LAW OFFICES
FARRAR & BATES, L.L.P.

211 Seventh Avenue North
Suite 420
Nashville, Tennessee 37219

Telephone 615-254-3060
Facsimile 615-254-9835
E-Mail fblaw@farrar-bates.com

J. Russell Farrar
William N. Bates
Kristin Ellis Berexa
Teresa Reall Ricks
Molly R. Cripps
Mary Byrd Ferrara*
Robyn Beale Williams
Jennifer Orr Locklin
Keith F. Blue
Heather C. Stewart
Pamela G. Vawter

*Also licensed in KY

Of Counsel
H. LaDon Baltimore

RECEIVED
2006 MAR 10
T.R.A. DOCKET ROOM

March 10, 2006

Honorable Ron Jones, Chairman
Tennessee Regulatory Authority
ATTN: Sharla Dillon, Dockets
460 James Robertson Parkway
Nashville, TN 37243-5015

06-00066

Re: Application of LMDS Holdings, Inc. for Authority to Provide Competitive Local Exchange and Interexchange Telecommunications Services in the State of Tennessee

Dear Chairman Miller:

Enclosed please find the original and 13 copies of the above-referenced application along with my check in the amount of $25.00 in payment of the filing fee. As you will see, Exhibit E to the application is **confidential and proprietary and is filed under seal.** A copy of the application (without Exhibit E) has been mailed to each of Tennessee's ILECs.

Please note the docket number and return a date stamped copy of the application. Thank you for your assistance. If you have questions, please do not hesitate to contact me.

Sincerely,

H. LdD Balti

H. LaDon Baltimore
Counsel for LMDS Holdings, Inc.

LDB/dcg
Enclosures

Before the
TENNESSEE REGULATORY AUTHORITY

Application of	)	
	)	
LMDS Holdings, Inc.	)	
	)	**Docket No. ____________**
for Authority to Provide	)	
Competitive Local Exchange and	)	
Interexchange Telecommunications	)	
Services in the State of Tennessee	)	

APPLICATION OF
LMDS HOLDINGS, INC.

LMDS Holdings, Inc. ("Applicant", "Company" or "Holdings"), by its attorneys and pursuant to Tenn. Code Ann. Sec. 65-4-201, Chapter 1220-4-8-.02, and to all other relevant Rules and Regulations of the Tennessee Regulatory Authority ("TRA"), respectfully requests that the Commission grant it a Certificate of Public Convenience and Necessity to provide facilities-based and resold local exchange and interexchange telecommunications services in the State of Tennessee In support thereof, Applicant provides the following information:

I. Identification of the Applicant

1. Applicant's full name is LMDS Holdings, Inc. and is headquartered at 11111 Sunset Hills Road, Reston, Virginia, 20190-5339. Applicant's principal officers, located at the same address, are:

Carl J. Grivner, President

Thomas W. Cady, Interim Chief Executive Officer and Senior Vice President, Marketing and Sales

Wayne Rehberger, Chief Operating Officer

Gregory W. Freiberg, Vice President and Chief Financial Officer

Bill Garrahan, Acting Chief Financial Officer and Senior Vice President, Corporate Development

Heather Burnett Gold, Senior Vice President, Government Relations

Terri Burke, Vice President, Human Resources

Rob Geller, Chief Information Officer

2. Holdings was incorporated under Delaware law on November 4, 2005 and is a wholly owned subsidiary of XO Communications, Inc., a publicly traded Delaware corporation, in which Carl C. Icahn holds a majority interest.[1] A copy of Applicant's Articles of Incorporation and the amendments thereto are appended hereto as ***Exhibit A***. Applicant is qualified to conduct business within the State of Tennessee as a foreign corporation. A copy of the qualifying document is attached hereto as ***Exhibit B***. Holdings is in the process of applying for Certificates in the following jurisdictions: Alabama, Arizona, California, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Massachusetts, Michigan, Minnesota, Nebraska, New Hampshire, New Jersey, New Mexico, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, Tennessee, and Wisconsin. Applicant has been granted certification in the District of Columbia, Maryland, Missouri, New York, Texas and Washington. Although this is the first time Holdings is applying for certification, it is

[1] XO Communications, Inc. is in the process of a *pro forma* restructuring merger. As a result of this restructuring, XO Communications, Inc. will be merged into XO Communications, LLC and removed from the ownership structure of Holdings. This will leave XO Holdings, Inc. in the place of XO Communications, Inc. as parent-company to Holdings. Holdings will share the same ultimate owner with XO Communications, LLC, Carl C. Icahn. A Notice of this transaction has been filed with the TRA under separate cover and was issued Docket Number 05-00334. A press release describing this transaction can be found at http://www.xo.com/news/278.html, a copy of which is attached as *Exhibit C*.

important to note that none of Applicant's affiliates have been denied a request for certification to provide telecommunications services by any jurisdictional authority.

II. Designated Contacts

3. The designated contact for this application is:

H. LaDon Baltimore
Farrar & Bates, L.L.P.
211 Seventh Avenue North, Suite 420
Nashville, Tennessee 37219
Telephone: (615) 254-3060
Facsimile: (615) 254-9835

and

Brad E. Mustchelknaus
Katherine E. Barker Marshall
KELLEY, DRYE AND WARREN, LLP
1200 19th Street, N.W., Suite 500
Washington, D.C. 20036
Telephone: (202) 955-9669
Facsimile: (202) 955-9792

4. Copies of all correspondence, notices, inquiries and orders in relation to this Application also should be sent to the following person:

David LaFrance
Regulatory and External Affairs
LMDS HOLDINGS, INC.
11111 Sunset Hills Road
Reston, VA 20190-2000
Telephone: (703) 547-2682
Facsimile: (703) 547-2881

Copies of all correspondence, notice, inquiries and orders relating to consumer issues, billing issues, technical service quality issues, and customer complaint issues should be sent to:

Tamie Whitefoot
Operations Director
LMDS Holdings, Inc.
4800 Concentric Blvd.

Saginaw, MI 48604
Telephone: (877) 714-6398
Facsimile: (989) 758-6510
Email: tamie.whitefoot @xo.com

Copies of all correspondence, notice inquiries and orders relating to tariff or pricing issues should be sent to:

David LaFrance
Regulatory and External Affairs
LMDS HOLDINGS, INC.
11111 Sunset Hills Road
Reston, VA 20190-2000
Telephone: (703) 547-2682
Facsimile: (703) 547-2881

5. Holdings' registered agent in Tennessee is:

Corporation Service Company
2908 Poston Avenue
Nashville, TN 37203

III. Description of Network and Authority Requested

6. By this Application, Holdings seeks authority to provide telecommunications transport services, as a facilities-based and resale competitive local exchange and interexchange carrier, to business customers and other carriers in the State of Tennessee. The Applicant plans to initially offer dedicated point-to-point or point-to-multipoint transport and data services to enterprise customers and other common carriers. At a later date, Holdings may expand its service offerings, to include a broader range of products and services. Accordingly, Holdings is requesting the TRA certify Holdings to provide a full range of local exchange and interexchange services.

7. Initially, Company intends to focus on deploying technology to provide a core set of communications transport services tailored to meet specific needs of carriers,

particularly commercial mobile radio service (CMRS) providers and enterprise business customers with high capacity point-to-point digital data communication needs. Further, as business and economic circumstances dictate, Company intends to provide additional local exchange, exchange access and dedicated transport services.

8. With respect to geographic coverage area for its intended services, Holdings requests authority to operate as a competitive local exchange carrier and interexchange carrier on a statewide basis.

9. Holdings will provide its data-only broadband managed network solutions primarily through a combination of traditional wireline elements and its FCC-licensed, Local Multipoint Distribution Service ("LMDS") spectrum. The company will provide high-capacity access alternatives to the exclusive use of existing copper and fiber optic based telecommunications services. These services will include point to point data connectivity at speeds ranging from T1 through OC-3 levels. The company's primary services will include Ethernet service using 10Mbps and 100Mbps interfaces and dedicated high speed Internet access. The equipment Holdings has selected for deployment includes ports for both traditional time division multiplexed ("TDM") circuits as well as Internet protocol ports for Ethernet services.

10. Insofar as the Company will not initially provide voice-grade local exchange services, it will not provide operator services and directory assistance. The Company intends to eventually collocate its equipment in incumbent local exchange carrier central offices in order to interconnect with other carriers and to secure access to unbundled network elements. To the extent that Holdings provides voice grade local exchange services in the future, operator services and directory assistance will be

provided.

11. Holdings has not been cited, sanctioned or investigated by any state or federal regulatory authority.

12. Initially, Holdings does not intend to offer dialtone or voice grade services to end users. Accordingly, Holdings respectfully requests waiver of reporting and service requirements that are applicable to carriers offering voice grade or dialtone services, including the provision of E-911 services. Holdings will comply with all rules and regulations governing the provision of dialtone or voice grade service if and when Holdings begins to offer such service.

IV. Qualifications of the Applicant

13. As demonstrated below, Holdings is well-qualified managerially, technically and financially to provide the competitive interexchange telecommunications services for which authority is requested in this Application.

14. Applicant's management team includes individuals with substantive experience in successfully developing and operating telecommunications business. Consequentially, the Company has the adequate internal technical resources to support its Tennessee operations. This expertise in the telecommunications industry makes Applicant's management team well-qualified to operate its local exchange and interexchange operations in Tennessee. Specific details of the business and technical experience of Holdings' officers and management personnel are attached as ***Exhibit D***, which also contain biographies and a brief description of the business experiences of key management personnel who will be responsible for Applicant's telecommunications services in Tennessee and throughout the United States.

15. As is evident from the information contained in ***Exhibit D***, Applicant is managed by persons with substantial technical expertise in operating telecommunications networks. This wealth of expertise will enable Holdings to provide its interexchange customers with advanced, state-of-the-art technology, for its telecommunications services.

16. Applicant is a recently-formed entity, and as such does not have a significant financial history of its own, and has attached projected financial statements as ***Exhibit E, under seal***. Applicant will receive an additional infusion of capital once the transaction outlined in Footnote 1 is completed.

17. Company has historically operated as a wholly owned subsidiary of XO Communications, Inc., a publicly traded company that has funded Applicant's operations. XO Communications, Inc.'s Securities and Exchange Commission Form 10K for the calendar years 2004 and 2005 are included as ***Exhibit F***.

18. Applicant will bill all of its end-user customers directly. Holdings does not intend to utilize a billing agent in issuing bills for services rendered to end users. Applicant will not use a "billing clearinghouse" or other outside entity to issue bills to its customers. All bills sent to end-user customers will bear the Company's name and provide a toll-free number for customer inquiries and complaints.

19. Holdings has a toll free number available for its customers to contact the Company with billing and service related issues: 1-877-714-6398.

20. Customers may contact the Company with billing related issues twenty four (24) hours a day, seven (7) days a week by using the toll free number provided in Paragraph 20. In addition, customers may request assistance for any billing questions or

general customer inquiries on-line via https://www.businesscenter.xo.com/ecustomer_enu. or for repair issues or other requests, including billing support, Customers may send an e-mail to cr-snaops@xo.com.

V. Small and Minority Business Plan

21. Holdings has attached its Small and Minority Business Plan as ***Exhibit G***.

VI. Dialing Parity Plan

22. Holdings does not plan to offer voice grade services. However, if in the future the Applicant does offer voice grade services, it will provide its Dialing Parity Plan to the TRA.

VII. Numbering Issues

23. Holdings does not plan to provision numbers on its own behalf, as Holdings only intends to offer data and transport services. If, in the future, Holdings offers voice grade telecommunications services, it will receive numbers from the ILEC. If, after provisioning numbers from the ILEC, the Applicant provisions numbers for itself, it will comply with all of the numbering conservation efforts of the TRA, including number pooling and utilization of 80% of an NXX prior to ordering additional numbers.

VIII. Tennessee Specific Operational Issues

24. Company's billing system will allow Holdings to bill the calling plan in accordance with TCA Section 65-21-114, if voice grade services are ever offered by the Company.

25. Holdings is aware of the county-wide calling database maintained by BellSouth and will utilize this service if Holdings ever offers voice grade telecommunications services.

26. Holdings is aware of the local calling areas provides by the Incumbent

Local Exchange Carriers in its proposed service areas should Holdings offer voice grade services in the future.

27. Holdings is aware of the local calling area database maintained by BellSouth and intends to utilize this services should Holdings offer voice grade service in the future.

28. The person responsible for working with the TRA for resolving customer complaints is:

Tamie Whitefoot
Operations Director
LMDS Holdings, Inc.
4800 Concentric Blvd.
Saginaw, MI 48604
Telephone: (877) 714-6398
Facsimile: (989) 758-6510
Email: tamie.whitefoot @xo.com

29. Holdings do not plan to telemarket any of its services.

IX. TRA Checklist for Competing Telecommunications Service Provider Applicants Information:

In accordance with Section VIII of the TRA's Checklist for Competiting Telecommunications Service Provider Applicants, Holdings submits the following:

(a) Pre-filed Testimony of David LaFrance, submitted as ***Exhibit H.***

(b) Applicant will file tariffs subsequent to approval of this Application and prior to commencing services within the State of Tennessee.

(c) Holdings is in the process of applying for Certificates in the following jurisdictions: Alabama, Arizona, California, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Massachusetts, Michigan, Minnesota, Nebraska, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, Tennessee, Texas, Washington and Wisconsin. Applicant has been granted certification in the District of Columbia, Maryland, Missouri, New York and Washington.

(d) Applicant has not been involved in a pertinent merger or acquisition.

(e) Applicant will not require customer deposits.

(f) Applicant has not had any complaints lodged against it by any federal or state regulatory agency.

(g) Holdings intends to offer its transport and data telecommunications services in areas served by incumbent carriers with fewer than 100,000 lines, however Holdings does not intend to offer voice grade services.

X. Requested Regulatory Treatment

30. Applicant hereby agrees to abide by all applicable statutes and all applicable Orders, Rules, and regulations entered and adopted by the Commission. Additionally, as a competitive provider of telecommunications services in Tennessee Applicant respectfully requests that it be subject to the same streamlined regulatory treatment applicable to other competitive carriers.

31. Applicant, pursuant to TCA Sec. 65-4-125 will late file a bond, as ***Exhibit I***, in the amount of $20,000.

32. Applicant has appended its Proposed Tariff as ***Exhibit J***.

33. Applicant respectfully requests that this Petition be given expedited consideration.

VI. Public Interest

34. A decision by the TRA to grant Applicant authority to provide local exchange and interexchange telecommunications services is in the public interest. Applicant is well qualified to operate as such a service provider in Tennessee. Consumers of telecommunications services in Tennessee will receive the benefits of downward pressure on prices, increased choice, improved quality of service and customer responsiveness, innovative service offerings, and access to increasingly advanced telecommunications technology. The market incentives for new and existing providers of

telecommunications services will be improved through an increase in the diversity of suppliers and competition within the local exchange and interexchange telecommunications market. Granting Holdings' Application would enhance the development of competition in the local exchange and interexchange markets and provide the consumers of Tennessee with all of the benefits described above.

WHEREFORE, Applicant respectfully requests that the Commission grant it a Certificate of Public Convenience and Necessity to provide competitive local exchange and interexchange telecommunications services in the State of Tennessee.

Respectfully submitted,

LMDS HOLDINGS, INC.

By: H. LaDon Baltimore

H. LaDon Baltimore
Farrar & Bates, L.L.P
211 Seventh Avenue North, Suite 420
Nashville, Tennessee 37219-1823
Telephone: (615) 254-3060
Facsimile: (615) 254-9835

Brad E. Mustchelknaus
Katherine E. Barker Marshall
KELLEY, DRYE AND WARREN, LLP
1200 19th Street, N.W., Suite 500
Washington, D.C. 20036
Telephone: (202) 955-9600
Facsimile: (202) 955-9792

Its Counsel

Dated: March 8, 2006

VERIFICATION

Commonwealth of Virginia :

: ss.

County of Fairfax :

Benjamin R. Preston, Affiant, being duly [sworn/affirmed] according to law, deposes and says that:

He is the Corporate Counsel, Director of Legal Affairs and Assistant Secretary of LMDS Holdings, Inc.;

That he is authorized to and does make this affidavit for LMDS Holdings, Inc.;

That the facts above set forth are true and correct to the best of his knowledge, information, and belief.

Benjamin R. Preston

Benjamin R. Preston
Corporate Counsel, Director of Legal
Affairs and Assistant Secretary
LMDS Holdings, Inc.

Sworn and subscribed before me this 2nd day of March, 2006.

Marsha J. Banks

Signature of official administering oath

My commission expires 5.31.09

Certificate of Service

The undersigned hereby certifies that on the 10th day of March, 2006, a true and correct copy of the foregoing was forwarded via U. S. Mail, first class postage prepaid, to the following incumbent local exchange telephone companies:

Ardmore Telephone Company, Inc.
P 0. Box 549
517 Ardmore Avenue
Ardmore, TN 38449

BellSouth Telecommunications, Inc.
333 Commerce Street
Nashville, TN 37201-3300

CenturyTel of Adamsville
P. 0. Box 405
116 N. Oak Street
Adamsville, TN 38310

CenturyTel of Claiborne
P. 0. Box 100
507 Main Street
New Tazewell, TN 37825

CenturyTel of Ooltewah-Collegdale
P. 0. Box 782
Ooltewah, TN 37363

Citizens Communications Company of Tennessee
P. 0. Box 770
300 Bland Street
Bluefield, WV 24701

Citizens Communications Company of the Volunteer State
P. 0. Box 770
300 Bland Street
Bluefield, WV 24701

Loretto Telephone Company, Inc.
P. 0. Box 130
Loretto, TN 38469

Millington Telephone Company, Inc.
P. 0. Box 429
4880 Navy Road
Millington , TN 38053

Sprint-United
112 Sixth Street
Bristol, TN 37620

TDS Telecom-Concord Telephone Exchange, Inc.
P. 0. Box 22610
Knoxville, TN 37933

TDS Telecom-Humphreys County Telephone Company
P. 0. Box 552
203 Long Sheet
New Johnsonville, TN 37134

TDS Telecom-Tellico Telephone Company, Inc.
P. 0. Box 9
102 Silence Street
Tellico Plains, TN 37385

TDS Telecom-Tennessee Telephone Company
P. 0. Box 22995
Knoxville, TN 37901

TEC-Crockett Telephone Company, Inc.
P. 0. Box 7
Friendship, TN 38034

TEC-People's Telephone Company, Inc.
P. 0. Box 310
Erin, TN 37061

TEC-West Tennessee Telephone Company, Inc.
P. 0. Box 10
244 E. Main Street
Bradford, TN 38316

United Telephone Company
P. 0. Box 38
120 Taylor Street
Chapel Hill, TN 37034

H. LD Batto

H. LaDon Baltimore

EXHIBIT A

ARTICLES OF INCORPORATION

Delaware

PAGE 1

The First State

I, HARRIET SMITH WINDSOR, SECRETARY OF STATE OF THE STATE OF DELAWARE, DO HEREBY CERTIFY THE ATTACHED IS A TRUE AND CORRECT COPY OF THE CERTIFICATE OF INCORPORATION OF "LMDS HOLDINGS, INC.", FILED IN THIS OFFICE ON THE FOURTH DAY OF NOVEMBER, A.D. 2005, AT 12:09 O'CLOCK P.M.

A FILED COPY OF THIS CERTIFICATE HAS BEEN FORWARDED TO THE NEW CASTLE COUNTY RECORDER OF DEEDS.

Harriet Smith Windsor

Harriet Smith Windsor, Secretary of State

4056099 8100

050903140

AUTHENTICATION: 4276245

DATE: 11-04-05

State of Delaware
Secretary of State
Division of Corporations
Delivered 12:19 PM 11/04/2005
FILED 12:09 PM 11/04/2005
SRV 050903140 - 4056099 FILE

CERTIFICATE OF INCORPORATION

OF

LMDS HOLDINGS, INC.

The undersigned, a natural person, for the purpose of organizing a corporation for conducting the business and promoting the purposes hereinafter stated, under the provisions and subject to the requirements of the laws of the State of Delaware (particularly Chapter 1, Title 8 of the Delaware Code and the acts amendatory thereof and supplemental thereto, and known, identified and referred to as the "General Corporation Law of the State of Delaware"), hereby certifies that:

FIRST: The name of the corporation (hereinafter called the "Corporation") is

LMDS HOLDINGS, INC.

SECOND: The address, including street, number, city, and county, of the registered office of the Corporation in the State of Delaware is 2711 Centerville Road, Suite 400, City of Wilmington, County of New Castle; and the name of the registered agent of the Corporation in the State of Delaware is Corporation Service Company.

THIRD: The nature of the business to be conducted and the purposes of the Corporation are:

To purchase or otherwise acquire, invest in, own, lease, mortgage, pledge, sell, assign and transfer or otherwise dispose of, trade and deal in and with real property and personal property of every kind, class and description (including, without limitation, goods, wares and merchandise of every kind, class and description), to manufacture goods, wares and merchandise of every kind, class and description, both on its own account and for others;

To make and perform agreements and contracts of every kind and description; and

Generally to engage in any lawful act or activity or carry on any business for which corporations may be organized under the Delaware General Corporation Law or any successor statute.

FOURTH:

The total number of shares of all classes of stock which the Corporation shall have authority to issue is Three Thousand (3,000), consisting of 3,000 shares of Common Stock, Zero Dollars and One Cent ($0.01) Par Value per share (the "Common Stock").

FIFTH: The name and mailing address of the sole incorporator is as follows:

Name	Mailing Address
Anne T. Leland	Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C. One Financial Center Boston, MA 02111

SIXTH: The Corporation is to have perpetual existence.

SEVENTH: For the management of the business and for the conduct of the affairs of the Corporation, and in further definition and not in limitation of the powers of the Corporation and of its directors and of its stockholders or any class thereof, as the case may be, conferred by the State of Delaware, it is further provided that:

A. The management of the business and the conduct of the affairs of the Corporation shall be vested in its Board of Directors. The number of directors which shall constitute the whole Board of Directors shall be fixed by, or in the manner provided in, the By-Laws. The phrase "whole Board" and the phrase "total number of directors" shall be deemed to have the same meaning, to wit, the total number of directors which the Corporation would have if there were no vacancies. No election of directors need be by written ballot.

B. After the original or other By-Laws of the Corporation have been adopted, amended or repealed, as the case may be, in accordance with the provisions of Section 109 of the General Corporation Law of the State of Delaware, and, after the Corporation has received any payment for any of its stock, the power to adopt, amend, or repeal the By-Laws of the Corporation may be exercised by the Board of Directors of the Corporation.

C. The books of the Corporation may be kept at such place within or without the State of Delaware as the By-Laws of the Corporation may provide or as may be designated from time to time by the Board of Directors of the Corporation.

EIGHTH: The Corporation shall, to the fullest extent permitted by Section 145 of the General Corporation Law of the State of Delaware, as the same may be amended and supplemented from time to time, indemnify and advance expenses to, (i) its directors and officers, and (ii) any person who at the request of the Corporation is or was serving as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, from and against any and all of the expenses, liabilities, or other matters referred to in or covered by said section as amended or supplemented (or any successor), provided, however, that except with respect to proceedings to enforce rights to indemnification, the By-Laws of the Corporation may provide that the Corporation shall indemnify any director, officer or such person in connection with a proceeding (or part thereof) initiated by such director, officer or such person only if such proceeding (or part thereof) was authorized by the Board of Directors of the Corporation. The

Corporation, by action of its Board of Directors, may provide indemnification or advance expenses to employees and agents of the Corporation or other persons only on such terms and conditions and to the extent determined by the Board of Directors in its sole and absolute discretion. The indemnification provided for herein shall not be deemed exclusive of any other rights to which those indemnified may be entitled under any By-Law, agreement, vote of stockholders or disinterested directors or otherwise, both as to action in their official capacity and as to action in another capacity while holding such office, and shall continue as to a person who has ceased to be a director, officer, employee, or agent and shall inure to the benefit of the heirs, executors and administrators of such a person.

NINTH: No director of this Corporation shall be personally liable to the Corporation or its stockholders for monetary damages for breach of fiduciary duty as a director except to the extent that exemption from liability or limitation thereof is not permitted under the General Corporation Law of the State of Delaware as in effect at the time such liability or limitation thereof is determined. No amendment, modification or repeal of this Article shall apply to or have any effect on the liability or alleged liability of any director of the Corporation for or with respect to any acts or omissions of such director occurring prior to such amendment, modification or repeal. If the General Corporation Law of the State of Delaware is amended after approval by the stockholders of this Article to authorize corporate action further eliminating or limiting the personal liability of directors, then the liability of a director of the Corporation shall be eliminated or limited to the fullest extent permitted by the General Corporation Law of the State of Delaware, as so amended.

TENTH: Whenever a compromise or arrangement is proposed between this Corporation and its creditors or any class of them and/or between this Corporation and its stockholders or any class of them, any court of equitable jurisdiction within the State of Delaware may, on the application in a summary way of this Corporation or of any creditor or stockholder thereof or on the application of any receiver or receivers appointed for this Corporation under the provisions of Section 291 of Title 8 of the Delaware Code or on the application of trustees in dissolution or of any receiver or receivers appointed for this Corporation under the provisions of Section 279 of Title 8 of the Delaware Code, order a meeting of the creditors or class of creditors, and/or of the stockholders or class of stockholders of this Corporation, as the case may be, to be summoned in such manner as the said court directs. If a majority in number representing three-fourths (3/4) in value of the creditors or class of creditors, and/or of the stockholders or class of stockholders of this Corporation, as the case may be, agree to any compromise or arrangement and to any reorganization of this Corporation as consequence of such compromise or arrangement, the said compromise or arrangement and the said reorganization shall, if sanctioned by the court to which the said application has been made, be binding on all the creditors or class of creditors, and/or on all the stockholders or class of stockholders, of this Corporation, as the case may be, and also on this Corporation.

ELEVENTH: From time to time any of the provisions of this Certificate of Incorporation may be amended, altered or repealed, and other provisions authorized by the laws of the State of Delaware at the time in force may be added or inserted in the manner and at the time prescribed by said laws, and all rights at any time conferred upon the stockholders of the Corporation by this Certificate of Incorporation are granted subject to the provisions of this Article.

I, the undersigned, being the sole incorporator, for the purpose of forming a Corporation under the laws of the State of Delaware, do make, file and record this Certificate of Incorporation, to certify that the facts herein stated are true, and accordingly have hereto set my hand this 4th day of November, 2005.

Anne T. Leland

Anne T. Leland

TRA 2088230v.1

EXHIBIT B

QUALIFICATION TO DO BUSINESS

Secretary of State
Division of Business Services
312 Eighth Avenue North
6th Floor, William R. Snodgrass Tower
Nashville, Tennessee 37243

DATE: 02/14/06
REQUEST NUMBER: 5684-1212
TELEPHONE CONTACT: (615) 741-2286
FILE DATE/TIME: 02/13/06 1358
EFFECTIVE DATE/TIME: 02/13/06 1358
CONTROL NUMBER: 0513365

TO:
CSC
2711 CENTERVILLE RD.
SUITE 400
WILMINGTON, DE 19808

RE:
LMDS HOLDINGS, INC.
APPLICATION FOR CERTIFICATE OF AUTHORITY -
FOR PROFIT

WELCOME TO THE STATE OF TENNESSEE. THE ATTACHED CERTIFICATE OF AUTHORITY HAS BEEN FILED WITH AN EFFECTIVE DATE AS INDICATED ABOVE.

A CORPORATION ANNUAL REPORT MUST BE FILED WITH THE SECRETARY OF STATE ON OR BEFORE THE FIRST DATE OF THE FOURTH MONTH FOLLOWING THE CLOSE OF THE CORPORATION'S FISCAL YEAR. PLEASE PROVIDE THIS OFFICE WITH WRITTEN NOTIFICATION OF THE CORPORATION'S FISCAL YEAR. THIS OFFICE WILL MAIL THE REPORT DURING THE LAST MONTH OF SAID FISCAL YEAR TO THE CORPORATION AT THE ADDRESS OF ITS PRINCIPAL OFFICE OR TO A MAILING ADDRESS PROVIDED TO THIS OFFICE IN WRITING. FAILURE TO FILE THIS REPORT OR TO MAINTAIN A REGISTERED AGENT AND OFFICE WILL SUBJECT THE CORPORATION TO ADMINISTRATIVE REVOCATION OF ITS CERTIFICATE OF AUTHORITY.

WHEN CORRESPONDING WITH THIS OFFICE OR SUBMITTING DOCUMENTS FOR FILING, PLEASE REFER TO THE CORPORATION CONTROL NUMBER GIVEN ABOVE.

FOR: APPLICATION FOR CERTIFICATE OF AUTHORITY -
FOR PROFIT

ON DATE: 02/14/06

FROM:
CSC (2711 CENTERVILLE RD)
2711 CENTERVILLE RD.
SUITE 400
WILMINGTON, DE 19808-0000

	FEES	
RECEIVED:	$600.00	$0.00
TOTAL PAYMENT RECEIVED:		$600.00

RECEIPT NUMBER: 00003869817
ACCOUNT NUMBER: 00250881

Riley C Darnell

RILEY C. DARNELL
SECRETARY OF STATE

SS-4458

67

State of Tennessee

Department of State
Corporate Filings
312 Eighth Avenue North
6th Floor, William R Snodgrass Tower
Nashville, TN 37243

APPLICATION FOR CERTIFICATE OF AUTHORITY (FOR PROFIT)

FILED

STATE OF TENNESSEE
2006 FEB 13 PM 1:58
SECRETARY OF STATE

For Office Use Only

Pursuant to the provisions of Section 48-25-103 of the Tennessee Business Corporation Act, the undersigned corporation hereby applies for a certificate of authority to transact business in the State of Tennessee, and for that purpose sets forth:

1. The name of the corporation is LMDS Holdings, Inc.
*If different, the name under which the certificate of authority is to be obtained is ______

[NOTES: The Secretary of State of the State of Tennessee may not issue a certificate of authority to a foreign corporation for profit if its name does not comply with the requirements of Section 48-14-101 of the Tennessee Business Corporation Act. *If obtaining a certificate of authority under a different corporate name, an application for registration of an assumed corporate name must be filed pursuant to Section 48-14-101(d) with an additional $20 00 fee.]

2. The state or country under whose law it is incorporated is Delaware

3 The date of its incorporation is November 4, 2005 (must be month, day, and year), and the period of duration, if other than perpetual, is ______.

4 The complete street address (including zip code) of its principal office is

Street	City	State/Country	Zip Code
11111 Sunset Hills Road	Reston	Virginia	20190

5. The complete street address (including the county and the zip code) of its registered office in Tennessee and the name of its registered agent is

Street	City	State/Country	Zip Code
2908 Poston Avenue	Nashville	TN	37203

Registered Agent Corporation Service Company

6. The names and complete business addresses (including zip code) of its current officers are: (Attach separate sheet if necessary)
See attached officer/director rider

7. The names and complete business addresses (including zip code) of its current board of directors are: (Attach separate sheet if necessary.) See attached officer/director rider

8. If the corporation commenced doing business in Tennessee prior to the approval of this application, the date of commencement (month, day and year) ______.

9. The corporation is a corporation for profit

10. If the document is not to be effective upon filing by the Secretary of State, the delayed effective date/time is
______, ______ (date), ______ (time).
[NOTE: A delayed effective date shall not be later than the 90th day after the date this document is filed by the Secretary of State]

[NOTE: This application must be accompanied by a certificate of existence (or a document of similar import) duly authenticated by the Secretary of State or other official having custody of corporate records in the state or country under whose law it is incorporated The certificate shall not bear a date of more than two (2) months prior to the date the application is filed in this state.]

February 10, 2006
Signature Date

Assistant Secretary
Signer's Capacity

LMDS Holdings, Inc.
Name of Corporation

Benjamin R Preston
Signature

Benjamin R. Preston
Name (typed or printed)

SS-4431 (Rev 4/01) Filing Fee: $600 RDA 1678

LMDS Holdings, Inc.

Officers and Directors

List of Officers:

Name: Carl J. Grivner **Title**: President and Chief Executive Officer
Bus. Addr.: 11111 Sunset Hills Road, Reston, VA 20190

Name: Wayne Rehberger **Title**: Exec. Vice President and Chief Operations Officer
Bus. Addr.: 11111 Sunset Hills Road, Reston, VA 20190

Name: Bill Garrahan **Title:** Acting Chief Financial Officer and Sr. Vice President, Corporate Development & Strategic Planning
Bus. Addr: 11111 Sunset Hills Road, Reston, VA 20190

Name: Simone Wu **Title:** Sr. Vice President, Acting Gen. Counsel & Secretary
Bus. Addr.: 11111 Sunset Hills Road, Reston, VA 20190

Name: Ron Scot **Title**: Vice President, Real Estate
Bus. Addr.: 11111 Sunset Hills Road, Reston, VA 20190

Name: Michael O'Day **Title**: Chief Tax Officer
Bus. Addr.: 11111 Sunset Hills Road, Reston, VA 20190

Name: Heather Burnett Gold **Title**: Sr. Vice President, Government Relations
Bus. Addr.: 11111 Sunset Hills Road, Reston, VA 20190

Name: Benjamin R. Preston **Title:** Corporate Counsel, Director of Legal Affairs & Assistant Secretary
Bus. Addr.: 11111 Sunset Hills Road, Reston, VA 20190

List of Directors

Name: Carl J. Grivner
Bus. Addr: 11111 Sunset Hills Road, Reston, VA 20190

Name: Wayne Rehberger
Bus. Addr.: 11111 Sunset Hills Road, Reston, VA 20190

Name: Simone Wu
Bus. Addr.: 11111 Sunset Hills Road, Reston, VA 20190

Delaware

The First State

I, HARRIET SMITH WINDSOR, SECRETARY OF STATE OF THE STATE OF DELAWARE, DO HEREBY CERTIFY "LMDS HOLDINGS, INC." IS DULY INCORPORATED UNDER THE LAWS OF THE STATE OF DELAWARE AND IS IN GOOD STANDING AND HAS A LEGAL CORPORATE EXISTENCE SO FAR AS THE RECORDS OF THIS OFFICE SHOW, AS OF THE TENTH DAY OF FEBRUARY, A.D. 2006.

AND I DO HEREBY FURTHER CERTIFY THAT THE FRANCHISE TAXES HAVE NOT BEEN ASSESSED TO DATE.

AND I DO HEREBY FURTHER CERTIFY THAT THE SAID "LMDS HOLDINGS, INC." WAS INCORPORATED ON THE FOURTH DAY OF NOVEMBER, A.D. 2005.

Harriet Smith Windsor

Harriet Smith Windsor, Secretary of State

4056099 8300

060127514

AUTHENTICATION: 4514916

DATE: 02-10-06

5684.1214

EXHIBIT C

PRESS RELEASE

XO Communications Announces Agreement to Create National Fixed Broadband Wireless Company

November 04, 2005

Company Will Focus Business on Delivering Fixed Broadband Wireless Services to Businesses and Service Providers

National Wireline Telecommunications Business Will Continue as a Private Company Wholly-Owned by Affiliates of Carl Icahn

RESTON, VA - XO Communications, Inc. (OTCBB: XOCM.OB) today announced an agreement that will create a leading provider of fixed broadband wireless services to businesses and service providers. In order to create and finance the fixed wireless business, XO will sell its national wireline telecommunications business for $700 million in cash. Following the sale, the Company will retain its fixed broadband wireless spectrum assets and be uniquely positioned to be a leading provider of fixed broadband wireless services nationally as one of the largest holders of fixed wireless licenses in the 28 GHz-31 GHz spectrum range covering more than 70 U.S. major metropolitan markets.

"The action we take today will create a pure-play fixed broadband wireless provider that combines significant resources with in-depth industry expertise to meet the growing demand for high-bandwidth broadband wireless services," said XO CEO Carl Grivner. "The market opportunity to provide these services has emerged, and our new focus on fixed wireless communications will enable us to offer robust fixed wireless solutions to businesses, mobile phone companies, and wireline telecommunications companies."

The proceeds from the sale of the wireline business will be used to repay XO's outstanding long-term debt, to offer to redeem, at the closing of the sale, XO's outstanding preferred stock and to fund growth and development of the wireless business. Once the sale is completed, the wireless business will be debt-free and is currently expected to have in excess of $300 million in cash to fund its operations and for other corporate purposes. The Company's wireless services have already been made available to businesses and wireless service providers in select markets and, using its cash position and new strong balance sheet, the Company plans to launch its services on a wider basis in the near future. The transaction is anticipated to close in late 2005 or early 2006.

The agreement is the culmination of an extensive process established by the Company over a period of several months during which multiple bids for the wireline business of the Company were evaluated by a Special Committee of the Company's Board of Directors. The winning bidder was Elk Associates LLC, an entity owned by XO's controlling stockholder, Carl Icahn, which has executed a definitive agreement to purchase the wireline business. However, as provided in the definitive agreement, the Company and the Special Committee remain open to consideration of superior proposals from third parties in certain events, subject to paying Elk Associates a break-up fee of 1% of the consideration payable in the transaction in the event that the Company receives and determines to accept a superior proposal.

The Special Committee overseeing this process consists solely of non-management directors who are not affiliated with Mr. Icahn. The Special Committee led the negotiation of the terms of the agreement with Elk Associates LLC on behalf of the Company and, after receiving the opinion of the Company's financial advisor, Jefferies & Co., Inc., to the effect that the consideration to be received by the Company in the transaction is fair to the Company from a financial point of view, approved the agreement and recommended its approval by the Board of Directors of the Company. Completion of the transaction will be subject to a number of conditions, including shareholder approval. The description of the agreement contained herein is qualified in its entirety by reference to such agreement, which will be publicly filed as required under applicable securities laws.

The "XO Communications" brand name will be transferred to the private company and thereby will remain with the national wireline telecommunications business. XO anticipates operating its fixed wireless business under a new name.

It is anticipated that the wireless and wireline companies will enter into commercial agreements to sell each other's products and services at competitive rates in order to take advantage of market opportunities.

About XO Communications
XO Communications is a leading provider of national and local telecommunications services to businesses, large enterprises and telecommunications companies. XO offers a complete portfolio of services, including local and long distance voice, dedicated Internet access, private networking, data transport, and Web hosting services as well as bundled voice and Internet solutions. XO provides these services over an advanced, national facilities-based IP network and serves more than 70 metropolitan markets across the United States. For more information, visit www.xo.com.

FOR MORE INFORMATION CONTACT:

CHAD COUSER / XO COMMUNICATIONS
703-547-2746
CHAD.COUSER@XO.COM

FORWARD LOOKING STATEMENT NOTE
THE STATEMENTS CONTAINED IN THIS RELEASE THAT ARE NOT HISTORICAL FACTS ARE "FORWARD-LOOKING STATEMENTS" (AS SUCH TERM IS DEFINED IN THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995) THAT INVOLVE RISKS AND UNCERTAINTIES. THESE STATEMENTS INCLUDE THOSE DESCRIBING XO'S EXPECTED FUTURE BUSINESS AND NETWORK OPERATIONS AND RESULTS OF OPERATIONS, XO'S ABILITY TO SERVICE THE GROWING DEMAND FOR HIGH-BANDWIDTH BROADBAND WIRELESS SERVICES, XO'S ABILITY TO INCREASE SALES ONCE IT BEGINS

OPERATING UNDER A NEW NAME, AND XO'S ABILITY TO CONTINUE TO IMPLEMENT EFFECTIVE COST CONTAINMENT MEASURES. MANAGEMENT CAUTIONS THE READER THAT THESE FORWARD-LOOKING STATEMENTS ARE ONLY PREDICTIONS AND ARE SUBJECT TO RISKS AND UNCERTAINTIES AND ACTUAL RESULTS MAY DIFFER MATERIALLY FROM THOSE INDICATED IN THE FORWARD-LOOKING STATEMENTS AS A RESULT OF A NUMBER OF FACTORS. THESE FACTORS INCLUDE, BUT ARE NOT LIMITED TO, THOSE RISKS AND UNCERTAINTIES DESCRIBED FROM TIME TO TIME IN THE REPORTS FILED BY XO COMMUNICATIONS, INC. WITH THE SECURITIES AND EXCHANGE COMMISSION, INCLUDING ITS ANNUAL REPORT ON FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2004 AND ITS QUARTERLY REPORTS ON FORM 10-Q.

Tariffs | P

EXHIBIT D

MANAGEMENT BIOGRAPHIES

Officer and Executive Team Biographies

Carl J. Grivner
President

Carl J. Grivner is Chief Executive Officer of XO Communications ("XO") and LMDS Holdings, Inc. ("Holdings").

Mr Grivner's career in telecom and technology spans more than 25 years He previously served as Chief Operating Officer at Global Crossing Prior to joining Global Crossing in June 2000, Mr Grivner served as Chief Executive Officer of Worldport Communications and before that, he served as Chief Executive Officer, Western Hemisphere, of Cable & Wireless PLC Additionally, Mr Grivner has held various senior executive positions at Advanced Fiber Communications and Ameritech Mr. Grivner began his career working in sales at IBM He also served in the United States Marine Corps from 1975-1978 He earned his Bachelor of Arts from Lycoming College

Thomas W. Cady
Interim Chief Executive Officer and Senior Vice President, Marketing and Sales

Tom Cady is a senior executive with an extensive background in the information technology industry Tom has in-depth general management experience, with expertise in marketing and sales leadership developed over twenty eight years in both corporate and entrepreneurial environments Tom's career began with a strong foundation built at Xerox and IBM, where he continuously progressed through positions of increased responsibility in sales, marketing and general management More recently, Tom has spent several years in the broadband communications industry, serving as Chief Marketing Officer for XO Communications and Adelphia Communications, President/COO & co-founder of BroadStreet Communications, and President & CEO of two early stage software companies focused on solutions for broadband service providers

Currently, Tom serves as a senior executive for LMDS Holdings, Inc., a wireless broadband service provider Additionally, Tom serves as the non-executive Chairman of AIMS Technology Group, whose focus is on developing technology solutions that support integrated and targeted marketing programs.

Tom holds a B.S. degree in Business Administration from Virginia Tech, and an MBA from the University of Richmond

Wayne Rehberger
Executive Vice President, Chief Operations Officer

Wayne Rehberger is chief operating officer of XO and Holdings. In this role he is responsible for all aspects of XO's operations including marketing, network and sales He previously served as the company's chief financial officer for more than three years During that time he led the company through a successful financial and operational restructuring that improved XO's operating metrics and financial performance through efficiency initiatives and the reduction of operating and overhead costs

Mr Rehberger has 20 years of diversified telecommunications management experience including having served in a number of executive roles at MCI Communications Corporation During his time at MCI, Mr Rehberger served in a variety of corporate and business unit accounting, finance, and operational support roles He was involved in major acquisition activities, both from a business development and operational integration role Mr Rehberger held the position of senior vice president of Finance at MCI WorldCom prior to joining XO

Prior to joining MCI, Mr Rehberger served four years in the U S Army, achieving the rank of captain before joining KPMG's consulting practice in Washington, D C where he worked on various management consulting engagements focused on business strategy, marketing, and program/product management

Gregory W. Freiberg
Vice President and Chief Financial Officer, LMDS Holdings, Inc.
Vice President and Controller, XO Communications

Greg Freiberg's career has focused on finance and strategy for organizations in transition and has included high level responsibility for both operational financial management and control. He has been responsible for significant activities in roadshow and stakeholder relations, Including the IPO and financing context, and numerous mergers, acquisitions and divestitures. He has worked to create shareholder value for many U S and International based multinational enterprises.

Mr Freiberg joined XO Communications as vice president and controller in June 2005 He is responsible for all of the companies accounting, SEC reporting, Sarbanes-Oxley compliance, and procurement In December of 2005, he was appointed chief financial officer of the LMDS Holdings, Inc 's business unit.

Mr. Freiberg previously served as senior vice president and controller of Asia Netcom, a wholly owned subsidiary of China Netcom He was also on the Board of Directors for joint ventures with Hutchison in Hong Kong, Dacom in Korea, Digitel in the Philippines, Starhub in Singapore, and Marubeni in Japan

Prior to Asia Netcom, Mr Freiberg was Senior Vice President and Controller of Asia Global Crossing He was a core member of the Executive team which guided the company through a successful restructuring and sale to China Netcom

Mr. Freiberg spent more than 8 years with MCI, including controller for MCI International, and 5 years as the founding CFO for MCI's expansion into Asia.

Mr Freiberg received a BS in Accounting from the University of South Dakota and has passed the Certified Public Accountant examination. He served in the Army National Guard for more than 9 years culminating as a Company Commander

Bill Garrahan
Acting Chief Financial Officer and Senior Vice President, Corporate Development & Strategic Planning

Bill Garrahan is both acting Chief Financial Officer and Senior Vice President of Corporate Development at XO and Holdings. He oversees the company's financial functions and leads the company's mergers and acquisitions, corporate strategy and new business development activities. He joined the company in July 2001 as a senior member of its corporate development team, later playing a critical role in the company's acquisition of Allegiance Telecom

Garrahan has nearly 20 years of experience in the telecommunications industry including previous positions at Lehman Brothers as a telecommunications equity analyst and MCI, where he held a variety of executive finance and business development functions, including Vice President of Corporate Planning and CFO of MCI's $6 billion consumer business unit

Simone Wu
Senior Vice President, Acting General Counsel & Secretary

Simone Wu is acting General Counsel and Vice President at XO and Holdings In this role, she oversees all of the company's legal affairs, which include commercial, corporate, employment, and intellectual property matters, as well as all litigation in which the Company is involved

Wu has more than 16 years of wide-ranging experience in the telecommunications industry, including domestic and international business and corporate development, intellectual property and commercial matters, and legal and regulatory affairs. Prior to joining XO in 2001, Wu held business and legal positions at MCI and AOL among other places, and practiced domestic and international transactional and telecommunications law at the law firm of Skadden, Arps, Slate, Meagher & Flom

She graduated with high honors from the University of Michigan with a degree in Political Science and as a Harlan Fiske Stone Scholar from Columbia University Law School.

Ron Scott
Vice President, Real Estate

Mr. Scott holds two senior executive titles at XO and Holdings and is currently responsible for XO's strategic business units and XO's national real estate portfolio As Group President/CEO of XO One, XO Hosting and XO Interactive. Ron is charged with growing revenue profitably and strategically positioning these business units to maximize XO's core customer value proposition Ron is also Senior Vice President of Real Estate responsible for managing XO's national real estate portfolio which includes building access and all company lease obligations.

Mr Scott has over 20 years experience in the telecommunication services industry Prior to joining XO, Ron co-founded Access Communications with the Trammell Crow family in Dallas, Texas. Access was a pioneer telecommunications startup that provided bundled telecommunication services to tenants in upscale commercial office properties. As President and CEO of Access Telecommunication Group, L.P , Ron spent 10 years growing this startup and ultimately led the transaction to sell the company to Shared Technologies Upon the sale of his company, Ron served as Vice Chairman of the Board of Shared Technologies in West Hartford, Connecticut

Prior to Mr. Scott's startup at Access, Ron held executive positions and led sales and marketing efforts in the cable industry He was National Sales VP for CCX, Inc , a cable and connector manufacturer Ron also spent several years as Director of Marketing and Sales for United Cable Television and Director of Sales for Cox Cable.

Mr. Scott was formerly on the Board of Directors for North American Telecommunication Association In 1992 and 1993, Mr Scott was recognized by the Southern Methodist University's Cox School of Business as CEO of the 11th and 25th fastest growing privately held company in the Dallas metropolitan area. Mr Scott has a Bachelor's degree in Political Science from the University of North Texas

Heather Burnett Gold
Senior Vice President, Government Relations

Heather Burnett Gold is Senior Vice President of Government Relations at XO and Holdings. In this role she oversees all of XO's advocacy with the federal government, including Congress, the FCC, other federal agencies, and the White House, and with state legislative and regulatory entities

A telecommunications veteran with more than 20 years of experience, Gold joined XO from the KDW Group, where she was a co-founder & principal, providing strategic and financial planning to companies in the telecommunications industry with respect to opportunities created by regulatory change Prior to The KDW Group, Gold was vice president of industry affairs at Intermedia Communications where she oversaw the company's regulatory, legislative and industry relations at both the state and federal levels Before Intermedia, Gold served as president of the Association for Local Telecommunications Services (ALTS) from 1993 to 1998. During her tenure at ALTS, Gold was a leading proponent for opening local telecommunications markets to facilities-based competition and a driving force behind the Telecommunications Act of 1996. Before joining ALTS, she served as vice president of member services for the Competitive Telecommunications Association (CompTel).

Gold holds an MBA in marketing and finance from Washington University in St Louis and Bachelors and Masters degrees in Economics from Tufts University

Benjamin R. Preston
Principal Counsel, Director of Legal Affairs & Assistant Secretary

Benjamin R Preston is Principal Counsel, Corporate Development & Finance and Assistant Secretary of XO Communications, Inc. and LMDS Holdings, Inc. In this role, Mr. Preston handles all mergers & acquisitions, joint ventures, corporate finance, Securities & Exchange Commission reporting, and corporate governance matters at XO

Mr. Preston has served in this capacity since January 2004 Prior to joining XO, Mr. Preston practiced corporate & securities law at Sidley Austin Brown & Wood LLP He is a graduate of the University of Massachusetts at Amherst, Georgetown University Law Center, and McDonough Graduate School of Business at Georgetown University

Chet Kudtarkar
Vice President- Finance

Chet Kudtarkar has over 26 years of experience with over 18 years in the telecommunications industry. He has served in various financial management positions in the area of Planning, Analysis and Business Development He also has experience in Marketing, Implementation and Program Management In 1994 he was involved in the early stages of starting MCIMetro, a competitive local exchange carrier With MCI, he was responsible for negotiating all interconnection agreements with incumbent local exchange companies He has an extensive background in Financial Planning and Telco Cost management Most recently, Kudtarkar has been the Director of Strategy and Corporate Development for XO Communications.

Chet Kudtarkar has an MBA from the Wharton School and a Masters in Engineering from the University of Mississippi.

Brad Magnuson
Director of Engineering

Brad Magnuson has over 15 years experience in design of public and private wireless telecommunications networks, metropolitan fiber based applications, and national IP infrastructures.

He has held various engineering management positions at XO Communications over the past ten years including District Director of Engineering for the Western Region where he designed CLEC networks in several western cities. He has also been involved in design of XO's national long haul fiber network, in development of its VoIP product and in its early technology trials of equipment operating in the LMDS spectrum Prior to joining XO, Brad spent four years with a regional gas utility where he assisted in engineering a private microwave system carrying voice and telemetry applications across three western states Brad currently serves as Director of Engineering for Fixed Wireless Applications within XO Communications

Brad has a Bachelor of Science in Electrical Engineering from the University of Utah with emphasis in Microwave Engineering, Computer Engineering, and Digital Signal Processing in telecommunications systems

EXHIBIT E

PROJECTED FINANCIAL STATEMENTS

CONFIDENTIAL AND PROPRIETARY – FILED UNDER SEAL

EXHIBIT F

SECURITIES AND EXCHANGE COMMISSION FILINGS OF XO COMMUNICATIONS, INC.

UNITED STATES
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 June 30, 2005

OR

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

Commission File No. 0-30900

XO Communications, Inc.

(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**54-1983517** **(I.R.S. employer identification no.)**

11111 Sunset Hills Road
Reston, Virginia 20190
(Address of principal executive offices, including zip code)
(703) 547-2000
(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 an accelerated filer (as defined by Rule 12b-2 of the Exchange Act.). YES ☑ NO ☐

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

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13, or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. YES ☑ NO ☐

As of August 8, 2005, the number of shares of common stock of XO Communications, Inc. issued and outstanding was 181,933,035.

XO Communications, Inc. and Subsidiaries

Index to Form 10-Q

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

XO Communications, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets
(Amounts in thousands, except for share and per share data)

	June 30, 2005 (Unaudited)	December 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 270,143	$ 233,989
Marketable securities and other investments	9,455	17,300
Accounts receivable, net of allowance for doubtful accounts of $37,145 at June 30 , 2005 and $38,981 at December 31, 2004, respectively	137,683	150,101
Other current assets	33,121	50,864
Total current assets	450,402	452,254
Property and equipment, net	764,729	820,536
Broadband wireless licenses and other intangibles, net	115,567	139,866
Other assets, net	44,917	46,729
Total assets	$1,375,615	$1,459,385
LIABILITIES, CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 86,055	$ 88,010
Other current liabilities	225,073	241,532
Total current liabilities	311,128	329,542
Long-term debt and accrued interest payable	382,646	366,247
Other long-term liabilities	67,502	73,691
Total liabilities	761,276	769,480
Class A convertible preferred stock	210,596	204,353
Commitments and contingencies		
Stockholders' equity:		
Preferred stock: par value $0.01 per share, 200,000,000 shares authorized: 4,000,000 shares of Class A convertible preferred stock issued and outstanding on June 30 , 2005 and December 31, 2004	—	—
Warrants and common stock, par value $0.01 per share, 1,000,000,000 shares authorized: 181,933,035 shares issued and outstanding on June 30 , 2005 and December 31, 2004	983,268	989,511
Deferred compensation	(463)	(574)

Accumulated other comprehensive income	1,400	4,712
Accumulated deficit	(580,462)	(508,097)
Total stockholders' equity	403,743	485,552
Total liabilities, convertible preferred stock and stockholders' equity	$1,375,615	$1,459,385

See accompanying notes to the unaudited condensed consolidated financial statements.

XO Communications, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations
(Amounts in thousands, except for share and per share data)
(Unaudited)

	Three months ended June 30, 2005	Three months ended June 30, 2004
Revenue	$ 362,164	$ 278,183
Costs and expenses:		
Cost of service (exclusive of depreciation and amortization)	138,024	118,822
Selling, operating, and general	187,772	164,149
Depreciation and amortization	61,097	30,065
Total costs and expenses	386,893	313,036
Loss from operations	(24,729)	(34,853)
Interest income	1,919	841
Investment gain (loss), net	1,891	(3,962)
Interest expense, net	(8,588)	(5,846)
Net loss	$ (29,507)	$ (43,820)
Preferred stock accretion	(3,145)	—
Net loss applicable to common shares	$ (32,652)	$ (43,820)
Net loss per common share, basic and diluted	$ (0.18)	$ (0.31)
Weighted average shares, basic and diluted	181,933,035	140,538,159

See accompanying notes to the unaudited condensed consolidated financial statements.

XO Communications, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations
(Amounts in thousands, except for share and per share data)
(Unaudited)

	Six months ended June 30, 2005	Six months ended June 30, 2004
Revenue	$ 723,669	$ 539,128
Costs and expenses:		
Cost of service (exclusive of depreciation and amortization)	285,947	228,783
Selling, operating, and general	379,466	332,702
Depreciation and amortization	119,461	55,762
Total costs and expenses	784,874	617,247
Loss from operations	(61,205)	(78,119)
Interest income	3,820	2,546
Investment gain (loss), net	1,612	(4,291)
Interest expense, net	(16,592)	(12,450)
Net loss	$ (72,365)	$ (92,314)
Preferred stock accretion	(6,242)	—
Net loss applicable to common shares	$ (78,607)	$ (92,314)
Net loss per common share, basic and diluted	$ (0.43)	$ (0.67)
Weighted average shares, basic and diluted	181,933,035	137,591,467

See accompanying notes to the unaudited condensed consolidated financial statements.

XO Communications, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows
(Amounts in thousands)
(Unaudited)

	Six months Ended June 30, 2005	Six months Ended June 30, 2004
OPERATING ACTIVITIES:		
Net loss	$ (72,365)	$ (92,314)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	119,461	55,762
Accrual of interest	16,399	12,886
Stock-based compensation	111	226
Realized loss on investments	3,191	5,665
Changes in assets and liabilities:		
Accounts receivable	12,418	(23,115)
Other assets	(5,875)	(15,198)
Accounts payable	(1,781)	9,118
Accrued liabilities	(21,123)	(7,722)
Net cash provided by (used in) operating activities	50,436	(54,692)
INVESTING ACTIVITIES:		
Capital expenditures, net	(39,529)	(49,124)
Acquisition payments	—	(361,517)
Sales of marketable securities and investments	1,342	21,144
Release of escrow account	25,430	—
Net cash used in investing activities	(12,757)	(389,497)
FINANCING ACTIVITIES:		
Repayments of long term debt and capital leases	(1,525)	(198,363)
Proceeds from issuance of common stock	—	197,612
Proceeds from exercise of stock options	—	2,714
Net cash (used in) provided by financing activities	(1,525)	1,963
Net increase (decrease) in cash and cash equivalents	36,154	(442,226)
Cash and cash equivalents, beginning of period	233,989	478,560
Cash and cash equivalents, end of period	$270,143	$ 36,334
SUPPLEMENTAL DATA:		
Cash paid for interest	$ 1,539	$ 1,140

Stock issued for acquired businesses	$ —	$ 311,307

See accompanying notes to condensed consolidated financial statements.

XO Communications, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements
(Unaudited)

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Overview

XO Communications Inc. ("XOC"), a Delaware corporation, through its subsidiaries (collectively referred to as the "Company" or "XO"), owns and operates an integrated metropolitan and nationwide fiber optic network that provides a comprehensive array of telecommunications services to business customers in over 70 United States markets. Voice services include local and long distance services, calling card and interactive voice response systems. Data services include Internet access, private data networking and hosting services. XOC, through its subsidiaries, also offers integrated combined voice and data services in flat rate "bundled" packages. In addition, XO owns licenses to deliver telecommunications services via local multipoint distribution service, or LMDS, wireless spectrum in 75 U.S. cities, which we have begun to use to provide fixed broadband wireless backhaul services to mobile wireless telecommunications carriers. The consolidated financial statements include the accounts and activities of XOC and its subsidiaries.

Basis of Presentation

The condensed consolidated financial statements of the Company are unaudited and have been prepared in accordance with guidelines established for interim financial statements by the Securities and Exchange Commission's (the "Commission") instructions to Form 10-Q and U.S. generally accepted accounting principles. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles in the United States for complete financial statements.

Operating results for any interim period are not necessarily indicative of the results for a full year or for any subsequent interim period. In the opinion of management, the unaudited condensed consolidated financial statements contain all the adjustments (consisting of those of a normal recurring nature) considered necessary to present fairly the financial position and the results of operations and cash flows for the periods presented in conformity with accounting principles generally accepted in the United States applicable to interim periods. The accompanying financial statements should be read in conjunction with the audited consolidated financial statements of XO, included in its Annual Report on Form 10-K for the year ended December 31, 2004 (the "2004 Annual Report").

On June 23, 2004 (the "Closing Date"), XO completed the acquisition of all of the telecommunications services assets (the "Acquired Businesses") of Allegiance Telecom, Inc. ("Allegiance"). XO did not acquire Allegiance's customer premises installation and maintenance business, shared hosting business, or dedicated dial-up Internet access service business (the "Unacquired Businesses"). The accompanying financial statements include the results of operations from the Acquired Businesses since June 23, 2004.

Principles of Consolidation

The Company's consolidated financial statements include all of the assets, liabilities and results of operations of subsidiaries in which the Company has a controlling interest. All inter-company accounts and transactions among consolidated entities have been eliminated.

Use of Estimates and Assumptions

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Management periodically assesses the accuracy of these estimates and assumptions. Actual results could differ from those estimates.

In the first and second quarter of 2005, the Company resolved certain billing disputes with telecommunications service providers (the "Carriers"). In accordance with the Company's policy for disputed charges, all amounts billed by the Carriers had previously been recorded as a cost of service in the Company's Condensed Consolidated Statement of Operations. Because these disputes were resolved favorably to the Company, they resulted in a reduction of cost of service of approximately $10.0 million and $10.5 million during the first and second quarters of 2005, respectively. Additionally, in the second quarter of 2005, the Company revised estimates related to liabilities assumed in relation to the Acquired Businesses. These revisions resulted in a reduction to cost of service of $3.9 million.

Reclassifications

Certain reclassifications have been made to prior period amounts in order to conform to the current year presentation.

Adjustments

In the second quarter of 2005, in conjunction with a review of certain accounting policies, the Company determined that it was not applying the proper generally accepted accounting principles to lease escalation provisions contained in certain of its operating leases since its emergence from bankruptcy in January 2003. Additionally, the Company determined that depreciation expense related to certain assets had been calculated using lives inconsistent with the Company's depreciation policy, and that certain leasehold improvements had not been expensed when the related lease contract had been terminated prior to the end of the original lease term. Accordingly, an adjustment of $8.3 million was recorded to increase selling, operating and general expenses and other current liabilities, and an adjustment of $2.5 million was recorded to increase depreciation expense and to reduce Property and Equipment, net during the three months ended June 30, 2005. The impact of these adjustments would have increased selling operating and general expense by approximately $4.5 million, $3.3 million, and $0.5 million for the years ended December 31, 2003, December 31, 2004 and the three months ended March 31, 2005, respectively, and would have increased depreciation expense by approximately $0.5 million, $1.0 million, and $1.0 million for the years ended December 31, 2003, December 31, 2004 and the three months ended March 31, 2005, respectively, had they been recorded in the appropriate periods. The Company has concluded that these adjustments are immaterial to the financial statements on both a quantitative and qualitative basis for previously issued financial statements, and to the estimated results of operations for the year ending December 31, 2005. Accordingly, the adjustments have been made in the current period financial statements. These adjustments do not affect the Company's historical or future cash flows or the timing of payments under the relevant leases.

Net Income (Loss) Per Share

Net income (loss) per common share, basic and diluted, is computed by dividing net income (loss) applicable to common shares by the weighted average number of common shares outstanding for the period. In periods of net loss, the assumed common share equivalents for options, warrants, and the Class A convertible preferred stock are anti-dilutive, and are therefore not included in the weighted average shares balance on the consolidated statement of operations. As of June 30, 2005, the Company has options outstanding to purchase approximately 9.5 million shares of common stock, of which 4.2 million are exercisable, and exercisable warrants to purchase shares up to an additional 23.7 million shares of common stock that can further dilute investors, if exercised.

Stock-Based Compensation

As allowed by Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure," ("SFAS No. 148"), the Company has chosen to continue to account for compensation cost associated with its employee stock option plan in accordance with the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," ("APB No. 25") adopting the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation," ("SFAS No. 123"). Under this method, no compensation expense is recorded if stock options are granted at an exercise price equal to or greater than the fair market value of the Company's stock on the grant date. If the Company had adopted the fair value method of accounting for its stock awards, stock-based compensation would have been determined based on the fair value for all stock awards at the grant date using a Black-Scholes pricing model and the following weighted average assumptions:

	Three months ended June 30, 2005	Three months ended June 30, 2004
Expected volatility	61.0%	63.0%
Risk free interest rate	3.8%	2.8%
Dividend yield	0.0%	0.0%
Expected life (range in years)	4.0	4.0
Fair value per share at grant date	$0.94	$2.76

	Six months ended June 30, 2005	Six months ended June 30, 2004
Expected volatility	61.0%	63.0%
Risk free interest rate	3.7%	2.7%
Dividend yield	0.0%	0.0%
Expected life (range in years)	4.0	4.0
Fair value per share at grant date	$0.96	$3.23

The Company's pro forma net loss applicable to common shares, and pro forma net loss per common share, basic and diluted, if the Company had used the fair value method would have been as follows (dollars in thousands, except per share data):

	Three months ended June 30, 2005	Three months ended June 30, 2004
Net loss applicable to common shares, as reported	$(32,652)	$(43,820)
Add: Stock-based employee compensation expense included in net loss, as reported	45	97
Deduct: Total stock-based employee compensation expense determined under fair value based methods for all stock awards	(1,776)	(2,227)
Pro forma net loss applicable to common shares	$(34,383)	$(45,950)
Net loss per common share, basic and diluted — as reported	$ (0.18)	$ (0.31)
Net loss per common share, basic and diluted — pro forma	$ (0.19)	$ (0.33)

	Six months ended June 30, 2005	Six months ended June 30, 2004
Net loss applicable to common shares, as reported	$(78,607)	$(92,314)
Add: Stock-based employee compensation expense included in net loss, as reported	111	226
Deduct: Total stock-based employee compensation expense determined under fair value based methods for all stock awards	(3,422)	(4,101)
Pro forma net loss applicable to common shares	$(81,918)	$(96,189)
Net loss per common share, basic and diluted — as reported	$ (0.43)	$ (0.67)
Net loss per common share, basic and diluted — pro forma	$ (0.45)	$ (0.70)

The XO Communications, Inc. 2002 Stock Incentive Plan (the "2002 Stock Incentive Plan") was adopted in

January 2003 and amended and restated in July 2003. Under the 2002 Stock Incentive Plan, the Company is authorized to issue awards for up to 17.6 million shares of its common stock in the form of restricted stock or options to purchase stock. The Company granted a total of 195,000 options during the three months ended June 30, 2005. The Company granted a total of 342,500 options during the six months ended June 30, 2005.

Comprehensive Loss

Comprehensive loss includes the Company's net loss applicable to common shares, as well as net unrealized gains and losses on available-for-sale investments. The following table reflects the Company's calculation of comprehensive loss for the three and six months ended June 30, 2005 and 2004 (dollars in thousands):

	Three Months Ended June 30,	
	2005	2004
Net loss applicable to common shares	$(32,652)	$(43,820)
Other comprehensive loss:		
Net unrealized (losses) gains on investment	(1,220)	1,627
Comprehensive loss	$(33,872)	$(42,193)

	Six Months Ended June 30,	
	2005	2004
Net loss applicable to common shares	$(78,607)	$(92,314)
Other comprehensive loss:		
Net unrealized (losses) gains on investment	(2,780)	3,021
Reclassification adjustment for gain included in net income	(532)	—
Comprehensive loss	$(81,919)	$(89,293)

Long-Lived Assets

Long-lived assets include property and equipment, broadband wireless licenses, and intangible assets to be held and used. Long-lived assets, excluding intangible assets with indefinite useful lives, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount should be addressed pursuant to Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," ("SFAS No. 144"). The criteria for determining impairment for such long-lived assets to be held and used is determined by comparing the carrying value of these long-lived assets to management's best estimate of future undiscounted cash flows expected to result from the use of the assets. The Company believes that no impairment existed under SFAS No. 144 as of June 30, 2005. In the event that there are changes in the planned use of the Company's long-lived assets or its expected future undiscounted cash flows are reduced significantly, the Company's assessment of its ability to recover the carrying value of these assets under SFAS No. 144 could change.

Intangible assets with indefinite useful lives are tested for impairment annually during the fourth quarter, or more frequently if an event indicates that the asset might be impaired, in accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"). XO retained independent appraisers to perform a preliminary valuation of its assets and liabilities as of December 31, 2004. This valuation was necessary as XO's fair value, as determined by its stock price, was less than its book value. Based on this preliminary valuation, XO recorded a $212.5 million non-cash impairment charge on its goodwill during the year ended December 31, 2004. A full valuation was completed in the first quarter of 2005. There were no changes to the estimate of the impairment recorded in the fourth quarter of 2004.

Recent Accounting Pronouncements

Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123R"), was issued in December 2004. Once effective, this statement will require entities to recognize compensation cost for all equity-classified awards granted, modified or settled after the effective date using a fair-value measurement method. In addition, public companies will recognize compensation expense for the unvested portion of awards outstanding as of the effective date based on their grant-date fair value as calculated under the original provisions of SFAS No. 123. The effective date for XO is the fiscal year beginning January 1, 2006. The amount of compensation expense that XO records after the adoption of SFAS No. 123R in 2006 and beyond will depend on the amount, timing and pricing of stock option grants.

2. MARKETABLE SECURITIES AND OTHER INVESTMENTS

The amortized cost, gross unrealized gains and losses and fair value of the equity securities available-for-sale as of June 30, 2005 and December 31, 2004, are in the following table. Other investments as of June 30, 2005 and December 31, 2004 consist of investments in the debt of McLeodUSA, Inc. (dollars in thousands):

	Fair Value	Cost Basis	Gross Unrealized Holding Gains	Gross Unrealized Holding (Losses)
As of June 30, 2005				
Equity securities	$ 2,940	$ 1,540	$ 1,400	$ —
Other investments	6,515	6,515	—	—
Total marketable securities and other investments	$ 9,455	$ 8,055	$ 1,400	$ —
As of December 31, 2004				
Equity securities	$ 6,417	$ 1,705	$ 4,712	$ —
Other investments	10,883	10,883	—	—
Total marketable securities and other investments	$17,300	$12,588	$ 4,712	$ —

3. LONG-LIVED ASSETS

XO's long-lived assets include property and equipment, broadband wireless licenses, and identifiable intangible assets to be held and used.

Property and Equipment

Property and equipment consisted of the following components (dollars in thousands):

	June 30, 2005	December 31, 2004
Telecommunications networks and acquired bandwidth	$ 711,296	$ 675,844
Furniture, fixtures, equipment, leasehold improvements and other	251,547	236,788
	962,843	912,632
Less: accumulated depreciation	(298,873)	(208,032)
	663,970	704,600
Construction-in-progress and undeployed assets	100,759	115,936
	$ 764,729	$ 820,536

Depreciation expense for the three and six months ended June 30, 2005 was $48.9 million and $95.2 million, respectively, and for the three and six months ended June 30, 2004 was $22.8 million and $42.0 million, respectively. Assets classified as construction-in-progress and undeployed assets are not being depreciated as they have not yet been placed in service. During the three and six months ended June 30, 2005, XO capitalized interest on construction costs of $0.8 million and $1.8 million, respectively and for the three and six months ended June 30, 2004 capitalized interest of $1.0 million and $1.9 million, respectively.

Broadband Wireless Licenses and Other Intangibles

Broadband wireless licenses and other intangible assets consisted of the following components (dollars in thousands):

	June 30, 2005	December 31, 2004
Broadband wireless licenses	$ 59,508	$ 59,508
Customer relationships	112,366	112,366
Internally developed technology	9,521	9,521
Acquired trade names	5,673	5,673
	187,068	187,068
Less: accumulated amortization	(88,163)	(63,864)
	98,905	123,204
XO Trade name — indefinite life asset	16,662	16,662
	$115,567	$139,866

Amortization expense related to intangible assets for each of the three and six months ended June 30, 2005 was $12.2 million and $24.3 million, respectively and for each of the three and six months ended June 30, 2004 was $7.2 million and $13.8 million, respectively.

4. LONG-TERM DEBT

The Company has a secured credit facility (the "Credit Facility") which matures on July 15, 2009. There are no additional borrowings available under the Credit Facility. At June 30, 2005, more than 90% of the underlying loans of the Credit Facility are held by an entity controlled by Mr. Carl C. Icahn, Chairman of the Company's Board of Directors ("Mr. Icahn"). At June 30, 2005, long-term debt consisted of $376.8 million in principal and $5.9 million of accrued interest that, if not paid, converts to principal. There are no current debt service requirements since cash interest payments as well as automatic and permanent quarterly reductions on the principal amount outstanding do not commence until 2009. However, in the event that consolidated excess cash flow (as defined in the Credit Facility) for any fiscal quarter during the term of the agreement is greater than $25.0 million, at the request of the lender, the Company will pay an amount equal to 50% of such excess cash flow greater than $25.0 million toward the reduction of outstanding indebtedness. In addition, if the ratio of XO's consolidated earnings before interest, taxes, depreciation and amortization ("EBITDA") to consolidated interest expense for four consecutive quarters exceeds 4:1, XO would be required to pay cash interest, unless waived by the lenders. The Company can elect to begin paying interest in cash prior to the required date. Loans under the Credit Facility bear interest, at the Company's option, at an alternate base rate, as defined, or a Eurodollar rate plus, in each case, applicable margins. Once the Company begins to pay accrued interest in cash, the applicable margins are reduced. At June 30, 2005, the annualized weighted average interest rate applicable to outstanding borrowings under the Credit Facility was 8.9%.

The security for the Credit Facility consists of all assets of XO including the stock of its direct and indirect subsidiaries, and substantially all the assets of those subsidiaries. The Credit Facility limits additional indebtedness, liens, dividend payments and certain investments and transactions, and contains certain covenants with respect to EBITDA requirements, as the term EBITDA is defined in the Credit Facility, and maximum capital expenditures. The Company was required to achieve a minimum consolidated EBITDA of not less than $135.0 million for the twelve-month period ended June 30, 2005. The Company is also required under the terms of the Credit Facility to maintain an unrestricted cash balance of $25 million at the end of each fiscal quarter.

In May of 2005, XO obtained a waiver of compliance with the minimum consolidated EBITDA covenant (the "Waiver") contained in the Credit Facility through December 31, 2006. The Waiver was obtained from the affiliate of Mr. Icahn which holds a majority of the Company's loans outstanding under that agreement. In connection with the Waiver, XO agreed that in the event of a sale of the Company and in the event of other significant sale or divestiture transactions, it will prepay all amounts outstanding under the Credit Facility in cash and offer to repurchase outstanding shares of XO's preferred stock at their liquidation value accrued through the date of redemption for cash or, in certain events, securities. The affiliate of Mr. Icahn which holds a majority of such Preferred Stock agreed to accept that offer, to the extent it consists of cash.

In the event that the Company is not in compliance with the minimum consolidated EBITDA covenant when the Waiver expires, there can be no guarantee that the Company will be able to obtain another waiver.

5. RELATED PARTY TRANSACTIONS

Various entities controlled by Mr. Icahn hold the following interests in XO:

	Outstanding Common Stock	Series A, B and C Warrants	Credit Facility	Preferred Stock
At December 31, 2004	Greater than 50%	Greater than 40%	Greater than 90%	95%
At June 30, 2005	Greater than 50%	Greater than 40%	Greater than 90%	95%

As a result of his majority ownership, Mr. Icahn can elect all of our directors, appoint the members of the committees of our Board of Directors, appoint key members of our executive management team, and appoint our auditors. Currently, Mr. Icahn is Chairman of the Board of Directors and three employees of Icahn Associates also sit on the Board of Directors and various Committees of the Board of Directors. Under applicable law and XO's Certificate of Incorporation and by-laws, certain actions cannot be taken without the approval of holders of a majority of our voting stock, including, without limitation, mergers, acquisitions, the sale of substantially all our assets, and amendments to our Certificate of Incorporation and by-laws.

Mr. Icahn, through various entities that he owns or controls, has the right to require XO to register, under the Securities Act of 1933, shares of XO's Common Stock held by such entities and to include shares of XO's Common Stock held by them in certain registration statements filed by XO.

The Company provides certain telecommunications services to companies affiliated with Mr. Icahn. The total revenue recognized on such services for the three months ended June 30, 2005 and 2004 was $1.2 million and $0.5 million, respectively. The total revenue recognized on such services for the six months ended June 30, 2005 and 2004 was $2.3 million and $0.7 million, respectively.

During the three months ended June 30, 2005 and 2004, the Company purchased approximately $0.3 million and $0.1 million, respectively, in services from Icahn affiliates. During the six months ended June 30, 2005 and 2004, the Company purchased approximately $0.6 million and $0.4 million, respectively, in services from Icahn affiliates.

During the three months ended June 30, 2005 and 2004, the Company purchased approximately $0.5 million and $0.1 million, respectively in hardware and services from Dell Computers, Inc. During the six months ended June 30, 2005 and 2004, the Company purchased approximately $0.6 million and $0.2 million, respectively, in hardware and services from Dell Computers, Inc. Mr. Adam Dell, an XO director, is the brother of Mr. Michael Dell, the Chairman of Dell Computers, Inc.

6. COMMITMENTS AND CONTINGENCIES

Legal Proceedings

XO is involved in lawsuits, claims, investigations and proceedings consisting of commercial, securities, tort, and employment matters, which arise in the ordinary course of business. In accordance with Statement of Financial Accounting Standards 5, "Accounting for Contingencies," XO makes a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. XO believes it has adequate provisions for any such matters. XO reviews these provisions at least quarterly and adjusts these provisions to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel, and other information and events pertaining to a particular case. Litigation is inherently unpredictable. However, XO believes that it has valid defenses with respect to legal matters pending against it. Nevertheless, it is possible that cash flows or results of operations could be materially and adversely affected in any particular period by the unfavorable resolution or disposition of one or more of these contingencies.

Allegiance Telecom Liquidating Trust Litigation

Subsequent to the Closing Date, the Unacquired Businesses as well as the ongoing Allegiance bankruptcy claims were transferred from Allegiance to the Allegiance Telecom Liquidating Trust (the "ATLT"). XO filed an administrative claim with the Bankruptcy Court in August 2004 against the ATLT, for at least approximately $40 million under the Purchase Agreement and other agreements between the parties, relating to a variety of actions allegedly taken by Allegiance and the ATLT. Subsequently, XO informed the ATLT that the amount in dispute approximates $50 million. The ATLT has asserted a counterclaim alleging that it is owed approximately $100 million in respect to operating, working capital and other disputes that have arisen between the parties. XO is vigorously trying its claim and believes that the ATLT's counterclaim is frivolous and without merit. As of June 30, 2005, XO had $8.0 million recorded in other assets, net related to certain payments made by XO on behalf of the Unacquired Businesses that XO believes is reimbursable by the ATLT. Other than this amount, the accompanying financial statements do not include any impact from the litigation. The case went to trial on May 2, 2005 and has not yet been decided.

Prior to the acquisition of the Acquired Businesses, XO purchased $92.5 million in face value of unsecured Allegiance debt securities (the "Claim"). Consequently, XO is a claimant in Allegiance's bankruptcy. It is difficult to assess how much of the Claim XO will recover, or when the recovery will be paid. This assessment could change based upon the total amount of claims the ATLT is directed to pay, the amount of administrative costs that it incurs, and the value of its assets, including 45.4 million shares of XO's common stock. The estimated fair value of the Claim of approximately $26.1 million is recorded in other assets in the Condensed Consolidated Balance Sheets as of June 30, 2005.

Telecom of Nevada Litigation

Start Investments Inc. ("Start") is XOC's 10% minority partner in Telecommunications of Nevada ("TON"), a Nevada joint venture company whose results of operations are consolidated into the accompanying financial statements. XOC and Start hold promissory notes ("the Notes") from TON for $63.5 million (the "XOC Note") and $7.1 million (the "Start Note"), respectively. The Notes became due in December 2002 and were not paid or extended on that date, but cannot be accelerated or foreclosed upon without the consent of XOC, which XOC has declined to give, acting in what it believes are the best interests of TON. TON has paid current interest on the Notes to both holders, but at the historic rate of interest, not the higher default rate. Start filed a suit against TON and XOC in October of 2003, which alleged that XOC had tortiously interfered with Start's contractual relations with TON and breached it's duty of good faith and fair dealing. The suit seeks temporary injunctive and declaratory relief, as well as damages of approximately $9.0 million, consisting primarily of the principal amount of the Start Note and interest at the default rate. In July 2005, Start moved to amend its complaint to add a claim against TON for breach of contract for failure to pay the Start Note. XOC believes it has valid defenses to the claims raised by Start and to its purported calculation of any damages. However, in the event that TON is required to pay the full principal amount of the Notes, absent a negotiated, out-of-court financial restructuring, TON may be forced to seek protection under chapter 11 of the Federal Bankruptcy Code, which could trigger a default on the Credit Facility of the Company.

The XOC Note and the accrued interest payable from TON to XOC, and the related note and interest receivable of XOC from TON, are inter-company balances and, in accordance with the principles of consolidation discussed in Note 1, have been eliminated in the consolidation of the financial statements. The Start Note and the related accrued interest payable, totaling approximately $8.3 million, are included in other current liabilities in the accompanying Condensed Consolidated Balance Sheet.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-looking and Cautionary Statements

Some statements and information contained in this document are not historical facts, but are "forward-looking statements," as such term is defined in the Private Securities Litigation Reform Act of 1995. These forward-looking statements can be identified by the use of forward-looking terminology such as "believes," "expects," "plans," "may," "will," "would," "could," "should," or "anticipates" or the negative of these words or other variations of these words or other comparable words, or by discussions of strategy that involve risks and uncertainties. Such forward-looking statements include, but are not limited to, statements regarding:

- our services, including the development and deployment of data products and services based on IP, Ethernet and other technologies and strategies to expand our targeted customer base and broaden our sales channels;
- the operation of our network and back office systems, including with respect to the development of IP protocols;
- liquidity and financial resources, including anticipated capital expenditures, funding of capital expenditures and anticipated levels of indebtedness;
- trends related to and expectations regarding the results of operations in future periods, including but not limited to those statements set forth in Management's Discussion and Analysis of Financial Condition and Results of Operations below; and
- the impact of judicial decisions, legislation, and regulatory developments on our cost structure, services, and marketing initiatives.

All such forward-looking statements are qualified by the inherent risks and uncertainties surrounding expectations generally and also may materially differ from our actual experience involving any one or more of these matters and subject areas. The operation and results of our business also may be subject to the effect of other risks and uncertainties in addition to the relevant qualifying factors identified in the "Liquidity Assessment" discussions set forth below and the "Risks and Uncertainties" discussion and the "Risk Factors" section of our 2004 Annual Report, including, but not limited to:

- general economic conditions in the geographic areas that we are targeting for the sale of telecommunications services;
- the ability to achieve and maintain market penetration and average per customer revenue levels sufficient to provide financial viability to our business;
- the quality and price of similar or comparable telecommunications services offered, or to be offered, by our current or future competitors; and
- future telecommunications-related legislation or regulatory developments and the conduct of incumbent carriers in reaction to such developments.

Management Overview

We provide a comprehensive array of telecommunications services to business customers. We provide our services, including local and long distance voice using both traditional delivery methods and Voice over Internet Protocol, or VoIP, Internet access, private data networking and hosting services, through our national telecommunications network, which consists of more than 9,000 route miles of fiber optic lines connecting 953 unique Incumbent Local Exchange Carrier, or ILEC, end-office collocations in 37 U.S. cities. In addition, we own licenses to deliver telecommunications services via local multipoint distribution service, or LMDS, wireless spectrum in 75 U.S. cities. We market our services primarily to business customers, ranging from small and medium businesses to Fortune 500 companies to carrier and wholesale customers. Our services offer an effective telecommunications solution for nearly any business, and our national telecommunications network is particularly advantageous to multi-location businesses that desire to improve telecommunications among their locations, whether within a single metropolitan area or across the country.

To serve our customers' broad telecommunications needs, we operate a network comprised of a series of rings of fiber optic cables located in the central business districts of numerous metropolitan areas, which we refer to as metro fiber networks, that are connected primarily by a network of numerous dedicated wavelengths of transmission capacity on fiber optic cables, which we refer to as an intercity network. By integrating these networks with advanced telecommunications technologies, we are able to provide a comprehensive array of telecommunications services primarily or entirely over a network that we own or control, from the initiation of the voice or data transmission to the point of termination, which we refer to as end-to-end service. This capability enables us to provide telecommunications services between customers connected to our network and among customers with multiple locations primarily or entirely over our network.

With the acquisition of Allegiance Telecom, Inc.'s, or Allegiance's, network assets and customer base, which we refer to as the Acquired Businesses, in June 2004, we became one of the nation's largest competitive providers of national local telecommunications and broadband services. We own one of the largest networks of nationwide connections to the Regional Bell Operating Companies', or RBOCs', networks, and doubled our Points of Presence (PoPs) within the 36 metropolitan areas where both XO and Allegiance operated. We believe that this extensive network will allow the combined company to (i) improve delivery of service to customers, (ii) improve operating results, and (iii) improve our ability to compete with other companies in the nationwide local telecommunications services market.

Management uses certain key performance indicators, or KPIs, to assess operational effectiveness of the business, including:

- Gross Margin
- Sales, Operating and General Expenses as a Percentage of Revenue
- EBITDA

The following table outlines the measurements of these KPIs as a percentage of revenue for the second quarter of 2005 and 2004:

	Three Months Ended June 30,	
	2005	2004
Gross margin	61.9%	57.3%
EBITDA	10.6%	(3.1%)
Sales, operating & general expenses	51.8%	59.0%
	Six Months Ended June 30,	
	2005	**2004**
Gross margin	60.5%	57.6%
EBITDA	8.3%	(4.9%)
Sales, operating & general expenses	52.4%	61.7%

Management believes that EBITDA and gross margin are measures of operating performance and liquidity that reflect the ongoing effectiveness of management's sales, cost reduction, and acquisition initiatives. Sales, operating and general expense is an important measure of the efficiency with which we sell, provision and support our services, and the efficiency of our back office operations. See the further discussion of EBITDA and gross margin in the Comparison of Financial Results section below.

As discussed further under the heading "Critical Accounting Policies and Estimates", the company settled certain billing disputes with telecommunications service providers in the first and second quarter of 2005, which resulted in a reduction of cost of service of approximately $10.0 million and $10.5 million, respectively. Additionally, in the second quarter of 2005, we revised estimates related to liabilities assumed in relation to the Acquired Businesses. These revisions resulted in a reduction to cost of service of $3.9 million. These settlements and estimate revisions contributed significantly to the improvements in the gross margin and EBITDA KPIs discussed above.

Recent Events

In March 2005, we retained Jefferies & Company, Inc. ("Jefferies") to present strategic alternatives based on, among other things, the competitive environment of the telecommunications industry, the current regulatory environment, and the recent and pending mergers and acquisitions in our industry. We have received the Jefferies report, which addressed potential operational improvements, disposition and financing possibilities, and in May 2005, we retained Jefferies to assist us in exploring our strategic alternatives.

On April 18, 2005, we launched the Company's initial Voice over Internet Protocol, or VoIP, product, named XOptions Flex, in 45 major metropolitan markets which includes more than 1,000 cities nationwide. We later expanded the product offering to two additional markets. VoIP enables customers to utilize "dynamic bandwidth allocation" to maximize the utilization of their bandwidth by allocating it for data applications during periods when voice lines are idle. XOptions Flex bundles unlimited local and long distance calling, dedicated Internet access and web hosting services for a flat monthly price. In July of 2005, we signed the 1000th order of the XOptions Flex bundle package.

We have also begun to provide fixed broadband wireless backhaul services to mobile wireless telecommunications carriers using our LMDS spectrum. In April 2005, we reached an agreement to provide fixed broadband wireless services on a limited basis to one of the national mobile wireless carriers. We will continue to pursue opportunities to market and sell our fixed wireless solution to mobile wireless carriers both for primary network connectivity and redundancy and are exploring market opportunities to use this spectrum to provide local transport services to other major enterprise customers. We also plan to offer customers an LMDS-based wireless transport solution that would aggregate data traffic onto Ethernet and other higher speed wireless paths.

Results of Operations

The operational results of XO for the three and six months ended June 30, 2005 are discussed below. As the acquisition of the Acquired Businesses closed on June 23, 2004, or the Closing Date, our consolidated results of operations include the Acquired Businesses from the Closing Date through June 30, 2005. Forward looking information with respect to consolidated XO is discussed at the end of each financial results analysis. Our actual experience may differ materially from our projections of the combined company based on many factors including, among others:

- the inherent uncertainties in projecting future results for any business;
- the inability to predict the outcome of future judicial decisions, telecommunications related legislation or regulatory decisions, or the reaction by incumbent carriers to such developments.

Three and Six Months Ended June 30, 2005 versus the Three and Six Months Ended June 30, 2004

The following table contains certain data from our unaudited consolidated and condensed statement of operations presented in thousands of dollars and expressed as a percentage of total revenue. The information in this table should be read in conjunction with our consolidated and condensed financial statements, including the notes thereto, appearing elsewhere in this report (amounts in thousands, except for share and per share data):

	Three Months Ended June 30,			
	2005		2004	
Revenue	$ 362,164	100.0%	$ 278,183	100.0%
Costs and expenses:				
Cost of service (exclusive of depreciation and amortization)	138,024	38.1%	118,822	42.7%
Selling, operating and general	187,772	51.8%	164,149	59.0%
Depreciation and amortization	61,097	16.9%	30,065	10.8%
Total costs and expenses	386,893	106.8%	313,036	112.5%
Loss from operations	(24,729)	(6.8%)	(34,853)	(12.5%)
Interest income	1,919	0.5%	841	0.3%
Investment gain (loss)	1,891	0.5%	(3,962)	(1.4%)
Interest expense, net	(8,588)	(2.4%)	(5,846)	(2.1%)
Net loss	$ (29,507)	(8.1%)	$ (43,820)	(15.8%)
Preferred stock accretion	(3,145)	(0.9%)	—	—%
Net loss applicable to common shares	$ (32,652)	(9.0%)	$ (43,820)	(15.8%)
Net loss per common share, basic and diluted	(0.18)		(0.31)	
Weighted average shares outstanding, basic and diluted	181,933,035		140,538,159	
Gross margin (1)	224,140	61.9%	159,361	57.3%
EBITDA (2)	38,259	10.6%	(8,750)	(3.1%)

	Six Months Ended June 30,					
	2005			2004		
Revenue	$	723,669	100.0%	$	539,128	100.0%
Costs and expenses:						
Cost of service (exclusive of depreciation and amortization)		285,947	39.5%		228,783	42.4%
Selling, operating and general		379,466	52.4%		332,702	61.7%
Depreciation and amortization		119,461	16.5%		55,762	10.3%
Total costs and expenses		784,874	108.5%		617,247	114.5%
Loss from operations		(61,205)	(8.5%)		(78,119)	(14.5%)
Interest income		3,820	0.5%		2,546	0.5%
Investment gain (loss)		1,612	0.2%		(4,291)	(0.8%)
Interest expense, net		(16,592)	(2.3%)		(12,450)	(2.3%)
Net loss	$	(72,365)	(10.0%)	$	(92,314)	(17.1%)
Preferred stock accretion		(6,242)	(0.9%)		—	—%
Net loss applicable to common shares	$	(78,607)	(10.9%)	$	(92,314)	(17.1%)
Net loss per common share, basic and diluted		(0.43)			(0.67)	
Weighted average shares outstanding, basic and diluted		181,933,035			137,591,467	
Gross margin (1)		437,722	60.5%		310,345	57.6%
EBITDA (2)		59,868	8.3%		(26,648)	(4.9%)

(1) Gross margin is defined as revenue less cost of service, and excludes depreciation and amortization. Gross margin is not intended to replace operating income (loss), net income (loss), cash flow and other measures of financial performance reported in accordance with generally accepted accounting principles in the United States. Rather, gross margin is an important measure used by management to assess operating performance of the Company. Additionally, we believe that gross margin is a standard measure of operating performance that is commonly reported and widely used by analysts, investors, and other interested parties in the telecommunications industry. Gross margin as used in this document may not be comparable to similarly titled measures reported by other companies due to differences in accounting policies. A reconciliation between gross margin and net loss is as follows:

	Three Months Ended June 30, 2005	2004
Net loss	$ (29,507)	$ (43,820)
Selling, operating and general	187,772	164,149
Interest income	(1,919)	(841)
Investment (gain) loss, net	(1,891)	3,962
Interest expense, net	8,588	5,846
Depreciation and amortization	61,097	30,065
Gross margin	$224,140	$159,361

	Six Months Ended June 30, 2005	2004
Net loss	$ (72,365)	$ (92,314)
Selling, operating and general	379,466	332,702
Interest income	(3,820)	(2,546)
Investment (gain) loss, net	(1,612)	4,291
Interest expense, net	16,592	12,450
Depreciation and amortization	119,461	55,762
Gross margin	$437,722	$310,345

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(2) EBITDA is defined as net income or loss before depreciation, amortization, interest expense, and interest income. EBITDA is not intended to replace operating income (loss), net income (loss), cash flow and other measures of financial performance reported in accordance with generally accepted accounting principles in the United States. Rather, EBITDA is an important measure used by management to assess operating performance of the company. EBITDA as used in this document may not be comparable to similarly titled measures reported by other companies due to differences in accounting policies. Additionally, EBITDA as defined here does not have the same meaning as EBITDA as defined in our secured credit facility agreement. A reconciliation between EBITDA and net loss is as follows:

	Three Months Ended June 30, 2005	2004
Net loss	$ (29,507)	$ (43,820)
Interest income	(1,919)	(841)
Interest expense, net	8,588	5,846
Depreciation and amortization	61,097	30,065
EBITDA	$ 38,259	$ (8,750)

	Six Months Ended June 30, 2005	2004
Net loss	$ (72,365)	$ (92,314)
Interest income	(3,820)	(2,546)
Interest expense, net	16,592	12,450
Depreciation and amortization	119,461	55,762
EBITDA	$ 59,868	$ (26,648)

Revenue. Total revenue for the three months ended June 30, 2005 increased 30.2% to $362.2 million from $278.2 million for the same period in 2004. Revenue for the six months ended June 30, 2005 increased 34.2% to $723.7 million from $539.1 million for the same period in 2004. Substantially all of the increase is attributable to the inclusion of the Acquired Businesses in the results for the three and six months ended June 30, 2005.

We believe that revenue for the remainder of 2005 will remain flat relative to the second quarter of 2005 results.

Revenue was earned from providing the following services (dollars in thousands):

	Three months ended June 30,				
	2005	% of Revenue	2004	% of Revenue	% Change
Voice services	$188,498	52.0%	$141,679	50.9%	33.0%
Data services	107,779	29.8%	95,612	34.4%	12.7%
Integrated voice and data services	65,887	18.2%	40,892	14.7%	61.1%
Total revenue	$362,164	100.0%	$278,183	100.0%	30.2%

	Six months ended June 30,				
	2005	% of Revenue	2004	% of Revenue	% Change
Voice services	$374,797	51.8%	$272,600	50.5%	37.5%
Data services	216,171	29.9%	188,561	35.0%	14.6%
Integrated voice and data services	132,701	18.3%	77,967	14.5%	70.2%
Total revenue	$723,669	100.0%	$539,128	100.0%	34.2%

Voice services revenue includes revenue from local and long distance voice services, prepaid calling card processing, interactive voice response services, stand-alone long distance services and other voice telecommunications based services. For the three and six months ended June 30, 2005, revenue from voice services increased $46.8 million or 33.0% and $102.2 million or 37.5% as compared to the same periods in 2004. Substantially all of the increase is attributable to the inclusion of the Acquired Businesses in the results for the three and six months ended June 30, 2005.

Data services revenue includes revenue from Internet access, network access and web hosting services. For the three and six months ended June 30, 2005, revenue from data services increased $12.2 million or 12.7% and $27.6 million or 14.6% as compared to the same periods in 2004. Substantially all of the increase is attributable to the inclusion of the Acquired Businesses in the results for the three and six months ended June 30, 2005.

Integrated voice and data services revenue includes revenue from our XOptions, XOptions Flex and Total Communications service offerings, XO's flat-rate bundled packages offering a combination of voice and data services and integrated access. For the three and six months ended June 30, 2005, revenue from integrated voice and data services increased $25.0 million or 61.1% and $54.7 million or 70.2% as compared to the same periods in 2004. Substantially all of the increase is attributable to the inclusion of the Acquired Businesses in the results for the three months ended June 30, 2005.

Costs and expenses. The table below provides costs and expenses by classification and as a percentage of revenue (dollars in thousands).

	Three months ended June 30,		Three months ended June 30,		
	2005	% of Revenue	2004	% of Revenue	% Change
Costs and expenses:					
Cost of service (excluding depreciation and amortization)	$138,024	38.1%	$118,822	42.7%	16.2%
Selling, operating and general	187,772	51.8%	164,149	59.0%	14.4%
Depreciation and amortization	61,097	16.9%	30,065	10.8%	103.2%
Total	$386,893		$313,036		23.6%

	Six months ended June 30,		Six months ended June 30,		
	2005	% of Revenue	2004	% of Revenue	% Change
Costs and expenses:					
Cost of service (excluding depreciation and amortization)	$285,947	39.5%	$228,783	42.4%	25.0%
Selling, operating and general	379,466	52.4%	332,702	61.7%	14.1%
Depreciation and amortization	119,461	16.5%	55,762	10.3%	114.2%
Total	$784,874		$617,247		27.2%

Cost of service (exclusive of depreciation and amortization). Cost of service includes expenses directly associated with providing telecommunications services to our customers. Cost of service includes, among other items, the cost of connecting customers to our network via leased facilities, the costs of leasing components of our network facilities and costs paid to third party service providers for interconnect access and transport services. Cost of service as a percentage of revenue for the three and six months ended June 30, 2005 decreased as compared to the same periods in 2004, primarily due to $20.5 million in settlements with two telecommunications service providers, $10.5 million of which was recorded during the three months ended June 30, 2005 and $10.0 million of which was recorded during the three months ended March 31, 2005. Additionally, in the second quarter of 2005, we revised estimates related to liabilities assumed in relation to the Acquired Businesses. These revisions resulted in a reduction to cost of service of $3.9 million. We originally estimated a potential benefit of approximately $60.0 million in pro forma annualized network synergies for the combined companies if our integration efforts with the Acquired Businesses were successful. We have made substantial progress integrating the two companies and are on plan to reach our synergy targets.

We believe that, excluding the settlements and estimate revisions referenced above, cost of service as a percentage of revenue for the remainder of 2005 will remain stable to slightly down relative to the second quarter of 2005 results. Cost of service will be adversely impacted due to the recently enacted regulatory rules on unbundled network element, or UNE, loop and transport rates as discussed in the "Regulatory Overview" section below. The UNE and transport rate increases will be phased in during 2005 and the first quarter of 2006. We expect these increases to have a total annualized impact, including transitional and special access rates, of approximately $85 million by the end of the first quarter of 2006. However, we believe that actions we are taking, including negotiating rate reductions, network optimization, and price increases to our customers, will offset these increases.

Selling, operating and general. Selling, operating and general expense includes expenses related to network maintenance, sales and marketing, network operations and engineering, information systems, general corporate office functions and collection risks. Selling, operating and general expense for the three months ended June 30, 2005 was $187.8 million or 51.8% of revenue compared to $164.1 million or 59.0% of revenue for the three months ended June 30, 2004. Selling, operating and general expense for the six months ended June 30, 2005 was $379.5 million or 52.4% of revenue compared to $332.7 million or 61.7% of revenue for the six months ended June 30, 2004. The improvements as a percentage of revenue are largely attributable to the synergies obtained through the integration of the Acquired Businesses. We originally estimated a potential benefit of approximately $100.0 million in pro forma annualized selling, operating and general expense synergies for the combined companies if our integration efforts with the Acquired Businesses were successful. We have completely integrated the administrative functions and have exceeded the estimated annualized synergies.

As discussed further in the section entitled Critical Accounting Policies and Estimates below, selling, operating and general expenses for the three and six months ended June 30, 2005 includes an adjustment of approximately $8.3 million relating to our accounting for leases.

We believe that selling, operating and general expense will remain stable or decrease slightly as a percentage of revenue during the remainder of 2005 as compared to the second quarter of 2005 results.

Depreciation and amortization. Depreciation expense was $48.9 million for the three months ended June 30, 2005, compared to $22.8 million for the same period in 2004 and $95.2 million for the six months ended June 30, 2005, compared to $42.0 million for the same period in 2004. Total amortization expense was $12.2 million for the second quarter of 2005 and $7.2 million for the second quarter of 2004 and was $24.3 million in the first half of 2005 and $13.7 million in the first half of 2004. Substantially all of the increases in depreciation and amortization are attributable to the acquisition of the Acquired Businesses.

As of June 30, 2005, we had approximately $100.8 million of fixed assets and $23.5 million of broadband wireless licenses that have not yet been placed into service and, accordingly, are not currently being depreciated or amortized. We expect depreciation and amortization expense to increase as a percentage of revenue for the remainder of 2005 as we place more fixed wireless licenses into service.

Interest income. Interest income for the three months ended June 30, 2005 increased to $1.9 million from $0.8 million for the three months ended June 30, 2004. Interest income for the six months ended June 30, 2005 increased to $3.8 million from $2.5 million in the six months ended June 30, 2004. The increase in interest income is due to an increase in the amount of cash and cash equivalents invested and an increase in interest rates.

Investment gain (loss), net. Investment gain (loss), net includes any realized gains or losses from the sale or other than temporary impairment of investments. For the three months ended June 30, 2005 we reported a net investment gain of $1.9 million while we reported net investment loss of $4.0 million for the same period of 2004. Investment gain, net for the six months ended June 30, 2005 was $1.6 million while we had net investment loss of $4.3 million for the same period in 2004. The improvement is largely attributable to a realized loss on the sale of an investment during the second quarter of 2004.

Interest expense, net. Interest expense, net includes interest expense on debt and capital leases, less any amounts capitalized. The majority of interest expense in the three and six months ended June 30, 2005 and 2004 is non-cash as our secured credit facility allows for accrued interest to be converted into principal if unpaid. Interest expense, net for the three months ended June 30, 2005 and 2004 was $8.6 million and $5.8 million, respectively. Interest expense, net for the six months ended June 30, 2005 and 2004 was $16.6 million and $12.5 million, respectively. The increase in interest expense is due to an increase in interest rates, as well as the compounding effect of the conversion of accrued interest to principal.

Net Loss. Net loss decreased $14.3 million to a loss of $29.5 million for the three months ended June 30, 2005, from a net loss of $43.8 million for the comparable period in 2004. Net loss decreased $19.9 million to a loss of $72.4 million for the six months ended June 30, 2005, from a net loss of $92.3 million for the comparable period in 2004. The decrease primarily resulted from the achievement of synergies resulting from the integration of the Acquired Businesses, offset by additional depreciation and amortization from the inclusion of the property and equipment and intangibles of the Acquired Businesses. Additionally, we recognized approximately $24.4 million of reductions in cost of service expenses for the six months ended June 30, 2005 from the settlements and estimate revisions discussed above.

EBITDA. EBITDA increased to $38.3 million for the three months ended June 30, 2005 from $(8.7) million for the comparable period in 2004 and increased to $59.9 million for the six months ended June 30, 2005 from $(26.6) million for the comparable period in 2004. The increase primarily resulted from the achievement of synergies resulting from the integration of the Acquired Businesses and the settlements and estimate revisions discussed above.

Critical Accounting Policies and Estimates

Our significant accounting policies are more fully described in the notes to the consolidated financial statements in our 2004 Annual Report. The preparation of the condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States requires management to make judgments, estimates and assumptions regarding uncertainties that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses. Management uses historical experience and all available information to make these judgments and estimates and actual results could differ from those estimates and assumptions that are used to prepare our financial statements at any given time. Despite these inherent limitations, management believes that Management's Discussion and Analysis and the accompanying condensed consolidated financial statements and footnotes provide a meaningful and fair perspective of our financial condition and our operating results for the current period. Management's Discussion and Analysis and Note 3 to the Consolidated Financial Statements in the XO Communications, Inc. Annual Report on Form 10-K for the year ended December 31, 2004 describe the significant estimates and accounting policies used in preparation of the Condensed Consolidated Financial Statements.

During the six months ended June 30, 2005, we resolved certain billing disputes with telecommunications service providers (the "Carriers"). In accordance with our policy for disputed charges, all amounts billed by the Carriers had previously been recorded as a cost of service in our Condensed Consolidated Statement of Operations. Because these disputes were resolved favorably to us, they resulted in a reduction of cost of service of approximately $10.0 million and $10.5 million during the first and second quarters of 2005, respectively.

In the second quarter of 2005, in conjunction with a review of certain accounting policies, we determined that we were not applying the proper generally accepted accounting principles to lease escalation provisions contained in certain of our operating leases since our emergence from bankruptcy in January 2003. Additionally, we determined that certain assets had been depreciating over lives inconsistent with our depreciation policy, and that certain leasehold improvements had not been expensed when the related lease contract had been terminated prior to the end of the initial lease term. Accordingly, an adjustment of $8.3 million was recorded to increase selling, operating and general expenses and other current liabilities, and an adjustment of $2.5 million was recorded to increase depreciation expense and to reduce Property and Equipment, net during the three months ended June 30, 2005. The impact of these adjustments would have increased selling operating and general expense by approximately $4.5 million, $3.3 million, and $0.5 million for the years ended December 31, 2003, December 31, 2004 and the three months ended March 31, 2005, respectively, and would have increased depreciation expense by approximately $0.5 million, $1.0 million, and $1.0 million for the years ended December 31, 2003, December 31, 2004 and the three months ended March 31, 2005, respectively, had they been recorded in the appropriate periods. We have concluded that the adjustment is immaterial to the financial statements on both a quantitative and qualitative basis for all periods affected. Accordingly, the adjustment has been made in the current period financial statements. The adjustment does not affect our historical or future cash flows or the timing of payments under the relevant leases.

Liquidity and Capital Resources

Capital Resources and Liquidity Assessment

During the three months ended June 30, 2005, our operating activities provided net cash of $32.2 million, our investing activities used net cash of $18.0 million and our financing activities used net cash of $0.7 million. For the six months ended June 30, 2005, our operating activities provided net cash of $50.4 million, our investing activities used net cash of $12.8 million, and our financing activities used net cash of $1.5 million. Our balance of cash and cash equivalents increased to $270.1 million at June 30, 2005 from $234.0 million at December 31, 2004.

Our cash flows from operating activities for the six months ended June 30, 2005 were aided by a cash settlement of approximately $10.0 million with a telecommunications service provider during the first quarter of 2005. Cash used in investing activities for the six months ended June 30, 2005 was aided by the release, during the first quarter of 2005, of approximately $25.4 million that had previously held in escrow and classified as other current assets in the Condensed Consolidated Balance Sheet.

We project that we will have sustainable positive cash flows by the end of 2005. Our projection is based upon, among other things, our estimated increased costs of service attributable to the recent Triennial Review Remand Order, or TRRO, discussed in the "Regulatory Overview" below, and other projected operating costs that are not entirely under our control. As a result, our projections may be incorrect if our estimates of such costs and expenses are inaccurate.

We have a secured credit facility, or the Credit Facility, which matures on July 15, 2009. There are no additional borrowings available under the Credit Facility. At June 30, 2005, more than 90% of the underlying loans of the Credit Facility are held by an entity controlled by Mr. Carl C. Icahn, Chairman of the Company's Board of Directors ("Mr. Icahn"). At June 30, 2005, long-term debt consisted of $376.8 million in principal and $5.9 million of accrued interest that, if not paid, converts to principal. There are no current debt service requirements since cash interest payments as well as automatic and permanent quarterly reductions on the principal amount outstanding do not commence until 2009. However, in the event that consolidated excess cash flow (as defined in the Credit Facility) for any fiscal quarter during the term of the agreement is greater than $25.0 million, at the request of the lender, we will pay an amount equal to 50% of such excess cash flow greater than $25.0 million toward the reduction of outstanding indebtedness. In addition, if the ratio of XO's consolidated earnings before interest, taxes, depreciation and amortization ("EBITDA"), as defined in the Credit Facility, to consolidated interest expense for four consecutive quarters exceeds 4:1, we would be required to pay cash interest, unless waived by the lenders. We can elect to begin paying interest in cash prior to the required date. Loans under the Credit Facility bear interest, at our option, at an alternate base rate, as defined, or a Eurodollar rate plus, in each case, applicable margins. Once we begins to pay accrued interest in cash, the applicable margins are reduced. At June 30, 2005, the annualized weighted average interest rate applicable to outstanding borrowings under the Credit Facility was 8.9%.

The security for the Credit Facility consists of all of our assets including the stock of our direct and indirect subsidiaries, and substantially all the assets of those subsidiaries. The Credit Facility limits additional indebtedness, liens, dividend payments and certain investments and transactions, and contains certain covenants with respect to EBITDA requirements, as the term EBITDA is defined in the Credit Facility, and maximum capital expenditures. The definition of EBITDA in the Credit Facility differs from the definition of EBITDA discussed in "Results of Operations" above. We were required to achieve a minimum consolidated EBITDA of not less than $135.0 million for the twelve-month period ended June 30, 2005. We are also required under the terms of the Credit Facility to maintain an unrestricted cash balance of $25.0 million at the end of each fiscal quarter.

In May of 2005, we obtained a waiver of compliance with the minimum consolidated EBITDA covenant contained in the Credit Facility through December 31, 2006. The waiver was obtained from the affiliate of Mr. Icahn which holds a majority of our loans outstanding under that agreement. In connection with that waiver, we agreed that in the event of a sale of the Company and in the event of other significant sale or divestiture transactions, we will prepay all amounts outstanding under the Credit Facility in cash and offer to repurchase outstanding shares of our preferred stock at their liquidation value accrued through the date of redemption for cash or, in certain events, securities. The affiliate of Mr. Icahn which holds a majority of such Preferred Stock has agreed to accept that offer, to the extent it consists of cash.

In the event that we are not in compliance with the minimum consolidated EBITDA covenant when the waiver expires, there can be no guarantee that we will be able to obtain another waiver.

Credit Risk

Financial instruments that potentially subject us to concentrations of credit risk consist primarily of trade receivables. Although our trade receivables are geographically dispersed and include customers in many different industries, a portion of our revenue is generated from services provided to other telecommunications service providers. We believe that our established valuation and credit allowances are adequate as of June 30, 2005 to cover these risks.

Regulatory Overview

Overview

We are subject to regulation by federal, state and local government agencies. Historically, the Federal Communications Commission, or FCC, had jurisdiction over interstate long distance services and international services, while state regulatory commissions had jurisdiction over local and intrastate long distance services. The

Telecommunications Act of 1996, or the Telecom Act, fundamentally changed the way telecommunications is regulated in this country. The FCC was given a major role in writing and enforcing the rules under which new competitors could compete in the local marketplace. Those rules, coupled with additional rules and decisions promulgated by the various state regulatory commissions, form the core of the regulatory framework under which we operate in providing our services.

With a few limited exceptions, the FCC continues to retain exclusive jurisdiction over our provision of interstate and international long distance services, and the state regulatory commissions regulate our provision of intrastate local and long distance services. Additionally, municipalities and other local government agencies may regulate limited aspects of our business, such as use of government-owned rights-of-way, and may require permits such as zoning approvals and building permits.

The Telecom Act and the related rules governing competition issued by the FCC, as well as pro-competitive policies already developed by state regulatory commissions, have enabled new entrants like us to capture a portion of the ILECs' market share of local services. However, there have been numerous attempts to limit the pro-competitive policies in the local exchange services market through a combination of proposed federal legislation, adoption of new rules by the FCC, and ILEC challenges to existing and proposed regulations. To date, the ILECs have succeeded in eliminating some of the market-opening regulations adopted by the FCC and the states through numerous court challenges. In particular, the ILECs appealed, and won partial reversals of, a series of FCC orders defining the ILEC facilities, known as UNEs, that ILECs must lease to competitors at cost-based rates. We expect the ILEC's efforts to scale back the benefits of the Telecom Act and local service competition to continue. However, while the FCC has eliminated certain UNEs, the basic framework of local competition for facilities-based competitors such as us, has remained intact. The successful implementation of our business plan is predicated on the assumption that the basic competitive framework and pro-competitive safeguards will remain in place.

The passage of the Telecom Act largely preceded the explosive growth of the Internet and Internet Protocol, or "IP", communications. Congress is currently considering whether to further amend the Telecom Act to, among other things, directly address IP communications. It is possible that any such amendment to the Telecom Act could eliminate or materially alter the market-opening regulatory framework of the Telecom Act in general, and the UNE regime in particular. Such a result could adversely affect XO's business. It is not possible to predict if, when, or how the Telecom Act will be amended.

Federal Regulation

The FCC exercises jurisdiction over our telecommunications facilities and services. We have authority from the FCC for the installation, acquisition and operation of our wireline network facilities to provide facilities-based domestic interstate and international services. In addition, we have obtained FCC authorizations for the operation of our LMDS and 39 GHz broadband wireless facilities. Because we are not dominant in any of our markets, unlike ILECs, we are not subject to price cap or rate of return regulation. Thus, our pricing policies for interstate and international end user services are only subject to the federal guidelines that charges for such services be just, reasonable, and non-discriminatory. The FCC allows us to file interstate tariffs for our interstate access services (rates charged by us to other carriers for access to our network). As for domestic interstate and international long distance services, the FCC requires us to make the terms, conditions and rates of the detariffed services available to the public on XO's web page, and such terms, conditions, and rates are located at http://www.xo.com/legal/.

Implementation of the Telecom Act

The Telecom Act's Local Competition Framework

One of the key goals of the Telecom Act is to encourage competition in the provision of local telephone service. To do this, the Telecom Act provides three means by which competitive local exchange carriers, or CLECs, such as XO can enter the local telephone service market. The three modes of entry are as follows:

- ***Access to UNEs.*** ILECs are required to lease to CLECs various elements in their network that are used individually or in combination with each other to provide local telephone service. As discussed in more detail below, the FCC determines which facilities must be made available by the ILECs as UNEs. The ILECs must make UNEs available at rates that are based on their forward-looking economic costs, a pricing regime known as "TELRIC," short for Total Element Long Run Incremental Cost. For XO, the most critical UNEs are local loops and transport, which enable us to connect our customers to our network.

- ***Construction of New Facilities.*** CLECs may also enter the local service market by building entirely new facilities. The ILECs are required to allow CLECs to interconnect their facilities with the ILECs' facilities in order to reach all customers.
- ***Resale.*** ILECs are required to permit CLECs to purchase their services for resale to the public at a wholesale rate that is less than the rate charged by the ILECs to their retail customers.

To facilitate competitors' entry into local telephone markets using one or more of these three methods, the Telecom Act imposes on the ILECs the obligation to open their networks and markets to competition. When requested by competitors, ILECs are required to negotiate, in good faith, agreements that set forth terms governing the interconnection of their network, access to UNEs, and resale. We have negotiated interconnection agreements with the ILECs in each of the markets in which we operate. Many of these interconnection agreements are currently being renegotiated.

The following is a summary of the interconnection and other rights granted by the Telecom Act that are important for effective local service competition and our belief as to the effect of those requirements, if properly implemented:

- interconnection with the networks of incumbents and other carriers, which permits our customers to exchange traffic with customers connected to other networks;
- requirements that the ILECs make available access to their facilities for our local loops and transport needs, thereby enabling us to serve customers not directly connected to our networks;
- compensation obligations, which mandate reciprocal payment arrangements for local traffic exchange between us and both incumbent and other competitive carriers and compensation for terminating local traffic originating on other carriers' networks;
- requirements concerning local number portability, which allows customers to change local carriers without changing telephone numbers, thereby removing a significant barrier for a potential customer to switch to our local voice services;
- access to assignment of telephone numbers, which enables us to provide telephone numbers to new customers on the same basis as incumbent carriers; and
- collocation rights allowing us to place telecommunications equipment in ILEC central offices, which enables us to have direct access to local loops and other network elements.

Although the rights established in the Telecom Act are a necessary prerequisite to the introduction of full local competition, they must be properly implemented and enforced to permit competitive telephone companies like XO to compete effectively with the incumbent carriers. Discussed below are several FCC and court proceedings relating to the application of certain FCC rules and policies that are significant to and directly impact our operations and costs as well as the nature and scope of industry competition.

Unbundling of Incumbent Network Elements

In a series of orders and related court challenges that date back to 1996, the FCC has promulgated rules implementing the market-opening provisions of the Telecom Act, including the requirement that the ILECs lease UNEs to competitors at cost-based rates. At the core of the series of FCC orders is the FCC's evolving effort to define which ILEC network facilities must be made available as UNEs. Initially, the FCC defined a broad list of UNEs, consisting of most of the elements of the ILECs' networks. Under pressure from the ILECs, the FCC has subsequently reduced the list, while preserving access to those network elements critical to the operation of XO's business.

The current list of UNEs was promulgated by the FCC in two orders. The first is the Triennial Review Order, or TRO, which was released on August 21, 2003. Several carriers and other entities appealed the FCC's TRO decision. On March 2, 2004, the U.S. Court of Appeals for the D.C. Circuit issued its opinion in United States Telecom Association v. FCC, No. 00-1012 ("USTA II Decision"). In the USTA II Decision, the court reversed and overturned many of the conclusions of the TRO. In the aftermath of the USTA II Decision, the FCC released the second of its two currently controlling orders, the TRRO, on February 4, 2005. Various parties, including XO, have appealed the TRRO. The case is currently pending before the United States Court of Appeals for the D.C. Circuit. It is not possible to predict the outcome of those appeals. It is possible that portions of the TRRO could be overturned and that the FCC will issue new rules in their place that further restrict access to UNEs. In addition to the court challenges, several parties, including XO, have petitioned the FCC to reconsider various aspects of the TRRO. It is not possible to predict when or how the FCC will rule with respect to those reconsideration petitions.

As of March 11, 2005, the effective date of the TRRO, the ILECs are obligated to provide as UNEs the following network facilities used by XO to serve its customers:

UNE Loops

DS0 loops. A DS0 loop is a single, voice-grade channel. Typically, individual business lines are DS0 loops. The ILECs must make DS0 loops available at UNE rates on an unlimited basis.

DS1 loops. A DS1 loop is a digital loop with a total speed of 1.544 megabytes per second, which is the equivalent of 24 DS0 circuits. Multiple voice lines and Internet access can be provided to a customer over a single DS1 loop. We provide most of our service with DS1 loops. The ILECs must provide DS1 loops at UNE rates at the majority of their central offices. Competitors, however, are limited to no more than 10 DS1 loops to any particular building.

DS3 loops. A DS3 loop is a digital loop with a total speed of 44.736 megabytes per second, which is the equivalent of 28 DS1 circuits. In some cases, XO serves its large business customers with DS3 loops. ILECs must provide DS3 loops at UNE rates at the majority of their central offices. Competitors, however, are limited to no more than one DS3 loop to any particular building.

ILECs are not required to provide optical capacity loops or dark fiber loops as UNEs. Optical capacity loops, referred to as OCn loops, are very high-capacity digital loops ranging in capacity from OC3 loops, which are the equivalent of three DS3s to OC192. This will not impact our costs.

The ILECs are also not required to provide certain mass market broadband loop facilities and functionality as UNEs. Under the TRO, the ILECs are not required to make newly-deployed fiber-to-the-home, or FTTH, loops available as UNEs and are only required to provide the equivalent of DS0 capacity on any FTTH loop built over an existing copper loop. These recent FCC orders should only limit availability for those specific network elements, which are not material to us. It is possible, however, that the ILECs will seek additional broadband regulatory relief in future proceedings.

UNE Transport

DS1 transport. Whether transport is available as a UNE is determined on a route-by-route basis. ILECs must make transport at UNE rates available at DS1 capacity levels between any two ILEC central offices unless both central offices either (1) serve more than 38,000 business lines or (2) have four or more fiber-based collocators. On routes where DS1 transport must be made available, each individual competitor is limited to no more than 10 DS1 transport circuits per route.

DS3 transport. Access to DS3 capacity-level transport is more limited than access to DS1 transport. ILECs must make transport at UNE rates available at DS3 capacity levels between any two ILEC central offices unless both central offices either (1) serve more than 24,000 business lines or (2) have three or more fiber-based collocators. On routes where DS3 transport must be made available, each individual competitor is limited to no more than 12 DS1 transport circuits per route.

Dark fiber transport. Dark fiber transport is available under the same conditions as DS3 transport.

ILECs are not required to provide access to transport at greater-than DS3 capacity levels. ILECs are also not required to provide dark fiber transport at any capacity level to connect an ILEC central office with a competitor's facilities.

Transitional availability where elements are no longer available as UNEs

For DS1, DS3, and dark fiber loops and transport that do not meet the criteria for availability set forth above, the FCC established a transitional period during which the ILECs must continue to make the elements available at UNE rates to serve existing customers. For DS1 and DS3 loops and transport, the ILECs must make the elements available at 115% of the TELRIC rate for one year beginning on March 11, 2005. For dark fiber loops and transport, the ILECs must make the elements available at 115% of the TELRIC rate for 18 months beginning on March 11, 2005.

Although these rules adopted by the FCC in the TRRO became effective on March 11, 2005, many of the requirements imposed by the FCC in the TRO and TRRO were not self-executing. Accordingly, the FCC made clear that carriers must follow the change of law procedures in their applicable interconnection agreements with ILECs to implement any TRO requirements that are not self-executing and that carriers must follow the procedures set forth in Section 252(b) of the Telecom Act to modify interconnection agreements that are silent as to implementation of changes in law. We have been in negotiations with ILECs to amend our interconnection agreements to implement relevant TRO requirements and, to date, have executed amendments in several states.

Additional Federal Regulations

The following discussion summarizes some additional specific areas of federal regulation that directly affect our business.

VoIP. Like a growing number of carriers, we utilize IP technology for the transmission of a portion of our network traffic. The regulatory status and treatment of IP-enabled services is unresolved. The FCC has held that Vonage's VoIP services and similar offerings by other providers are subject to the FCC's interstate jurisdiction, preempting state efforts to regulate VoIP providers as intrastate telecommunications providers. Four separate state commissions have appealed this ruling and the case is currently pending. The FCC, however, left open the question of whether VoIP providers provide "telecommunications" — i.e., basic transmission services — or enhanced "information services." Under the Communications Act of 1934, as amended, or the Communications Act, those are mutually exclusive categories. Generally, telecommunications carriers, including traditional local and long distance telecommunications companies, are regulated under the Communications Act; information service providers are generally unregulated. The FCC has initiated a rulemaking proceeding to address the classification of VoIP and other IP-enabled service offerings. It is not possible to predict the outcome of that proceeding or its effect on XO's operations.

AT&T Declaratory Ruling Re: VoIP. On April 21, 2004, the FCC released an order, the AT&T Order, denying AT&T's request that the FCC find that VoIP services are exempt from switched access charges. The FCC held that an interexchange service that uses ordinary customer premises equipment that originates and terminates on the public switched telephone network, or PSTN, that provides no enhanced functionality, and that undergoes no net protocol conversion, is a telecommunications service and subject to switched access charges. The AT&T order apparently places interexchange services similar to those VoIP services offered by AT&T in the same regulatory category as traditional telecommunications services and, therefore, potentially subjects such VoIP services to access charges and other regulatory obligations including Universal Service fees. Although the FCC did not rule on the applicability of access charges for services provided prior to April 21, 2004, the ILECs may attempt to assert claims against other telecommunications companies including us for the retroactive payment of access charges. On April 22, 2004, SBC Communications filed a collections lawsuit against AT&T and other carriers seeking retroactive payment of unpaid access charges. On February 4, 2005, SBC amended an existing collection case it had filed against Global Crossing and filed a complaint against XO.

Level 3 Forbearance Petition. On December 23, 2003, Level 3 filed a petition requesting the FCC not to apply interstate or intrastate access charges on IP traffic that originates or terminates on the PSTN. Level 3 withdrew that petition on March 21, 2005, shortly before the FCC's statutory deadline for acting. Some observers have interpreted Level 3's withdrawal of the petition as a signal that the FCC was not likely to rule in Level 3's favor. The FCC may ultimately rule on this issue either in its VoIP rulemaking proceeding or in the intercarrier compensation reform proceeding discussed below. The issue of whether access charges apply to VoIP and other IP traffic that originates or terminates on the PSTN is potentially significant for XO and other carriers.

ILEC Provision of Broadband Telecommunications Services and Information Services. Currently, the ILECs, as dominant carriers, are subject to a relatively high degree of regulation with respect to their broadband service offerings. The FCC, however, has initiated a rulemaking proceeding in which it is considering deregulating, or applying a lower degree of regulation to, ILEC broadband offerings. If the ILECs are largely freed from dominant carrier regulation, they will have much greater pricing flexibility and will pose a greater competitive threat to XO. In a second, related rulemaking, the FCC is considering whether to eliminate certain requirements it imposes on the ILECs with respect to their broadband Internet access services. Currently, where the ILECs offer Internet access or other information services over broadband facilities, they must (1) purchase the underlying broadband transmission facilities from themselves at tariffed rates and (2) make the underlying facilities available to competitors on a non-discriminatory basis. If the FCC were to eliminate these requirements, it could result in an increase to our network costs. To date, these deregulatory trends have been directed towards facilities used primarily by residential customers, and not by business customers.

Intercarrier Compensation Reform. Currently, telecommunications carriers are required to pay other carriers for interstate access charges and local reciprocal compensation charges. These two forms of intercarrier compensation have been under review by the FCC since 2001. The FCC continues to consider a broad order reforming the intercarrier compensation system and issued a Notice of Proposed Rulemaking on February 10, 2005 to seek further comment on intercarrier compensation reform. Although we are unable to predict the outcome of the FCC's rulemaking procedures, inasmuch as access charges and reciprocal compensation payments make up our largest network expense item, the FCC's action could have a material, adverse affect on our operations and cost of doing business.

Cost-based TELRIC Pricing. On September 10, 2003, the FCC initiated a new proceeding to consider significantly revamping the current TELRIC methodology used for the pricing of UNEs. If the FCC reverses the methodology used for determining UNE rates to allow for rate increases, this could substantially raise XO's costs for leasing UNEs in the future. A decision is expected sometime in 2005. Several state commissions have also initiated proceedings to review the rates that the ILECs charge for UNEs. An adverse ruling in these proceedings would allow the ILECs to increase UNE rates in the applicable state and this could substantially raise our costs for leasing UNEs in the future.

State and Local Regulation

In general, state regulatory commissions have regulatory jurisdiction over us when our facilities and services are used to provide local and other intrastate services. Under the Telecom Act, state commissions continue to set the requirements for providers of local and intrastate services, including quality of services criteria. State regulatory commissions also can regulate the rates charged by CLECs for intrastate and local services and can set prices for interconnection by new telecommunications service providers with the ILEC networks, in accordance with guidelines established by the FCC. In addition, state regulatory commissions in many instances have authority under state law to adopt additional regulations governing local competition and consumer protection, as long as the state's actions are not inconsistent with federal law or regulation.

Most state regulatory commissions require companies that wish to provide intrastate common carrier services to register or be certified to provide these services. These certifications generally require a showing that the carrier has adequate financial, managerial and technical resources to offer the proposed services in a manner consistent with the public interest. We are certified in all of the states in which we conduct business. In most states, we are also required to file tariffs setting forth the terms, conditions and prices for services that are classified as intrastate, and to update or amend our tariffs as rates change or new products are added. We may also be subject to various reporting and record-keeping requirements.

Where we choose to deploy our own transmission facilities, we may be required, in some cities, to obtain street opening and construction permits, permission to use rights-of-way, zoning variances and other approvals from municipal authorities. We also may be required to obtain a franchise to place facilities in public rights-of-way. In some areas, we may be required to pay license or franchise fees for these approvals. We cannot provide assurances that fees will remain at current levels, or that our competitors will face the same expenses, although the Telecom Act requires that any fees charged by municipalities be reasonable and non-discriminatory among telecommunications carriers.

California Public Utilities Commission Proceeding. On September 23, 2004, the California Public Utilities Commission, or the CA Commission, issued a decision that required SBC to adjust monthly recurring rates for certain types of services offered to CLECs by SBC. As a result of that decision, we believed that we were owed a retroactive credit. The billing adjustments and true-up payments required by the decision had been stayed until the CA Commission could: (a) consider mitigations to lessen the negative effect of such true-up payments; and (b) consider issues raised by the U.S. Court of Appeals for the Ninth Circuit regarding the shared and common cost mark-up element. After issuance of the September 23, 2004 decision, the CA Commission issued three separate alternate draft decisions all of which proposed different true-up payment schemes and different shared and common cost mark-up factors as well as retroactive and non-retroactive treatment of the mark-up factor. These three alternate decisions were contentious and were being debated by the CA Commission and various parties to the proceeding.

On March 22, 2005 XO and SBC executed a settlement agreement resolving these issues. As a result of this settlement, on March 25, 2005 SBC made a payment to XO of approximately $10.0 million. The settlement agreement provides XO with finality on these issues as the settlement agreement prohibits SBC from seeking rehearing before the CA Commission or appealing to any state of federal court the true-up or payment of the true-up monies to XO.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We had $382.7 million in secured loans as of June 30, 2005. Currently, we do not pay cash interest on the loans under the Credit Facility. As interest accrues at variable rates, our Credit Facility subjects us to interest rate risks.

Marketable securities and other investments at June 30, 2005 consist primarily of investments in equity and debt investments of publicly-traded companies. The fair value of our investment in equity and debt securities exposes us to market risk; however, if the fair value were to increase or decrease immediately, it would not likely have a material impact on our financial position or our results of operations. We are not currently engaged in the use of off-balance sheet derivative financial instruments, to hedge or partially hedge interest rate exposure nor do we maintain any other off-balance sheet arrangements for the purposes of credit enhancement, hedging transactions, or other financial or investment purposes.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The term "disclosure controls and procedures" is defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934. These rules refer to the controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized and reported within required time periods. Our Principal Executive Officer and our Principal Financial Officer have evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on the evaluation, they have concluded that, as of the end of such period, the controls and procedures were effective at ensuring that required information was accurate and disclosed on a timely basis in our report filed under the Exchange Act.

Changes in Internal Controls

We maintain a system of internal accounting controls that is designed to provide reasonable assurance that our books and records accurately reflect our transactions and that our established policies and procedures are followed.

During the first quarter of 2005, we implemented a new sales commissioning system and began migrating certain customers to a new billing system. We anticipate the migration of our customers to the new billing system will be completed in the third quarter of 2005. Additionally, we are in the process of combining the customer provisioning system acquired through the acquisition of the Acquired Businesses with the system of the legacy XO business. These actions have resulted in changes to our internal controls over financial reporting.

Except as noted above, there were no other changes to our internal controls that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We are involved in lawsuits, claims, investigations and proceedings consisting of commercial, regulatory, securities, tort and employment matters, which arise in the ordinary course of business. In accordance with Statement of Financial Accounting Standards No. 5, " Accounting for Contingencies," we make a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. We believe we have adequate provisions for any such matters. We review these provisions at least quarterly and adjust these provisions to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel, and other information and events pertaining to a particular case. Litigation is inherently unpredictable. However, we believe that we have valid defenses with respect to legal matters pending against the Company. Nevertheless, it is possible that cash flows or results of operations could be materially and adversely affected in any particular period by the unfavorable resolution of one or more of these contingencies.

We filed an administrative claim in August 2004 against the Allegiance Telecom Liquidating Trust (the "ATLT"). We have claimed that we are entitled to approximately $50 million in damages related to a variety of actions allegedly taken by Allegiance and the ATLT. The ATLT filed a counterclaim against us on November 24, 2004 seeking damages of approximately $100.0 million, which claim we believe to be frivolous and without merit. The case went to trial in the United States Bankruptcy Court for the Southern District of New York on May 2, 2005 and has not yet been decided.

Start Investments Inc, or Start, is XO Communications, Inc.'s, or XOC, 10% minority partner in Telecommunications of Nevada, or TON, a Nevada joint venture company whose results of operations are consolidated into the accompanying financial statements. XOC and Start hold promissory notes, collectively referred to as the Notes, from TON for $63.5 million, referred to as the XOC Note, and $7.1 million, referred to as the Start Note, respectively. The Notes became due in December 2002 and were not paid or extended on that date, but cannot be accelerated or foreclosed upon without the consent of XOC, which XOC has declined to give, acting in what it believes are the best interests of TON. TON has paid current interest on the Notes to both holders, but at the historic rate of interest, not the higher default rate. Start filed a suit against TON and XOC in the District Court for Clark County Nevada in October of 2003, which alleged that XOC had tortiously interfered with Start's contractual relations with TON and breached its duty of good faith and fair dealing. The suit seeks temporary injunctive and declaratory relief, as well as damages of approximately $9.0 million, consisting primarily of the principal amount of the Start Note and interest at the default rate. In July 2005, Start moved to amend its complaint to add a claim against TON for breach of contract for failure to pay the Start Note. We believe we have valid defenses to the claims raised by Start and to its purported calculation of any damages. However, in the event that TON is required to pay the full principal amount of the Notes, absent a negotiated, out-of-court financial restructuring, TON may be forced to seek protection under chapter 11 of the Federal Bankruptcy Code, which could trigger a default on our Credit Facility.

The XOC Note and the accrued interest payable from TON to XOC, and the related note and interest receivable of XOC from TON, are intercompany balances and, in accordance with the principles of consolidation, have been eliminated in the consolidation of the financial statements. The Start Note and the related accrued interest payable, totaling approximately $8.3 million, are included in other current liabilities in our Condensed Consolidated Balance Sheet.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

The XO Communications, Inc. annual meeting of shareholders was held on May 9, 2005 in New York, New York.

At the 2005 annual meeting of shareholders, the shareholders elected the following individuals to the Board of Directors for the succeeding year and until their successors are duly qualified and elected:

	Votes For	Votes Withheld
Carl C. Icahn	129,371,004	1,117,934
Carl J. Grivner	129,382,705	1,106,233
Adam Dell	129,423,773	1,065,165
Vincent J. Intrieri	129,389,651	1,102,287
Keith Meister	129,387,177	1,101,761
Robert Knauss	129,420,266	1,068,672
Fredrik Gradin	129,425,819	1,063,119
Jon F. Weber	129,389,369	1,099,569

Item 5. Other Information

None.

Item 6. Exhibits

31.1 Rule 13a — 14(a)/15(d) — 14(a) Certification

31.2 Rule 13a — 14(a)/15(d) — 14(a) Certification

32.1 Certificate pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certificate pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrants have duly caused this report to be signed on their behalf by the undersigned thereunto duly authorized.

XO Communications, Inc.

Date: August 9, 2005

By: /s/ William Garrahan
William Garrahan
Senior Vice President and
Acting Chief Financial Officer
(Principal Financial Officer)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2004

OR

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

Commission File No 0-30900

XO COMMUNICATIONS, INC.
(Exact name of registrant as specified in its charter)

Delaware	**54-1983517**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. employer identification no.)**

11111 Sunset Hills Road
Reston, Virginia 20190
(Address of principal executive offices, including zip code)

(703) 547-2000
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:
None

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, par value $0.01 per share
(Title of class)

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

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

The aggregate market value of the common stock held by non-affiliates of the Registrant, based upon the closing sale price of the common stock on June 30, 2004 (which is the last business day of the Registrant's second fiscal quarter), as reported on the NASDAQ Over-the-Counter Bulletin Board, was approximately $375 7 million Shares of common stock held by each executive officer and director and by certain persons who own 5% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates This determination of affiliate status is not necessarily a conclusive determination for other purposes

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

Number of shares of common stock outstanding as of March 14, 2005 181,933,035

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement to be issued in conjunction with registrant's annual stockholders' meeting to be held on May 9, 2005 are incorporated in Part III

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PART I

Item 1. Business

This document contains certain "forward-looking statements," within the meaning of the Private Securities Litigation Reform Act of 1995, including statements regarding, among other items, our expected financial position, business, and financing plans These forward-looking statements are based on our current expectations and are naturally subject to risks, uncertainties, and changes in circumstances, certain of which are beyond our control Actual results may differ materially from those expressed or implied by such forward-looking statements

The words "believe," "plan," "target," "expect," "intends," and "anticipate," and expressions of similar substance identify forward-looking statements. Although we believe that the expectations reflected in such forward-looking statements are reasonable, we can give no assurance that those expectations will prove to be correct Important factors that could cause actual results to differ materially from the expectations described in this report are set forth under "Risk Factors" in Item 1 and elsewhere in this report Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of their dates We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise

Business Overview

XO Communications, Inc , or XO, a Delaware corporation, is a leading facilities-based, competitive telecommunications services provider that delivers a comprehensive array of telecommunications services to business customers We provide our services, including local and long distance voice, Internet access, private data networking and hosting services, through our national telecommunications network, which consists of more than 6,700 metro route miles of fiber optic lines connecting 953 unique ILEC end-office collocations in 37 U S cities In addition, we own licenses to deliver telecommunications services via local, multipoint distribution service, or LMDS, wireless spectrum in all of the largest U S cities We market our services primarily to business customers, ranging from small and medium businesses to Fortune 500 companies to carrier and wholesale customers Our services offer an effective telecommunications solution for nearly any business, and our national telecommunications network is particularly advantageous to multi-location businesses that desire to improve communications among their locations, whether within a single metropolitan area or across the country

2004 Highlights

- *Acquisition of Allegiance Telecom, Inc* We acquired the telecommunications services assets of Allegiance Telecom, Inc on June 23, 2004 The acquisition of Allegiance substantially expanded our local facilities, and significantly increased the number of business customers to which we can cost-effectively provide service We completely integrated their administrative functions and have achieved all of the originally estimated $100 million of annualized selling, operating and general synergies We have made substantial progress in achieving the originally estimated $60 million of annualized network synergies

- *Positive Cash Flow from Operations for 2004* We generated positive cash flow from operations (excluding capital expenditures) in 2004, marking the third consecutive fiscal year that we have achieved that operating milestone

- *Raised $200 million of Capital* In August 2004, we strengthened our balance sheet by raising an additional $200 million in capital to support our ongoing operations and to fund potential acquisitions 95% of which came from our significant shareholder.

The U.S. Telecommunications Market

While competitive local exchange carriers, or CLECs, like us have provided telecommunications competition and service since 1996, the market for telecommunications services, particularly local exchange services, remains dominated by the incumbent telecommunications carriers or ILECs, consisting primarily of the former subsidiaries of AT&T known as the Regional Bell Operating Companies, or RBOCs, — Verizon, SBC Communications, Qwest Communications, and BellSouth — which each own substantially the entire local exchange network in their respective operating regions of the United States.

Aggregate revenue earned from the sale of wired telecommunications services in 2004 has been estimated at approximately $225 billion, down approximately three percent from 2003 Telecommunications sales to business customers, however, is estimated to have remained relatively constant at $91 billion, with sales of local exchange services estimated to have increased by approximately one percent to approximately $42.5 billion in 2004 compared to 2003 Telecommunications spending by businesses who spend less than $10,000 per month, or small and medium businesses, was estimated to be $75 billion in 2004

The telecommunications industry currently remains in a state of competitive transition The telecommunications services market has remained focused on pricing and many telecommunications providers have continued to face significant competitive pressure to reduce prices Also, the combination of new federal and state regulations, emergence of new technologies, industry consolidation, growth of the mobile wireless market, and entry of new telecommunications competitors has contributed to a rapidly changing market for telecommunications services These issues and the potential impact to XO are discussed below

Recent Federal Rulemaking. Effective as of March 11, 2005, the Federal Communications Commission's, or FCC's, Triennial Review Remand Order, or TRRO, altered a number of significant federal regulations applicable to the provision of competitive telecommunications services in a manner favorable to incumbent carriers The TRRO established new standards for when CLECs obtain cost-based rates from ILECs when leasing unbundled network elements, or UNEs, which connect a customer's location with the applicable communications network end office, commonly referred to as "loops" This aspect of the TRRO will result in an increase to our overall costs of service in 2005

The TRRO also curtailed the ability of CLECs to obtain cost-based UNE rates for network elements linking central offices in which they have located their own equipment, but between which they do not own proprietary fiber lines Fiber lines between central offices is referred to in our industry as "local transport" This aspect of the TRRO will not have a material impact on us as we own or lease under long-term agreements nearly all of the local transport that we use to connect central offices in which we own equipment This aspect of the TRRO could, however present opportunities for us to sell our own network capacity to telecommunications companies that are negatively impacted by the TRRO ruling on local transport

The TRRO also severely curtailed the ability of CLECs to lease switching capacity from ILECs at cost-based rates, which practice is known in the telecommunications industry as unbundled network element platform, or UNE-P We are not materially impacted by this aspect of the TRRO as we own all of the switching facilities we use in our business We anticipate that one of the results of the TRRO will be that many CLECs that are substantially dependent on UNE-P will need to either acquire their own switches, seek a facilities-based partner to switch their customers' traffic, or find other strategic alternatives to their current business models One possible result of the TRRO on UNE-P dependent carriers is additional consolidation of existing telecommunications carriers

Emergence of New Technologies. Several new technologies are being adopted by telecommunications carriers that could cause significant changes in the competitive landscape for telecommunications services Such technologies include

- **IP Communications.** Voice over Internet Protocol, or VoIP, technology enables delivery of voice and data telecommunications services over a single Internet Protocol or IP network, rather than through the existing Public Switched Telephone Network or PSTN XO's experience and network architecture allows us to take advantage of the development of VoIP services XO's initial VoIP implementation, named XOptions Flex, enables customers to utilize "dynamic bandwidth allocation" to maximize the utilization of their bandwidth by allocating it for data applications during periods when voice lines are idle XO also anticipates that it will add additional IP-enabled features to its existing products

- **Fixed Broadband Wireless.** With the exception of building locations to which we have constructed our own fiber or network connections, we are dependent upon the ILECs for obtaining network access to our customers' buildings, which access is referred to in our industry as "last mile" connectivity There has been ongoing development of technical equipment and data encryption and compression protocols that permit the use of high bandwidth wireless connections between physical locations that are located within a line of sight across relatively short distances, usually under five miles This fixed wireless, point-to-point connectivity may, in limited circumstances, allow us to obtain direct network access to our customers' buildings via wireless connection without the requirement of leasing network access from the ILECs

- **Mobile Wireless Technologies.** Wireless carriers have engaged in rapid development of new high bandwidth applications to be delivered to their customers via wireless devices, commonly referred to as "3G" broadband wireless networks Such applications include the delivery of video and photos via wireless connection The ongoing adoption of broadband networks and applications could mean that current wireless telecommunications carriers will require significantly greater wireline bandwidth for transport of their customers' traffic, presenting an opportunity for facilities based carriers such as XO to offer transport and termination services to those wireless carriers

Industry Consolidation. On January 31, 2005, SBC Communications, Inc and AT&T Corp announced their intention to enter into a business combination In February 2005, Verizon Communications, Inc and MCI, Inc announced and agreement to enter into a business combination, and Qwest Communications International, Inc announced a bid to compete with Verizon's purchase offer Such transactions, if consummated, would result in substantial consolidation of U S wireline telecommunications resources and revenue In addition, as reflected in our acquisition of the CLEC businesses of Allegiance Telecom, Inc and the acquisitions of Cable and Wireless USA, Inc by Savvis Communications, Inc , Focal Communications, Inc by Broadwing Corporation, and KMC Telecom Corp by CenturyTel, Inc , substantial consolidation has also taken place among CLECs Assuming that each of the announced transactions involving AT&T and MCI occur as planned, market power for U S telecommunications services will be further consolidated among the ILECs, and both business and residential consumer choice will be significantly reduced While it is not certain what the effects of this industry consolidation will be, we believe that one possible result could be that prices for telecommunications services would stabilize due to reduced competition

Growth of the Mobile Wireless Market. Unlike the market for wireline telecommunications services, the overall market for mobile wireless telecommunications services has continued to grow in recent years While some of our target business customers have supplemented their existing wireline telecommunications infrastructure with mobile wireless communications services, we believe that business customers will generally continue to require wireline services that we provide because of the bandwidth limits of mobile wireless services and the current lower costs of wireline telecommunications services

Entry of New Telecommunications Competitors. In recent years, new competitors have emerged to traditional, facilities-based telecommunications services providers Among these new competitors are VoIP providers, including companies such as Vonage and Covad, and providers of other forms of media or telecommunications services, including cable companies such as Comcast and Cox Communications The FCC has noted in several public comments that it expects that such competitors will provide significant competition to the ILECs in the future While such companies are likely to experience growth in their telecommunications services businesses in the future, we believe that we will not compete directly with these competitors as they are focused primarily on residential, and, to a lesser extent, small business customers

Competitive Strategy

We are executing on our strategic plan by focusing on the five key strategic elements below.

In addition, we are also retaining investment bankers and consultants who will develop and make recommendations to us regarding our strategic alternatives

Leverage National Network Footprint. Our primary competitive strategy is to leverage the national reach and technological sophistication of our metro and intercity fiber network We maintain a national network that includes 953 collocations from which we have the capability to serve over 70 U S markets We believe that our network footprint gives us the network capability to provide approximately 45% of all telecommunication services revenue from U S small to medium businesses, or SMBs Our national network can also reach markets and customers that no single ILEC is currently capable of serving over its own regional network, and we are among a small number of CLECs with national capabilities Consequently, we believe that our national network has capabilities that appeal to business customers in a manner that cannot currently be duplicated by any of the ILECs, and our national reach allows us to market to a significant portion of the total market for business telecommunications services

Our network includes an OC-192 IP backbone with extensive cross connections between the Internet and the public switched telephone network, or PSTN, enabling us to accept IP packets of data originated or carried over the Internet, and convert that information to voice traffic terminated or switched over the traditional PSTN We believe that the interoperability of our network for both PSTN and IP traffic will allow carrier and wholesale customers to access our network more flexibly, and enable us to offer services with significant appeal to carrier and wholesale customers

Focus on Business Customers. XO's services include a broad portfolio across voice, data and integrated bundled offerings tailored for the business customer Although we have both small customers with limited telecommunications needs and large telecommunications carrier/wholesale customers, our predominant focus is SMBs

Focus on Profitable Revenue. We monitor our sales and provisioning systems to maintain and increase the profitability of the telecommunications services that we provide In addition, we have implemented provisioning rules that, based on geography and the location of our network facilities, allow us to measure at the time of sale whether a prospective sale will be profitable to us

Diverse Service Offerings. We offer a broad portfolio of voice, data and integrated services to business customers Our core integrated SMB service offerings deliver simplicity of use and billing Although we believe that wireline telecommunications revenues have been in decline among mature telecommunications carriers in general, we have experienced slight increases in sales of our data and enhanced products and features that add value for our SMB customers We continue to introduce new products and will launch the first in a series of planned VoIP services, including XOptionsFlex, in 2005

Strategic Acquisitions. We actively consider strategic merger and acquisition opportunities that are likely to result in increased revenue and reduced costs of service by, among other things, expanding our network, allowing us to optimize our network assets, expanding our service portfolio, or expanding our customer base We believe that such merger and acquisition opportunities will arise in the telecommunications industry in 2005 generally as a result of regulatory developments, technological developments and shifting marketplace pressures

Our Services

We provide business customers with a comprehensive array of voice and data telecommunications services, including local and long distance voice, Internet access, private data networking and hosting services We have designed these telecommunications services principally to meet the needs of our business customers, from SMBs to multi-location businesses, large enterprises, as well as carrier and wholesale service providers

Integrated Voice and Data Services

XOptions and Total Communications. We offer integrated bundled packages of voice and data services, known as XOptions and Total Communications, to SMBs that include flat-rate packages for specified amounts of certain services, including local and long distance voice services, Internet access and web hosting services Both of these bundled services include a variety of service options designed to accommodate different customers with anywhere from 10 to 100 employees per location. These services can result in significant savings over the average cost of buying these services from separate competitive voice and data providers We also offer Integrated Access Services, which can reduce SMB's telecommunications costs by combining local voice, long distance, and dedicated Internet access on a single facility.

IP Communications Services. Utilizing our IP backbone, and related IP equipment and software, XO anticipates the introduction of a broad IP-based portfolio that caters to SMBs as well as larger companies that may choose either a hosted or premise-based IP Telephony solution XO's first planned service to be marketed in 2005, which will be named XOptions Flex, is a solution for SMBs that features dynamic bandwidth allocation, unlimited local and long distance calling, as well as a web-based portal for use by customers in making changes to the use of the product

Managed Services. We also provide managed services, including shared tenant services, which are telecommunications management services provided to groups of businesses located in the same office building Managed services enable SMBs to benefit from the efficiencies, including volume discounts, normally available only to larger enterprises We install a telecommunications system throughout each building we serve, leasing space for on-site sales and service, and offer tenants products and services such as telephones, voice mail, local calling lines, long distance and high-speed Internet connections, all on a single invoice

Voice Services

Local and Long Distance Voice Services

We offer a variety of voice applications and services as an alternative to the ILECs These voice services include

- local standard dial tone, including touch-tone dialing, 911 access and operator assisted calling,
- local multi-trunk dial tone services, including primary rate interface, or PRI, with direct inward dialing, and direct outward dialing,
- long distance services, including 1+, toll free, calling card and operator services,
- IP termination services,
- voice messaging with personalized greetings, send, transfer, reply and remote retrieval capabilities,
- conferencing services, including voice and web conferencing services,
- directory listings and assistance, and
- hosted interactive voice response services

In each of our markets, we have negotiated and entered into interconnection agreements with the applicable ILEC and certain independent carriers, and implemented permanent local number portability, which allows our new customers to retain their telephone numbers when they choose XO as their service provider

Data Services

Internet Access

Our Internet access offerings include dedicated access services targeted at businesses that desire single or multipoint high-speed, dedicated connections to the Internet Our dedicated Internet access service provides guaranteed internet speeds ranging from 56 kilobits per second, or kbps, to 1 Gigabit per second, or Gbps. Our digital subscriber line, or DSL, service also includes a wide range of dedicated access speeds for SMBs We are a tier-1 Internet backbone provider in the U S , with over 200 public and private peering arrangements with other Internet backbone networks

Private Data Networking

We provide dedicated transmission capacity on our networks to customers that desire high-bandwidth data links between locations We offer special access and point-to-point circuits to telecommunications carriers and other high volume customers, which they use as both primary and back-up circuits In addition, fiber optic technology that enables signals to be transmitted at different wavelengths on a single fiber allows us to lease one or more dedicated wavelengths to customers that desire high-bandwidth links between locations We currently offer these services with connections of up to 9 6 gigabits per second, a transmission rate that is described in our industry as OC-192 This service supports a variety of transmission protocols, including Asynchronous Transfer Mode, or ATM, Frame Relay, and Synchronous Optical Network, or SONET

Our virtual private network, or VPN, services enable customers to deploy tailored, IP-based business applications for secure internal enterprise, business-to-business and business-to-customer data communications among geographically dispersed locations, while also affording high-speed access to the Internet VPN services also provide secure access for remote users, such as traveling employees and employees working from home or a remote location, which is not possible using private line and frame relay services We also offer managed firewall services

Finally, we offer a suite of Ethernet services, including Gigabit Ethernet, or GigE, in most of our U S markets, as well as intercity Ethernet services between our markets Our Ethernet services are designed to provide high-speed, high-capacity connections between customers' local area networks, or LANs, within and between metropolitan areas, which reduces their costs as it eliminates the need for ongoing configuration, management and acquisition of equipment by the customer

Hosting Services

We offer a range of applications hosting services that can manage a customer's web-based infrastructure and operational needs, allowing customers to focus on their web-based content In addition, we provide server management tools and services to manage customers' larger computers, which are known as servers, for them

Our hosting services include

- ***Web Hosting:*** support for customers' websites, including design, maintenance and telecommunications services, and

- ***Server Collocation:*** collocation of customers' servers in our data centers

We also offer a variety of value-added tools and applications that enable our customers to conduct targeted email marketing, register their web site with hundreds of Internet search engines and directories, build catalogues and sell products over the web, and coordinate meetings and appointments online. And finally, we offer a suite of hosting outsourcing services that provides customers web-based access to email, group distribution lists, calendaring, contacts databases management and file sharing

Our Network

Our network consists of state of the art metro fiber rings and intercity network capable of carrying high volumes of data, voice, video and Internet traffic We utilize network assets located across the United States, substantially all of which we own or control through indefeasible exclusive rights or other leasing or contractual arrangements, making us a national facilities-based carrier We are able to provide our services to our customers entirely over an integrated national network, from the initiation of the voice or data transmission to the point of termination. This allows XO to offer our customers high quality of service and a high level of service

Metro Fiber Networks and Local Facilities

Our metro fiber networks consist of rings of more than 888,000 fiber miles of fiber optic cables encircling the central business districts of numerous metropolitan areas A "fiber mile" is equal to the number of route miles multiplied by the number of fibers along that path We operate 37 metro fiber networks in 22 states and the District of Columbia, including 25 of the 30 largest metropolitan areas in the U.S In the aggregate, our metro fiber networks connect approximately 953 unique ILEC end-office collocations.

The core of each of our metro fiber networks is a ring of fiber optic cable in a city's central business district that connects to our central offices from which we can provision services to our customers These central offices contain the switches and routers that direct data and voice traffic to their destinations, and also have the space to house the additional equipment necessary for future telecommunications services A critical element of our metro fiber network is the number of central offices in which we have located our routing and transmission equipment within each of our local markets, referred to as collocations In general, a CLEC is able to provision services at lower cost if it operates a collocation within a relatively short distance of its customer Following our acquisition of the telecommunications assets of Allegiance Telecom, Inc in June 2004, we operate collocations in 953 central offices as part of our network, virtually all of which are concentrated in the business districts in which our target customers are located We operate one of the most extensive collocation footprints in the United States We believe that our extensive collocations provide us with substantial market opportunities to both sell services to our targeted SMB customers and to service as points of termination for traffic originated by other carriers

Whenever we can, we build and own these metro fiber networks ourselves or obtain indefeasible rights to use fiber so that we can control the design and technology used to best meet our customers' needs We built our high capacity metro fiber networks using a backbone density typically ranging between 72 and 432 strands of fiber optic cable Fiber optic cables have the capacity, or bandwidth, to carry tens of thousands of times the amount of traffic as traditionally-configured copper wire Our high-count fiber strands allow us to augment the scale of our broadband and voice services without incurring significant additional construction costs. Indefeasible exclusive rights are contracts with the owners of fiber optic cables that allow us to use a specified amount of capacity on a specified fiber on those cables for terms ranging from 10 to 25 years

We operate 37 metro fiber networks serving over 70 markets noted below

State	Metro Fiber Network Location	Service Market
AZ	Phoenix	Phoenix
CA	Los Angeles	Los Angeles
CA	Orange County	Anaheim
		Costa Mesa
		Fullerton
		Garden Grove
		Huntington Beach
		Inglewood
		Irving
		Long Beach
		Orange
		Santa Ana
CA	Sacramento	Sacramento
CA	San Diego	San Diego
CA	San Francisco	San Francisco
		Oakland
CA	San Francisco (cont)	Fremont
		Milpitas
		Mountain View
		Palo Alto
		Santa Clara
		Sunnyvale
CA	San Jose	San Jose
CO	Denver	Denver
		Boulder-Longmont
DC/VA	Washington DC/ No VA	Washington, DC-MD-VA-WV
FL	Ft Lauderdale	Ft Lauderdale
FL	Miami	Miami
		West Palm Beach-Boca Raton
FL	Orlando	Orlando
FL	Tampa	Tampa-St Petersburg- Clearwater
GA	Atlanta	Atlanta
		Marietta
IL	Chicago	Chicago
MA	Boston	Boston, MA-NH
		Brockton
		Lawrence, MA-NH
		Lowell, MA-NH
		Worcester, MA-CT
MD	Baltimore	Baltimore
MI	Detroit	Detroit
MN	Minneapolis	Greater Minneapolis/ St Paul
MO	St Louis	St Louis
NJ	New Jersey	Bergen/ Passaic
		Middlesex-Somerset-Hunterdon
		Newark
		Jersey City
		Monmouth-Ocean
		Trenton
NV	Las Vegas	Las Vegas
NY	New York	Manhattan
		Nassau-Suffolk
OH	Cleveland/ Akron	Cleveland-Lorain-Elyria
		Akron
		Canton-Massillon
OH	Columbus	Columbus
OR	Portland	Portland-Vancouver, OR-WA
PA/ DE	Central PA	Allentown-Bethlehem-Easton
		Harrisburg-Lebanon-Carlisle
		Lancaster
		Reading
		Scranton-Wilkes-Barre-Hazleton
		York
		Wilmington-Newark, DE-MD
		Dover
PA	Philadelphia	Philadelphia, PA-NJ
TN	Memphis	Memphis, TN-AR-MS
TN	Nashville	Nashville
TX	Austin	Austin-San Marco
TX	Dallas/ Ft Worth	Dallas
		Fort Worth-Arlington
TX	Houston	Houston
TX	San Antonio	San Antonio
UT	Salt Lake City	Salt Lake City-Ogden
		Orem/Provo
WA	Seattle	Seattle-Bellevue-Everett
WA	Spokane	Spokane
		Lewiston

Clarkston
Coeur d'Alene

Intercity Network

Our metro fiber networks are connected by our own switching, routing and optical equipment to dedicated, high-capacity wavelengths of transmission capacity, on intercity fiber optic cables, which we refer to as wavelengths and which composes the majority of our over 290,000 intercity fiber miles of network By using our own switching and routing equipment, we maximize the capacity and enhance the performance of our intercity network as needed to meet our customers' current and future telecommunications needs

XO has designed and built an advanced and reliable intercity network There are at least two physically diverse fiber lines connecting each of our markets to any other of our markets This allows us to reroute traffic around fiber cuts to ensure end-to-end connectivity to our customers Each metro fiber ring is also connected to our other rings at a minimum of two points This ensures that customer traffic can be rerouted around any given market to avoid network problems like facility congestion This also ensures that any problem in a given market will not significantly affect the rest of the network

Our SONET IP architecture provides the highest level of restoration available today over 10 Gbps wavelengths Redundant routes and capacity are identified and reserved so that in the event of a failure, the network will systematically restore traffic in the shortest time possible without the need for human involvement

We prepaid to lease wavelengths, primarily from Level 3 Communications, Inc , or Level 3, for five year periods The leases for our intercity wavelength capacity will expire in 2006 and 2007 Given the level of traffic in relationship to capacity and the availability of wavelength capacity that was available to us at cost-efficient lease rates, to date, it has generally been more cost-effective to lease wavelengths rather than deploy our own equipment to activate segments of our intercity fiber network, which is discussed below However, we have designed and installed much of the equipment we use to route traffic so that we can easily transfer voice and data traffic from leased wavelength capacity onto our intercity fiber network as increased traffic on certain segments makes that the more cost effective approach. We expect to either renew the wavelength leases for this capacity, lease the capacity from another vendor, or light our intercity fiber network Based on the most cost effective option per segment, the current estimate to execute these different options ranges from $25 million to $40 million, although we believe that through the development of technology and a competitive bidding process, we will be able to obtain the necessary capacity for less Lighting our intercity fiber network may be strategically beneficial to XO because it provides a lower cost basis for future augments enabling faster and more profitable growth

Our intercity fiber network is a twenty year indefeasible exclusive right to use 18 fiber optic strands pursuant to arrangements with Level 3, substantially all of which are currently unlit. These fibers are part of a fiber network that traverses over 16,000 miles and connects more than 60 cities in the United States and Canada, including most of the major metropolitan markets served by our metro fiber networks Fiber optic capacity that is not currently connected to transmission equipment is referred to in our industry as unlit

Along specific segments of our intercity network where the demand for telecommunications capacity justifies the required capital expenditures, we have proceeded with lighting those specific segments During 2004 we lit intercity fiber in the following segments San Diego to Phoenix, Chicago to Detroit and Detroit to Cleveland In prior years we have lit intercity fiber in the flowing segments Los Angeles to San Diego and Denver to Salt Lake City Additionally, we previously lit fiber acquired from AboveNet, formerly known as Metromedia Fiber Network, Inc that runs from New York to Washington, D C to provide an additional route to the lit intercity fiber network along that segment and we have also lit fiber in Texas Based on current pricing and demand projections, we may light another three to nine segment routes in 2005

Our IP network consists of an OC-192 capacity backbone running through or adjacent to our intercity fiber network Our IP backbone connects to our intercity fiber network at nine IP backbone nodes, 62 local facilities in 34 markets, and two hosting data centers Each IP backbone node provides intercity IP transport between each of our metro fiber networks and connectivity to other Internet Service Providers or ISPs, which is commonly referred to as peering Peering with other ISPs is done in each of our IP backbone facilities except for Denver

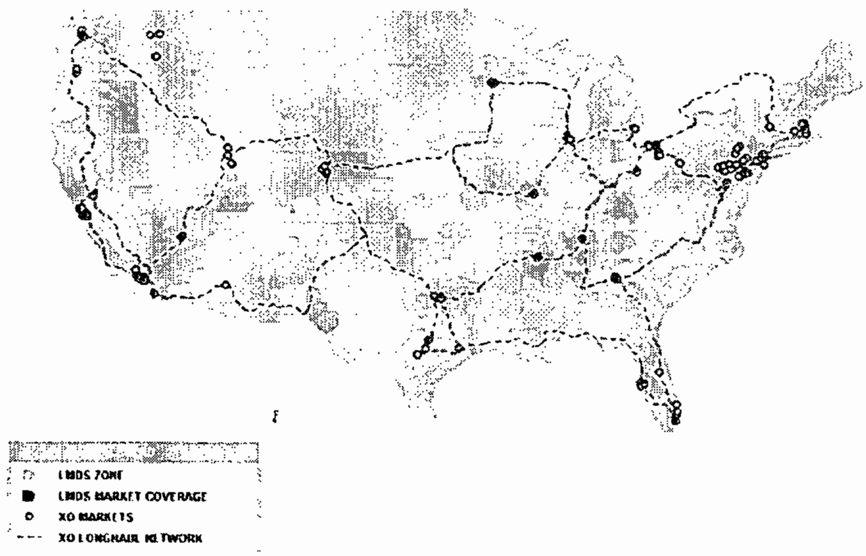
Broadband Wireless

In addition to our fiber and equipment assets, we hold licenses for 1,150 to 1,300 MHz of local multipoint distribution services, or LMDS, spectrum in 59 cities Our licenses also include

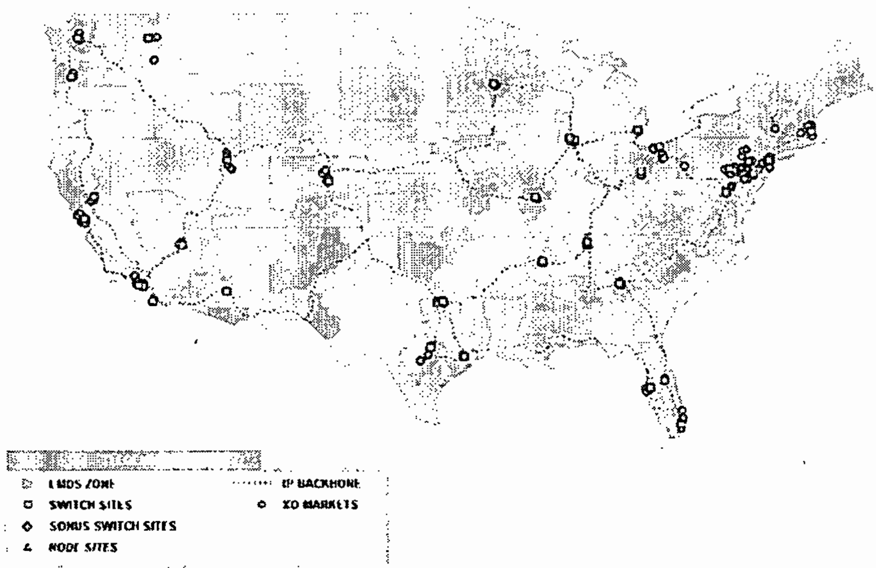
- 150 MHz of LMDS spectrum in 14 other cities,
- 150 MHz of LMDS spectrum in the five boroughs that comprise New York City (300 MHz total), and
- 400 MHz of LMDS spectrum in Denver

We also hold ten broadband wireless licenses in the 39 GHz (gigahertz) frequency band, of which five provide from 100 to 300 additional MHz in two cities where we hold a 150 MHz LMDS license, plus 100 MHz in Denver and 200 MHz of spectrum in Las Vegas, where we do not hold a LMDS license

The following diagrams depict the physical components of our nationwide network There are additional maps located on our web site at www xo com The map below depicts our intercity fiber network and the geographic zones in which we are licensed to deploy fixed wireless services, as well as the local markets in which we are currently able to cost-effectively deploy fixed wireless solutions



The map below depicts our IP backbone and the facilities related to its operation, such as Sonus IP switches and network IP nodes



Connecting Customers to Our Networks

We connect our customers directly to our networks through one of three methods In most cases, we lease ILEC network elements at either cost-based UNE or special access retail rates that connect our facilities directly to our customers' premises, known in our industry as "local loops " Alternatively, we connect customers to our networks by using fiber optic cable and a direct connection to our network. Third, we connect our customers directly to our networks using fixed broadband wireless equipment

Leasing UNEs. In the majority of cases, we lease facilities from an ILEC to connect a customer to our network, and we attempt to minimize the cost of leasing that capacity by minimizing the distance from our network to a potential customer Because the cost of leasing those facilities is generally based on the distance of the leased connection, shorter distance connections are less expensive than longer distance connections One of the most significant advantages of our acquisition of the telecommunications assets of Allegiance was our addition of nearly 833 unique collocations for a combined total of 953 unique collocations The Allegiance acquisition also added approximately 8,000 metro fiber miles and 2,000 intercity fiber miles to XO for a combined total of 888,000 metro fiber miles and 290,000 intercity fiber miles This additional local network will allow us to access some of our existing customers and many potential customers more cost effectively than which we were previously able to do so

Direct Fiber Connection. In cases where the anticipated revenues justify the construction cost, we will install a new fiber optic extension from our network to the customer's premises Whether it is economical to construct a fiber optic extension depends, among other things, on

- the existing and potential revenue base located in the building in question,
- the building location relative to our network and our ability to access the communications equipment in that building, and

• local permit requirements, landlord requirements, and construction costs

Direct Fixed Broadband Wireless Connection. In limited cases where economically and technologically feasible, we may deploy a high-bandwidth fixed wireless connection between an antenna on the roof of the customer's premises and an antenna attached to our metro fiber network In those cases, we must secure roof and other building access rights, including access to conduits and wiring from the owners of each building or other structure on which we propose to install our equipment, and may need to obtain construction, zoning, franchise or other governmental permits

Network Technology

Over the past few years, both optical and IP-based networking technologies have undergone rapid innovation Many of these innovations have the effect of increasing the efficiency of the physical components of our network by increasing the effective capacity of networks for these types of applications In the future, we expect that IP-based technology will become the preferred technology for voice calls and facsimile transmission as well We believe that our IP-based service platform will provide us with significant future opportunities, because it enables data, voice and video to be carried less expensively and more efficiently over our end-to-end, facilities-based network Consequently, we have made and will continue to make significant investments in supplementing our data and voice switching technology with IP equipment

Voice Switching Technology. There are two commonly used switching technologies currently deployed in most telecommunications networks circuit switched-based systems and packet switched-based systems Circuit switch-based systems are currently used on the PSTN and most telecommunications networks Circuit switch-based systems establish a dedicated channel for each telecommunication signal (such as a telephone call for voice or fax), maintain the channel for the duration of the call, and disconnect the channel at the conclusion of the call

Packet switch-based telecommunications systems, which format the information to be transmitted into a series of shorter digital messages called "packets," are the preferred means of data transmission Packet-switched telecommunications technology is the foundation for VoIP and delivery of voice communications via the Internet In packet switching, each packet consists of a portion of the complete message plus the addressing information to identify the destination and return address A key feature that distinguishes Internet architecture and packet switching from the PSTN and circuit switching is that on the packet-switched Internet, a single dedicated channel between telecommunication points is not required as it is in circuit switched communications

Packet switch-based systems offer several advantages over circuit switch-based systems, including the ability to commingle packets from several telecommunications sources, particularly those with bursts of information followed by periods of "silence," the ability to commingle packets provides for superior network utilization, and efficiency, resulting in more information being transmitted through a given telecommunication channel We currently carry more than 90% of our voice and data traffic in packetized form over our intercity network

XO was one of the early adopters of softswitch and VoIP technologies XO's voice switching strategy relies on strategic integration of our circuit technology switches and IP-based Sonus softswitch network We have designed our network to provide both flexibility and high quality service XO has 60 Nortel DMS-500 and Lucent 5ESS circuit switches in its network providing a rich array of services, national presence and connectivity to the PSTN Our Sonus softswitch network, which enables the deployment of VoIP technology, has been in service since 2001 The Sonus network has more than 80 gateways in 33 markets interconnected by a high capacity IP network. The Sonus network fully interoperates with the Nortel and Lucent circuit switches and has connectivity to the national common channel signaling network to access industry databases such as number portability databases The Sonus network carries several hundred million minutes of usage per month of traffic resulting from toll free, long distance and ISP offload services

The rapid advance of using packet technology for voice has brought to market several new types of service providers that want to offer voice services using IP transmission but that do not wish to invest in establishing a softswitch network XO, with its Sonus network and extensive connectivity to the PSTN, is positioned to provide connectivity to these VoIP service providers XO is currently offering products to allow these service providers to transfer such IP traffic to XO in its IP form, as opposed to the traditional requirement that such traffic be converted to the PSTN traffic protocol

Packet communication for voice and other technologies allows XO to offer enhanced services and to enable our business customers to efficiently connect to our network for their voice, data, and other private data networking needs This cost-effective connection to our network would not be possible through traditional circuit switching technology because, in the absence of IP transmission, our customers would be required in many cases to access our network through switching and other facilities owned by third party carriers This capability allows greater utilization of XO's network assets than a circuit switched solution, with virtually no degradation in service to customers, and allows XO to offer all of those services on a single connection to the customer's premises

Use of packet-based transport also allows XO to leverage its IP backbone for a variety of other uses In addition to having voice services supplied across the IP network, XO can provide a variety of private data network connectivity including Frame-Relay and Ethernet to provide XO's customers secure data transport between customer locations For customer locations that are directly connected to XO's fiber network, XO can utilize technologies such as Ethernet for transport of customer data from the customer premises to our network which further increase XO's network efficiency and allows our customers to use an operationally less complex and inexpensive connection method as compared to older circuit switching technologies To increase our ability to provide Ethernet connectivity for customers who are not directly connected to our network via fiber, we utilize Ethernet transport over copper and other existing ILEC facilities to provide that customer-preferred interconnection We believe that packet switching will eventually replace circuit switched technologies and will be the foundation of integrated networks which treat all transmissions, including voice, fax, and video, simply as forms of data transmission

Fixed Broadband Wireless Technology. We are the licensee of the largest U S footprint of fixed wireless spectrum We deploy fixed broadband wireless connections pursuant to 91 LMDS spectrum licenses issued to us by the FCC exclusively or nonexclusively through which all of our currently deployed wireless applications have been provided, and ten additional 39GHz licenses available to us, but through which we have not yet deployed any wireless applications We currently deploy LMDS connections in very limited circumstances The following tables shows (i) the license number, (ii) the metropolitan areas and frequency band for each area covered by the license, (iii) the estimated population for each area, (iv) the amount of spectrum for each area, and (v) the expiration date for each license

License Number	City	State	Population	A Band	B Band	39 GHz Chanls	License Renewal
WPOL286	New York (PMSA of 5 boroughs & 3 counties)	NY	8,546,846	A3			2/01/2006
WPLM417	Atlanta	GA	3,197,171		B		6/17/2008
WPLM412	Austin	TX	899,361		B		6/17/2008
WPLM416	Baltimore	MD	2,430,563		B		6/17/2008
WPLM430	Birmingham	AL	1,200,336	A			6/17/2008
WPLM413	Boston	MA	4,133,895		B		6/17/2008
WPLM418	Chattanooga	TN	510,860	A			6/17/2008
WPLM405	Chicago	IL	8,182,076		B		6/17/2008
WPLM424	Cincinnati	OH	1,990,451		B		6/17/2008
WPLM422	Cleveland-Akron	OH	2,894,133		B		6/17/2008
WPLM410	Columbia	SC	568,754	A			6/17/2008
WPLM438	Columbus	OH	1,477,891		B		6/17/2008
WPON926	Denver	CO	2,073,952	A1(part)			6/17/2008
WPLM408	Detroit	MI	4,705,164		B		6/17/2008
WPLM398	Hartford	CT	1,123,678		B		6/17/2008
WPLM411	Hickory-Lenoir-Morganton	NC	292,409	A			6/17/2008

License Number	City	State	Population	A Band	B Band	39 GHz Chanls	License Renewal
WPLM431	Huntsville	AL	439,832	A			6/17/2008
WPLM435	Indianapolis	IN	1,321,911		B		6/17/2008
WPLM436	Kansas City	MO	1,839,569		B		6/17/2008
WPLM434	Klamath Falls	OR	74,566		B		6/17/2008
WPLM420	Lakeland-Winterhaven	FL	405,382		B		6/17/2008
WPLM429	Lexington	KY	816,101	A			6/17/2008
WPLM401	Los Angeles*	CA	14,549,810	A			6/17/2008
WPLM428	Louisville	KY	1,352,955	A			6/17/2008
WPLM423	Mansfield	OH	221,514		B		6/17/2008
WPLM433	Medford-Grants Pass	OR	209,038		B		6/17/2008
WPOH970	Milwaukee	WI	1,751,525	A			6/17/2008
WPLM419	Minneapolis-St Paul	MN	2,840,561	A			6/17/2008
WPOH945	New Haven-Waterbury- Meriden	CT	978,311		B		6/17/2008
WPLM400	New London- Norwich	CT	357,482		B		6/17/2008
WPLM397	New York (whole BTA)	NY	18,050,615		B		6/17/2008
WPLM421	Ocala	FL	194,833		B		6/17/2008
WPLM432	Portland	OR	1,690,930	A			6/17/2008
WPOH956	Providence-Pawtucket, New Bedford- Fall River	RI,MA	1,509,789	A			6/17/2008
WPLM437	Rochester	NY	1,118,963		B		6/17/2008
WPLM407	Sacramento	CA	1,656,581	A			6/17/2008
WPLM402	San Diego	CA	2,498,016		B		6/17/2008
WPLM406	San Francisco- Oakland- San Jose	CA	6,420,984		B		6/17/2008
WPLM404	San Luis Obispo	CA	217,162	A			6/17/2008
WPLM403	Santa Barbara- Santa Maria	CA	369,608	A			6/17/2008
WPLM427	Seattle-Tacoma	WA	2,708,949	A			6/17/2008
WPLM425	St Louis	MO	2,742,114		B		6/17/2008
WPLM409	Toledo	OH	782,184		B		6/17/2008
WPLM415	Washington	DC	4,118,628		B		6/17/2008
WPOH677	Albuquerque	NM	688,612	A			9/1/2008
WPOH679	El Paso	TX	649,860	A			9/1/2008
WPOH676	Tucson	AZ	666,880	A			9/1/2008
WPOH683	Lawton-Duncan	OK	177,830	A			9/1/2008
WPOH682	Oklahoma City	OK	1,305,472	A			9/1/2008
WPOH684	Omaha	NE	905,991	A			9/1/2008
WPOH676	Tulsa	OK	836,559	A			9/1/2008
WPOH944	Albany-Schenectady	NY	1,028,615	A			10/6/2008
WPOH963	Atlanta	GA	3,197,171	A			10/6/2008
WPOH954	Austin	TX	899,361	A			10/6/2008
WPOH962	Baltimore	MD	2,430,563	A			10/6/2008
WPOH955	Boston	MA	4,133,895	A			10/6/2008
WPOH955	Buffalo-Niagara Falls	NY	1,231,795	A			10/6/2008
WPOH950	Charlotte-Gastonia	NC	1,671,037	A			10/6/2008
WPOH948	Chicago	IL	8,182,076	A			10/6/2008
WPOH953	Dallas	TX	4,329,924	A			10/6/2008
WPOH975	Des Moines	IA	728,830	A			10/6/2008
WPOH949	Detroit	MI	4,705,164	A			10/6/2008
WPOH952	Greenville-Spartanburg	NC	788,212	A			10/6/2008
WPOH943	Hartford	CT	1,123,678	A			10/6/2008
WPOH966	Houston	TX	4,054,253	A			10/6/2008
WPOH974	Indianapolis	IN	1,321,911	A			10/6/2008
WPOH979	Jacksonville	FL	1,114,847	A			10/6/2008
WPOH981	Knoxville	TN	948,055	A			10/6/2008
WPOH947	Los Angeles	CA	14,549,810		B		10/6/2008
WPOH959	Manchester-Nashua- Concord	NH	540,704	A			10/6/2008
WPOH973	Memphis	TN	1,396,390	A			10/6/2008
WPOH967	Miami-Ft Lauderdale	FL	3,270,606	A			10/6/2008
WPLM426	Milwaukee	WI	1,751,525		B		10/6/2008
WPOH964	Minneapolis- St Paul	MN	2,840,561		B		10/6/2008
WPOH980	Nashville	TN	1,429,309	A			10/6/2008

License Number	City	State	Population	A Band	B Band	39 GHz Chanls	License Renewal
WPLM399	New Haven-Waterbury- Meriden	CT	978.311	A			10/6/2008
WPOH942	New York (unencumbered by PMSA)	NY	9.503.769	A			10/6/2008
WPOH960	Philadelphia, Wilmington (DE), Trenton (NJ)	PA	5,899.345	A			10/6/2008
WPOH971	Pittsburgh	PA	2,507.839	A			10/6/2008
WPLM414	Providence-Pawtucket, New Bedford- Fall River	RI,MA	1,509.789		B		10/6/2008
WPOH951	Raleigh-Durham	NC	1,089,423	A			10/6/2008
WPOH972	Richmond-Petersburg	VA	1,090,869	A			10/6/2008
WPOH978	Rochester	NY	1,118.963	A			10/6/2008
WPOH976	San Antonio	TX	1.530.954	A			10/6/2008
WPOH958	Springfield-Holyoke	MA	672,970	A			10/6/2008
WPOH969	St Louis	MO	2,742,114	A			10/6/2008
WPOH946	Syracuse	NY	791.140	A			10/6/2008
WPOH965	Tampa-St Petersburg- Clearwater	FL	2,249.405	A			10/6/2008
WPOH961	Washington	DC	4.118.628	A			10/6/2008
WPOH968	West Palm Beach- Boca Raton	FL	893,145	A			10/6/2008
WPOH957	Worcester-Fitchburg- Leominster	MA	709,705	A			10/6/2008
WPQT938	Denver-Boulder- Greeley	CO	2.073.952			B	10/18/2010
WPQT942	Las Vegas	NV	857.856			E	10/18/2010
WPQT946	Las Vegas	NV	857,856			G	10/18/2010
WPQT939	San Diego	CA	2,498.016			B	10/18/2010
WPQT944	San Diego	CA	2,498.016			F	10/18/2010
WPQT947	San Diego	CA	2,498.016			N	10/18/2010
WPQT940	San Francisco	CA	6,420.984			D	10/18/2010
WPQT945	San Francisco	CA	6,420,984			F	10/18/2010
WPQT941	Toledo	OH	782,184			E	10/18/2010
WPQT943	Toledo	OH	782.184			F	10/18/2010

Legend	
A	27,500 to 28,350 MHz, 29,100 to 29,250 GHz, 31,075 to 31,225 GHz = 1,150 MHz
A1	27,500 to 28,350 MHz = 850 MHz
A3	31,075 to 31,225 GHz = 150 MHz
B	31,000 to 31,075 MHz, 31 225 to 31,300 MHz = 150 MHz
39 GHz B	38,650 to 38,700 MHz, 39,350 to 39,400 = 100 MHz
39 GHz E	38,800 to 38,850 MHz, 39,500 to 39,550 = 100 MHz
39 GHz G	38,900 to 38,950 MHz, 39,600 to 39,650 = 100 MHz
39 GHz F	38,850 to 38,900 MHz, 39,550 to 39,600 = 100 MHz
39 GHz N	39,250 to 39,300 MHz, 39,950 to 40,000 = 100 MHz
39 GHz D	38,750 to 38,800 MHz, 39,450 to 39,500 = 100 MHz
	The higher the frequency, the higher the attenuation (loss) For the same amount of transmission power, a lower frequency signal will propagate farther.

The spectrum under the licenses we hold can transmit voice, data or video signals from one fixed antenna to one or many others As the word "local" in the local multipoint distribution service name implies, the radio links using LMDS frequencies are of limited distance, typically five miles or less, due to the degradation of these high-frequency signals over greater distances

There are additional holders in some of the cities where we hold licenses There are also competitors who are licensed broadband fixed wireless operators in the 39 GHz spectrum bands Examples include First Avenue Networks and AT&T Business Services There are existing users of the 39 GHz spectrum that may require XO as a new user of the spectrum to coordinate its use to avoid interference with an existing user We do not believe that the coordination process will significantly limit our ability to use the spectrum

The term of each of the licenses for our broadband wireless spectrum generally is ten years Although the licenses are renewable for an additional ten year term, renewal is conditioned on our ability to satisfy utilization requirements established by the FCC The first license expiration is in 2006 We have applied for a two year extension from the FCC, and anticipate that the extension will be approved We continue to evaluate recent improvements in the price and performance of fixed wireless equipment, and have plans to meet the FCC's "substantial service" test before the licenses are due for renewal proceedings If we do not meet the FCC's substantial service test at the end of the license expiration date, we may request an extension of time or waiver of license forfeiture from the FCC

Employees

As of December 31, 2004 we employed approximately 5,000 people, including full-time and part-time employees Overall, we consider our employee relations to be good None of our employees is covered by a collective bargaining agreement

Sales Overview

Our sales organization includes both direct and indirect sales representatives

Direct Sales. Our direct sales and sales support organization consisted of more than 1,200 employees at December 31, 2004 Our direct sales force includes two sales organizations, one that addresses the needs of commercial retail customers and one that services wholesale carrier accounts Our commercial sales organization focuses on our SMB customers, developing multi-market accounts and national accounts Our carrier sales organization focuses solely on servicing telecommunications providers who, in combination with other capabilities, provide telecommunications services under their own brand Our carrier customers benefit from our national network, our data service capabilities, our broad range of services and our cost effective solution design In addition, as a result of the recent limitations on the availability of cost-based UNE rates for local transport imposed by the FCC TRRO, as discussed in greater detail below, we believe that our extensive local network may provide additional opportunities for carrier accounts

We have structured our sales efforts to develop a direct and personal relationship with our customers We have integrated the Allegiance and XO sales forces with an effort to retain the most productive representatives We have restructured our compensation formula for our direct sales force in 2005 to reward our salespeople for services that we install and provision to a customer and for ongoing services purchased by that customer over time versus at the point of sale We train our sales force regularly and will continue to emphasize training in 2005 We believe that this compensation and benefit structure will further our corporate strategy of maximizing profitable revenue growth and promote long term, service-focused relationships with our customers

Indirect Sales Representatives. We have complemented our direct sales force with over 5,000 third party sales agents to distribute the products and services available to our customers We currently have distribution arrangements with a number of national, regional and local agents and agency firms, whose representatives market a broad range of XO services The deployment of indirect sales agents also furthers our strategy of increasing our profitable revenue, as we do not incur costs for indirect sales agents unless and until a sale is made and installed

Network Services

Our network services organization consists of more than 1,700 employees whose main objective is to deliver superior service and to enhance the customers' experience Network service employees are located in all of our markets Their main objectives include the design, deployment, and maintenance of our network assets In addition, they are responsible for installing customer premise equipment and activating new customers as well as maintaining and, when necessary, repairing any service outages our customers might experience To be proactive in repairing any network outages and to maintain the highest network quality, we have a 24x7 network operations center with a full network surveillance system

Customer Care

Once a customer's services have been installed, our customer care operations support customer retention and satisfaction Our goal is to provide customers with a customer care group that has the ability and resources to respond to and resolve customer questions and issues as they arise We conduct much of our customer care operations from two call centers We also provide locally-based care for many large customers We have integrated the XO and Allegiance customer care organizations, and support the needs of the combined businesses with 600 customer care representatives

Competition

We compete with a large number of telecommunications services providers in each of our target customer markets

Incumbent Carriers. In each of our 70 markets, the ILEC generally maintains a dominant market position in the delivery of local exchange services We compete with ILECs such as Verizon, SBC, Qwest and BellSouth on the basis of our ability to provide nationwide service, our commitment to customer service, and, where our cost structure permits, on the basis of price If, however, SBC and Verizon or Qwest complete their acquisitions of AT&T and MCI, respectively, SBC and Verizon or Qwest will also be able to offer services nationally While we believe that we have competitive advantages over the ILECs, each of the ILECs is significantly larger than we are in annual revenues, total assets, and financial resources, and have increased their marketing to our target market of SMBs In addition, the recent TRRO included several rulings favorable to incumbent carriers, including the elimination in specific central offices of the requirement that the incumbent carriers lease last mile connections to competitive carriers like us at cost-based, UNE rates

Competitive Local Exchange Carriers. In addition to competing with the ILECs, we also compete with many CLECs, most of which are regionally focused In general, CLECs often maintain a market or competitive focus that enables them to be successful with specific products or in specific geographic or customer segments Consequently, in each of our markets, we compete with CLECs who may have different competitive focuses While we believe that our national reach and breadth of products makes us competitive with nearly any telecommunications carrier, we have to address a wide range of competitive conditions in each of our markets

Long Distance Companies. Many of the long distance telecommunications services providers, such as AT&T, MCI, and Sprint, also operate national networks While long distance carriers such as AT&T and MCI have experienced declining revenues in recent years, these long distance carriers remain significantly larger than we are in annual revenues, total assets, and financial resources In addition, several of these companies have continued to achieve significant competitive success with business customers

Data and Internet Services Companies. There are a number of large Internet service providers with which we compete in providing various Internet access and data products Such competitors include Level 3, Global Crossing, and Covad Communications

VoIP Carriers. Several companies have initiated VoIP services in recent years, including Vonage, Covad, Qwest, and AT&T, that provide voice telecommunications services exclusively by means of IP

Cable-Based Service Providers. Several companies historically focused on the delivery of cable television services have expanded their service offerings to include broadband connections and, in some cases, local voice services While several such competitors, such as Comcast, Cox Communications, and Time Warner have focused on the residential market for voice communications services, many of these competitors are significantly larger than we are in annual revenues, total assets, and financial resources While we believe that we enjoy competitive advantages over such companies because of our industry experience in providing telecommunications services, many large cable providers may build a substantial residential customer base and market to our core SMB market in the future

Company History

Our principal executive and administrative offices are located at 11111 Sunset Hills Road, Reston, Virginia 20190 and our telephone number is (703) 547-2000 Our Internet address is www xo com, where, under "About XO-Investor Center", you can find copies of our annual report on Form 10-K as of and for the year ended December 31, 2004, and our quarterly reports on Form 10-Q and current reports on Form 8-K and amendments thereto, all of which we make available as soon as reasonably practicable after the report is filed with the Securities and Exchange Commission, or the Commission

The initial predecessor entity of XO was formed as a Washington limited partnership in 1994 In 1995, that entity merged into a Washington limited liability company that became known as "NEXTLINK Communications, L L C " In January 1997, NEXTLINK Communications, L L C merged into NEXTLINK Communications, Inc , a Washington corporation, which in June 1998 reincorporated in Delaware under the same name On June 16, 2000, in connection with the acquisition of Concentric Network Corporation, NEXTLINK Communications, Inc merged with and into a new corporation and that corporation, as the surviving corporation in the merger, changed its name to NEXTLINK Communications, Inc On September 25, 2000, NEXTLINK Communications, Inc began doing business as "XO Communications" and, on October 25, 2000, changed its name to XO Communications, Inc We conduct our business primarily through the more than 20 subsidiaries that XO owns and manages

In December 2001, XO voluntarily delisted its pre-petition class A common stock from the Nasdaq National Market, which was traded under the symbol "XOXO", and, on December 17, 2001, began trading on the Over-the-Counter Bulletin Board, or OTCBB On June 17, 2002, we filed for protection under the Bankruptcy Code On November 15, 2002, the Bankruptcy Court confirmed our plan of reorganization, and, on January 16, 2003, we consummated the plan of reorganization and emerged from our Chapter 11 reorganization proceedings with a significantly restructured balance sheet

On June 23, 2004, we acquired the telecommunication services assets of Allegiance, for approximately $325 2 million in cash and approximately 45 38 million shares of our common stock

During the fourth quarter of 2004, we completed a legal entity reorganization of our operating subsidiaries We consolidated approximately 75 of our operating subsidiaries with and into a new, nationally-licensed operating company called XO Communications Services, Inc , or XOCS, a directly, wholly-owned subsidiary of XO Communications, Inc We anticipate that nearly all of our consolidated revenues from the sale of regulated telecommunications services will be earned either by XO or XOCS

Regulatory Overview

Overview

We are subject to regulation by federal, state and local government agencies Historically, the FCC had jurisdiction over interstate long distance services and international services, while state regulatory commissions had jurisdiction over local and intrastate long distance services The Telecommunications Act of 1996, or the "Telecom Act" fundamentally changed the way telecommunications is regulated in this country The FCC was given a major role in writing and enforcing the rules under which new competitors could compete in the local marketplace Those rules, coupled with additional rules and decisions promulgated by the various state regulatory commissions, form the core of the regulatory framework under which we operate in providing our services

With a few limited exceptions, the FCC continues to retain exclusive jurisdiction over our provision of interstate and international long distance service, and the state regulatory commissions regulate our provision of intrastate local and long distance service Additionally, municipalities and other local government agencies may regulate limited aspects of our business, such as use of government-owned rights-of-way, and may require permits such as zoning approvals and building permits

The Telecom Act and the related rules governing competition issued by the FCC, as well as pro-competitive policies already developed by state regulatory commissions, have enabled new entrants like us to capture a portion of the ILECs' market share of local services However, there have been numerous attempts to limit the pro-competitive policies in the local exchange services market through a combination of proposed federal legislation, adoption of new rules by the FCC, and ILEC challenges to existing and proposed regulations To date, the ILECs have succeeded in eliminating some of the market-opening regulations adopted by the FCC and the states through numerous court challenges In particular, the ILECs appealed, and won partial reversals of, a series of FCC orders defining the ILEC facilities — known as unbundled network elements or "UNEs" — that ILECs must lease to competitors at cost-based rates We expect the ILEC's efforts to scale back the benefits of the Telecom Act and local service competition to continue. However, while the FCC has eliminated certain UNEs, the basic framework of local competition, including the UNE regime itself, has remained intact The successful implementation of our business plan is predicated on the assumption that the basic competitive framework and pro-competitive safeguards will remain in place.

The passage of the Telecom Act largely preceded the explosive growth of the Internet and IP communications Congress is currently considering whether to further amend the Telecom Act to, among other things, directly address IP communications It is possible that any such amendment to the Telecom Act could eliminate or materially alter the market-opening regulatory framework of the Telecom Act in general, and the UNE regime in particular Such a result could adversely affect XO's business It is not possible to predict if, when, or how the Telecom Act will be amended

Federal Regulation

The FCC exercises jurisdiction over our telecommunications facilities and services We have authority from the FCC for the installation, acquisition and operation of our wireline network facilities to provide facilities-based domestic interstate and international services In addition, we have obtained FCC authorizations for the operation of our LMDS and 39 GHz broadband wireless facilities Because XO is not dominant in any of its markets, unlike ILECs, we are not currently subject to price cap or rate of return regulation Thus, our pricing policies for interstate and international end user services are only subject to the federal guidelines that charges for such services be just, reasonable, and non-discriminatory The FCC allows us to file interstate tariffs for our interstate access services (rates charged by us to other carriers for access to our network) As for domestic and international long distance services, the FCC requires us to make the terms, conditions and rates of the detariffed services available to the public on XO's web page, and such terms, conditions, and rates are located at http //www.xo com/legal/

Implementation of the Telecom Act

The Telecom Act's Local Competition Framework

One of the key goals of the Telecom Act is to encourage competition in the provision of local telephone service To do this, the Telecom Act provides three means by which CLECs such as XO can enter the local telephone service market The three modes of entry are as follows

- ***Access to UNEs.*** ILECs are required to lease to CLECs various elements in their network that are used individually or in combination with each other to provide local telephone service As discussed in more detail below, the FCC determines which facilities must be made available by the ILECs as UNEs The ILECs must make UNEs available at rates that are based on their forward-looking economic costs, a pricing regime known as "TELRIC," short for Total Element Long Run Incremental Cost For XO, the most critical UNEs are local loops and transport, which enable us to connect our customers to our network
- ***Construction of New Facilities.*** CLECs may also enter the local service market by building entirely new facilities The ILECs are required to allow CLECS to interconnect their facilities with the ILECs' facilities in order to reach all customers
- ***Resale.*** ILECs are required to permit CLECs to purchase their services for resale to the public at a wholesale rate that is less than the rate charged by the ILECs to their retail customers

To facilitate competitors' entry into local telephone markets using one or more of these three methods, the Telecom Act imposes on the ILECs the obligation to open their networks and markets to competition When requested by competitors, ILECs are required to negotiate, in good faith, agreements that set forth terms governing the interconnection of their network, access to UNEs, and resale XO has negotiated interconnection agreements with the ILECs in each of the markets in which it operates Many of these interconnection agreements are being renegotiated now

The following is a summary of the interconnection and other rights granted by the Telecom Act that are important for effective local service competition and our belief as to the effect of those requirements, if properly implemented

- interconnection with the networks of incumbents and other carriers, which permits our customers to exchange traffic with customers connected to other networks,
- requirements that the ILECs make available access to their facilities for our local loops and transport needs, thereby enabling us to serve customers not directly connected to our networks,
- compensation obligations, which mandate reciprocal payment arrangements for local traffic exchange between us and both incumbent and other competitive carriers and compensation for terminating local traffic originating on other carriers' networks,
- requirements concerning local number portability, which allows customers to change local carriers without changing telephone numbers, thereby removing a significant barrier for a potential customer to switch to our local voice services,
- access to assignment of telephone numbers, which enables us to provide telephone numbers to new customers on the same basis as incumbent carriers, and
- collocation rights allowing us to place telecommunications equipment in ILEC central offices, which enables us to have direct access to local loops and other network elements

Although the rights established in the Telecom Act are a necessary prerequisite to the introduction of full local competition, they must be properly implemented and enforced to permit competitive telephone companies like XO to compete effectively with the incumbent carriers Discussed below are several FCC and court proceedings relating to the application of certain FCC rules and policies that are significant to and directly impact our operations and costs as well as the nature and scope of industry competition

Unbundling of Incumbent Network Elements

In a series of orders and related court challenges that date back to 1996, the FCC has promulgated rules implementing the market-opening provisions of the Telecom Act, including the requirement that the ILECs lease UNEs to competitors at cost-based rates At the core of the series of FCC orders is the FCC's evolving effort to define which ILEC network facilities must be made available as UNEs Initially, the FCC defined a broad list of UNEs, consisting of most of the elements of the ILECs' networks Under pressure from the ILECs, the FCC has subsequently reduced the list, while preserving access to those network elements critical to the operation of XO's business

The current list of UNEs was promulgated by the FCC in two orders The first is the Triennial Review Order, or "TRO", which was released on August 21, 2003 Several carriers and other entities appealed the FCC's TRO decision On March 2, 2004, the U S Court of Appeals for the D C Circuit issued its opinion in United States Telecom Association v FCC, No 00-1012 ("USTA II Decision") In the USTA II Decision, the court reversed and overturned many of the conclusions of the TRO In the aftermath of the USTA II Decision, the FCC released the second of its two currently controlling orders, the TRO Remand Order or "TRRO", on February 4, 2005 It is expected that various parties will appeal the TRRO It is not possible to predict the outcome of those appeals It is possible that portions of the order could be overturned and that the FCC will issue new rules in their place that further restrict access to UNEs

As of March 11, 2005, the effective date of the TRRO, the ILECs are obligated to provide as UNEs the following network facilities used by XO to serve its customers

UNE Loops

DS0 loops. A DS0 loop is a single, voice-grade channel Typically, individual business lines are DS0 loops The ILECs must make DS0 loops available at UNE rates on an unlimited basis

DS1 loops. A DS1 loop is a digital loop with a total speed of 1 544 megabytes per second, which is the equivalent of 24 DS0s Multiple voice lines and Internet access can be provided to a customer over a single DS1 loop We serve most of our customers with DS1 loops The ILECs must provide DS1 loops at UNE rates at the majority of their central offices Competitors, however, are limited to no more than 10 DS1 loops to any particular building

DS3 loops. A DS3 loop is a digital loop with a total speed of 44 736 megabytes per second In some cases, XO serves its large business customers with DS3 loops ILECs must provide DS3 loops at UNE rates at the majority of their central offices Competitors, however, are limited to no more than one DS3 loop to any particular building

As of the TRRO, ILECs are not required to provide optical capacity loops or dark fiber loops as UNEs Optical capacity loops, referred to as OCn loops, are very high-capacity digital loops ranging in capacity from OC3 loops, which are the equivalent of three DS3s to OC192 This will not impact our costs

The ILECs are also not required to provide certain mass market broadband loop facilities and functionality as UNEs Under the TRO, the ILECs are not required to make newly-deployed fiber-to-the-home or FTTH loops available as UNEs and are only required to provide the equivalent of DS0 capacity on any FTTH loop built over an existing copper loop These recent FCC orders should only limit availability for those specific network elements, which are not material to us It is possible, however, that the ILECs will seek additional broadband regulatory relief in future proceedings

UNE Transport

DS1 transport. Whether transport is available as a UNE is determined on a route-by-route basis ILECs must make transport at UNE rates available at DS1 capacity levels between any two ILEC central offices unless both central offices either (1) serve more than 38,000 business lines or (2) have four or more fiber-based collocators On routes where DS1 transport must be made available, each individual competitor is limited to no more than 10 DS1 transport circuits per route

DS3 transport. Access to DS3 capacity-level transport is more limited than access to DS1 transport ILECs must make transport at UNE rates available at DS3 capacity levels between any two ILEC central offices unless both central offices either (1) serve more than 24,000 business lines or (2) have three or more fiber-based collocators On routes where DS3 transport must be made available, each individual competitor is limited to no more than 12 DS1 transport circuits per route

Dark fiber transport. Dark fiber transport is available under the same conditions as DS3 transport

ILECs are not required to provide access to transport at greater-than DS3 capacity levels ILECs are also not required to provide transport at any capacity level to connect an ILEC central office with a competitor's facilities

Transitional availability where elements are no longer available as UNEs

For DS1, DS3, and dark fiber loops and transport that do not meet the criteria for availability set forth above, the FCC established a transitional period during which the ILECs must continue to make the elements available at UNE rates to serve existing customers For DS1 and DS3 loops and transport, the ILECs must make the elements available at 115% of the TELRIC rate for one year beginning on

March 11, 2005 For dark fiber loops and transport, the ILECs must make the elements available at 115% of the TELRIC rate for 18 months beginning on March 11, 2005

Although these rules adopted by the FCC in the TRRO became effective on March 11, 2005, many of the requirements imposed by the FCC in the TRO and TRRO were not self-executing. Accordingly, the FCC made clear that carriers must follow the change of law procedures in their applicable interconnection agreements with ILECs to implement any TRO requirements that are not self-executing and that carriers must follow the procedures set forth in section 252(b) of the Telecom Act to modify interconnection agreements that are silent as to implementation of changes in law We have been in negotiations with ILECs to amend our interconnection agreements to implement relevant TRO requirements and, to date, have executed amendments in several states

Additional Federal Regulations

The following discussion summarizes some additional specific areas of federal regulation that directly affect our business

VoIP. Like a growing number of carriers, we utilize IP technology for the transmission of a portion of our network traffic The regulatory status and treatment of IP-enabled services is unresolved In particular, there is uncertainty as to the imposition of access charges, Universal Service fund contributions, and other taxes, fees, and surcharges on VoIP services In a recent order, the FCC held that Vonage's VoIP services and similar offerings by other providers are subject to the FCC's interstate jurisdiction, preempting state efforts to regulate VoIP providers as intrastate telecommunications providers Four separate state commissions have appealed this ruling and the case is currently pending The FCC, however, left open the question of whether VoIP providers provide "telecommunications" — i e , basic transmission services — or enhanced "information services " Under the Communications Act, those are mutually exclusive categories Generally, telecommunications carriers, including traditional local and long distance telecommunications companies are regulated under the Communications Act, information service providers are generally unregulated The FCC has initiated a rulemaking proceeding to address the classification of VoIP and other IP-enabled service offerings It is not possible to predict the outcome of that proceeding or its effect on XO's operations In conjunction with the rulemaking proceeding, the FCC is considering a petition filed on February 5, 2004 by SBC Communications requesting that the FCC forbear from applying common carrier regulation to IP-based networks Under the Communications Act, the FCC must act on forbearance petitions within one year, or the petition is deemed granted, subject to a single, 90-day extension available to the FCC at its discretion On December 10, 2004, the FCC exercised its right to extend the deadline for action until May 5, 2005

AT&T Declaratory Ruling Re: VoIP. On April 21, 2004, the FCC released an order denying AT&T's request that the FCC find that VoIP services are exempt from switched access charges, the AT&T Order The FCC held that an interexchange service that uses ordinary customer premises equipment that originates and terminates on the PSTN, that provides no enhanced functionality, and that undergoes no net protocol conversion, is a telecommunications service and subject to switched access charges The order apparently places interexchange services similar to those VoIP services offered by AT&T in the same regulatory category as traditional telecommunications services and, therefore, potentially subjects such VoIP services to access charges and other regulatory obligations including Universal Service fees Although the FCC did not rule on the applicability of access charges for services provided prior to April 21, 2004, the ILECs may attempt to assert claims against other telecommunications companies including us for the retroactive payment of access charges On April 22, 2004, SBC Communications filed a collections lawsuit against AT&T and other carriers seeking retroactive payment of unpaid access charges On February 4, 2005, SBC amended an existing collection case it had filed against Global Crossing and filed a complaint against XO

Level 3 Forbearance Petition. On December 23, 2003, Level 3 filed a petition requesting the FCC not to apply interstate or intrastate access charges on IP traffic that originates or terminates on the PSTN If the FCC grants Level 3's petition, we would expect that there would be reductions in our network costs associated with the termination of certain IP-to-PSTN and PSTN-to-IP traffic If, on the other hand, the FCC rules against Level 3 and adopts rules that require interstate access charges to be paid for the termination of IP-to-PSTN traffic, our network costs will increase The FCC must rule on Level(3)'s pending petition for forbearance by March 22, 2005 or the petition will be granted

ILEC Provision of Broadband Telecommunications Services and Information Services. Currently, the ILECs, as dominant carriers, are subject to a relatively high degree of regulation with respect to their broadband serving offerings The FCC, however, has initiated a rulemaking proceeding in which it is considering deregulating, or applying a lower degree of regulation to, ILEC broadband offerings If the ILECs are largely freed from dominant carrier regulation, they will have much greater pricing flexibility and will pose a greater competitive threat to XO In a second, related rulemaking, the FCC is considering whether to eliminate certain requirements it imposes on the ILECs with respect to their broadband Internet access services Currently, where the ILECs offer Internet access or other information services over broadband facilities, they must (1) purchase the underlying broadband transmission facilities from themselves at tariffed rates and (2) make the underlying facilities available to competitors on a non-discriminatory basis If the FCC were to eliminate these requirements, it could result in an increase to our network costs To date, these deregulatory trends have been directed towards facilities used primarily by residential customers, and not by business customers

Intercarrier Compensation Reform. Currently, telecommunications carriers are required to pay other carriers for interstate access charges and local reciprocal compensation charges These two forms of intercarrier compensation have been under review by the FCC since 2001 The FCC continues to consider a broad order reforming the intercarrier compensation system and issued a Notice of Proposed Rulemaking on February 10, 2005 to seek further comment on intercarrier compensation reform Although we are unable to predict the outcome of the FCC's rulemaking procedures, inasmuch as access charges and reciprocal compensation payments make up our largest network expense item, the FCC's action could have a material, adverse affect on our operations and cost of doing business

Cost-based TELRIC Pricing. On September 10, 2003, the FCC initiated a new proceeding to consider significantly revamping the current TELRIC methodology used for the pricing of UNEs If the FCC reverses the methodology used for determining UNE rates to allow for rate increases, this could substantially raise XO's costs for leasing UNEs in the future A decision is expected sometime in 2005 Several state commissions have also initiated proceedings to review the rates that the ILECs charge for UNEs An adverse ruling in these proceedings would allow the ILECs to increase UNE rates in the applicable state and this could substantially raise our costs for leasing UNEs in the future

State and Local Regulation

California PUC Proceeding. On September 23, 2004, the California Public Utilities Commission, the CA Commission, issued a decision that requires SBC to adjust monthly recurring rates for certain types of services offered to CLECs by SBC As a result of this decision, we believe that we are owed a retroactive credit The billing adjustments and true-up payments required by the decision have been stayed until the CA Commission can (a) consider mitigations to lessen the negative effect of such true-up payments; and (b) consider issues raised by the Ninth Circuit Court of Appeal regarding the shared and common cost mark-up element Since the decision, the CA Commission has issued three separate alternate draft decisions which propose different true-up payment schemes and different shared and common cost mark-up factors 10%, 15%, and 21%, respectively The date that the CA Commission will vote on the draft decisions is unknown at this time, but the next possible date that this issue could be considered by the CA Commission is March 17, 2005 Therefore, we currently are unable to determine the amount or the timing of the expected credit

In general, state regulatory commissions have regulatory jurisdiction over us when our facilities and services are used to provide local and other intrastate services Under the Telecom Act, state commissions continue to set the requirements for providers of local and intrastate services, including quality of services criteria State regulatory commissions also can regulate the rates charged by CLECs for intrastate and local services and can set prices for interconnection by new telecommunications service providers with the ILEC networks, in accordance with guidelines set by the FCC In addition, state regulatory commissions in many instances have authority under state law to adopt additional regulations governing local competition and consumer protection, so long as the state's actions are not inconsistent with federal law or regulation

Most state regulatory commissions require companies that wish to provide intrastate common carrier services to register or be certified to provide these services These certifications generally require a showing that the carrier has adequate financial, managerial and technical resources to offer the proposed services in a manner consistent with the public interest We are certified in all of the states in which we conduct business In most states, we are also required to file tariffs setting forth the terms, conditions and prices for services that are classified as intrastate, and to update or amend our tariffs as rates change or new products are added We may also be subject to various reporting and record-keeping requirements

Where we choose to deploy our own transmission facilities, we may be required, in some cities, to obtain street opening and construction permits, permission to use rights-of-way, zoning variances and other approvals from municipal authorities We also may be required to obtain a franchise to place facilities in public rights of way In some areas, we may be required to pay license or franchise fees for these approvals We cannot assure you that fees will remain at current levels, or that our competitors will face the same expenses, although the Telecom Act requires that any fees charged by municipalities be reasonable and non-discriminatory among telecommunications carriers

Risk Factors

Risks Related to Liquidity, Financial Resources, and Capitalization

The covenants in our Credit Agreement restrict our financial and operational flexibility, which could have an adverse affect on our results of operations.

Our Credit Agreement contains covenants that restrict, among other things, the amount of our capital expenditures, our ability to borrow money, grant additional liens on our assets, make particular types of investments or other restricted payments, sell assets or merge or consolidate A company controlled by Mr Carl Icahn holds more than 90% of the principal amount of the loans outstanding under the Credit Agreement Because amendments to or waivers of covenants under the Credit Agreement generally require the approval or consent of holders of only a majority of the outstanding principal amount under the Credit Agreement, decisions whether to amend or waive compliance with such covenants by the holders of loans under the Credit Agreement can be made by Mr Icahn, whether or not the other holders agree.

Our Credit Facility includes a financial covenant requiring us to maintain minimum earnings before interest, taxes, depreciation, and amortization, or EBITDA, for the twelve-month period ending each fiscal quarter We did not meet this covenant in 2004 and based on current financial results and our current business plan, we do not expect to comply with this covenant in 2005 We have obtained a waiver through December 31, 2005, but we can not be certain that we will be able to obtain any further waivers of this, or any other, covenant in our Credit Facility If we are not able to (i) amend this Credit Facility covenant to remove the minimum EBITDA requirements or decrease the requirement to a level we believe we can achieve, (ii) obtain an extension on the waiver to at least March 31, 2006, or (iii) repay the Credit Facility with a new debt or equity offering so that we are in compliance, under the current accounting guidelines we will be required to reclassify the $366 2 million amount outstanding from long term to short term as of March 31, 2005 While the existing waivers prevent the lenders under the Credit Facility from accelerating repayment of the outstanding indebtedness under the Credit Facility until March 31, 2006, this reclassification would cause a significant deterioration to our disclosed working capital and financial position The security for the Credit Agreement consists of substantially all of the assets of XO and our subsidiaries A default under the Credit Agreement could adversely affect our rights under other commercial agreements

The Credit Agreement and the existence of the loans under the Credit Agreement also could affect our financial and operational flexibility, as follows

- they may impair our ability to obtain additional financing in the future,
- they may limit our flexibility in planning for or reacting to changes in market conditions, and
- they may cause us to be more vulnerable in the event of a downturn in our business

We may not prevail in our $50 million claim against the Allegiance Telecom Liquidating Trust, and we may not be successful in defending ourselves from the Allegiance Telecom Liquidating Trust's $100 million counterclaim against us.

In August 2004, XO filed an administrative claim against the Allegiance Telecom Liquidating Trust, or ATLT, the successor to the assets and liabilities of Allegiance Telecom, Inc that we did not acquire We have claimed that we are entitled to approximately $50 million in damages related to a variety of actions taken by Allegiance and the ATLT The ATLT filed a counterclaim against us in November 2004 seeking damages of approximately $100 million We are vigorously pursuing our claims against the ATLT, and we are disputing the ATLT counterclaim as being frivolous and without merit There can be no assurance, however, that we will be successful in recovering the damages to which we believe we are entitled, or that we will successfully defend ourselves against the ATLT counterclaim, in which case our financial condition and results of operations could be materially and adversely affected

We incurred a net loss in 2004 and, in the near term, may not generate funds from operations sufficient to meet all of our cash requirements.

For each period since inception, we have incurred net losses For 2004, we posted a net loss attributable to common stockholders of approximately $410 5 million In the near term, we expect to use cash to fund our ongoing capital expenditure requirements

We may not realize the network synergies that we estimate in connection with the acquisition of the Allegiance assets.

While we have been successful in realizing many of the network synergies that we estimated were achievable in connection with the acquisition of the Allegiance assets, and we are confident that we will achieve additional synergies, it is possible that our estimates could prove to be incorrect For example, we may discover during the process of further integrating the Allegiance assets into our network and business infrastructures that some of the acquired assets require greater maintenance or earlier replacement than originally anticipated In addition, unanticipated growth in our business as a result of the acquisition of the Allegiance assets may require that some facilities or support functions that we currently anticipate will be combined or reduced may be necessary to retain for us to maintain our operations The synergies that we anticipate to realize are also dependent on our ability to combine the Allegiance assets with our own network infrastructure in a manner that permits us to realize those synergies If we have not estimated the potential synergies correctly, or if we are not able to integrate the Allegiance assets into our network infrastructure effectively, we may not realize any further network synergies in connection with the acquisition of the Allegiance assets, or such synergies may take longer to realize

We are also retaining investment bankers and consultants who will develop and make recommendations to us regarding our strategic alternatives

Risks Related to Our Operations

The failure of our operations support systems, including the systems for sales tracking, order entry and provisioning, and billing, to perform as we expect could impair our ability to retain customers and obtain

new customers, or provision their services, or result in increased capital expenditures, which would adversely affect our revenues or capital resources.

Our operations support systems are an important factor in our operations Critical information systems used in daily operations perform sales and order entry, provisioning, billing and accounts receivable functions, and cost of service verification and payment functions, particularly with respect to facilities leased from ILECs Although we have integrated some systems with respect to the products and customers we acquired from Allegiance Telecom, Inc we do maintain separate systems for XO and Allegiance in several key areas, such as provisioning. If any of these systems fail or do not perform as expected, or if we fail to coordinate our remaining separately-existing Allegiance and XO systems, such failures would impact our ability to process orders and provision sales, and to bill for services efficiently and accurately, which could, in turn, cause us to suffer customer dissatisfaction, loss of business or the inability to add new customers or additional services to existing customers in a timely basis, any of which would adversely affect our revenues In addition, system failure or performance issues could impact our ability to effectively audit and dispute invoicing and provisioning data provided by service providers from whom we lease facilities

Our Disaster Recovery framework to control and address systems risks is not fully redundant, and we may incur the costs, delays and customer complaints associated with system failures In addition, our ability to efficiently and accurately provision new orders for services on a timely basis is necessary for us to begin to generate revenue related to those services We have experienced, and may continue to experience, delays and related problems in processing service orders, provisioning sales and billing in connection with the transition to these new systems If the delays or related problems continue, or if any unforeseen problems emerge in connection with our migration to the new provisioning software and systems, delays and errors may occur in the provisioning process, which could significantly increase the time until an order for new service can begin to generate revenue, which could have a material adverse effect on our operations

Our rights to the use of the unlit capacity that make up our network may be affected by the financial health of our fiber providers.

We possess the right to use the unlit capacity that is included in our network, particularly in our intercity network, through long-term leases or indefeasible right of use agreements A bankruptcy or financial collapse of one of these fiber providers could result in a loss of our rights under such leases and agreements with the provider, which in turn could have a negative impact on the integrity of our network, our ability to expand the capacity of our network as our business grows, and ultimately on our results of operations For example, we lease or have indefeasible rights of use on networks owned and maintained by Level 3 If Level 3 were to encounter severe financial difficulties, we may not be able to maintain or protect our rights in important components of our intercity network In such an event, there can be no assurance that we will be able to lease comparable strands of unlit capacity if we are not able to retain our rights to use the existing unlit capacity we have obtained from Level 3, nor that we will be able to lease such strands from another provider at competitive or economical rates

We may not be able to continue to connect our network to the ILEC's network or maintain Internet peering arrangements on favorable terms, which would impair our growth and performance.

We are required to be a party to interconnection agreements with the ILECs in order to connect our customers to the PSTN If we are unable to renegotiate or maintain interconnection agreements in all of our markets on favorable terms, it could adversely affect our ability to provide services in the affected markets

Peering agreements with ISPs allow us to access the Internet and exchange traffic with these providers. Depending on the relative size of the providers involved, these exchanges may be made without settlement charge Recently, many ISPs that previously offered peering have reduced or eliminated peering relationships or are establishing new, more restrictive criteria for peering and an increasing number of these ISPs are seeking to impose charges for transit. Increases in costs associated with Internet and exchange transit could have an adverse effect on our margins for our services that require Internet access We may not be able to renegotiate or maintain peering arrangements on favorable terms, which would impair our growth and performance

We may not be able to successfully extend the termination date of our LMDS licenses for New York City and the surrounding vicinity.

Our licenses to use the wireless point-to-point LMDS spectrum for the geographic region that includes New York City are currently scheduled to expire in 2006 Although we have filed applications to extend the deadlines for the expiration of those licenses, there can be no assurance that we will be successful in extending the expiration date of our LMDS licenses in New York City beyond 2006 If we are not successful in extending the expiration date of those licenses, the value would be impaired, and we would adjust our asset balance In addition, we would not be able to develop our wireless, point-to-point solutions in that market, which could either require us to expend resources to obtain alternative spectrum or curtail our opportunity for developing wireless, point-to-point last mile connectivity in that market

We depend on a limited number of third party service providers for the performance of selected business operations, and if any such third party service providers were to experience significant interruptions in their business operations, or were to otherwise cease to provide such services, our operations could be materially and adversely affected.

We depend on a limited number of third party service providers for the performance of several our business operations, including payroll and billing services. If any of these third party providers were to experience significant interruptions in their business operations, terminate their agreements with us, or fail to perform the services required under the terms of our contracts with them, our own processing could be materially and adversely affected for a period of time that we can not predict There can be no assurance that we would be able to locate alternative providers of such services, or that we could do so at economical rates

We may be unable to adequately protect our intellectual property or rights to licenses for use of third-party intellectual property, and may be subject to claims that we infringe the intellectual property of others, which could substantially harm our business.

We rely on a combination of patents, copyrights, and other proprietary technology that we license from third parties We have been issued several United States and foreign trademarks and may consider filing for additional trademarks in the future We have also been issued one United States patent and may consider filing for additional patents in the future However, we cannot assure you that any additional patents or trademarks will issue or that our issued patent or trademarks will be upheld in all cases We cannot guarantee that these and other intellectual property protection measures will be sufficient to prevent misappropriation of our trademark or technology or that our competitors or licensors will not independently develop technologies that are substantially equivalent to or superior to ours In addition, the legal systems in many other countries do not protect intellectual property rights to the same extent as the legal system of the United States If we are unable to adequately protect our proprietary interests and business information or our present license arrangements, our business, financial condition and results of operations could be adversely affected Further, the dependence of the telecommunications industry on proprietary technology has resulted in frequent litigation based on allegations of the infringement of patents and other intellectual property In the future, we may be subject to litigation to defend against claimed infringement of the rights of others or to determine the scope and validity of the proprietary rights of others Future litigation also may be necessary to enforce and protect our trade secrets and other intellectual property rights Any intellectual property litigation could be costly and cause diversion of our management's attention from the operation of our business Adverse determinations in any litigation could result in the loss of proprietary rights, subject us to significant liabilities or require us to seek licenses from third parties that may be available on commercially reasonable terms, if at all We could also be subject to court orders preventing us from providing certain services in connection with the delivery of our services to our customers

We experience turnover among our experienced and trained employee base, which could result in our inability to continue performing certain functions and completing certain initiatives in accordance with our existing budgets and operating plans.

We depend on the performance of our executive officers and key sales, engineering, and operations personnel, many of whom have significant experience in the telecommunications industry and substantial tenures with either our company or that of one of the companies that we have acquired We experience turnover among our employees as a whole, and if we are not able to retain our executive officers or other key employees, we could experience a material and adverse effect on our financial condition and results of operations In addition, in spite of the recent downturn in the U S economy, recruitment and retention of qualified employees remain highly competitive, and there can be no assurance that, if we lose one or more of our senior executives or key employees, we will be able to replace those persons, or, if we are able to replace such persons, that we will be able to do so without incurring significant additional labor costs or disruptions in our operations

Several customers account for a significant portion of our revenue, and some our customer agreements may not continue due to bankruptcies, acquisitions, nonrenewal, or other factors.

We have substantial business relationships with large telecommunications carriers for whom we provide long distance and local transport services The highly competitive environment and the industry consolidation in the long distance and wireless markets has challenged the financial condition and growth prospects of some of our carrier customers, and has caused such carrier customers to optimize the telecommunications capacity that they utilize among competing telecommunications services providers' networks, including ours Replacing this revenue may be difficult because individual enterprise and SMB customers tend to place smaller service orders than our larger carrier customers In addition, pricing pressure on products that we sell to our carrier customers may challenge our ability to grow revenue from carrier customers As a result, if our larger carrier customers terminate the services they receive from us, our revenues and results of operations could be materially and adversely affected

Risks Related to Competition and Our Industry

Technological advances and regulatory changes are eroding traditional barriers between formerly distinct telecommunications markets, which could increase the competition we face and put downward pressure on prices, which could impair our results.

New technologies, such as VoIP, and regulatory changes — particularly those permitting ILECs to provide long distance services — are blurring the distinctions between traditional and emerging telecommunications markets In addition, the increasing importance of data services has focused the attention of most telecommunications companies on this growing sector As a result, a competitor in any of our business areas is potentially a competitor in our other business areas, which could impair our prospects, put downward pressure on prices and adversely affect our operating results

The telecommunications industry is highly competitive, and has experienced the consolidation of many existing competitors and the introduction of significant new competitors.

The communications industry is highly competitive Many of our competitors generate significantly greater revenue, and possess significantly greater assets and financial resources than we do In addition, if the business combinations involving SBC and AT& T, and either Verizon or Qwest and MCI that have been announced to date are consummated, those businesses as combined will enable SBC and Verizon or Qwest to offer the same or similar network reach as we do, and enable those companies to more effectively target the potential customers that are the focus of our business This competition places downward pressure on prices for local and long distance telephone service and data services, which can adversely affect our operating results Also, as the technology to deliver VoIP services is improved, more companies will be able to compete with us in our metro markets without constructing or acquiring PSTN assets in those markets In addition, we could face competition from other companies, such as other competitive carriers, cable television companies, microwave carriers, wireless telephone system operators and private networks built by large end-users We are much smaller in size and resources than many of our competitors If we are not able to successfully compete against our larger competitors and the new entrants into the telecommunications market, our financial condition and results of operations could be materially and adversely affected

Our company and industry are highly regulated, which restricts our ability to compete in our target markets and imposes substantial compliance costs on us that adversely impact our results.

We are subject to varying degrees of regulation from federal, state and local authorities This regulation imposes substantial compliance costs on us It also restricts our ability to compete For example, in each state in which we desire to offer our services, we are required to obtain authorization from the appropriate state commission If any required authorization for any of our markets or services is revoked or otherwise terminated, our ability to operate in the affected markets would be adversely affected

Attempts to limit the basic competitive framework of the Telecom Act could interfere with the successful implementation of our business plan.

Successful implementation of our business plan is predicated on the assumption that the basic framework for competition in the local exchange services market established by the Telecom Act will remain in place We expect that there will be attempts to limit or eliminate this basic framework through a combination of federal legislation, new rulemakings by the FCC and ILEC challenges to existing and proposed regulations It is not possible to predict the nature of any such action or its impact on our business and operations

Risks Related to Our Common Stock

An entity owned and controlled by Mr. Carl C. Icahn is our majority stockholder.

An entity owned and controlled by Mr Carl C Icahn, Chairman of our board of directors, has filed a Form 13D with the Securities and Exchange Commission in August 2004 disclosing that his beneficial ownership, as defined therein, was 60 7% of XO As a result, Mr. Icahn has the power to elect all of our directors Under applicable law and our certificate of incorporation and by-laws, certain actions cannot be taken without the approval of holders of a majority of our voting stock including, without limitation, mergers and the sale of substantially all of our assets and amendments to our certificate of incorporation and by-laws

Future sales or issuances of our common stock could adversely affect its price and/or our ability to raise capital.

Future sales of substantial amounts of our common stock, or the perception that such sales could occur, could adversely affect the prevailing market price of our common stock and our ability to raise capital In particular, we anticipate that the ATLT holder of approximately 45,380,000 shares of our common stock, may exercise its rights under an existing Registration Rights Agreement with us to cause us to file a registration statement to register the public resale of some or all of those shares

As of March 14, 2005, there were 181,933,035 shares of our common stock outstanding The shares of our common stock owned by an entity owned and controlled by Mr Icahn are restricted shares that may be sold only under a registration statement or an exemption from federal securities registration requirements Mr Icahn, through various entities that he owns or controls, has the right to require XO to register, under the Securities Act of 1933, shares of common stock held by such entities and to include shares of our common stock held by them in certain registration statements filed by XO

We have issued and there remain outstanding three series of warrants to purchase up to an aggregate of approximately 9 5 million, 7 1 million and 7.1 million additional shares of our common stock, at exercise prices of $6 25, $7 50 and $10 00 per share, respectively The warrants will expire on January 16, 2010

We have options outstanding to purchase approximately 11 3 million shares of common stock reserved for issuance under our 2002 Stock Incentive Plan as of December 31, 2004 Unless surrendered or cancelled earlier under the terms of the stock incentive plan, those options will expire beginning in 2013 In addition, our 2002 Stock Incentive Plan authorizes future grants of options to purchase common stock, or awards of restricted common stock, with respect to an additional 6 3 million shares of common stock in the aggregate

Forward-Looking Statements

Our forward-looking statements are subject to a variety of factors that could cause actual results to differ significantly from current beliefs

Some statements and information contained in this Annual Report on Form 10-K are not historical facts, but are "forward-looking statements," as such term is defined in the Private Securities Litigation Reform Act of 1995 These forward-looking statements can be identified by the use of forward-looking terminology such as "believes," "expects," "plans," "may," "will," "would," "could," "should," or "anticipates" or the negative of these words or other variations of these words or other comparable words, or by discussions of strategy that involve risks and uncertainties Such forward-looking statements include, but are not limited to, statements regarding

- our services, including the development and deployment of data products and services based on IP, Ethernet and other technologies and strategies to expand our targeted customer base and broaden our sales channels,
- the operation of our network, including with respect to the development of IP protocols,
- liquidity and financial resources, including anticipated capital expenditures, funding of capital expenditures and anticipated levels of indebtedness, and
- trends related to and expectations regarding the results of operations in future periods, including but not limited to those statements set forth in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations below

All such forward-looking statements are qualified by the inherent risks and uncertainties surrounding expectations generally, and also may materially differ from our actual experience involving any one or more of these matters and subject areas The operation and results of our business also may be subject to the effect of other risks and uncertainties, in addition to the relevant qualifying factors identified in the above "Risk Factors" section and elsewhere in this annual report and in the documents incorporated by reference in this annual report, including, but not limited to

- general economic conditions in the geographic areas that we are targeting for communications services,
- the ability to achieve and maintain market penetration and average per customer revenue levels sufficient to provide financial viability to our business,
- the quality and price of similar or comparable communications services offered or to be offered by our current or future competitors, and
- future telecommunications-related legislation or regulatory actions

Item 2. Properties

We own or lease, in our operating territories, telephone property which includes fiber optic backbone and distribution network facilities, wireless distribution sites, central office switching equipment, connecting lines between customers' premises and the central offices, and customer premise equipment Our central office switching equipment includes electronic switches and peripheral equipment.

The fiber optic backbone and distribution network and connecting lines include aerial and underground cable, conduit, poles and wires These facilities are located on public streets and highways or on privately-owned land We have permission to use these lands pursuant to consent or lease, permit, easement, or other agreements

We lease facilities for our administrative and sales offices, central switching offices, network nodes and warehouse space The various leases expire in years ranging from 2005 to 2029 Most have renewal options

Our headquarters are located in Reston, Virginia, where we are currently leasing approximately 170,000 square feet of space In February 2003, Dixon Properties, LLC, which is owned by Mr Carl Icahn, acquired ownership of the building in which our headquarters is located in a transaction that was approved by the Bankruptcy Court in our Chapter 11 proceedings

Item 3. Legal Proceedings

XO is involved in lawsuits, claims, investigations and proceedings consisting of commercial, regulatory, securities, tort and employment matters, which arise in the ordinary course of business In accordance with SFAS No 5, "Accounting for Contingencies," XO makes a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated XO believes it has adequate provisions for any such matters XO reviews these provisions at least quarterly and adjusts these provisions to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel, and other information and events pertaining to a particular case Litigation is inherently unpredictable However, XO believes that it has valid defenses with respect to legal matters pending against it Nevertheless, it is possible that cash flows or results of operations could be materially affected in any particular period by the unfavorable resolution of one or more of these contingencies

XO filed an administrative claim in August 2004 against the ATLT XO has claimed that it is entitled to approximately $50 million in damages related to a variety of actions allegedly taken by Allegiance and the ATLT The ATLT filed a counterclaim against XO on November 24, 2004 seeking damages of approximately $100 million, which claim XO believes to be frivolous and without merit This action is pending in the U S Bankruptcy Court for the Southern District of New York

In addition, disputes with respect to general unsecured claims and one administrative claim against XO in the amount of approximately $2 1 million, remain pending from the XO's 2002 Chapter 11 proceedings

Item 4. Submission of Matters to a Vote of Security Holders

No matter was submitted to a vote of security holders during the fourth quarter

Part II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock is quoted on the OTCBB under the symbol "XOCM OB " According to the records of our transfer agent, we had 68 stockholders of record as of March 14, 2005 The majority of our shares that are held by non-affiliates are held in approximately 35,000 customer accounts held by brokers and other institutions on behalf of stockholders The following table sets forth the low and high sale price of our common stock, based on the last daily sale, in each of our last eight fiscal quarters

	2004		2003	
	High	Low	High	Low
First Quarter	$ 7 90	$ 4 98	$ 4 00	$ 0.35
Second Quarter	$ 5 70	$ 3 33	$ 7 80	$ 3 90
Third Quarter	$ 4 00	$ 3 16	$ 8 33	$ 5 60
Fourth Quarter	$ 3 62	$ 2 67	$ 5 80	$ 4 97

All of the 2004 over-the-counter market quotations set forth in this table reflect inter-dealer quotations, without retail mark-up, mark-down, or commission and may not necessarily reflect actual transactions Our Credit Facility prohibits the payment of cash dividends

Item 6. Selected Financial Data

Our selected financial data table follows (dollars in thousands, except share data)

	Reorganized XO(f)		Predecessor XO(f)		
	Year Ended December 31,		Year Ended December 31,		
	2004(a)	2003	2002	2001	2000
Statement of Operations Data:					
Revenue	$ 1,300,420	$ 1,110,483	$ 1,259,853	$ 1,258,567	$ 723,826
Loss from operations (b)	(370,292)	(111,858)	(1,208,898)	(1,949,891)	(1,011,652)
Net loss (c)	(405,543)	(102,554)	(3,386,818)	(2,086,125)	(1,101,299)
Net loss applicable to common shares (c)(d)	(410,453)	(102,554)	(3,350,362)	(1,838,917)	(1,247,655)
Net loss per common share, basic and diluted	(2 57)	(1 07)	(7 58)	(4 55)	(3 87)
Statement of Cash Flow Data:					
Net cash (used in) provided by operating activities	$ 150	$ 6,301	$ 17,602	$ (560,877)	$ (559,414)
Net cash (used in) provided by investing activities	(444,837)	153,036	57,582	(708,598)	(1,464,495)
Net cash (used in) provided by financing activities	200,116	5,185	(6,079)	(1,019,647)	1,648,663
Balance Sheet Data:					
Cash, cash equivalents and marketable securities	$ 251,289	$ 520,612	$ 560,983	$ 755,167	$ 1,860,963
Property and equipment, net	820,536	485,984	2,780,589	3,742,577	2,794,105
Broadband wireless licenses and other intangibles, net (c)	139,866	109,515	984,614	2,977,575	3,912,209
Total assets (c)	1,459,385	1,265,165	4,585,496	7,930,465	9,085,375
Total long-term debt and accrued interest payable (c)	366,247	536,791	5,165,718	5,109,503	4,396,596
Redeemable preferred stock, net of issuance costs	204,353	—	1,708,316	1,781,990	2,097,016
Total stockholders' equity (deficit) (e)	485,552	380,425	(3,032,282)	297,416	1,838,401

(a) The selected consolidated financial data includes the accounts and activities of the businesses we acquired from Allegiance Telecom, Inc from June 23, 2004, the acquisition date through December 31, 2004

(b) In 2004, loss from operations included a $212 5 million non-cash impairment charge of goodwill In 2002, loss from operations included non-cash charges totaling $477 3 million in connection with the amendment to the terms of fiber acquisition and maintenance arrangements with Level 3 Communications, and the return of previously acquired intercity fiber in connection therewith In 2001, loss from operations included restructuring charges totaling $509 2 million associated with the restructuring of certain aspects of our business operations Loss from operations in 1999 included restructuring charges totaling $30 9 million associated with relocating our Bellevue, Washington headquarters to Reston, Virginia

(c) In 2004, net loss included a $212 5 million non-cash impairment charge of goodwill In 2003, net loss included a $33 5 million gain on investment sales In 2002, net loss and total assets reflects a $1,876 6 million impairment charge to write-off all of our goodwill as a cumulative effect of accounting change, pursuant to SFAS No 142 In 2001, net loss included a gain of $345 0 million resulting from the repurchase of certain of our senior notes In 2000, net loss included a $225 1 million net gain from the sale of an equity investment

(d) The comparability of net loss applicable to common shares is impacted by the transactions discussed in c above In 2001, net loss applicable to common shares includes a gain of $376 9 million resulting from the repurchase of certain of our preferred stock

(e) In January 2004, we completed a rights offering An aggregate of 39 7 million shares were issued in the offering, yielding net proceeds of $197 6 million These proceeds were used to pay down our long-term debt and accrued interest payable

(f) The reorganized selected consolidated financial data as of and for the years ended December 31, 2004 and 2003 reflects the impact of adopting fresh start as of January 1, 2003, and is not comparable to that of predecessor XO The predecessor selected consolidated financial data below as of and for the years ended December 31, 2002, 2001, and 2000 does not include the effects of the fresh start accounting provisions of SOP 90-7 Fresh start required that XO adjust the historical cost of its assets and liabilities to their fair values as determined by the reorganization value of the Company

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Executive Overview of Our Business

State of the Telecommunications Industry

In general, growth in the telecommunications industry has been sluggish for the past three years Demand for some services, such as wireless and integrated product offerings has increased, but for many other products and services price compression, reductions in regulated rates and lower demand have resulted in year over year revenue declines for many telecommunication companies As a result our industry has seen

- Reduced new customer demand and/or reductions in existing customer services,
- High number of bankruptcies in the telecommunications industry and the economy in general,
- Continued competitive pressures, including price cutting in some product lines,
- Mandated FCC carrier access rate reductions

Aggregate revenue earned from the sale of wired telecommunications services in 2004 has been estimated at approximately $225 billion, down approximately three percent from 2003 Telecommunications sales to business customers, however, is estimated to have remained relatively constant at $91 billion, with sales of local exchange services estimated to have increased by approximately one percent to approximately $42 5 billion in 2004 compared to 2003 Telecommunications spending by businesses who spend less that $10,000 per month or SMBs, was estimated to be $75 billion in 2004

The telecommunications industry currently remains in a state of competitive transition as the combination of new federal and state regulations, industry consolidation, emergence of new technologies, growth of the mobile wireless market, and entry of new telecommunications competitors, such as cable television companies, has contributed to a rapidly changing market for telecommunications services

Business Overview

We provide a comprehensive array of telecommunications services to business customers We provide our services, including local and long distance voice, Internet access, private data networking and hosting services, through our national telecommunications network, which consists of more than 6,700 route miles of fiber optic lines connecting 953 unique ILEC end-office collocations in 37 U S cities In addition, we own licenses to deliver telecommunications services via local, multipoint distribution service, or LMDS, wireless spectrum in all of the largest U S cities We market our services primarily to business customers, ranging from small and medium businesses to Fortune 500 companies to carrier and wholesale customers Our services offer an effective telecommunications solution for nearly any business, and our national telecommunications network is particularly advantageous to multi-location businesses that desire to improve communications among their locations, whether within a single metropolitan area or across the country

Key Performance Indicators

Management uses various key performance indicators, or KPIs, to assess operational effectiveness in certain areas These include:

- Revenue Growth — This KPI tracks a combination of sales trends, pricing strategy and operational effectiveness
- Operating expenses as a percentage of revenue — This KPI tracks our efficiencies in providing services and our profitability
- Customer attrition or churn — This KPI tracks the financial impact of customer attrition, or churn, in comparison to new sales Management reviews this KPI to judge the effectiveness of operational measures intended to promote customer retention and satisfaction with our services, and the net impact on revenue

System Conversions

During 2004, we continued to invest capital into the development and implementation of our information systems that increase revenue and/or improve our customer's experience, and/or increase productivity

- XO has completed a number of systems initiatives that improved our sales operations and customer service, including
  - A customer and prospect management system to facilitate the handling of customer and prospect leads,
  - A network pricing tool to facilitate production of price quotes for the sales team,
  - A project integration tool to allow cross selling of XO products by Allegiance sales personnel and the reverse,
  - A vendor and customer referral tool for lead generation, and
  - An ordering system for the selling of the first XO VoIP product, XOptions Flex
- In order to improve productivity through the automation of business processes, we focused on improving the order installation process by implementing systems initiatives including
  - An electronic bonding system for trouble ticketing and order management between XO and several ILECs,
  - A new ordering platform to enable standardized selling processes,
  - An order flow through from our order entry system to our provisioning and billing systems for XO's four key products,
  - An Automated Switch Translation system, which automated the interface between the provisioning systems and the network elements, and
  - A new Workforce Management system with full integration between the Workforce Management system and provisioning and trouble ticketing
- In addition, to improve productivity and to take advantage of the combination of the Allegiance and XO assets, XO assessed the capabilities of both systems' portfolios and delivered a combined architecture, leveraging the best systems while reducing overall cost Systems that have been consolidated include
  - Network monitoring systems,
  - Virus management systems,

- General Ledger and Accounts Receivable systems,
- Human Resource systems,
- Sales commission systems,
- Telco cost management platforms,
- Carrier Access Billing systems,
- Payroll systems,
- Time and attendance systems, and
- Call Management systems

Other 2004 Transactions and Developments

Acquisition of Assets of Allegiance Telecom, Inc

On June 23, 2004, we acquired the telecommunication services of Allegiance Telecom, Inc , or Allegiance, for approximately $325 2 million in cash and approximately 45 38 million shares of our common stock After the acquisition, XO became one of the nations' largest competitive providers of national local telecommunications and broadband services with approximately $1 5 billion in pro forma annual revenues We currently own one of the largest network of nationwide connections to the ILEC's networks, and doubled our collocations within the 36 metropolitan areas where we operate

As of December 31, 2004, we have completely integrated the administrative functions of XO and Allegiance and have achieved all of the originally estimated $100 million of annualized synergies We have made substantial progress in achieving the originally estimated $60 million of annualized network synergies We have connected all of the former Allegiance collocations, allowing us to carry traffic across the combined XO and Allegiance networks We have also integrated many administrative systems and contracts and have reduced the aggregate workforce of the combined companies from over 7,000 as of January 1, 2004 to approximately 5,000 as of December 31, 2004

After the Closing Date, Allegiance transferred the remaining assets that XO did not buy to the ATLT XO filed an administrative claim in August 2004 against the ATLT XO has claimed that it is entitled to approximately $50 million in damages related to a variety of actions allegedly taken by Allegiance and the ATLT The ATLT filed a counterclaim against XO on November 24, 2004 seeking damages of approximately $100 million, which claim XO believes to be frivolous and without merit The accompanying financial statements do not include any financial impact from this litigation as it is too early in the process to assess any outcome This action is pending in the U S Bankruptcy Court for the Southern District of New York

Convertible Preferred Stock

On August 6, 2004, XO completed a private placement of 4 0 million shares of its 6% Class A Convertible Preferred Stock (the "Preferred Stock Offering") for net proceeds of $199 4 million Affiliates of Mr Icahn purchased 95% of the preferred shares sold in the Preferred Stock Offering, and an affiliate of Amalgamated Gadget, L P , holder of approximately 8% of XO's outstanding common stock, purchased the remaining five percent

The Preferred Stock Offering was reviewed and approved by a special committee of XO's Board of Directors consisting of XO's three independent directors, Messrs Dell, Gradin and Knauss The special committee selected its own counsel and financial advisor The financial advisor advised the special committee that, subject to specified qualifications, assumptions and limitations, the material terms of the 6% Class A Convertible Preferred Stock were fair to XO, from a financial point of view, at the time of issuance Proceeds of the Preferred Stock Offering will be used for general working capital purposes and to fund possible future acquisitions that would add additional scale and synergies to XO's business

Liquidity and Capital Resources

Capital Resources and Liquidity Assessment

Our cash and cash equivalents decreased from $478 6 million at December 31, 2003, to $234 0 million at December 31, 2004 largely due to our acquisition of Allegiance's telecommunications services assets which included a cash payment of $325 2 million Other significant liquidity events during the year included raising capital through the issuance of common stock under a rights offering that provided net proceeds of $197 6 million, and the issuance of preferred stock that provided net proceeds of $199 4 million In addition, we paid down $199 7 million of principal outstanding under our Credit Facility and capital leases during the year, and invested $106 0 million of capital into our telecommunications network and information systems Our operating activities provided net cash of $0 2 million during 2004 This is largely due to the growth in revenue and the improvement of selling, operating and general expenses as a percentage of revenue due to the synergies achieved after the acquisition of Allegiance's telecommunications services assets.

Our Credit Facility includes a financial covenant requiring us to maintain minimum earnings before interest, taxes, depreciation, and amortization, or EBITDA, for the twelve-month period ending each fiscal quarter We did not meet this covenant in 2004 and based on current financial results, we do not expect to comply with this covenant in 2005. We have obtained a waiver through December 31, 2005 If we are not able to (i) amend this Credit Facility covenant to either remove the minimum EBITDA requirements or to decrease the requirement to a level we believe we can achieve, (ii) obtain an extension on the waiver to at least March 31, 2006, or (iii) repay the Credit Facility with a new debt or equity offering, under the current accounting guidelines we will be required to reclassify the $366 2 million amount outstanding from long term to short term as of March 31, 2005 While the existing waivers prevent the lenders under the Credit Facility from accelerating repayment of the outstanding indebtedness under the Credit Facility until March 31, 2006, this reclassification would cause a significant deterioration to our disclosed working capital and financial position

There are no additional borrowings available under our Credit Facility We have no current debt service requirements since cash interest payments as well as automatic and permanent quarterly reductions of the principal amount outstanding under the Credit Facility do not commence until 2009 However, in the event that consolidated excess cash flow (as defined in the Credit Facility) for any fiscal quarter during the term of the agreement is greater than $25 million, at the request of the lender, XO will pay an amount equal to 50% of such excess cash flow greater than $25 million toward the reduction of outstanding indebtedness. In addition, if the ratio of our consolidated earnings before interest, taxes depreciation and amortization to consolidated interest expense for the four consecutive quarters exceeds 4 1, we would be required to pay cash interest, unless waived by the lenders

We project that we will make significant progress on our operating results such that we will be cash flow positive in 2005 and that in late 2005 we will be able to fund our capital expenditures from operating cash flows Our projection is based upon our current estimates of, among other things, our estimated increased costs of service attributable to the recent TRRO and other projected operating costs that are not entirely in XO's control As a result, our 2005 projections may not prove to be correct if our estimates of such costs and expenses are inaccurate In addition, our ability to remain cash flow positive over the longer term is dependent on our ability to extend the waiver of our existing senior debt covenants, refinance our existing senior debt, or repay that senior debt from then-existing cash reserves

We expect that the majority of our planned capital expenditures will be "success based" in that they will be used to grow revenue by purchasing and installing customer-related equipment and network electronics for either new customers or by adding services provided to existing customers Much of our non-success based capital will be for the continued development and implementation of our information systems in support of new product introductions, cost management, continued automation of XO's business processes, and continued integration of XO's and Allegiance's information systems

Our national network requires various ongoing maintenance costs and software licenses and fees so that we can continue to provide high quality telecommunication services to our customers Where we do not have our own network to provide telecommunication services we pay access rights and use fees to other service providers To achieve the most cost efficient rates, we often commit to a multi year purchase for these services and licenses The Company is leasing premises under various noncancelable operating leases for administrative space, building access, and other leases, which, in addition to rental payments, require payments for insurance, maintenance, property taxes and other executory costs related to the leases The lease agreements have various expiration dates and renewal options through 2029 The following table summarizes our payment obligations under various operating and financing agreements as of December 31, 2004 (dollars in thousands)

Year Ending December 31,	Credit Facility	Other long-term contractual obligations	Operating lease obligations	Capital lease obligations	Total obligations
2005	$ —	$ 61,273	$ 70,822	$ 4,789	$ 136,884
2006	—	52,521	66,657	4,537	123,715
2007	—	48,806	61,527	3,854	114,187
2008	—	47,524	51,394	2,398	101,316
2009	366,247	33,679	43,257	1,770	444,953
Thereafter	—	95,787	168,235	13,681	277,703
Total minimum commitments	$366,247	$ 339,590	$ 461,892	$ 31,029	$ 1,198,758

As discussed in Part I, Item 1, Business, we prepaid to lease wavelength capacity from Level 3 for intercity network capacity The leases expire in 2006 and 2007 At that time, we will either renew these leased wavelengths at current market rates or install our own optical equipment and light certain segment routes of our intercity fiber network, either of which will be a substantial capital commitment

If we successfully either, extend the waivers for the financial covenants or renegotiate or refinance the Credit Facility as discussed above, we expect that our current cash balance will allow us to successfully execute our current business plan Current economic conditions of the telecommunications industry may create opportunities for us acquire on other companies or portions of companies at attractive prices We expect to continue to pursue the acquisition of additional telecommunication companies or assets throughout 2005 We do not know what the terms of any such transactions would be Any offers involving cash consideration could significantly and adversely affect our liquidity To support further business expansion, including investments in or acquisitions of other companies or portion of other companies, we may issue additional equity and/or debt securities

Comparison of Financial Results

The operational results for the year ended December 31, 2004 are discussed below The 2004 amounts include the results of operations of the Allegiance telecommunication services assets, which we refer to as the Acquired Businesses from June 23, 2004 through December 31, 2004

XO Year Ended December 31, 2004 Compared to Year Ended December 31, 2003

Revenue. Total revenue for the year ending December 31, 2004 increased 17 1% to $1,300 4 million from $1,110 5 million for the year ending December 31, 2003 The 2004 financial results include approximately $217 2 million of revenue from the Acquired Businesses Without the revenue from the Acquired Businesses our 2004 revenue decreased $27 3 million or 2 5% from 2003 results Customer churn and continued pricing pressures, particularly in carrier long distance, offset revenue growth from new customers Customer churn is driven by a highly competitive environment, large customers downsizing their telecom needs, and finally our deemphasizing of products like DSL, Hosting and Dial-up allowing our sales resources to focus on larger customers and products We expect 2005 annualized revenue to be consistent with our fourth quarter 2004 results

Revenue was earned from providing the following services (dollars in thousands)

	Year Ended December 31,		Year Ended December 31,		
	2004	% of 2004 Revenue	2003	% of 2003 Revenue	% Change
Voice services	$ 673,318	51 8%	$ 572,774	51 6%	17 6%
Data services	414,782	31 9%	392,742	35 4%	5 6%
Integrated voice and data services	212,320	16 3%	144,967	13 0%	46 5%
Total revenue	$ 1,300,420	100 0%	$ 1,110,483	100 0%	17 1%

Voice services revenue includes revenue from local and long distance voice services, prepaid calling card processing, interactive voice response services, stand-alone long distance services and other voice telecommunications based services. Our 2004 results include approximately $127 0 million of voice services revenue from the Acquired Businesses Voice services revenue for the year ended December 31, 2004 exclusive of voice services revenue from the Acquired Businesses, decreased $26.5 million or 4 6% from 2003 results The decrease is attributable to customer churn, competitive pricing pressures, particularly long distance, and reduced FCC mandated rates

Data services revenue includes revenue from Internet access, network access and web applications hosting services Our 2004 results include approximately $32 2 million of data services revenue from the Acquired Businesses Data services revenue for the year ended December 31, 2004 exclusive of data services revenue from the Acquired Businesses decreased $10 1 million or 2 6% from 2003 results The decrease was attributable to an increase in customer churn due to network downsizing from high end customers and our deemphasizing certain less profitable products such as DSL, dial up, and hosting services

Integrated voice and data services revenue is attributed to our XOptions and Total Communications service offerings, XO's flat-rate bundled packages offering a combination of voice and data services and integrated access Our 2004 results include approximately $58 0 million of integrated voice and data services revenue from the Acquired Businesses Integrated voice and data services revenue for the year ended December 31, 2004 exclusive of services revenue from the Acquired Businesses increased $9 3 million or 6 4% from 2003 results due to growth in our integrated access services, as well as our XOptions service offering

Costs and expenses. The table below provides costs and expenses by classification and as a percentage of revenue (dollars in thousands) Our consolidated costs and expenses in 2004 include the costs to run the Acquired Businesses since June 23, 2004

	Year Ended December 31,		Year Ended December 31,		
	2004	% of 2004 Revenue	2003	% of 2003 Revenue	% Change
Costs and expenses					
Cost of service	$ 552,735	42 5%	$ 422,129	38 0%	30 9%
Selling, operating and general	727,666	56 0%	679,286	61 2%	7.1%
Depreciation and amortization	177,781	13 7%	109,308	9 8%	62 6%
Goodwill impairment charge	212,530	16 3%	—	0 0%	100 0%
Restructuring and asset write-downs	—	0 0%	11,618	1 1%	(100 0%)
Total	$ 1,670,712	128 5%	$ 1,222,341	110 1%	36 7%

Cost of service. Cost of service includes expenses directly associated with providing telecommunications services to our customers Cost of service includes, among other items, the cost of connecting customers to our networks via leased facilities, the costs of leasing components of our network facilities and costs paid to third party service providers for interconnect access and transport services Cost of service as a percentage of revenue for the year ended December 31, 2004 increased as compared to the same period in 2003 due to the impact of pricing pressures from both mandated FCC carrier access rate reductions and general pricing reductions on revenue, as well as an unfavorable shift in traffic mix for terminations, offset by savings from synergies associated with the integration of the Acquired Business

We believe that cost of service as a percentage of revenue in 2005 for the combined companies will remain relatively stable with 2004 results However, cost of service in both absolute dollars and as a percentage of revenue may be adversely impacted due to recently proposed regulatory rules on UNE loop and transport rates as discussed in the "Regulatory Overview" section in Part I, Item 1 Our current estimates project an annualized increase of approximately $45 million due to these regulatory changes These increases will be phased in during 2005, and be fully implemented by 2006 We believe that we should be able to recover the majority of these cost increases through network optimization, and price increases throughout our markets

We originally estimated a potential benefit of approximately $60 0 million in pro forma annualized network synergies for the combined companies if our integration efforts with the Acquired Businesses were successful We have made substantial progress integrating the two companies and are on plan to achieve this target

Selling, operating and general. Selling, operating and general expense includes expenses related to network maintenance, sales and marketing, network operations and engineering, information systems, general corporate office functions and collection risks Selling, operating and general expense for the year ended December 31, 2004 was $727 7 million or 56 0% of revenue versus $679 3 million or 61 2% of revenue for the year ended December 31, 2003 The decrease in selling, operating and general expense as a percentage of revenue for the year ended December 31, 2004 when compared to 2003 results is due to the achievement of synergies related to the Acquired Businesses Our fourth quarter 2004 results are reduced due to favorable settlements for $11 9 million

We believe that, selling, operating and general expense will decrease as a percentage of revenue in 2005 when compared with 2004 results We originally estimated a potential benefit of approximately $100 0 million in pro forma annualized selling, operating and general expense synergies for the combined companies if our integration efforts with the Acquired Businesses were successful We have completely integrated the administrative functions and have achieved all of the estimated annualized synergies.

Depreciation and amortization. Depreciation and amortization expense was $177 8 million for the year ended December 31, 2004, and $109 3 million for the year ended December 31, 2003 The increase is largely due to the inclusion of fixed assets and intangibles of the Acquired Businesses

As of December 31, 2004, we had approximately $115 9 million of fixed assets and $23 5 million of broadband wireless licenses that have not yet been placed into service and, accordingly, are not currently being depreciated or amortized We expect depreciation and amortization expense during 2005 to increase as additional assets are placed into service and as we recognize a full year of depreciation and amortization of the assets of the Acquired Businesses

Goodwill impairment charge. We retained independent appraisers to perform a preliminary valuation of our assets and liabilities as of December 31, 2004 This valuation was necessary as our fair value as determined by our stock price, was less than our book value Based on this appraisal we recorded a $212 5 million non-cash impairment charge on our goodwill

Restructuring and asset write-downs. Restructuring and asset write-downs were $11 6 million for the year ended December 31, 2003 Restructuring charges in 2003 included costs for a reduction in our workforce by approximately 550 employees and estimated losses associated with restructured leases

Investment income, net. Investment income, net includes interest income as well as any realized gains or losses from the sale of investments Investment income, net was a loss of $9 0 million and a net gain of $46 2 million in 2004 and 2003, respectively The 2004 balance includes a $10 4 million impairment adjustment on an investment, that was considered to be other than temporary The 2003 balance is primarily from a gain on the sale of an investment

Interest expense, net Interest expense, net includes interest expense on debt and capital leases, less any amounts capitalized The majority of interest expense in 2004 and 2003 is non-cash as our Credit Facility allows for accrued interest to be converted into principal if unpaid Interest expense, net for the years ended December 31, 2004 and 2003 was $26 2 million and $36 8 million, respectively. The significant reduction for 2004 was due to a $197 6 million repayment of outstanding principal under the Credit Facility in January 2004 During 2004 and 2003, XO capitalized interest of $4 0 million and $3 0 million, respectively

Reorganized XO Year Ended December 31, 2003 Compared to Predecessor XO Year Ended December 31, 2002

As a consequence of our Chapter 11 reorganization, the financial results for the year ended December 31, 2003 have been separately presented under the label "Reorganized XO" and are not comparable with prior year results The reorganized Company has adopted the policy of expensing customer installation costs in the period in which the costs are incurred The predecessor Company capitalized and amortized these costs In accordance with SOP 90-7, the reorganized Company was required to implement newly issued accounting pronouncements that would require adoption within twelve months of applying fresh start

Revenue. Total revenue for the year ending December 31, 2003 decreased 11 8% to $1,110 5 million from $1,259 9 million for the year ending December 31, 2002 Customer churn, of approximately 2 4% in 2003, exceeded acquisition revenue particularly in the carrier, stand alone, DSL and dial-up customer base The majority of this decline is driven by major reductions in the carrier revenue stream due to bankruptcies, downsizing network requirements, as well as competitive pricing pressures Additionally, year-over-year revenue decreased in ancillary stand alone products such as Dial Up and DSL Internet access, and Hosting due to XO focusing on more profitable offerings The commercial offerings to middle market businesses, however, remained relatively stable as revenue acquisition kept pace with attrition

Revenue was earned from providing the following services (dollars in thousands)

	Reorganized XO		Predecessor XO		
	Year Ended December 31,		Year Ended December 31,		
	2003	% of 2003 Revenue	2002	% of 2002 Revenue	% Change
Voice services	$ 572,774	51 6%	$ 659,558	52 3%	(13 2%)
Data services	392,742	35 4%	472,247	37 5%	(16 8%)
Integrated voice and data services	144,967	13 0%	128,048	10 2%	13 2%
Total revenue	$ 1,110,483	100 0%	$ 1,259,853	100 0%	(11 8%)

Voice services revenue includes revenue from local and long distance voice services, prepaid calling card processing, and other voice telecommunications based services, interactive voice response services and stand-alone long distance services Voice services revenue for the year ended December 31, 2003 decreased to $572 8 million from $659 6 million for the same period of 2002 The decrease is attributable to reduced FCC mandated rates, price reductions in long distance services due to reduced cost of service due to technological improvements, and customer disconnects and usage reductions arising from customers' downsizing due to the state of the domestic economy

Data services revenue includes revenue from Internet access, network access and web applications hosting services Data services revenue for the year ended December 31, 2003 decreased to $392 7 million from $472 2 million for the same period of 2002 The decline was attributable to an increase in customer bankruptcies, and customer disconnects, and a lower demand from large customers due to reductions in those customers' data capacity needs

Integrated voice and data services revenue is generated largely from our XOptions service offerings, a flat-rate bundled package offering a combination of voice and data services Integrated voice and data services revenue for the year ended December 31, 2003 increased to $145 0 million from $128 0 million for the same period in 2002 The increase is due to the continued acceptance in the marketplace of our XOptions service offering

Costs and expenses. The table below provides costs and expenses by classification and as a percentage of revenue (dollars in thousands)

	Reorganized XO		Predecessor XO		
	Year Ended December 31,		Year Ended December 31,		
	2003	% of 2003 Revenue	2002	% of 2002 Revenue	% Change
Costs and expenses					
Cost of service	$ 422,129	38 0%	$ 522,924	41 5%	(19 3%)
Selling, operating and general	679,286	61 2%	765,853	60 8%	(11 3%)
Depreciation and amortization	109,308	9 8%	699,806	55 5%	(84 4%)
Restructuring and asset write-downs	11,618	1 1%	480,168	38 1%	(97.6%)
Total	$ 1,222,341	110 1%	$ 2,468,751	196 0%	(50 5%)

Cost of service. Cost of service includes expenses directly associated with providing telecommunications services to our customers Cost of service includes, among other items, the cost of connecting customers to our networks via leased facilities, the costs of leasing components of our network facilities and costs paid to third party service providers for interconnect access and transport services Cost of service for the year ended December 31, 2003 decreased in absolute dollars and as a percentage of revenue compared to the same period in 2002 The year over year decline as a percentage of revenue was due primarily to cost optimization programs which reduced expenses by transferring traffic from third party facilities onto our owned or controlled facilities, and favorable resolutions of disputed third party costs The decline was partially offset by our adoption of an accounting policy during the first quarter of 2003, to expense rather than defer costs associated with the installation of customer services and the revenue reductions in carrier long-distance services due to the excess long haul capacity in the sector.

Selling, operating and general. Selling, operating and general expense includes expenses related to sales and marketing, internal network operations and engineering, information systems, general corporate office functions and collection risks Selling, operating and general expense for the year ended December 31, 2003 was $679 3 million or 61 2% of revenue versus $765 9 million or 60 8% of revenue for the year ended December 31, 2002 Selling, operating and general expense decreased in absolute dollars due to our reorganization that resulted in reduced headcount, contract rejections and renegotiations, and fair value adjustments to our long term contractual commitments and property as required by fresh start accounting which resulted in expense reductions in various contracted services, rent and property taxes These reductions were partially offset by our adoption of the policy of expensing internal labor costs directly associated with customer installation and the construction of our network The increase in selling, operating and general expense as a percentage of revenue for the year ended December 31, 2003 when compared to 2002 results is due to the large reduction of revenues due to bankruptcies and price declines discussed above, with no associated offsetting direct expense reduction

Depreciation and amortization. As discussed above, we implemented fresh start on January 1, 2003 and adjusted the carrying value of our property and equipment and other intangibles to their fair value which resulted in a significant reduction of the aggregate historical carrying value Consequently, depreciation and amortization expense decreased to $109 3 million for the year ended December 31, 2003, versus $699 8 million for the year ended December 31, 2002

Restructuring and asset write-downs. Restructuring and asset write-downs decreased to $11 6 million for the year ended December 31, 2003 from $480.2 million for the year ended December 31, 2002

Restructuring charges in 2003 include costs for a reduction in our workforce by approximately 550 employees, primarily employed in network operations, sales and marketing and information technology and estimated losses associated with restructured leases

The 2002 restructuring charges primarily include a $477 3 million non-cash asset write-down during the third quarter of 2002 as a result of returning intercity assets to Level 3 in exchange for reduced future maintenance expenses beginning in 2003

Investment income (loss), net. Investment income (loss), net includes interest income as well as any realized gains or losses from the sale of investments Investment income (loss), net was a gain of $46 2 million for 2003 and a gain of $16 3 million in 2002 The 2003 balance is primarily for a gain on the sale of an investment

Interest expense, net. Interest expense, net includes interest expense on debt and capital leases, less any amounts capitalized for construction efforts The majority of interest expense in 2003 is non-cash as the Credit Facility allows for accrued interest to be converted into principal if unpaid Interest expense, net for the years ended December 31, 2003 and 2002 was $36 8 million and $226 5 million, respectively During 2003 and 2002, XO capitalized interest of $3 0 million and $11 1 million, respectively Contractual interest was $501.1 million for the year ended December 31, 2002 The significant reduction for 2003 was caused by the cancellation of our pre-petition senior notes and pre-petition convertible subordinated notes and the reduction in the amount outstanding under our Credit Facility upon consummation of our Plan of Reorganization

Critical Accounting Policies and Estimates

The preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States requires management to make judgments, estimates and assumptions regarding uncertainties that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses Management uses historical experience and all available information to make these judgments and estimates Actual results could differ Despite these inherent limitations, management believes that Management's Discussion and Analysis and the accompanying consolidated financial statements and footnotes provide a meaningful and fair perspective of our financial condition and our operating results for the current period Management believes the following critical accounting policies represent the more significant judgments and estimates used in the preparation of our audited consolidated financial statements included in this form 10-K

Business Combinations

Upon the Closing Date, XO acquired title to the Acquired Businesses XO retained independent appraisers to determine the fair value of the property, plant and equipment and intangible assets acquired as required under SFAS No 141 The following are the estimated fair value of assets acquired and liabilities assumed (dollars in thousands)

Current assets	$ 51,618
Property and equipment	372,405
Goodwill	212,530
Other intangible assets	68,052
Other long-term assets	2,933
Total assets acquired	707,538
Current liabilities	(58,193)
Long-term liabilities	(12,790)
Total liabilities acquired	(70,983)
Purchase price	$ 636,555

The values assigned in these financial statements are preliminary and represent management's best estimate of current values which are subject to revision due to changes in estimates of fair value as well as the pending claim discussed in Part I, Item 3 "Legal Proceedings " As required by the SFAS No 142, we tested our goodwill for impairment at December 31, 2004 and recorded a non-cash impairment of $212 5 million This is discussed in more detail in long-lived assets below

Long-Lived Assets

Our long-lived assets include property and equipment, goodwill, broadband wireless licenses, and identifiable intangible assets to be held and used Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets The estimated useful lives of telecommunications networks and acquired bandwidth are 3 to 20 years and 5 to 7 years for furniture fixtures, equipment and other These useful lives are determined based on historical usage with consideration given to technological changes and trends in the industry that could impact the network architecture and asset utilization This latter assessment is significant because we operate within an industry in which new technological changes could render some or all of our network related equipment obsolete requiring application of a shorter useful life or, in certain circumstances, a write-off of the entire value of the asset Accordingly, in making this assessment, we consider our planned use of the assets, the views of experts both from internal and outside sources regarding the impact of technological advances and trends in the industry on the value and useful lives of our network assets Costs of additions and improvements are capitalized and repairs and maintenance are charged to expense as incurred Direct external and internal costs of constructing property and equipment are capitalized including interest costs related to construction Depreciation or amortization of the long-lived assets, with finite lives, begins when the asset is substantially complete or placed into service

Investments in broadband wireless licenses are amortized over the portion of the original license term remaining after the license is placed in service, or 10 years, whichever is shorter The original license period is determined by the FCC In order to receive an extension of the original license term from the FCC, we are required to show substantial service in the license area within ten years of being licensed Failure to meet this requirement could result in forfeiture of the license Approximately $23 5 million in book value of these licenses have not yet been placed into service Had these licenses been in service during all of 2004, amortization expense would have increased by approximately $5 5 million If we fail to show substantial service in the licensed geographic area at the end of the original ten year period and are not granted an extension or renewal from the FCC, we would forfeit the right to offer such services in that market XO is evaluating recent improvements in the price and performance of broadband wireless equipment, and is developing a plan to meet the FCC's substantial service test in all its licensed areas before the licenses are due for renewal proceedings

Other intangibles consist of customer relationships, internally developed technology and trade names The customer relationships, internally developed technology and certain trade names are being amortized using the straight-line method over the estimated useful lives of three years Certain trade names were determined to have indefinite lives and are not being amortized Goodwill and indefinite life trade names are reviewed at least annually for impairment, as required under Statement of Financial Accounting Standards 142, "Goodwill and Other Intangible Assets", or SFAS No 142 We retained independent appraisers to perform a preliminary valuation of our assets and liabilities as of December 31, 2004 This valuation was necessary as our estimated fair value as determined by our stock price, was less than our book value Based on this appraisal we recorded a $212 5 million non-cash impairment charge on our goodwill This report will be finalized in the first quarter of 2005 and could result in a change to this preliminary estimate

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount should be addressed pursuant to SFAS No 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," or SFAS No. 144 The criteria for determining impairment for long-lived assets to be held and used is determined by comparing the carrying value of these long-lived assets to management's best estimate of future undiscounted cash flows expected to result from the use of the assets and their eventual disposition Based on our analysis, we believe that no impairment existed under SFAS No 144 as of December 31, 2004 In the event that there are changes in the planned use of our long-lived assets or our expected future undiscounted cash flows are reduced significantly, our assessment of our ability to recover the carrying value of these assets under SFAS No 144 could change

Revenue Recognition

Revenues from telecommunications services are recognized when the services are performed, evidence of an arrangement exists, the charges are fixed and determinable and collectability is probable In circumstances when these criteria are not met, revenue recognition is deferred until resolution occurs For example, if a customer files for bankruptcy protection, we believe the probability of collection is weakened Consequently, under such circumstances, although we continue to bill the customer for all services provided, we do not recognize revenue until cash is received In addition, telecommunications customers often dispute the amounts that we invoice them due to regulatory issues, late payment fees, and early termination charges based on differences of opinion regarding contract terms or service levels Accordingly, as these billings are not considered fixed and determinable and collection of such amounts is not considered probable while these amounts are disputed, revenue recognition is deferred until the dispute is resolved and the collection is probable

Service discounts and incentives related to telecommunications services are recorded as a reduction of revenue when granted or ratably over a contract period Fees billed in connection with customer installations and other non-recurring fees are deferred and recognized ratably over the estimated customer life of three years

We establish an allowance for collection of doubtful accounts and other sales credit adjustments Allowances for sales credits are established through a charge to revenue, while allowances for doubtful accounts are established through a charge to selling, operating and general expenses We assess the adequacy of these reserves monthly by considering general factors, such as the length of time individual receivables are past due, historical collection experience, the economic and competitive environment, and changes in the creditworthiness of our customers As considered necessary, we also assess the ability of specific customers to meet their financial obligations to us and establish specific valuation allowances based on the amount we expect to collect from these customers We can and have experienced material changes to our reserve requirements on a month to month basis. We believe that our established credit and valuation allowances were adequate as of December 31, 2004 If circumstances relating to specific customers change or economic conditions worsen such that our past collection experience and assessment of the economic environment are no longer valid, our estimate of the recoverability of our trade receivables could be changed If this occurs, we would adjust our valuation allowance in the period the new information is known

Cost of Service

Cost of service includes expenses directly associated with providing telecommunications services to customers We accrue for the estimated costs of services received from third party telecommunications providers during the period the services are received Invoices received from the third party telecommunications providers are often disputed due to billing discrepancies We accrue for all invoiced amounts, even amounts in dispute, as these amounts represent contingent liabilities that are considered probable and measurable Disputes resolved in our favor may reduce cost of service in the period the dispute is settled As the period of time required to resolve these types of disputes often lapses over several quarters, the benefits associated with the favorable resolution of such disputes are normally realized in periods subsequent to the accrual of the disputed amount

Subsequent Events

On March 16, 2005, McLeodUSA Inc, McLeod, announced that it is looking into financial restructuring options due to its on-going cash requirements XO currently holds McLeod debt securities that are included in marketable securities and other investments It is too early to conclude what type of restructuring option McLeod will choose, or if any will be approved by their creditors and how that would impact our investment Based on this announcement, there is a risk that the carrying value of $10 8 million will be impaired, and require adjustment in 2005

Off-Balance Sheet Arrangements

We are not currently engaged in the use of off-balance sheet derivative financial instruments, to hedge or partially hedge interest rate exposure nor do we maintain any other off-balance sheet arrangements for the purpose of credit enhancement, hedging transactions, or other financial or investment purposes

Recent Accounting Pronouncements Implemented in 2004

Statement No 123 (revised 2004), "Share-Based Payment", SFAS 123R, was issued in December 2004 Once effective this statement will require entities to recognized compensation cost for all equity-classified awards granted, modified or settled after the effective date using the fair-value measurement method In addition, public companies will recognize compensation expense for the unvested portion of awards outstanding as of the effective date based on their grant-date fair value as calculated under the original provisions of SFAS 123 The effective date for public entities is June 15, 2005 The amount of compensation expense that we record after the adoption of SFAS 123R in 2005 and beyond, will depend on the amount, timing and pricing of stock option grants

Item 7A. Quantitative and Qualitative Disclosure About Market Risk

As of December 31, 2004, our Credit Facility was comprised of $361 0 million in secured loans and $5 2 million of accrued interest Currently, we do not pay cash interest on the Credit Facility and accrued interest converts to principal ratably throughout the loan period As interest accrues at variable rates, our Credit Facility subjects us to interest rate risks Interest rate risk as of December 31, 2004 is illustrated in the following table (dollars in millions)

	Annual Interest Expense Given an Interest Rate decrease of X Basis Points			No Change in Interest Rates	Annual Interest Expense Given an Interest Rate increase of X Basis Points		
Interest Rate Risk	(150 BPS)	(100 BPS)	(50 BPS)	Fair Value	50 BPS	100 BPS	150 BPS
Credit Facility	$ 22.9	$ 24 8	$ 26 6	$ 28 4	$ 30 3	$ 32 1	$ 33 9

The sensitivity analysis provides only a limited, point in time view of the market risk sensitivity of the loans under our Credit Facility The actual impact of market interest rate changes may differ significantly from those shown in the above sensitivity analysis

Marketable securities, available for sale, at December 31, 2004 consist primarily of investments in equity and debt securities of publicly traded companies The fair value of our investment in equity and debt securities exposes us to market risk These investments are subject to changes in the market price of the securities The table that follows summarizes the fair values of our marketable securities and provides a sensitivity analysis of the estimated fair value of these financial instruments assuming a 5%, 10% and 15% increase or decrease in market price (dollars in millions)

	Fair value assuming the following percentage decrease in market price			No Change in Fair Value	Fair value assuming the following percentage increase in market price		
Market Risk	15%	10%	5%	0%	5%	10%	15%
Market price	$ 14 0	$ 14 9	$ 15 7	$ 16 5	$ 17 4	$ 18 2	$ 19 0

Item 8. Financial Statements and Supplementary Data

Our consolidated financial statements are filed under this Item, beginning on page F-1 of this Report

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

On September 24, 2003, we notified our independent auditors, Ernst & Young LLP that our Audit Committee of our Board of Directors had decided to change auditors On September 30, 2003, the Audit Committee of XO's Board of Directors appointed KPMG LLP to serve as its new independent registered public accounting firm for the year ending December 31, 2003 The change was effective immediately Ernst & Young LLP's report on XO's consolidated financial statements as of and for the year ended December 31, 2002 did not contain an adverse opinion or disclaimer of opinion, nor was it qualified or modified as to uncertainty, audit scope or accounting principles During the fiscal year ending December 31, 2002, there were (i) no disagreements with Ernst & Young on any matter of accounting principle or practice, financial statement disclosure or auditing scope or procedure which, if not resolved to Ernst & Young's satisfaction, would have caused them to make reference to the subject matter in connection with their report on our financial statements for such years, and (ii) there were no reportable events as defined in Item 304(a)(1)(v) of Regulation S-K

During the year ended December 31, 2002 and through the date of their appointment, we did not consult KPMG LLP with respect to the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on our consolidated financial statements, or any other matters or reportable events listed in Items 304(a)(2)(i) and (ii) of Regulation S-K

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The term disclosure controls and procedures is defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 These rules refer to the controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized and reported within required time periods Our Principal Executive Officer and our Principal Financial Officer have evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report Based on the evaluation they have concluded that, as of the end of such period the controls and procedures were effective at ensuring that required information was disclosed on a timely basis in our report filed under the Exchange Act

Changes in Internal Controls over Financial Reporting

We maintain a system of internal accounting controls that are designed to provide reasonable assurance that our books and records accurately reflect our transactions and that our established policies and procedures are followed As of June 23, 2004, the newly combined company that includes the acquired Allegiance telecommunication assets has been aggressively working to consolidate overlapping processes, controls, and systems With the exception of Carrier Access Billings and the legacy-Allegiance revenue cycle, the vast majority of overlapping processes, systems, and controls have migrated to the legacy-XO control environment The Carrier Access Billings process for the combined entity has migrated to the legacy-Allegiance control environment The legacy-Allegiance revenue and sales commission cycles remain unchanged but are subject to the same general internal controls over financial reporting that we apply to our legacy businesses, although they were excluded from our effectiveness evaluation as discussed below

Management Report on Internal Control over Financial Reporting

Management of XO is responsible for establishing and maintaining adequate internal control over financial reporting as such term is defined in Exchange Act Rules 13a-15(f) In accordance with the

Securities and Exchange Commission Rulemaking Release Nos 33-8238 and 34-47986 issued in August 2003, management has evaluated the effectiveness of XO's internal controls over financial reporting based on the framework in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission or more commonly referred to as the COSO Framework

Based on our evaluation under the COSO framework, management has concluded that, XO's internal control over financial reporting was effective as of December 31, 2004. KPMG LLP, XO's independent registered public accounting firm, has audited the financial statements included in this Annual Report on Form 10-K, and has issued an attestation report on management's assessment of XO's internal control over financial reporting

On June 23, 2004, XO completed the acquisition of all of the telecommunications services assets of Allegiance Telecom, Inc (Allegiance), and management excluded from its assessment of the effectiveness of XO's internal control over financial reporting as of December 31, 2004, Allegiance's internal control over financial reporting associated with total revenues of approximately $217 2 million included in the consolidated financial statements of XO for the year ended December 31, 2004 Our exclusion of Allegiance's internal control over financial reporting is allowed by the Securities and Exchange Commission's response to Question No 2 contained in the Frequently Asked Questions entitled *Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, Frequently Asked Questions (revised October 6, 2004)*

PART III

Item 10. Directors and Executive Officers of the Registrant

Certain information required by Items 401 and 405 of Regulation S-K is incorporated by reference from our definitive proxy statement for the 2005 Annual Meeting of Stockholders to be held on May 9, 2005 to be filed with the SEC pursuant to Regulation 14A within 120 days after the end of our 2004 fiscal year

Audit Committee Financial Expert

Our Board of Directors has determined Robert Knauss is an "audit committee financial expert" as defined under Item 401(h) of Regulation S-K Mr Knauss is an independent director, as defined in Item 7(d)(3)(iv) of Schedule 14A

Code of Ethics

We have adopted a Code of Ethics within the meaning of Item 406(b) of Regulation S-K This Code of Ethics applies to our principal executive officer, our principal financial officer and principal accounting officer, as well as all other employees This Code of Ethics is publicly available on our website at www xo com If we make substantive amendments to this Code of Ethics or grant any waiver, including any implicit waiver, we will disclose the nature of such amendment or waiver on our website or in a report on Form 8-K within five days of such amendment or waiver

Item 11. Executive Compensation

The information required by this Item is incorporated by reference from the information provided under the heading "Executive Compensation" of our Proxy Statement

Item 12. Security Ownership of Certain Beneficial Owners and Management

Information required by this Item with respect to Securities Authorized for Issuance under Equity Compensation Plans is incorporated herein by reference from the information provided in the proposal to approve the amendment of our Directors' Stock Option Plan under the heading "Equity Compensation Plan" of our Proxy Statement

Information required by this Item with respect to Stock Ownership of Certain Beneficial Owners and Management is incorporated herein by reference from the information provided under the heading "Stock Ownership of Certain Beneficial Owners and Management" of our Proxy Statement

Item 13. Certain Relationships and Related Transactions

Various entities controlled by Mr Icahn hold the following interests in XO

	Outstanding Common Stock	Warrants	Credit Facility	Preferred Stock Outstanding
At December 31, 2004	Greater than 50%	Greater than 40%	Greater than 90%	95%

The terms of the common stock, warrants and the Credit Facility, as well as the lease and tax allocation agreements discussed below, were all approved by the bankruptcy court as part of the Chapter 11 proceedings from which XO emerged in January 2003.

In August 2004, after the closing of the Preferred Stock Offering discussed in Part II, Item 7, Mr Icahn filed a schedule 13D amendment with the Securities and Exchange Commission disclosing that his beneficial ownership, as defined therein, was 60 7% of XO

As a result of his significant majority ownership, Mr Icahn has the right to elect all of XO's directors, who in turn have the right to (i) appoint the members of the committees of XO's Board of Directors, (ii) appoint key members of XO's executive management team, and (iii) appoint XO's auditors Currently, Mr Icahn is Chairman of the Board of Directors and three employees of Icahn Associates also sit on the Board of Directors and various committees of the Board of Directors Under applicable law and XO's Certificate of Incorporation and by-laws, certain actions cannot be taken without the approval of holders of a majority of the Company's voting stock, including, without limitation, mergers, acquisitions, the sale of substantially all of the assets, and amendments to XO's Certificate of Incorporation and by-laws

Mr Icahn, through various entities that he owns or controls, has the right to require XO to register, under the Securities Act of 1933, shares of XO's Common Stock held by such entities and to include shares of XO's Common Stock held by them in certain registration statements filed by XO

Dixon Properties, LLC or Dixon, which is controlled by Mr Icahn, owns the building in which XO's headquarters is located XO currently leases approximately 170,000 square feet of space in that building Pursuant to the lease agreement, XO has paid $3 5 million in lease rent to Dixon for the year ended December 31, 2004, and XO is obligated to pay approximately $12 1 million to Dixon through the expiration of the initial term of the lease, which is November 30, 2007

XO entered into a Tax Allocation Agreement, dated January 16, 2003, between XO and Starfire Holding Corporation or Starfire, the parent entity of the affiliated group of corporations controlled by Mr Icahn XO and Starfire filed consolidated returns during the period in which Mr Icahn's ownership of XO was equal to or greater than 80%, as required by the Internal Revenue Code Upon the closing of the Rights Offering in January 2004, Mr Icahn's ownership percentage fell below 80% Consequently, XO is no longer included as part of Starfire's consolidated group after January 2004 Upon deconsolidation, the Tax Allocation Agreement generally provides that Starfire will reimburse XO each year going forward for the excess of XO's actual income tax expense over the income tax that XO would have owed if the net operating losses or other tax attributes used in prior periods by the Starfire consolidated group were still available to XO

The Company provides certain telecommunications services to companies affiliated with Mr Icahn For the year ended December 31, 2004, the total revenue recognized on such services to Icahn Affiliates was approximately $2 0 million During the year ended December 31, 2004, the Company purchased approximately $0 6 million in services from Icahn Affiliates During the year ended December 31, 2004, the Company purchased $1 0 million in hardware and services from Dell, Inc Mr Adam Dell, an XO director, is the brother of Mr. Michael Dell, the Chairman of Dell, Inc

XO provided telecommunications services to Allegiance from February 18, 2004 through the Closing Date Total revenue recognized for those services was approximately $1 7 million In addition, XO provided Allegiance management services under an Operating Agreement between the Early Funding Date of April 13, 2004 and the Closing Date XO believes it is owed a monies under the terms of the Operating Agreement and this is part of the total claim that is discussed in Part 1, Item 3 Based on the contingent nature of this claim, it is not recorded in the accompanying consolidated financial statements

On June 8, 2004 XO entered into a Registration Rights Agreement with the ATLT, holder of approximately 24 9% of XO's outstanding common stock, pursuant to which XO agreed to utilize its best efforts to register for public resale, the 45,380,000 shares of XO common stock issued as part of the acquisition of the Acquired Businesses XO has not filed such registration statement

On November 2, 2004, XO entered into an Indemnification Agreement with each of Mrs Dell, Knauss and Gradin, each of whom is an independent member of XO's Board of Directors, pursuant to which XO has agreed to indemnify each of such directors for any personal liability and costs that he may incur in connection with the performance of services as a director of XO, and advance to each such director any expenses that he may incur in connection with any litigation or actions related to such services

Item 14. Principal Accounting Fees and Services

Information with respect to fees paid to our principal accountant and our audit committee's pre-approval policies and procedures are incorporated herein by reference to the Proxy Statement to be filed pursuant to Regulation 14A

PART IV

Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a) (1) and (2) Financial Statements and Schedule:

(3) List of Exhibits — Refer to Exhibit Index, which is incorporated herein by reference

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities and Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized

XO Communications, Inc

Date: March 18, 2005

By /s/ CARL J GRIVNER

Carl J Grivner
President and Chief Executive Officer
(Principal Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on or before March , 2004 by the following persons on behalf of the Registrant and in the capacities indicated

Name	Title
/s/ CARL J GRIVNER Carl J Grivner	President and Chief Executive Officer, Director (Principal Executive Officer)
/s/ WILLIAM GARRAHAN William Garrahan	Senior Vice President and Acting Chief Financial Officer (Principal Financial Officer)
/s/ CARL C ICAHN Carl C Icahn	Chairman of the Board of Directors
/s/ ANDREW R COHEN Andrew R Cohen	Director
/s/ ADAM DELL Adam Dell	Director
/s/ FREDRIK GRADIN Fredrik Gradin	Director
/s/ VINCENT J INTRIERI Vincent J Intrieri	Director
/s/ ROBERT L KNAUSS Robert L Knauss	Director
/s/ KEITH MEISTER Keith Meister	Director

EXHIBIT INDEX

2 1	Third Amended Plan of Reorganization of XO Communications, Inc , dated July 22, 2002, (Incorporated herein by reference to exhibit 2 1 filed with the Current Report on Form 8-K/ A of XO Communications, Inc , filed on November 26, 2002)
2 2	Plan Supplement, dated October 23, 2003, to the Third Amended Plan of Reorganization of XO Communications, Inc , dated July 22, 2002 (Incorporated herein by reference to exhibit 2 2 filed with the Current Report on Form 8-K/ A of XO Communications, Inc , filed on November 26, 2002)
2 3	Order Confirming Third Amended Plan of Reorganization, dated November 15, 2002 (Incorporated herein by reference to exhibit 99 1 filed with the Current Report on Form 8-K/ A of XO Communications, Inc , filed on November 26, 2002)
2 4	Asset Purchase Agreement, dated as of February 18, 2004, by and among XO Communications, Inc , Allegiance Telecom, Inc , and Allegiance Telecom Company Worldwide (Incorporated herein by reference to exhibit 10 1 filed with the Current Report on Form 8-K of XO Communications, Inc filed on February 24, 2004)
3 1	Amended and Restated Certificate of Incorporation of XO Communications, Inc. (Incorporated herein by reference to exhibit 3 1 filed with the Registration Statement on Form 8-A of XO Communications, Inc , filed on February 7, 2003, pursuant to the Securities Exchange Act)
3 2	Certificate of Designations setting forth the powers, preferences and relative, participating, optional and other special rights of the 6% Class A Convertible Preferred Stock (Incorporated by reference herein to exhibit 3 1 filed with the Quarterly Report on Form 10-Q of XO Communications, Inc filed on August 9, 2004)
3 3	Amended and Restated Bylaws of XO Communications, Inc (Incorporated by reference herein to exhibit 3 1 filed with the Annual Report on Form 10-K of XO Communications, Inc. filed on March 15, 2004).
4 1	Form of Stock Certificate of Common Stock (Incorporated herein by reference to exhibit 4 1 filed with the Annual Report on Form 10-K of XO Communications, Inc for the year ended December 31, 2002, filed on March 21, 2003)
4 2	Series A Warrant Agreement, dated as of January 16, 2003, by and between XO Communications, Inc and American Stock Transfer & Trust Company (Incorporated herein by reference to exhibit 10 1 filed with the Current Report on Form 8-K of XO Communications, Inc , filed on January 30, 2003)
4 3	Series B Warrant Agreement, dated as of January 16, 2003, by and between XO Communications, Inc and American Stock Transfer & Trust Company (Incorporated herein by reference to exhibit 10 2 filed with the Current Report on Form 8-K of XO Communications, Inc , filed on January 30, 2003)
4 4	Series C Warrant Agreement, dated as of January 16, 2003, by and between XO Communications, Inc and American Stock Transfer & Trust Company (Incorporated herein by reference to exhibit 10 3 filed with the Current Report on Form 8-K of XO Communications, Inc , filed on January 30, 2003)
10 1	XO Communications, Inc 2002 Stock Incentive Plan (Incorporated herein by reference to exhibit 10 1 1 to the Annual Report on Form 10-K of XO Communications, Inc for the year ended December 31, 2002, filed on March 21, 2003)
10 2	XO Communications, Inc Retention Bonus and Incentive Plan (Incorporated herein by reference to exhibit 10 1 2 to the Annual Report on Form 10-K of XO Communications, Inc for the year ended December 31, 2002, filed on March 21, 2003)
10 3	Registration Rights Agreement, dated as of January 16, 2003, between XO Communications, Inc. and High River Limited Partnership and Meadow Walk Limited Partnership (Incorporated herein by reference to exhibit 10 4 filed with the Current Report on Form 8-K of XO Communications, Inc , filed on January 30, 2003)

10 4	Registration Rights Agreement, dated as of August 6, 2004, by and among XO Communications, Inc , Tramore LLC, Cardiff Holdings, LLC and Amalgamated Gadget, L P (Incorporated herein by reference to exhibit 10 1 filed with the Quarterly Report on Form 10-Q filed by XO Communications, Inc for the quarterly period ended June 30, 2004, filed on August 9, 2004)
10 5	Registration Rights Agreement, dated as of June 23, 2004, by and among Allegiance Telecom, Inc , Allegiance Telecom Company Worldwide, the Allegiance Telecom Liquidating Trust, and XO Communications, Inc
10 6	Tax Allocation Agreement, dated as of January 16, 2003, between XO Communications, Inc and Starfire Holding Corporation (Incorporated herein by reference to exhibit 10 5 filed with the Current Report on Form 8-K of XO Communications, Inc , filed on January 30, 2003)
10 7	Employment Term Sheet, dated as of April 30, 2003, delivered by XO Communications, Inc to Carl J Grivner, President and Chief Executive Officer of XO Communications, Inc (Incorporated herein by reference to exhibit 10 1 filed with the Quarterly Report on Form 10-Q of XO Communications, Inc for the three months ended March 31, 2003, filed on May 15, 2003)
10 8	Change in Control Agreement by and between XO Communications, Inc and Carl J Grivner, President and Chief Executive Officer of XO Communications, Inc (Incorporated herein by reference to exhibit 10 2 filed with the Quarterly Report on Form 10-Q of XO Communications, Inc. for the three months ended March 31, 2003, filed on May 15, 2003)
10 9	Employment Agreement, effective as of September 25, 2000, by and between Wayne M Rehberger and XO Communications, Inc (Incorporated by reference herein to exhibit 10 10 filed with the Annual Report on Form 10-K of XO Communications, Inc filed on March 15, 2004)
10 10	Indemnification Agreement by and between Robert Knauss and XO Communications, Inc , dated as of November 2, 2004 (Incorporated herein by reference to exhibit 10 2 filed with the Quarterly Report on Form 10-Q filed by XO Communications, Inc for the quarterly period ended September 30, 2004, filed on November 9, 2004)
10 11	Indemnification Agreement by and between Adam Dell and XO Communications, Inc , dated as of November 2, 2004 (Incorporated herein by reference to exhibit 10 1 filed with the Quarterly Report on Form 10-Q filed by XO Communications, Inc for the quarterly period ended September 30, 2004, filed on November 9, 2004)
10 12	Indemnification Agreement by and between Fredrik Gradin and XO Communications, Inc , dated as of November 2, 2004 (Incorporated herein by reference to exhibit 10 3 filed with the Quarterly Report on Form 10-Q filed by XO Communications, Inc for the quarterly period ended September 30, 2004, filed on November 9, 2004)
10 13	Cost Sharing and IRU Agreement, dated July 18, 1998, between Level 3 Communications, LLC and XO Intercity Holdings No 2, LLC (f/k/a INTERNEXT LLC) (Incorporated herein by reference to exhibit 10 8 filed with the quarterly report on Form 10-Q for the quarterly period ended September 30, 1998 of NEXTLINK Communications, Inc and NEXTLINK Capital, Inc , filed on November 16, 1998)
10 14	Master Agreement, dated August 8, 2002, between Level 3 Communications, Inc and XO Communications, Inc (Incorporated herein by reference to exhibit 10 4 2 filed with the Annual Report on Form 10-K of XO Communications, Inc for the year ended December 31, 2002, filed on March 21, 2003)
10 15	Amended and Restated Credit and Guaranty Agreement, dated as of January 16, 2003, among XO Communications, Inc , certain subsidiaries of XO Communications, Inc., the Lenders party thereto from time to time, and Mizuho Corporate Bank, as Administrative Agent (Incorporated herein by reference to exhibit 10 5 filed with the Annual Report on Form 10-K of XO Communications, Inc for the year ended December 31, 2002, filed on March 21, 2003)
10 16	XO Communications, Inc Code of Ethics (Incorporated by reference herein to exhibit 14 1 filed with the Annual Report on Form 10-K of XO Communications, Inc filed on March 15, 2004)
21 1	Subsidiaries of XO Communications, Inc
23 1	Consent of KPMG LLP

23 2	Consent of Ernst & Young LLP
31 1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended
31 2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended
32 1	Certification of Chief Executive Officer pursuant to 18 U S C 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32 2	Certification of Chief Financial Officer pursuant to 18 U S C 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
XO Communications, Inc

We have audited management's assessment, included in the accompanying Management Report on Internal Control over Financial Reporting that XO Communications, Inc and subsidiaries (XO) maintained effective internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) XO's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States) Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances We believe that our audit provides a reasonable basis for our opinion

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate

In our opinion, management's assessment that XO maintained effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on criteria established in Internal Control -Integrated Framework issued by COSO Also, in our opinion, XO maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control -Integrated Framework issued by COSO

On June 23, 2004, XO completed the acquisition of all of the telecommunications services assets of Allegiance Telecom, Inc (Allegiance), and management excluded from its assessment of the effectiveness of XO's internal control over financial reporting as of December 31, 2004, Allegiance's internal control over financial reporting associated with total revenues of approximately $217 2 million included in the consolidated financial statements of XO for the year ended December 31, 2004 Our audit of internal control over financial reporting of XO also excluded an evaluation of Allegiance's internal control over financial reporting

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of XO as of December 31, 2004 and 2003, and the related consolidated statements of operations, stockholders' equity and cash flows for the year ended December 31, 2004 and the period from January 1, 2003 to December 31, 2003, and for the portion of January 1, 2003, related to Predecessor XO's reorganization gain and our report dated March 18, 2005 expressed an unqualified opinion on those consolidated financial statements and the related 2004 and 2003 consolidated financial statement schedule

/s/ KPMG LLP
McLean, Virginia

March 18, 2005

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
XO Communications, Inc

We have audited the accompanying consolidated balance sheets of XO Communications, Inc and subsidiaries (XO) as of December 31, 2004 and 2003, and the related consolidated statements of operations, stockholders' equity, and cash flows for the year ended December 31, 2004 and for the period from January 1, 2003 to December 31, 2003 (XO period) and for the portion of January 1, 2003, related to Predecessor XO's reorganization gain (Predecessor XO period) In connection with our audits of the XO period, we have also audited the 2004 and 2003 consolidated financial statement schedule as listed in the accompanying index These consolidated financial statements and financial statement schedule are the responsibility of the Company's management Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits

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

In our opinion, the XO period consolidated financial statements referred to above present fairly, in all material respects, the financial position of XO Communications, Inc and subsidiaries as of December 31, 2004 and 2003, and the results of their operations and their cash flows for the XO period, in conformity with U S generally accepted accounting principles Further, in our opinion, the Predecessor XO period consolidated financial statements referred to above present fairly, in all material respects, the results of their operations and their cash flows for the portion of January 1, 2003 related to the Predecessor's reorganization gain in conformity with U S generally accepted accounting principles Also in our opinion, the related 2004 and 2003 consolidated financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein

As discussed in Note 20 to the consolidated financial statements, on January 16, 2003, XO Communications, Inc emerged from bankruptcy The consolidated financial statements of XO reflect the impacts of adjustments to reflect the fair value of assets and liabilities under fresh start reporting, which was applied effective January 1, 2003 As a result, the consolidated financial statements of XO are presented on a different basis than those of Predecessor XO and, therefore, are not comparable in all respects

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of XO's internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 18, 2005 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting On June 23, 2004, XO completed the acquisition of all of the telecommunications services assets of Allegiance Telecom, Inc (Allegiance), and management excluded from its assessment of the effectiveness of XO's internal control over financial reporting as of December 31, 2004, Allegiance's internal control over financial reporting associated with total revenues of approximately $217 2 million included in the consolidated financial statements of XO for the year ended December 31, 2004 Our audit of internal control over financial reporting of XO also excluded an evaluation of Allegiance's internal control over financial reporting

/s/ KPMG LLP

March 18, 2005

McLean, VA

REPORT OF ERNST & YOUNG LLP, INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors of XO Communications, Inc

We have audited the accompanying consolidated statements of operations, stockholders' equity (deficit) and cash flows of XO Communications, Inc (the "Company") for the year ended December 31, 2002 Our audit also included the financial statement schedule listed in the Index at item 15(a) These financial statements and schedule are the responsibility of the Company's management Our responsibility is to express an opinion on these financial statements and schedule based on our audit.

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

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

As discussed in Note 2 to the consolidated financial statements, effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards No 142, "Goodwill and Other Intangible Assets"

As discussed in Note 20 to the consolidated financial statements, effective January 16, 2003, the Company was reorganized under a plan of reorganization confirmed by the United States Bankruptcy Court for the Southern District of New York In connection with its reorganization, the Company will apply fresh start accounting in the first quarter of 2003

/s/ ERNST & YOUNG LLP

Baltimore, Maryland
February 28, 2003

XO Communications, Inc.

Consolidated Balance Sheets
(Dollars in thousands, except for share and per share data)

	December 31, 2004	December 31, 2003
ASSETS		
Current assets		
Cash and cash equivalents	$ 233,989	$ 478,560
Marketable securities and other investments	17,300	42,052
Accounts receivable, net of allowance for doubtful accounts of $38,981 and $32,986, at December 31, 2004 and 2003, respectively	150,101	93,958
Other current assets	50,864	12,421
Total current assets	452,254	626,991
Property and equipment, net	820,536	485,984
Broadband wireless licenses and other intangibles, net	139,866	109,515
Other assets	46,729	42,675
Total assets	$ 1,459,385	$ 1,265,165
LIABILITIES, CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 88,010	$ 63,064
Accrued liabilities	241,532	208,353
Total current liabilities	329,542	271,417
Long-term debt and accrued interest payable	366,247	536,791
Other long-term liabilities	73,691	76,532
Total liabilities	769,480	884,740
Class A convertible preferred stock	204,353	—
Commitments and contingencies		
Stockholders' equity		
Preferred stock: par value $0.01 per share, 200,000,000 shares authorized 4,000,000 shares of Class A convertible preferred stock issued and outstanding on December 31 2004	—	—
Warrants and common stock, par value $0 01 per share, 1,000,000,000 shares authorized 181,933,035 and 96,274,140 shares issued and outstanding on December 31 2004 and December 31, 2003, respectively	989,511	482,440
Subscription rights exercised, 32,503,234 shares authorized none issued and outstanding	—	162,516
Subscription rights receivable, 32,503,234 shares authorized none issued and outstanding	—	(162,516)
Deferred compensation	(574)	(839)
Accumulated other comprehensive income	4,712	1,378
Accumulated deficit	(508,097)	(102,554)
Total stockholders' equity	485,552	380,425
Total liabilities, convertible preferred stock and stockholders' equity	$ 1,459,385	$ 1,265,165

See accompanying notes to the consolidated financial statements

XO Communications, Inc.

Consolidated Statements of Operations
(Dollars in thousands, except for share and per share data)

	Year Ended December 31, 2004	Year Ended December 31, 2003	Predecessor XO January 1, 2003	Predecessor XO Year Ended December 31, 2002
Revenue	$ 1,300,420	$ 1,110,483	$ —	$ 1,259,853
Costs and expenses				
Cost of service (excludes depreciation and amortization)	552,735	422,129	—	522,924
Selling, operating and general	727,666	679,286	—	765,853
Depreciation and amortization	177,781	109,308	—	699,806
Goodwill impairment charge	212,530	—	—	—
Restructuring and asset write-downs	—	11,618	—	480,168
Total costs and expenses	1,670,712	1,222,341	—	2,468,751
Loss from operations	(370,292)	(111,858)	—	(1,208,898)
Investment (loss) income, net	(9,037)	46,152	—	16,278
Interest expense, net	(26,214)	(36,848)	—	(226,451)
Reorganization gain (expense), net	—	—	3,032,282	(91,121)
Net (loss) income before cumulative effect of accounting change	(405,543)	(102,554)	3,032,282	(1,510,192)
Cumulative effect of accounting change	—	—	—	(1,876,626)
Net (loss) income	(405,543)	(102,554)	3,032,282	(3,386,818)
Recognition of preferred stock modification fee, net — reorganization item	—	—	—	78,703
Preferred stock dividends and accretion of preferred stock redemption obligation, net	(4,910)	—	—	(42,247)
Net (loss) income applicable to common shares	$ (410,453)	$ (102,554)	$ 3,032,282	$ (3,350,362)
Net (loss) income per common share, basic and diluted				
Net (loss) income before cumulative effect of accounting change	$ (2.54)	$ (1.07)	$ 6.86	$ (3.42)
Cumulative effect of accounting change	—	—	—	(4.24)
Net (loss) income	(2.54)	(1.07)	6.86	(7.66)
Recognition of preferred stock modification fee, net — reorganization item	—	—	—	0.18
Preferred stock dividends and accretion of preferred stock redemption obligation, net	(0.03)	—	—	(0.10)
Net (loss) income per common share, basic and diluted	$ (2.57)	$ (1.07)	$ 6.86	$ (7.58)
Weighted average shares, basic and diluted	159,883,403	95,632,859	441,964,342	441,964,342

See accompanying notes to consolidated financial statements

XO Communications, Inc.

Consolidated Statements of Stockholders' Equity
(Dollars in thousands, except share data)

	Common Stock		Subscription Rights Exercised		Subscription Receivable		Deferred Compensation	Accumulated Deficit	Accumulated Other Comprehensive Income	Total
	Shares	Amount	Shares	Amount	Shares	Amount				
Balance at January 1, 2003	—	$ —	—	$ —	—	$ —	$ —	$ —	$ —	$ —
Issuance of common stock	95,000,001	475,000	32,503,234	162,516	(32,503,234)	(162,516)	—	—	—	475,000
Issuance of common stock through employee benefit plans, net	1,274,139	7,440	—	—	—	—	(839)	—	—	6,601
Comprehensive loss										
Net loss	—	—	—	—	—	—	—	(102,554)	—	(102,554)
Other comprehensive income — unrealized holding gains arising during the year	—	—	—	—	—	—	—	—	1,378	1,378
Total comprehensive loss	—	—	—	—	—	—	—	—	—	(101,176)
Balance at December 31, 2003	96,274,140	482,440	32,503,234	162,516	(32,503,234)	(162,516)	(839)	(102,554)	1,378	380,425
Issuance of common stock for acquisition	45,380,000	311,306	—	—	—	—	—	—	—	311,306
Issuance of common stock under rights offering	39,722,466	197,612	(32,503,234)	(162,516)	32,503,234	162,516	—	—	—	197,612
Issuance of common stock through employee benefit plans, net	556,429	3,063	—	—	—	—	265	—	—	3,328
Preferred stock accretion	—	(4,910)	—	—	—	—	—	—	—	(4,910)
Comprehensive loss										
Net loss	—	—	—	—	—	—	—	(405,543)	—	(405,543)
Other comprehensive income — unrealized holding gains arising during the year, net	—	—	—	—	—	—	—	—	3,334	3,334
Total comprehensive loss	—	—	—	—	—	—	—	—	—	(402,209)
Balance at December 31, 2004	181,933,035	$989,511	—	$ —	—	$ —	$ (574)	$ (508,097)	$ 4,712	$ 485,552

See accompanying notes to consolidated financial statements

XO Communications, Inc.

Consolidated Statements of Stockholders' Equity (Deficit)
(Dollars in thousands, except share data)

	Common Stock						
	Shares				Accumulated Other		
Predecessor Company	Class A	Class B	Amount	Deferred Compensation	Comprehensive Income (Loss)	Accumulated Deficit	Total
Balance at December 31, 2001	337,774,204	104,423,158	$ 4,628,509	$ (37,428)	$ 10,406	$ (4,304,071)	$ 297,416
Compensation attributable to stock options and restricted stock vesting	—	—	—	28,928	—	—	28,928
Issuance of common stock through employee benefit plans	85,854	—	24	—	—	—	24
Conversion of 6½% redeemable cumulative preferred stock into Class A common stock	3,173	—	35	—	—	—	35
Conversion of Preferred Stock	23,570	—	—	—	—	—	—
Refund of Employee Stock Purchase Plan funds withheld after cancellation(a)		—	(429)	—	—	—	(429)
Cancellation of Craig McCaw's Class A common stock	(6,853,582)	—	—	—	—	—	—
Comprehensive loss							
Net loss	—	—	—	—	—	(3,386,818)	(3,386,818)
Recognition of preferred stock modification fee, net — reorganization item	—	—	—	—	—	78,703	78,703
Preferred stock dividends and accretion of preferred stock redemption obligation, net	—	—	—	—	—	(42,247)	(42,247)
Realized net losses and foreign currency translation adjustments transferred to current period earnings	—	—	—	—	(7,894)	—	(7,894)
Total comprehensive loss	—	—	—	—	—	—	(3,358 256)
Balance at December 31, 2002	331,033,219	104,423,158	4,628,139	(8,500)	2,512	(7,654 433)	(3,032,282)
Cancellation of predecessor common sock, deferred compensation, accumulated deficit and accumulated other comprehensive income under Plan of Reorganization	(331,033,219)	(104,423,158)	(4 628,139)	8,500	(2,512)	7,654,433	3,032 282
Balance at January 1, 2003	—	—	$ —	$ —	$ —	$ —	$ —

(a) In the latter half of 2001, the Company's Employee Stock Purchase Plan was cancelled, however employee salary deferrals continued in December 2001, and were subsequently refunded in early 2002

See accompanying notes to consolidated financial statements

XO Communications, Inc.

Consolidated Statements of Cash Flows
(Dollars in thousands)

	Year Ended December 31, 2004	Year Ended December 31, 2003	Predecessor XO January 1, 2003	Predecessor XO Year Ended December 31, 2002
OPERATING ACTIVITIES:				
Net (loss) income	$ (405,543)	$ (102,554)	$ 3,032,282	$ (3,386,818)
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities				
Goodwill impairment charge	212,530	—	—	—
Depreciation and amortization	177,781	109,308	—	699,806
Accrual of interest	27,068	36,791	—	—
Stock-based compensation	406	708	—	28,928
Realized loss (gain) on investments	5,238	(27,224)	—	—
Non-cash restructuring charges and asset write-downs	10,360	6,765	—	477,250
Non-cash reorganization (gain) expense, net	—	—	(3,032,282)	89,448
Cumulative effect of accounting change	—	—	—	1,876,626
Changes in assets and liabilities, net of effects from acquisitions				
Accounts receivable	(8,084)	22,583	—	85,514
Other assets	(9,952)	1,317	—	(21,572)
Accounts payable	8,503	(7,568)	—	—
Accrued liabilities	(18,157)	(33,825)	—	—
Other liabilities subject to compromise	—	—	—	195,904
Other liabilities not subject to compromise	—	—	—	(27,484)
Net cash provided by (used in) operating activities	150	6,301	—	17,602
INVESTING ACTIVITIES:				
Capital expenditures, net	(106,023)	(82,346)	—	(208,713)
Sales of marketable securities and investments	22,848	473,423	—	367,230
Purchases of marketable securities and investments	(36,413)	(238,041)	—	(103,935)
Cash (paid for) received from (acquisitions) divestitures	(325,249)	—	—	3,000
Net cash (used in) provided by investing activities	(444,837)	153,036	—	57,582
FINANCING ACTIVITIES:				
Proceeds from issuance of common stock, net	200,326	6,452	—	—
Proceeds from issuance of preferred stock, net	199,443	—	—	—
Repayments of long term debt and capital leases	(199,653)	(1,267)	—	(6,079)
Net cash provided by (used in) financing activities	200,116	5,185	—	(6,079)
Effect of exchange rate changes on cash	—	—	—	(1,256)
Net (decrease) increase in cash and cash equivalents	(244,571)	164,522	—	67,849
Cash and cash equivalents, beginning of year	478,560	314,038	314,038	246,189
Cash and cash equivalents, end of year	$ 233,989	$ 478,560	$ 314,038	$ 314,038

See accompanying notes to consolidated financial statements

XO Communications, Inc.

Notes to Consolidated Financial Statements
December 31, 2004, 2003 and 2002

1. ORGANIZATION AND DESCRIPTION OF BUSINESS

Overview

XO Communications Inc , a Delaware corporation, through its subsidiaries, owns and operates an integrated metropolitan and nationwide fiber optic network that provides a comprehensive array of telecommunication services to business customers in over 70 United States markets Voice services include local and long distance services, calling card and interactive voice response systems Data services include Internet access, private data networking and hosting services XO, through its subsidiaries, also offers integrated combined voice and data services in flat rate "bundled" packages The consolidated financial statements include the accounts and activities of XO, and its subsidiaries (collectively referred to as the "Company" or "XO") On June 23, 2004, XO completed the acquisition of all of the telecommunications services assets of Allegiance Telecom, Inc The accompanying financial statements include the results of operations from this acquisition from June 23, 2004 through December 31, 2004 See note 2 for additional information

2. BUSINESS COMBINATIONS

On June 23, 2004 (the "Closing Date"), XO completed the acquisition of all of the telecommunications services assets (the "Acquired Businesses") of Allegiance Telecom, Inc ("ATI") under the terms of the Asset Purchase Agreement (the "Purchase Agreement") entered into on February 18, 2004 by and among the Company, ATI and Allegiance Telecom Company Worldwide (together with ATI, "Allegiance"), and approved by the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court") on February 19, 2004 Allegiance and its direct and indirect subsidiaries operated as debtors-in-possession under the Bankruptcy Code from May 14, 2003 to June 23, 2004 Allegiance was a facilities-based national local exchange carrier that provided integrated telecommunications services to business and other institutional customers in 36 major metropolitan areas across the United States Allegiance's service offerings included voice, data, and integrated telecommunications services. XO did not acquire Allegiance's customer premises installation and maintenance business, shared hosting business, or dedicated dial-up Internet access service business (the "Unacquired Businesses")

Under the Purchase Agreement, XO paid approximately $636 6 million for the Acquired Businesses consisting of approximately $325 2 million of cash, including $14 1 million of adjustments for working capital and direct costs, and 45,380,000 shares of XO common stock valued at approximately $311 3 million using XO's common stock market price for a reasonable period before and after the Allegiance acquisition was announced

After the Closing Date, the Unacquired Businesses as well as the ongoing Allegiance bankruptcy claims were transferred from Allegiance to the Allegiance Telecom Liquidating Trust (the "ATLT") XO filed an administrative claim with the Bankruptcy Court in August 2004 against the ATLT, for at least approximately $40 0 million under the Purchase Agreement and other agreements between the parties Subsequently, XO informed the ATLT that the amount in dispute approximates $50 0 million The ATLT has counter claimed in correspondence that it believes it is owed approximately $100 million in respect to operating, working capital and other disputes that have arisen between the parties XO is vigorously pursuing its claim and believes that the ATLT's counter claim is frivolous and completely without merit XO and the ATLT are litigating their case, and are in the early stages of the litigation The accompanying financial statements do not include any financial impact from this litigation as it is too early in the process to assess any outcome

Upon the Closing Date, XO acquired title to the Acquired Businesses XO retained independent appraisers to determine the fair value of the property, plant and equipment and intangible assets acquired