilities and operating contractual commitments, to CIII Communications, LLC and CIII Communications Operations, LLC (collectively CIII). Accordingly, the assets to be sold have been classified as Assets held for sale . As such, the Company ceased depreciation on these assets, in accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144).

On June 6, 2003, and June 13, 2003, the selling subsidiaries amended the agreement for the sale of the broadband assets to, among other things, reduce the purchase price to $108.7 million (which at the first stage closing was paid in $91.5 million of cash and a $17.2 million preliminary promissory note, as described below), subject to certain purchase price adjustments and other post-closing obligations, and the assumption of certain liabilities and operating contractual commitments, and to eliminate certain of the conditions to the consummation of the first stage closing of the sale.

On June 13, 2003, the selling subsidiaries consummated the first (and most significant) stage closing of the sale of their broadband assets, in which they transferred substantially all of the broadband assets except for those for which state regulatory approval for transfer was still pending. At the first stage closing, the selling subsidiaries received regulatory approval in states where approximately 75% of 2002 broadband revenue was generated and effectively transferred control of the broadband business. In connection with the first stage closing, the buyers paid the cash purchase price of $91.5 million, of which $29.3 million was placed into escrow to support certain potential purchase price adjustments and the portion of the purchase price payable upon the consummation of the second and third stage closings, and issued to the sellers a $17.2 million preliminary promissory note in connection with a purchase price working capital adjustment. The final promissory note is expected to be approximately $1.3 million, which corresponds with the decrease in working capital from May 31, 2003 through the date of the first stage closing. (Refer to Note 3).

As of June 30, 2003 the Company s primary business consisted of the local and wireless telephone businesses. The only remaining BRCOM subsidiaries with operating assets were Cincinnati Bell Technology Solutions Inc., an information technology consulting subsidiary, and Cincinnati Bell Any Distance (CBAD), a subsidiary whose assets service the Other segment long distance business.

Under the terms of the Company s debt agreements, the Company and its subsidiaries other than BRCOM may not make investments in or fund the operations of BRCOM and its subsidiaries beyond an aggregate amount of $118 million after October 1, 2002. As of June 30, 2003, the Company had the ability to invest an additional $86.8 million in BRCOM and its subsidiaries based on these provisions. This $86.8 million includes $62.2 million of gross proceeds received from the first stage closing of the broadband asset sale. In addition, BRCOM s cash balance as of June 30, 2003 was $2.0 million, for total

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

BRCOM liquidity of $88.8 million. The uncertainty of BRCOM s available liquidity resulting from these funding constraints, prompted BRCOM s independent accountants to include a going concern explanatory paragraph in their audit report filed along with the stand alone annual financial statements of BRCOM for the year ended December 31, 2002. The going concern explanatory paragraph means that, in the opinion of BRCOM s independent accountants, there is substantial doubt about BRCOM s ability to continue to operate as a going concern. If BRCOM is unable to meet its remaining obligations, it may be forced to seek protection from its creditors through bankruptcy proceedings.

Basis of Presentation The Condensed Consolidated Financial Statements of the Company have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) and, in the opinion of management, include all adjustments necessary for a fair presentation of the results of operations, financial position and cash flows for each period presented.

The adjustments referred to above are of a normal and recurring nature except for those outlined in Notes 1, 2, 3, 4, 5, 6, 14, 15, and as outlined below. Certain prior year amounts have been reclassified to conform to the current classifications with no effect on financial results. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to SEC rules and regulations.

The December 31, 2002 Condensed Consolidated Balance Sheet was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles. It is suggested that these Condensed Consolidated Financial Statements be read in conjunction with the notes thereto included in the Company s 2002 Annual Report on Form 10-K.

Basis of Consolidation The consolidated financial statements include the consolidated accounts of Cincinnati Bell Inc. and its majority-owned subsidiaries over which it exercises control. Significant intercompany accounts and transactions have been eliminated in the consolidated financial statements.

Use of Estimates Preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported. Actual results could differ from those estimates.

Unbilled Receivables Unbilled receivables arise from local, wireless and broadband services rendered but not yet billed, in addition to network construction revenue that is recognized under the percentage-of-completion method. Network construction receivables are billable upon achievement of contractual milestones or upon completion of contracts. As of June 30, 2003 and December 31, 2002, unbilled receivables, net of allowances, totaled $24.3 million and $40.4 million, respectively.

Allowance for Uncollectible Accounts Receivables The Company establishes provisions for uncollectible accounts receivable using both percentages of aged accounts receivable balances to reflect the historical average of credit losses and specific provisions for certain large, potentially uncollectible balances. The Company believes that its allowance for potential losses is adequate based on the methods described above. However, if one or more of the Company s larger customers were to default on its accounts receivable obligations or general economic conditions in the United States of America deteriorated, the Company could be exposed to potentially significant losses in excess of the provisions established.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Property, Plant and Equipment Property, plant and equipment is stated at cost. The Company s provision for depreciation of telephone plant is determined on a straight-line basis using the whole life and remaining life methods. Provision for depreciation of other property is based on the straight-line method over the estimated useful life. Repairs and maintenance expense items are charged to expense as incurred. The cost of removal for telephone plant is included in costs of products and services.

Goodwill and Indefinite-Lived Intangible Assets Goodwill represents the excess of the purchase price consideration over the fair value of assets acquired recorded in connection with purchase business combinations. Indefinite-lived intangible assets consist primarily of Federal Communications Commission (FCC) licenses of the Wireless segment. The Company determined that its wireless licenses met the definition of indefinite-lived intangible assets under Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (SFAS 142) as the technology that the Company uses to provide wireless service is not expected to change significantly in the foreseeable future, and the wireless licenses may be renewed in a routine manner every ten years for a nominal fee, provided that the Company continues to meet the service and geographic coverage provisions required by the FCC. Upon the adoption of SFAS 142 on January 1, 2002, the Company recorded a goodwill impairment charge of $2,008.7 million, net of tax, related to the Broadband segment and ceased amortization of remaining goodwill and indefinite-lived intangible assets as discussed in Note 5.

Pursuant to SFAS 142, goodwill and intangible assets not subject to amortization are tested for impairment annually, or when events or changes in circumstances indicate that the asset might be impaired. For goodwill, a two-step impairment test is performed. The first step compares the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying value of a reporting unit exceeds its fair value, then the second step of the impairment test is performed to measure the amount of impairment loss. The second step compares the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. The implied fair value is determined by allocating the fair value of a reporting unit to all of the assets and liabilities of that unit as if the reporting unit had been acquired in a business combination. The excess of the fair value of a reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of goodwill. If the carrying amount of the reporting unit goodwill is in excess of the implied fair value of that goodwill, then an impairment loss is recognized equal to that excess. For indefinite-lived intangible assets, the impairment test consists of a comparison of the fair value of the intangible asset with its carrying value. If the carrying value of an indefinite-lived asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess.

Impairment of Long-lived Assets, Other than Goodwill and Indefinite-lived Intangibles The Company reviews the carrying value of long-lived assets, other than goodwill and indefinite-lived assets discussed above, when events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. An impairment loss is recognized when the estimated future undiscounted cash flows expected to result from the use of an asset (or group of assets) and its eventual disposition are less than its carrying amount. An impairment loss is measured as the amount by which the asset s carrying value exceeds its fair value.

During the fourth quarter of 2002, the Company performed an impairment assessment of its Broadband segment assets as a result of the restructuring plan implemented during the quarter and the strategic alternatives being explored, including the potential sale of the Broadband business. This assessment considered all of the contemplated strategic alternatives for the Broadband segment, including a potential sale of assets, using a probability-weighted approach. Based on this assessment, it was determined that

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

the long-lived assets of the Company s Broadband segment were impaired and the Company recorded a $2.2 billion non-cash impairment charge to reduce the carrying value of these assets. Of the total charge, $1,901.7 million related to tangible fixed assets and $298.3 million related to finite-lived intangible assets.

Deferred Financing Costs Deferred financing costs are costs incurred in connection with obtaining long-term financing; such costs are amortized as interest expense over the terms of the related debt agreements. Such expense amounted to $7.4 million and $2.3 million in the second quarter of 2003 and 2002, respectively, and $11.2 million and $4.6 million in the six month period ended June 30, 2003 and 2002, respectively**.**

Asset Retirement Obligations The Company adopted Statement of Financial Accounting Standards No. 143, Accounting for Asset Retirement Obligations (SFAS 143) as of January 1, 2003. This statement requires entities to record the fair value of a legal liability for an asset retirement obligation in the period it is incurred. The removal cost is initially capitalized and depreciated over the remaining life of the underlying asset. The associated liability is accreted over the life of the underlying asset. Once the obligation is ultimately settled, any difference between the final cost and the recorded liability is recognized as income or loss on disposition. The Company determined the Local segment did not have a liability under SFAS 143, while the Wireless segment and Other segment did have a liability. The Company recorded a non-recurring increase to net income as a change in accounting principle as of January 1, 2003 of $85.9 million, net of tax. The Local segment recorded $86.3 million of income related to depreciation previously recorded for asset removal costs, offset by $0.4 million of expense recorded in the Wireless segment. Additionally, the Company recorded a liability for removal costs at fair value of approximately $2.6 million and an asset of approximately $2.3 million in the first quarter of 2003 related to the Wireless and Other segments. The assets will be depreciated straight line over the remaining lives of the assets, while the interest component of the liability will be accreted over the remaining lives of the assets.

Revenue Recognition Local and broadband transport service revenue is billed monthly, in advance, with revenue being recognized when earned. Wireless, switched voice and data and Internet product revenue are billed monthly in arrears, while the revenue is recognized as the services are provided. Revenue from product sales and certain services is generally recognized upon performance of contractual obligations, such as shipment, delivery, installation or customer acceptance. Upfront fees for customer connection and activation are deferred and amortized into revenue on a straight-line basis over the average customer life. The related connection and activation costs, to the extent of the upfront fees, are deferred and amortized on a straight-line basis over the average customer life.

Indefeasible right-of-use agreements (IRU) represent the lease of network capacity or dark fiber and are recorded as unearned revenue at the earlier of the acceptance of the applicable portion of the network by the customer or the receipt of cash. The buyer of IRU services typically pays cash upon execution of the contract, and the associated IRU revenue is then recognized over the life of the agreement as services are provided, beginning on the date of customer acceptance. In the event the buyer of an IRU terminates a contract prior to the contract expiration and releases the Company from the obligation to provide future services, the remaining unamortized unearned revenue is recognized in the period in which the contract is terminated. IRU and related maintenance revenue are included in the broadband transport category of the Broadband segment.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Fiber Exchange Agreements In connection with the development of its optical network, the Company entered into various agreements to exchange fiber usage rights. The Company accounts for agreements with other carriers to either exchange fiber asset service contracts for capacity or services based on the carrying value of the assets exchanged.

Income Taxes The income tax provision consists of an amount for taxes currently payable and an expense (or benefit) for tax consequences deferred to future periods. In evaluating the carrying value of its deferred tax assets, the Company considers prior operating results, future taxable income projections, expiration of tax loss carryforwards and ongoing prudent and feasible tax planning strategies. As of June 30, 2003, the Company had a net deferred tax liability of $83.9 million, which included a valuation allowance of $1,066.2 million. The valuation allowance is necessary due to the uncertainties surrounding the Company s subsidiary BRCOM s ability to continue as a going concern, which could limit the ultimate realization of certain deferred tax assets. Such deferred tax assets consist substantially of net operating loss carryforwards generated by BRCOM. Upon elimination of these uncertainties, the Company may reverse a substantial portion of the valuation allowance, creating a non-recurring income tax benefit.

Stock-Based Compensation The Company accounts for stock-based compensation plans under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees (APB 25), and related interpretations. Compensation cost is measured under the intrinsic value method. Stock-based employee compensation cost is not reflected in net income (loss), as all options granted under these plans had an exercise price equal to the market value of the underlying common stock on the date of grant. If the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS 123), the expense that would have been recognized totaled $8.8 million and $7.6 million in the second quarter of 2003 and 2002, respectively and $17.7 million and $15.2 million in the year-to-date periods ended June 30, 2003 and 2002, respectively. The following table illustrates the effect on net income (loss) and earnings (loss) per share if the Company had applied the fair value recognition provisions of SFAS 123, to stock-based employee compensation in all periods presented.

	Three Months Ended June 30,		**Six Months Ended June 30,**	
(dollars in millions except per share amounts)	**2003**	**2002**	**2003**	**2002**
	(Restated)	**(Restated)**	**(Restated)**	
Net income (loss) applicable to common shareowners:				
As reported	$317.8	$(21.7)	$439.0	$(1,848.1)
Pro forma	$309.0	$(29.3)	$421.3	$(1,863.3)
Basic earnings included in net income (loss)				
As reported	$ 1.45	$(0.10)	$ 2.01	$ (8.47)
Pro forma	$ 1.41	$(0.13)	$ 1.92	$ (8.54)
Numerator for diluted earnings (loss) per share:				
As reported	$331.8	$(21.7)	$464.2	$(1,848.1)
Pro forma	$323.0	$(29.3)	$446.5	$(1,863.3)
Diluted earnings (loss) per share:				
As reported	$ 1.33	$(0.10)	$ 1.90	$ (8.47)
Pro forma	$ 1.30	$(0.13)	$ 1.82	$ (8.54)

The weighted average fair values at the date of grant for the Company options granted to employees were $1.24 and $3.04 for the three months ended June 30, 2003 and 2002, respectively, and were $1.13 and $3.57 for the six months ended June 30, 2003 and 2002, respectively. Such amounts were estimated using the Black-Scholes option-pricing model with the following weighted average assumptions:

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	**2002**	**2003**	**2002**
Expected dividend yield				
Expected volatility	35.0%	85.1%	35.0%	82.3%
Risk-free interest rate	1.8% &nbs			