

# 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, 2001  
OR

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

Commission File No. 0-29092

## PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**54-1708481**

(I.R.S. Employer Identification No.)

**1700 Old Meadow Road, Suite 300 McLean, VA**

(Address of principal executive offices)

**22102**

(Zip Code)

**(703) 902-2800**

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
<b>None</b>	<b>N/A</b>

Securities registered pursuant to Section 12(g) of the Act:

**Common Stock, par value \$.01 per share**

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 the registrants' 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.

Non-affiliates of Primus Telecommunications Group, Incorporated held 41,865,146 shares of Common Stock as of March 28, 2002. The fair market value of the stock held by non-affiliates is \$21,351,224 based on the sale price of the shares on March 28, 2002.

As of March 31, 2002, 64,775,097 shares of Common Stock, par value \$.01, were outstanding.

### Documents Incorporated by Reference:

Portions of the definitive Proxy Statement to be delivered to Stockholders in connection with the Annual Meeting of Stockholders are incorporated by reference into Part III.

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## PART I

### ITEM 1. BUSINESS

#### General

We, Primus Telecommunications Group, Incorporated, are a global facilities-based Total Service Provider offering bundled international and domestic Internet, data and voice services to business and residential retail customers and other carriers located in the United States, Canada, Brazil, the United Kingdom, continental Europe, Australia, India and Japan. We were incorporated in February 1994. We serve the demand for high-quality, low cost international communications services which is being driven by the globalization of the world's economies, the worldwide trend toward telecommunications deregulation and the growth of data and Internet traffic.

We primarily target customers with significant international long distance usage, including small- and medium-sized enterprises (SMEs), multinational corporations, ethnic residential customers and other telecommunications carriers and resellers. We also target Internet-based businesses as we deploy our global asynchronous transfer mode (ATM) + Internet protocol (IP) network. As of December 31, 2001, we had approximately 2.4 million customers. We provide our customers with a portfolio of competitively priced services, including:

- international and domestic long distance services and private networks;
- prepaid and calling cards, toll-free services and reorigination services;
- local services in Australia, Canada, Puerto Rico and the United States Virgin Islands;
- ATM+IP broadband services;
- dial-up, dedicated and high-speed Internet access;
- managed and shared Web hosting services and applications;
- Voice over IP (VoIP) services;
- e-commerce applications and services; and
- co-location services.

We generally price our services at a savings compared to the major carriers operating in our principal service regions. We expect to continue to generate net revenue from internal growth through sales and marketing efforts focused on customers with significant international long distance usage, including SMEs, multinational corporations, ethnic residential customers and other telecommunications carriers and resellers.

By constructing and expanding our network, we have reduced costs, improved service reliability and increased flexibility to introduce new products and services. We believe that, as the volume of telecommunications traffic carried on our network increases, we should continue to improve profitability as we more fully utilize our network capacity and realize economies of scale. Currently, over 25 countries are connected directly to our network.

## Strategy

Our objective is to become a leading global provider of international and domestic Internet, data, e-commerce and voice services. Key elements of our strategy include:

- *Provide One-Stop Shopping for Internet, Data and Voice Services:* We offer a portfolio of bundled Internet, data and voice services in selected markets. By bundling our traditional voice services with data and Internet services, we believe that we will attract and retain a strong base of retail business and residential customers.

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- *Expand the Reach and Data Capabilities of Our Global Network:* Through the geographic expansion of our global network, we expect to be able to increase the amount of our on-net traffic and thereby continue to reduce transmission costs and operating costs as a percentage of revenue, improve gross margins, reduce reliance on other carriers, and improve service reliability. In addition, we are leveraging our existing network to provide an ATM, frame relay and IP-based data and voice communications over a global broadband ATM+IP network. We also offer Web hosting services at various locations in our core markets.
  - *Build Base of Retail Customers with Significant International Communications Usage:* We are focused on building a retail customer base with significant demand for international Internet, data and voice services. These customers typically include SMEs, multinational corporations, Internet-based businesses and ethnic residential customers. We target SME customers worldwide by focusing on the need SMEs have for secure Internet and data services. By offering high quality services at competitive prices through experienced sales and service representatives and bundling a comprehensive portfolio of communications services, our goal is to further broaden our retail base.
  - *Grow Through Selected Acquisitions, Joint Ventures and Strategic Investments:* We evaluate potential acquisitions, joint ventures and strategic investments, some of which may be material, with companies in the voice, data and Internet businesses. We view acquisitions, joint ventures and strategic investments as a means to enter additional markets, add new products and market segments, expand our operations within existing markets and generally accelerate the growth of our customer and revenue base.

## Description of Operating Markets

The following is a description of our operations in each of our primary service regions:

*United States.* In the United States, we provide long distance services to SMEs, residential customers, multinational corporations and other telecommunication carriers. We operate international gateway telephone switches in the New York City area and Los Angeles which are connected with countries in Europe, Latin America and the Asia-Pacific region through owned and leased international fiber cable systems. We lease and own United States domestic fiber to interconnect our switches, data centers, and domestic United States points of presence (POPs). We maintain a

direct sales organization in New York, Florida, Massachusetts and Virginia to sell to business customers and have telemarketing centers in Florida, Virginia and Iowa. To reach residential customers, we advertise in national and regional ethnic newspapers and other publications, offering discounted rates for international calls to targeted countries. We also utilize independent agents to reach and enhance sales to both business and residential customers and have established a direct sales force for marketing international services to other long distance carriers. We maintain customer service centers in Florida, Virginia and Iowa, and operate a 24-hour global network management control center in Virginia that monitors our network. In addition to international long distance services, we also provide local service in Puerto Rico and the United States Virgin Islands. We also offer digital subscriber line (DSL) Internet access services to business and residential customers. We also provide managed and shared Web hosting and e-commerce applications and services through our data centers located in McLean, Virginia and Lynn, Massachusetts.

*Canada.* In Canada, we provide long distance services to SMEs, residential customers and other telecommunication carriers and have sales and customer service offices in Vancouver, Toronto and Montreal. We operate international gateway switches in Toronto and Vancouver, maintain POPs in Ottawa, Montreal and Calgary, and operate a nationwide backbone network which is owned by us on a 20-year indefeasible rights of use (IRU) basis. This network provides an integrated backbone for all of our voice, data, Internet and private line services. Each of the 24 nodes on the backbone is equipped

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with Sonet add/drop, ATM, frame and IP equipment to provide a complete spectrum of voice and data communications products to our customers. We operate two Nortel DMS 500 switches in Toronto and Vancouver which provide on-net equal access coverage to an estimated 90% of the population of Canada. We also operate a voice dial access network which consists of some 70 POPs across the country.

We recently completed two data centers co-located with our switch sites in Vancouver and Toronto through which we offer a complete line of shared and managed hosting and co-location services. We have an extensive Internet footprint and provide dial-up and ISDN Internet coverage to over 700 communities across Canada through a network of 51 POPs.

*Europe.* We are a licensed carrier in the United Kingdom, Germany, France, Spain, Italy, Denmark, Netherlands and Switzerland. Our network architecture consists of core backbone voice/data nodes in London, Frankfurt and Paris with feeder nodes in Milan, Madrid, Copenhagen, Amsterdam and Zurich. Additionally, the network is also supported by more than 20 POPs throughout Europe including Munich, Hamburg, Dusseldorf, Berlin and Barcelona. The European network interconnects with the Primus global network. We have constructed a state-of-the-art data center for Web hosting and e-commerce services in London. Also, in London we have a 16 meter standard A earth station and currently lease satellite capacity on the Intelsat-62 satellite. This earth station is able to carry voice, data and Internet traffic to and from countries in the Indian Ocean/Southeast Asia region. We have four 3.8-meter Internet earth stations in New Delhi, Bangalore, Hyderabad and Chennai pursuant to a satellite gateway license.

Our European operation is headquartered in London, with local offices in country. Our product portfolio provides bundled voice and data services to residential customers, small businesses, and other telecommunications carriers. We maintain a European multilingual customer service call center in Glasgow, Scotland. We market our services across Europe using a combination of direct sales, agents, and direct-media advertising, primarily to ethnic customers who make a higher-than-average percentage of international calls. Over time our European network and business has been enhanced through key acquisitions including LCR Telecom, InterNeXt and Telegroup Europe.

We operate an Ericsson AXE-10 switch in Paris and provide service to retail business and residential customers in France. In Germany, we operate an AXE-10 switch in Frankfurt with POPs in Munich, Dusseldorf, Berlin and Hamburg. We hold a Class-4 switched voice telephone license in Germany, an L34.1 switched voice license in France and a voice services license in Switzerland. We have expanded our base of SME customers in Germany through our acquisitions of A-Tel and Citrus. We have acquired two Spanish ISPs, Nexus and Seker, which operate an Internet backbone in Spain. With these acquisitions we now offer voice, data and Internet services to existing and new customers in Spain. Through our acquisition of InterNeXt, we provide value-added ISP services and Web hosting services in France.

*Asia-Pacific.* We are a licensed carrier permitted to own and operate transmission facilities in Australia. We are the fourth largest long distance company in Australia based on revenues, providing domestic and international long distance services, data and Internet access services, as well as local and cellular service on a resale basis, to SMEs and ethnic residential customers. We have built a national domestic long distance network. We operate a five-city switched network using Northern Telecom switches in Sydney, Melbourne, Perth, Adelaide and Brisbane with over 100 POPs covering over 90% of Telstra local exchanges. We maintain both a 24-hour customer service center and a network management control center in Australia.

We have constructed a data center in Melbourne which offers hosting, bandwidth and e-commerce applications and services. We offer a complete range of telecommunications services for corporate customers in Australia, including fully integrated voice and data networks, as well as Internet access. We market our services through a combination of direct sales to SMEs, independent agents, which

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market to retail business and residential customers, and media advertising aimed at ethnic residential customers living in Australia who make a high volume of international calls.

In Japan, we maintain an office in downtown Tokyo and operate an international gateway switch to provide international calling services to retail residential customers, small businesses, and other carriers. We interconnect our Tokyo switch to Los Angeles. We have a Type I carrier license, which permits us to provide selected telecommunications services using our own facilities in Japan. We market our services in Japan through direct sales, agents, and media advertising. Through our Internet subsidiary, Bekko, we provide Internet access, hosting, and other Web services to retail customers in Japan.

## **Services**

We offer a broad array of communications services through our network and through interconnection with the networks of other carriers. Our decision to offer certain services in a market is based on competitive factors and regulatory restraints within the market. Below is a summary of

services we offer:

- *International and Domestic Long Distance.* We provide international long distance voice services terminating in over 240 countries, and provide domestic long distance voice services within selected countries within our principal service regions.
- *Private Network Services.* For business customers, we design and implement international private network services that may be used for voice, data and video applications.
- *Data and Internet Services.* We offer ATM, frame relay, and Internet/IP services globally to Australia, Japan, Canada, Brazil, France, Germany, India, United Kingdom and the United States. In Australia, we offer data transfer services over ATM and frame relay networks in addition to Internet access services. We also offer Web design, Web hosting, co-location and e-commerce services in our primary operating regions, including the United States, Canada, the United Kingdom, France, Germany, Brazil and Australia.
- *Reorigination Services.* In selected countries, we provide call reorigination services which allow non-United States country to country calling to originate from the United States, thereby taking advantage of lower United States accounting rates.
- *Voice over IP Services.* We offer to ISPs, telecommunications carriers worldwide, and enterprise customers VoIP services both over the public Internet as well as direct point-to-point VoIP services over our ATM+IP network.
- *Local Switched Services.* We offer local service on a resale basis in Australia, Canada, Puerto Rico and the United States Virgin Islands.
- *Toll-free Services.* We offer domestic and international toll-free services within selected countries in our principal service regions.
- *Cellular Services.* We resell Telstra digital cellular services in Australia.
- *Prepaid and Calling Cards.* We offer prepaid and calling cards that may be used by customers for domestic and international telephone calls both within and outside of their home country.

## Network

*General.* We have deployed a global intelligent telecommunications network consisting of international and domestic switches, related peripheral equipment, undersea and trans-continental fiber optic cable systems, leased satellite and cable capacity. We believe that our network allows us to control both the quality and cost of the on-net communications services we provide to our customers. To ensure high-quality communications services, our network employs digital switching and fiber optic

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technologies, incorporates the uses of SS7/C7 signaling, and is supported by comprehensive network monitoring and technical support services. Our network consists of:

- a global backbone network connecting international gateway switches in our principal service regions;
- a domestic long distance network presence within certain countries within our principal service regions; and
- a combination of owned and leased transmission facilities, resale arrangements and foreign carrier agreements.

Each of our international gateway switches is connected to our domestic and international networks as well as those of other carriers in a particular market, allowing us to:

- provide seamless service;
- package and market the voice and data services purchased from other carriers under the "Primus" brand name; and
- maintain a substantial portion of each market's United States-bound return traffic through our integrated communications network to maintain quality of service and cost efficiencies, and to increase overall gross margins.

*Switching System and Global Points of Presence.* Our network consists of 21 carrier-grade switches, including 14 international gateway switches, three domestic switches in the United States and four domestic switches in Australia. We also have deployed and operate an additional 20 enhanced switching platforms in support of specialized product sets. We currently operate more than 300 POPs and Internet access nodes within our principal service regions.

Here is further information about the location and type of our switching systems:

Location	Type of Switch
New York City area	International Gateway
Los Angeles	International Gateway
Toronto	International Gateway
Vancouver	International Gateway
London(2)	International Gateway
Paris	International Gateway
Frankfurt	International Gateway
Sydney	International Gateway

Tokyo	International Gateway
Copenhagen	International Gateway
Milan	International Gateway
Madrid	International Gateway
Puerto Rico	International Gateway
New York City area(2)	Domestic
Fort Lauderdale	Domestic
Adelaide	Domestic
Brisbane	Domestic
Melbourne	Domestic
Perth	Domestic

*Fiber Optic Cable Systems.* The Company has purchased and leased undersea and land-based fiber optic cable transmission capacity to connect to our various switching systems. Where traffic is light or

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moderate, we obtain capacity to transmit traffic on a per-minute variable cost basis. When there is a sufficient increase in traffic volume and such commitments are cost effective, we either purchase or lease lines at a rate and term basis for a fixed cost and acquire economic interests in transmission capacity through minimum assignable ownership units (MAOUs) and indefeasible rights of use (IRUs) to international traffic destinations. The following chart sets forth a listing of the undersea fiber optic cable systems in which we have capacity (which includes both MAOUs and IRUs):

Cable System	Countries Served	Status
Gemini	United States—United Kingdom	Existing
CANTAT	United States—Canada	Existing
CANUS	United States—Canada	Existing
FLAG	United Kingdom—Italy	Existing
	United Kingdom—Israel	Existing
UK—France 5	United Kingdom—France	Existing
Arianne	France—Greece	Existing
CIOS	United Kingdom—Israel	Existing
Aphrodite	United Kingdom—Cyprus	Existing
TPC 5	United States—Japan	Existing
APCN	Japan—Indonesia	Existing
Jasaurus	Indonesia—Australia	Existing
Atlantic Crossing-1	United States—United Kingdom	Existing
Columbus II	United States—Mexico	Existing
Americas I	United States—Brazil	Existing
	United States—United States Virgin Islands	Existing
	United States Virgin Islands—Trinidad	Existing
PTAT-1	United States—Bermuda	Existing
CARAC	United States—United States Virgin Islands	Existing
Taino—Carib	United States Virgin Islands—Puerto Rico	Existing
ECMS	United States Virgin Islands—Antigua—St. Martin—St. Kitts—Martinique— Guyana	Existing
CANTAT 3	United States—Denmark	Existing
ODIN	Netherlands—Denmark	Existing
RIOJA	Netherlands—Belgium	Existing
Pacific Crossing I	United States—Japan	Existing
SEMEWE 3	Germany—Cyprus	Existing
Antillas 1	Puerto Rico—Dominican Republic	Existing
Southern Cross	United States—Australia	Existing
Americas II	United States—Brazil—Puerto Rico	Existing
Columbus III	United States—Portugal—Spain—Italy	Existing

In December 1999, we expanded our fiber capacity agreement with Qwest. Pursuant to this expansion, we agreed to purchase approximately \$23.2 million of fiber capacity which provides us with an ATM+IP based international broadband backbone of nearly 11,000 route miles of fiber optic cable in the United States and overseas, and provides us with access to OC-3 and OC-12 capacity between our six existing gateway switches in the United States and up to at least nine future POPs in 12 cities in the United States including New York, Los Angeles, San Francisco, Chicago, Boston and Washington, D.C. Under the agreement, we also could choose to expand to OC-48 capacity as our bandwidth requirements increase. This network expansion has enabled us to carry an increasing percentage of our global data, Internet and voice traffic on our network, particularly from our international ISP customers whose Internet traffic is often routed through the United States. In March 2000, we agreed to purchase an additional \$20.8 million of fiber capacity. As of June 30, 2001, we had fulfilled the total purchase

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obligation. As of December 31, 2001, we had made cash payments of \$27.1 million. At December 31, 2001, we had a liability of \$16.9 million, which reflects a promissory note payable over three and one-half years bearing interest at a rate equal to the Prime Rate plus 3.5% per annum (8.25% at December 31, 2001).

In June 2000, we committed to purchase on an IRU basis a national network from AT&T Canada for \$16.8 million. We have purchased \$16.0 million under the agreement as of December 31, 2001. In December 2000, we entered into a financing arrangement to purchase fiber optic capacity on an IRU basis in Australia for \$26.1 million (51.1 million Australian dollars ("AUD")) from Optus Networks Pty. Limited. As of December 31, 2001, we had fulfilled the total purchase obligation with cash of \$6.6 million (13 million AUD) and a \$19.5 million (38.1 million AUD) promissory note payable over a four-year term bearing interest at a rate of 14.29%.

During the three months ended June 30, 2001, the Company accepted delivery of fiber optic capacity on an IRU basis from Southern Cross Cables Limited ("SCCL"). The Company and SCCL entered into an arrangement financing the capacity purchase. During the three months ended December 31, 2001, the Company renegotiated the payment terms with SCCL. Under the new terms, the payments for each capacity segment will be made over a five-year term bearing an interest rate of 8.44%. At December 31, 2001, the Company had a liability recorded under this agreement in the amount of \$11.6 million. During the three months ended December 31, 2001, the Company entered into an agreement with SCCL to purchase approximately \$12.2 million of additional fiber optic capacity.

*Foreign Carrier Agreements.* In selected countries where competition with the traditional Post Telegraph and Telecommunications companies (PTTs) is limited or is not currently permitted, we have entered into foreign carrier transit agreements with PTTs or other service providers which permit us to provide traffic into and receive return traffic from these countries. We have existing foreign carrier agreements with PTTs and other licensed operators in Cyprus, Greece, India, Iran, Italy, New Zealand, the Philippines, Belgium, Denmark, Israel, Ireland, Singapore, Malaysia, Japan, Australia, France, Switzerland, Argentina, the Bahamas and the Dominican Republic and maintain additional agreements with other foreign carriers in other countries.

*Network Management and Control.* We own and operate network management control centers in McLean, Virginia; Coralville, Iowa; Toronto, Canada; and Sydney, Australia, which are used to monitor and control a majority of the switching systems, global data network, and other digital transmission equipment used in our network. These network management control centers operate seven days per week, 24 hours per day, 365 days per year.

*Network for Data and Internet Services.* We have built an Internet backbone network as an overlay to our existing network architecture that enables our existing global network to carry Internet and data traffic for our business, residential, carrier and ISP customers. This network uses packet switched technology, including IP and ATM. This network allows us to offer to existing and new customers data and voice communications services, including, in selected geographic areas, dial-up and dedicated Internet access, Web hosting, e-commerce, managed virtual private network services, VoIP, and ATM and frame relay data services.

## Customers

As of December 31, 2001, we had approximately 2.4 million business and residential customers comprised of the following:

- *Businesses.* Our business sales and marketing efforts target SMEs with significant international long distance traffic. We also have targeted larger multinational businesses. We now offer a broad array of services (including long distance voice, Internet, data and cellular services) in the

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United States, Australia, Canada, the United Kingdom, Germany, France, Brazil, India, Japan and Italy. We believe that businesses are and will continue to be attracted to us primarily due to price savings compared to traditional carriers and, secondarily, due to our personalized approach to customer service and support, including customized billing and bundled service offerings.

- *Residential Customers.* Our residential sales and marketing strategy targets ethnic residential customers who generate high international long distance traffic volumes. We believe that such customers are attracted to us because of price savings as compared to traditional carriers, simplified pricing structure, and multilingual customer service and support. We are now offering Internet access to our residential customers in select markets and expanding our Internet and data offerings to additional markets and bundling them with traditional voice services.
- *Telecommunications Carriers, Resellers and ISPs.* We compete for the business of other telecommunications carriers and resellers primarily on the basis of price and service quality. Sales to other carriers and resellers help us maximize the utilization of our network and thereby reduce our fixed costs per minute of use.

We strive to provide personalized customer service and believe that the quality of our customer service is one of our competitive advantages.

## Sales and Marketing

We market our services through a variety of sales channels, as summarized below:

- *Direct Sales Force.* As of December 31, 2001, our direct sales force was comprised of 286 full-time employees who focus on business customers with substantial international traffic, including multinational businesses and international governmental organizations. We use our direct sales force to offer bundled voice, Internet and data services to existing and new business customers. Direct sales personnel are compensated with a base salary plus commissions. We currently have sales offices in New York City, McLean, Tampa, Puerto Rico, Montreal, Toronto, Vancouver, London, Frankfurt, Munich, Adelaide, Brisbane, Melbourne, Perth, Sydney and Tokyo. Approximately 115 full-time sales representatives focus on ethnic residential consumers, and 22 direct sales representatives exclusively sell wholesale services to other long distance carriers and resellers.
- *Independent Sales Agents.* We also sell our services through independent sales agents and representatives, who typically focus on residential consumers and SMEs. An agent receives commissions based on revenue generated by customers obtained for us by the agent. We usually grant only nonexclusive sales rights and require our agents and representatives to maintain minimum revenues. We also market our services through representatives of network marketing companies.
- *Telemarketing.* We employ full-time telemarketing sales personnel to supplement sales efforts to ethnic residential consumers and SMEs.

- *Media and Direct Mail.* We use a variety of print, television and radio advertising to increase name recognition and generate new customers. We reach ethnic residential customers by print advertising campaigns in ethnic newspapers, and by advertising on select radio and television programs.

## **Management Information and Billing Systems**

We have various management information, network and customer billing systems in our different operating subsidiaries to support the functions of network and traffic management, customer service and customer billing. For financial reporting, we consolidate information from each of our markets into

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a single database. For our billing requirements in the United States, we use a customer billing system developed by Electronic Data Systems Inc. (EDS) which supplies, operates and maintains this system and is responsible for providing backup facilities and disaster recovery. The EDS system is widely used in the telecommunications industry and has been customized to meet our specific needs. Elsewhere, we use other third party systems or systems developed in-house to handle our billing requirements. We bill all of our business, reseller and residential customers directly in all of our principal service regions.

We believe that our financial reporting and billing systems are generally adequate to meet our needs in the near term. We transitioned our European financial systems to handle the conversion to the Euro currency during 2001. As we continue to grow, we will need to invest additional capital to purchase hardware and software, license more specialized software, increase capacity and link our systems among different countries.

## **Competition**

### **Voice**

The international communications industry is highly competitive and significantly affected by regulatory changes, marketing and pricing decisions of the larger industry participants and the introduction of new services made possible by technological advances. We believe that long distance service providers compete on the basis of price, customer service, product quality and breadth of services offered. In each country of operation, we have numerous competitors. We believe that as the international communications markets continue to deregulate, competition in these markets will increase, similar to the competitive environment that has developed in the United States following the AT&T divestiture in 1984. Prices for long distance voice calls in the markets in which we compete have declined historically and are likely to continue to decrease. In addition, many of our competitors are significantly larger, have substantially greater financial, technical and marketing resources and larger networks.

Privatization and deregulation have had, and are expected to continue to have, significant effects on competition in the industry. For example, as a result of legislation enacted in the United States, regional Bell operating companies will be allowed to enter the long distance market; AT&T, WorldCom and other long distance carriers will be allowed to enter the local telephone services market and cable television companies and utilities will be allowed to enter both the local and long distance telecommunications markets. In addition, competition has begun to increase in the European Union (EU) communications markets in connection with the deregulation of the telecommunications industry in most EU countries, which began in January 1998. This increase in competition could adversely affect net revenue per minute and gross margin as a percentage of net revenue.

The following is a brief summary of the competitive environment in selected countries within each of its principal service regions:

#### *North America.*

*United States.* In the United States, which is the most competitive and among the most deregulated long distance markets in the world, competition primarily is based upon pricing, customer service, network quality and the ability to provide value-added services. AT&T is the largest supplier of long distance services, with WorldCom and Sprint being the next largest providers. As a result of recently enacted federal legislation, we now also compete with regional Bell operating companies, local exchange carriers and ISPs in providing domestic and international long distance services.

*Canada.* The Canadian communications market is highly competitive and is dominated by a few established carriers whose marketing and pricing decisions have a significant impact on the other industry participants, including us. In residential markets we compete primarily with each of the

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incumbent telcos (Bell Canada, Telus and the former Stentor members) in their territory and Call-Net Enterprises (Sprint Canada) and other smaller resellers and re-billers. In the highly competitive business market we compete with Bell Canada and Telus, who are both expanding beyond their traditional territory and competing with each other across the country, and with AT&T Canada, Call-Net Enterprises and other smaller carriers and resellers.

#### *Europe.*

*United Kingdom.* Our principal competitors in the United Kingdom are British Telecom, the dominant supplier of telecommunications services in the United Kingdom, Cable & Wireless Communications, Colt, Energis and Worldcom. Other competitors in the United Kingdom include Opal Telecom and Ventelo Group. We compete in the United Kingdom and continental Europe, and expect to compete in other European countries, by offering competitively-priced bundled and stand-alone services, personalized customer service and value-added services.

*Germany.* Our principal competitor in Germany is Deutsche Telekom, the dominant carrier. We also compete with Vodafone (formally Mannesmann ARCOR/O.tel.o Communications), VIAG Interkom, MobilCom, Talkline, NTS/Colt and WorldCom. Additionally, we also face

competition from other licensed public telephone operators that are constructing their own facilities-based networks, cable companies and switch-based resellers, including the emerging German local exchange carriers known as "City Carriers".

#### *Asia-Pacific.*

*Australia.* Australia is one of the most deregulated and competitive communications markets in the Asia-Pacific region. Our principal competitors in Australia are Telstra, the dominant carrier, Cable & Wireless Optus and a number of other switchless resellers. We compete in Australia by offering a comprehensive menu of competitively-priced products and services, including value-added services, and by providing superior customer service and support. We believe that competition in Australia will increase as more companies are awarded carrier licenses in the future.

*Japan.* Our principal competitor in Japan is KDD, the dominant carrier, as well as Japan Telecom, Cable & Wireless IDC, and a number of second tier carriers, including TNet and WorldCom.

#### **Data/Internet**

The market for data services and Internet services is extremely competitive. We anticipate that competition will continue to intensify. Our current and prospective competitors offering these services include national, international, regional and local Internet service providers such as AOL and EarthLink, Web hosting companies, other long distance and international long distance telecommunications companies, including AT&T, WorldCom and Sprint, local exchange telecommunications companies such as Verizon and SBC, cable television, direct broadcast satellite, wireless communications providers and on-line service providers. Many of these competitors have a significantly greater market presence, experience, expertise and brand recognition than we do. Many of our competitors also have greater financial, technological and marketing resources than those available to us.

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#### **Government Regulation**

As a global communications company, we are subject to varying degrees of regulation in each of the jurisdictions in which we provide services. Local laws and regulations, and the interpretation of such laws and regulations, differ significantly among the jurisdictions in which we operate. There can be no assurance that future regulatory, judicial and legislative changes will not have a material adverse effect on us, that domestic or international regulators or third parties will not raise material issues with regard to our compliance or noncompliance with applicable regulations or that regulatory activities will not have a material adverse effect on us.

Regulation of the telecommunications industry is changing rapidly both domestically and globally. The Federal Communications Commission (FCC) is considering a number of international service issues in the context of several policy rulemaking proceedings in response to specific petitions and applications filed by other international carriers. We are unable to predict how the FCC will resolve the pending international policy issues or how such resolution will effect its international business. In addition, the World Trade Organization Agreement, which reflects efforts to dismantle government-owned telecommunications monopolies throughout Europe and Asia may affect us. Although we believe that these deregulation efforts will create opportunities for new entrants in the telecommunications service industry, there can be no assurance that they will be implemented in a manner that would benefit us.

The regulatory framework in certain jurisdictions in which we provide services is described below:

##### **United States**

In the United States, our services are subject to the provisions of the Communications Act of 1934, FCC regulations thereunder, as well as the applicable laws and regulations of the various states and state regulatory commissions.

As a carrier offering services to the public, we must comply with the requirements of common carriage under the Communications Act, including the offering of service on a nondiscriminatory basis at just and reasonable rates, and obtaining FCC approval prior to any assignment of authorizations or any transfer of de jure or de facto control of the company. We are classified as a non-dominant common carrier for domestic service and are not required to obtain specific prior FCC approval to initiate or expand domestic interstate services.

*International Service Regulation.* International common carriers like us are required to obtain authority under Section 214 of the Communications Act. We have obtained all required authorizations from the FCC to use, on a facilities and resale basis, various transmission media for the provision of international switched services and international private line services. In 2001, the FCC ordered all carriers to physically terminate or withdraw their tariffs for international services on file with the FCC. We have taken this action and have replaced our international FCC tariff with a general service agreement and price list posted on our Web site (also as required by FCC order). Detariffing has given us greater pricing flexibility in our service offerings, but we are no longer entitled to legal protection under the "filed rate doctrine," which provides protection to carriers from customers' legal actions challenging terms and conditions of service.

In addition to the general common carrier principles, we must conduct our international business in compliance with the FCC's International Settlements Policy, the rules that establish the permissible boundaries for United States-based carriers and their foreign correspondents to settle the cost of terminating each others' traffic over their respective networks.

*Domestic Service Regulation.* We are considered a non-dominant domestic interstate carrier subject to minimal regulation by the FCC. We are not required to obtain FCC authority to expand our domestic interstate operations, but we are required to obtain FCC approval to transfer control or

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discontinue service and to file various reports and pay various fees and assessments. Among other things, interstate common carriers must offer service on a nondiscriminatory basis at just and reasonable rates. As a non-dominant carrier, we are subject to the FCC's complaint jurisdiction. In



particular, we may be subject to complaint proceedings in conjunction with alleged noncompliance such as unauthorized changes in a customer's preferred carrier.

As of July 31, 2001, the FCC ordered all common carriers of Domestic Interstate services to cancel their tariffs and provide service in accordance with contracts with customers. We took this action and replaced our FCC tariff for Domestic Interstate services with a general service agreement and price list posted on our Web site (also as required by FCC order). As a result, we will no longer be subject to protection under the "filed rate doctrine," which provides protection to carriers from customers' legal actions challenging terms and conditions of services.

Our costs of providing long distance services will be affected by changes in the switched access charge rates imposed by local exchange carriers (LECs) for origination and termination of calls over local facilities. FCC rules currently cap the rates that both incumbent and competitive LECs may charge for switched access, and restrain incumbent LECs ability to change their charges. The FCC's decision to place caps on competitive LECs charges has been appealed in court. The FCC continues to grant incumbent LECs greater pricing flexibility and relaxed regulation of new switched access services in those markets where there are other providers of access services. As such, the incumbent LECs may offer volume discounts that may benefit larger long distance carriers.

All interstate telecommunications carriers, including us, are required to make contributions to support federal universal service programs. The FCC is currently considering revisions to its universal service funding mechanism and new regulations regarding carriers' pass-through of universal service costs to their customers. We cannot predict the outcome of these proceedings or their potential effect on the company.

*State Regulation.* Our intrastate long distance operations are subject to various state laws and regulations, including, in most jurisdictions, certification and tariff filing requirements. Some states also require the filing of periodic reports, the payment of various fees and surcharges and compliance with service standards and consumer protection rules. States often require pricing approval or notification for certain stock or asset transfers or, in several states, for the issuance of securities, debt or for name changes. We have received the necessary certificate and tariff approvals to provide intrastate long distance service in 49 states. Certificates of authority can generally be conditioned, modified, canceled, terminated, or revoked by state regulatory authorities for failure to comply with state law and/or the rules, regulations, and policies of the state regulatory authorities. Fines and other penalties also may be imposed for such violations. Public service commissions also regulate access charges and other pricing for telecommunications services within each state. The regional Bell operating companies and other local exchange carriers have been seeking reduction of state regulatory requirements, including greater pricing flexibility which, if granted, could subject us to increased price competition. We may also be required to contribute to universal service funds in some states.

*Wireless Service Regulations.* Through TresCom, we hold a variety of wireless licenses issued by the FCC. As a licensee authorized to provide microwave and satellite earth station services, we are subject to Title III of the Communications Act of 1934, as amended by the 1996 Telecommunications Act, and FCC regulations promulgated thereunder. Pursuant to Title III, foreign entities may not directly hold more than 20% of the stock or other ownership interests in an entity, including us, that holds certain types of FCC licenses, such as the wireless licenses held by TresCom and referred to above. In addition, unless granted an FCC waiver, foreign citizens and entities may not indirectly hold 25% or more of the stock or other ownership interest in such entities.

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## Canada

The operations of telecommunications carriers are regulated by the Canadian Radio-television and Telecommunications Commission (CRTC). Full facilities-based and resale competition was introduced in the provision of international services in Canada, effective October 1, 1998, coincident with the elimination of traffic routing limitations on switched hubbing through the United States. In addition, foreign ownership rules for facilities-based carriers were waived in relation to ownership of international submarine cables landed in Canada and satellite earth stations used for telecommunications purposes. Effective January 1, 1999, all international service providers must be licensed by the CRTC under the Telecommunications Act of 1993, and we received our international license as of December 23, 1998. Our international operations remain subject to conditions of our CRTC license, which address matters such as competitive conduct and consumer safeguards.

We, as a reseller of domestic Canadian telecommunications, are largely unregulated by the CRTC. In particular, because we do not own or operate transmission facilities in Canada, we are not directly subject to the Canadian Telecommunications Act or directly regulated by the CRTC, except to the extent that our provision of international telecommunications services is subject to CRTC licensing and other regulations. Therefore, we may provide resold Canadian domestic long distance service without rate, price or tariff regulation, or ownership limitations.

The CRTC recently implemented a revenue-based contribution regime to replace the per minute contribution. This new revenue-based contribution mechanism collects from a wider base of telecommunications service providers and has consequently lowered our contribution expenses considerably in 2001.

*Competition.* Long distance competition has been in place in Canada since 1990 for long distance resellers and since 1992 for facilities-based carriers. Since 1994, the incumbent local exchange carriers have been required to provide "equal access" which eliminated the need for customers of competitive long distance providers to dial additional digits when placing long distance calls. In June 1992, the CRTC issued its ground-breaking Telecom Decision CRTC 92-12 requiring the incumbent local exchange carriers to interconnect their networks with their facilities-based as well as resale competitors. However, these companies have now disbanded the Stentor alliance effective January 1, 1999, and former Stentor companies, Bell Canada and TELUS Communications, the two largest carriers in Canada, have begun to compete against one another. Other nationwide providers are AT&T Canada Corp. and Sprint Canada. Additional long distance services competition is provided by a substantial resale long distance industry in Canada.

*Foreign Ownership Restrictions.* Under Canada's Telecommunications Act and certain regulations promulgated pursuant to such Act, foreign ownership restrictions are applicable to facilities-based carriers (known as "Canadian carriers"), CLECs and microwave license holders but not to companies which do not own or operate facilities or to resellers, which may be wholly foreign-owned and controlled. These restrictions limit the amount of direct foreign investment in Canadian carriers to no more than 20% of the voting equity of a Canadian carrier operating company and no more than 33<sup>1</sup>/<sub>3</sub>% of the voting equity of a Canadian carrier holding company. The restrictions also limit the number of seats which may be occupied by non-Canadians on the board of directors of a Canadian carrier operating company to 20%. In addition, under Canadian law, a majority of Canadians must occupy the seats on the board of directors of a Canadian carrier holding company. Although it is possible for foreign investors to

also hold non-voting equity in a Canadian carrier, the law requires that the Canadian carrier not be "controlled in fact" by non-Canadians. Primus Canada, along with several other telecommunications service providers, has lobbied to the Canadian government to review foreign ownership restrictions with a view to lowering these restrictions.

## Australia

The provision of our services is subject to federal regulation. The two primary instruments of regulation are the Australian Telecommunications Act of 1997 and federal regulation of anti-competitive practices pursuant to the Australian Trade Practices Act of 1974. The current regulatory framework came into effect in July 1997.

We are licensed under the Telecommunications Act of 1997 to own and operate transmission facilities in Australia. Under the regulatory framework, we are not required to maintain a carriage license in order to supply carriage services to the public using network facilities owned by another carrier. Instead, with respect to carriage services, we must comply with legislated "service provider" rules contained in the Telecommunications Act of 1997 covering matters such as compliance with the Telecommunications Act of 1997, operator services, regulation of land access, directory assistance, provision of information to allow maintenance of an integrated public number database and itemized billing.

Two federal regulatory authorities exercise control over a broad range of issues affecting the operation of the Australian telecommunications industry. The Australian Communications Authority (ACA) is the authority regulating matters including the licensing of carriers and technical matters, and the Australian Competition and Consumer Commission (ACCC) has the role of promotion of competition and consumer protection and in particular dealing with carrier to carrier interconnection and network access. We are required to comply with the terms of our own license, are subject to the greater controls applicable to licensed facilities-based carriers and are under the regulatory control of the ACA and the ACCC. In addition, other federal legislation, various regulations pursuant to delegated authority and legislation, ministerial declarations, codes, directions, licenses, statements of Australian government policy and court decisions affecting telecommunications carriers also apply to us. As a carrier we must also be a member of the Telecommunications Industry Ombudsman (TIO) Scheme. The TIO is responsible for handling complaints from consumers about carriers and Internet service providers. The TIO may impose financial penalties upon carriers which do not satisfactorily deal with consumer complaints.

There is no limit to the number of carriers who may be licensed. Any company that meets the relevant financial and technical standards and complies with the license application process can become a licensed carrier permitted to own and operate transmission facilities in Australia. Carriers are licensed individually, are subject to charges that are intended to cover the costs of regulating the telecommunications industry and are obliged to comply with license conditions (including obligations to comply with the Telecommunications Act of 1997, with certain commitments made in their industry development plan and with the telecommunications access regime and related facilities access obligations). Carriers also must meet the universal service obligation, to assist in providing all Australians, particularly in remote areas, with reasonable access to standard telephone services. The levy required to be paid in connection with this obligation has been set previously at a level that is not material.

*Fair Trading Practices.* The ACCC enforces legislation for the promotion of competition and consumer protection, particularly rights of access (including pricing for access) and interconnection. The ACCC can issue a competition notice to a carrier which has engaged in anti-competitive conduct. Where a competition notice has been issued, the ACCC can seek pecuniary penalties, and other carriers can seek damages, if the carrier continues to engage in the specified conduct.

The Telecommunications Act of 1997 package of legislation includes a telecommunications access regime that provides a framework for regulating access rights for specific carriage services and related services through the declaration of services by the ACCC. The regime establishes mechanisms within which the terms and conditions of access can be determined. The Australian government intends the access regime to reduce the power of Telstra and Singtel (as the former protected fixed line carriers)

and other carriers who may come to own or control important infrastructure or services necessary for competition.

The access regime establishes a mechanism for the industry to develop an access code containing model terms and conditions for access to particular declared services. Once approved by the ACCC, those model terms and conditions may be adopted in an undertaking by individual carriers who are under an access obligation. The Productivity Commission recently inquired into and made recommendations to the Federal Government concerning the state of competition in the telecommunications market. As a result the government may choose to retain the current regime, lighten regulation on the incumbent carrier or increase regulation in some areas. The government is likely to decide the issue some time in the second quarter 2002. While the outcome is uncertain, it seems most likely that the government will not make any material changes to the current regime.

Since July 1997, the ACCC has mandated progressively that Telstra provide access to a range of its facilities at specified rates to other service providers including us. We have negotiated access arrangements with Telstra in substitution for certain mandated arrangements. In July 1999, the ACCC mandated access to Telstra's local call network which has provided us with new opportunities as a full service carrier.

*Foreign Ownership Limitations.* Foreign investment in Australia is regulated by the Foreign Acquisitions and Takeovers Act 1975. We notified the Australian government of our proposed acquisition of Axicorp in 1996 and were informed at that time that there were no objections to the investment in terms of Australia's foreign investment policy. There can be no assurance, however, that additional foreign ownership restrictions will not be imposed on the telecommunications industry or other foreign investors, including us, in the future.

## Japan

Our services in Japan are subject to regulation by the Japanese Ministry of Post and Telecommunications under the Japanese Telecommunications Business Law. We have obtained licenses as a Type I business, and as a Special Type II business, and also as a General Type II business through the Telegroup acquisition. Our licenses allow us to provide selected international telecommunications services using our

own facilities, as well as leased facilities, and domestic telecommunications services using leased facilities. There can be no guarantee that the Japanese regulatory environment will allow us to provide service in Japan at competitive rates.

## **European Union**

In Europe, the regulation of the telecommunications industry is governed at a supranational level by the European Parliament, Council and Commission, consisting of members from the following countries: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom. These institutions are responsible for creating pan-European policies and, through legislation, developing a regulatory framework to ensure an open, competitive telecommunications market.

In March 1996, the EU adopted the Full Competition Directive containing two provisions which required EU member states to allow the creation of alternative telecommunications infrastructures by July 1, 1996, and which reaffirmed the obligations of EU member states to abolish the PTTs' monopolies in voice telephony by 1998. Certain EU countries were allowed to delay the abolition of the voice telephony monopoly based on derogations established in the Full Competition Directive. These countries include Luxembourg (July 1, 1998), Spain and Ireland (which were liberalized on December 1, 1998), Portugal (January 1, 2000) and Greece (December 31, 2000).

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Each EU member state in which we currently conduct or plan to conduct our business has a different regulatory regime and such differences have continued beyond January 1998. The requirements for us to obtain necessary approvals vary considerably from country to country and are likely to change as competition is permitted in new service sectors. Most EU member states require companies to obtain a license in order to provide voice telephony services or construct and operate telecommunications networks. However, the EU generally does not permit its member states to require individual licenses for other types of services. In addition, we have obtained and will continue to seek to obtain interconnection agreements with other carriers within the EU. While EU directives require that dominant carriers offer cost-based and non-discriminatory interconnection to competitors, individual EU member states have implemented and may implement this requirement differently. As a result, we may be delayed in obtaining or may not be able to obtain interconnection in certain countries that would allow us to compete effectively. Moreover, there can be no guarantee that long distance providers like us will be able to afford customers "equal access" to their networks, and the absence of such equal access could put such long distance companies at a disadvantage with respect to existing PTTs.

The European Commission proposed a new legislative package to the European Parliament and Council on July 12, 2000. The proposed new regulatory regime seeks to reinforce competition, particularly at a local level, mainly by opening up the competition in the local loop. The Regulation of the European Parliament and Council on unbundled access to the local loop came into force on January 2, 2000 and the rest of the legislative package (comprising of directives on the new framework of the legislation, licensing and authorization, access and interconnection, universal service and data protection) is due to be in place during the course of 2002.

During the course of 2001 a number of alternative carriers operating in Europe either went out of business or contracted their operations particularly in the United Kingdom, France and Germany. While this may provide short term advantage to the remaining operators in these markets, the wider trend appears to be that customers may be reluctant to use alternative carriers and may go back to the local PTT.

## **United Kingdom**

Our services are subject to the provisions of the United Kingdom Telecommunications Act 1984. The Secretary of State for Trade and Industry, acting on the advice of the United Kingdom Department of Trade and Industry, is responsible for granting UK telecommunications licenses, while the Director General of Telecommunications of OfTel is responsible for enforcing the terms of such licenses. OfTel is responsible for promoting effective competition both in networks and in services to redress anti-competitive behavior.

In 1991, the British government established a "multi-operator" policy to replace the duopoly that had existed between British Telecom and Cable & Wireless Communications. Under the multi-operator policy, the Department of Trade and Industry recommends the grant of a license to operate a telecommunications network to any applicant that it believes has a reasonable business plan and where there are no other overriding considerations not to grant such license. All public telecommunications operators operate under individual licenses granted by the Secretary of State for Trade and Industry pursuant to the United Kingdom Telecommunications Act. An operator who is providing certain publicly available network or telecommunications services (bearer services) and running a system with which to interconnect to other operators can apply for listing in the United Kingdom as an Annex II operator under the Telecommunications (Interconnection) Regulations 1997 and as such will be entitled to request interconnection from other Annex II operators. Under the terms of British Telecom's license, it is required to allow any such Annex II licensed operator to interconnect its system to British Telecom's system, unless it is not reasonably practicable to do so (e.g., due to incompatible equipment).

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Our subsidiary, Primus Telecommunications Limited, holds an Annex II Public Telecommunications Operator (PTO) license that authorizes it to provide fixed link telecommunications services of all types in the United Kingdom, all international resale services and international facilities based services including switched voice services over leased private lines to all international points and international and United Kingdom domestic facilities-based voice services. The PTO license enables the holder to acquire ownership interests in or construct the United Kingdom half circuit of any IRU as well as backhaul and to other United Kingdom domestic facilities provision. In addition the PTO license enables us to acquire ownership interests in the United Kingdom half-circuit of satellite space segment in order to provide satellite-based services, it is also necessary to apply for a Wireless Telegraphy Act 1949 license which authorizes the use of the spectrum.

Telegroup UK Ltd. also holds an Annex II PTO license which was originally an international facilities based license granted on December 30, 1997 amended as effective September 27, 1999.

*Tariffs.* Telecommunications tariffs on Annex II operators in the United Kingdom (excluding British Telecom) are generally not subject to prior review or approval by regulatory authorities, although OfTel has historically imposed price caps on British Telecom. British Telecom has advocated and will likely continue to advocate for greater pricing flexibility, including flexibility for pricing non-geographic numbers (e.g. toll free and other

services). Greater pricing flexibility could allow British Telecom to charge us higher prices for certain services or to charge end user customers prices that are lower than we are able to charge.

*Interconnection and Indirect Access.* We must interconnect our United Kingdom network to networks of other service providers in the United Kingdom and allow our end user customers to obtain access to our services in order to compete effectively in the United Kingdom. In the United Kingdom, licensed long distance carriers like us can obtain interconnection to British Telecom at cost-based rates. As of December 2001, Oftel introduced a permanent Carrier Pre-Selection (CPS) obligation into British Telecom's license that allows customers to choose between different operators for different types of calls without dialing extra digits or using an auto dialer box. While restricted CPS became available in mid 2001, adoption by customers has been limited. All calls CPS have become available from the beginning of 2002, but it is anticipated that this will not have significant adoption until mid-2002.

*Fair Trading Practices.* Under the general competition regime in the United Kingdom, the Office of Fair Trading (OFT) is the competent authority for dealing with anti-competitive agreements and abuses of market power across all sectors of the economy. Oftel is the sector specific regulator for telecommunications with a statutory duty to promote competition in the telecommunications market which works closely with OFT on competition issues involving the telecommunications sector. There are no foreign ownership restrictions that apply to telecommunications company licensing in the United Kingdom, although the Department of Trade and Industry does have a discretion as to whether to award licenses on a case by case basis. We also are subject to general European law, which, among other things, prohibits certain anti-competitive agreements and abuses of dominant market positions through Articles 81 and 82 of the Treaty of Rome.

*Anticipated Regulatory Changes.* On December 12, 2000, the UK Government published its Communications White Paper on the reform of the regulatory framework of the telecommunications and broadcasting sectors. The White Paper does not indicate whether the existing legislative framework will be repealed in its entirety and new legislation introduced, or whether the Government will simply amend the current legislation, or a combination of both. The Government has invited comments on the proposed reforms and the date/outcome of the next general election will dictate the formal implementation program. The consultation process is still proceeding, and there is no given date for legislation.

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## Germany

The German Telecommunications Act of 1996 liberalized all telecommunications activities as of January 1, 1998. The German Telecom Act has been complemented by several ordinances. Under the German regulatory scheme, licenses are required for the operation of transmission lines and the provision of voice telephony services. Licenses required for the operation of transmission lines are divided into 3 license classes: mobile telecommunications (license class 1), satellite (license class 2), and other telecommunications services for the general public (license class 3). In addition to the infrastructure licenses, a separate license is required for provision of voice telephony services to the general public on the basis of self-operated telecommunications networks (license class 4). A class 4 license does not include the right to operate transmission lines. All other telecommunications services (e.g. value-added, data, etc.) are only subject to a notification requirement. We operate under a license class 4 which has been extended to a Germany-wide area license under a change of regulatory policy that requires Germany-wide area licenses for the Germany-wide offer of public switched voice telephony. License fees caused by this license extension are high, but are being challenged by a German court and have therefore not yet been imposed. The German Government is required to recalculate the license fees. This is expected to take place during 2002.

Under the German Telecommunications Act, companies that desire to connect with Deutsche Telekom's network must enter into an interconnection agreement with the regulated interconnection tariffs. We entered into an interconnection agreement with Deutsche Telekom on February 27, 1998 at the regulated standard interconnection rates presently under court review. The interconnection agreement may be terminated by commencing a six-month notice period at the end of the calendar year.

Several complaints, the outcome of which may affect our business, currently are pending before the Regulierungsbehörde für Telekommunikation und Post (RegTP) or German courts concerning interconnection with Deutsche Telekom. The RegTP issued a decision in January 2000 on our application. Aspects of the RegTP's decision are being disputed in German courts. It is possible that the final resolution of these disputes and the interconnection agreement with Deutsche Telekom will include terms that are adverse to us, including minimum traffic requirements and restrictions on sharing points of interconnection. We cannot predict the results of the new interconnection regulation, but the results may severely affect our business in Germany.

The RegTP established provisional interconnection tariffs in September 1997 that Deutsche Telekom has since challenged in court. These rates have been part of the standard offer of Deutsche Telekom and were valid for all interconnected and licensed carriers until the end of 1999. On December 23, 1999, RegTP adopted a decision with which new, substantially lower interconnection rates, effective as of January 1, 2000, have been permitted based on a higher rate application by Deutsche Telekom. Deutsche Telekom may have attacked these in court. Deutsche Telekom issued a statement in December 2001 that they planned to establish a new interconnection pricing model, the "Elementary Base of Charge" (EBC). However certain operators have issued proceedings against Deutsche Telekom preventing them from implementing this new pricing model. The German courts are expected to make a decision on the implementation of EBC in the next few months.

Non-discrimination with regard to pricing as between large and smaller carriers such as us will become an important regulatory issue in the market. Discrimination would severely affect our business.

Further, the general price depression in the end-customer market along with the fact that the RegTP has authorized Deutsche Telekom's price cuts in the end-customer market may adversely affect us. Other large operators also have reduced their prices which may adversely affect our business. These price cuts have come under attack before the European Commission and the courts. The outcome of these proceedings is, however, difficult to predict.

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Deutsche Telekom has also established a new "payphone access charge" for all 0800 interconnection calls from all public telephones in

Germany as from December 1, 2001. This may have an impact in relation to our business.

## France

The French Telecommunications Act of 26 July 1996 further developed the new legal framework for the development of a competitive telecommunications market in France.

As a result, the French Regulator (Autorite de Regulation des Telecommunications) was created on January 1, 1997 with the task of overseeing the development of a competitive telecommunications sector which would provide benefits to the user. In addition, the monopoly on the provision of voice telephony services to the public was abolished as of January 1, 1998.

Under the French regulatory regime, an L33.1 license is required for the establishment and running by the operator of a telecommunications network open to the public (an infrastructure license) and the provision of public voice telephony services requires an L34.1 license. An infrastructure license is required by those operators who wish to install or purchase dark fiber for the running of a network. As with the L34.1 voice license, L33.1 infrastructure licenses are granted on a regional or nationwide basis and it is possible to be granted a license just for the region of Paris and its suburbs. Primus Telecommunications S.A. was awarded the first L34.1 only license on May 29, 1998. Call back operators and least cost routing operators not using their own leased lines as defined by the French Regulator, do not need to apply and obtain an L34.1 license.

Effective January 1, 2000, Primus Telecommunications S.A. merged with Telecontinent S.A. and formed Primus Telecommunications France S.A. This merged company has both an L33.1 license and L34.1 license. Following the merger of the two entities, Primus Telecommunications France S.A. handed back to the French Regulator the 1633 carrier selection code held by Telecontinent S.A. The merged company has also the use of two "3PBQ" numbers which are equivalent to four digit free phone access numbers for use in regions where the carrier selection code is not operational due to the lack of point of interconnection.

Companies that desire to interconnect with France Telecom's network must enter into an interconnection agreement which applies certain fixed interconnection tariffs set out in an interconnection catalog. In order to obtain the lowest available interconnection tariffs throughout France, we would need to obtain a nationwide infrastructure license and install dark fiber and points of interconnection in all the different French regions (a minimum of 18 regions) where we are to be originating and terminating traffic.

We have entered into an interconnection agreement with France Telecom at the regulated standard interconnection rates applicable to L34.1 voice license holders set out in the interconnection catalog. In order to interconnect with France Telecom, we are required to install, in addition to our principal switch in the city of Paris, a second POP to be interconnected with France Telecom in the outer zone of the Parisian region as defined for telecommunications purposes. We have located a site for our principal Ericsson AXE-10 switch and have ordered the leased lines from France Telecom to interconnect our switch with the most convenient France Telecom points of interconnection. We are now interconnected with France Telecom for the ZU region covering Paris and its immediate suburbs. This should allow us to benefit from better purchasing costs from France Telecom.

It is possible that the license fees currently paid could be further increased. In addition, the interconnection fees payable to France Telecom include an element relating to the funding of France Telecom's universal service financing obligations, and it is possible that the levels of such contributions will be raised in the foreseeable future.

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We have been granted the 1656 four digit indirect access code; however, there have been seven one digit indirect access numbers granted to other telecommunications providers in France. Those operators with a one digit access number will have a competitive advantage. It is highly unlikely that we will be able to obtain a one digit access number.

## Latin America

Various countries in Latin America have taken initial steps towards deregulating their telecommunications markets. Each Latin American country has a different national regulatory regime and each country is in a different stage of liberalization. Historically, Latin American countries have reserved the provision of voice services to the state-owned PTTs. In the last few years, several Latin American countries have privatized completely or partially their national carriers, including Argentina, Brazil, Chile, Mexico, Peru and Venezuela. In addition, certain countries have opened partially or completely their local and/or long distance markets, most notably Chile, which has competitive operators in all sectors. Argentina has liberalized certain telecommunications services, such as value-added, paging, data transmission and personal communications services. Brazil currently is in the process of opening its telecommunications market to competition. Brazil privatized Telecomunicações Brasileiras S.A. (Telebras), that, through its 28 regional subsidiaries, held a monopoly over the provision of local telephone services, as well as Empresa Brasileira de Telecomunicações S.A., the former monopoly provider of long distance and international telephone services. Moreover, Colombia recently has opened national and international long distance services to competition and has awarded two new concessions for the provision of these services to two major local exchange carriers in Colombia—Empresa Colombiana de Telecomunicaciones S.A. de Bogota and Orbitel, S.A. In Colombia the provision of value-added services and voice services to closed-user groups is open to competition. Mexico initiated competition in the domestic and international long distance services market on January 1, 1996, which are subject to a concession requirement. In addition, the Mexican government has opened recently basic telephony and currently is auctioning radio-electric spectrum frequencies for the provision of personal communications services and Local Multipoint Distribution System Services. Value-added services are also fully open to competition in Mexico. Finally, in the Central American region, Guatemala and El Salvador recently have opened their telecommunications market to competition, abolishing all restrictions on foreign investment in this sector. Other countries in Central America, such as Nicaragua and Honduras, are in the process of privatizing their state-owned carriers, and have not opened fully their markets to competition.

## Employees

The following table summarizes the number of our full-time employees as of December 31, 2001, by region and classification:

North America	Europe	Asia-Pacific	Total
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Sales and Marketing	271	122	221	614
Technical	303	115	162	580
Management and Administrative	311	102	104	517
Customer Service and Support	281	31	204	516
<b>Total</b>	<b>1,166</b>	<b>370</b>	<b>691</b>	<b>2,227</b>

We have never experienced a work stoppage, and none of our employees are represented by a labor union or covered by a collective bargaining agreement. We consider our employee relations to be excellent.

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## ITEM 2. PROPERTIES

We currently lease our corporate headquarters which is located in McLean, Virginia. Additionally, we also lease administrative, technical and sales office space, as well as space for our switches and data centers, in various locations in the countries in which we operate. Total leased space in the United States, Canada, Australia, the United Kingdom, Japan, Mexico, Germany and France, as well as other countries in which we operate, approximates 840,000 square feet and the total annual lease costs are approximately \$17.0 million. The operating leases expire at various times with the longest commitment expiring in 2012.

Certain communications equipment which includes network switches and transmission lines is leased through operating leases, capital leases and vendor financing agreements. We believe that our present administrative and sales office facilities are adequate for our anticipated operations and that similar space can be obtained readily as needed, and we further believe that the current leased facilities are adequate to house existing communications equipment.

## ITEM 3. LEGAL PROCEEDINGS

On December 9, 1999, Empresa Hondurena de Telecomunicaciones, S.A., based in Honduras, filed suit in Florida State Court in Broward County against TresCom and one of TresCom's wholly-owned subsidiaries, St. Thomas and San Juan Telephone Company, alleging that such entities failed to pay amounts due to plaintiff pursuant to contracts for the exchange of telecommunications traffic during the period from December 1996 through September 1998. We acquired TresCom in June 1998 and TresCom is currently our subsidiary. Plaintiff is seeking approximately \$14 million in damages, plus legal fees and costs. We filed an answer on January 25, 2000 and discovery has commenced. Our ultimate legal and financial liability with respect to such legal proceeding cannot be estimated with any certainty at this time, while an adverse result for the full amount sought or some significant percentage thereof could have a material adverse effect on our financial results. We intend to defend the case vigorously. Management believes that this suit will not have a material adverse effect on our financial condition, results of operations or cash flows.

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

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

None.

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## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

#### Common Stock

Primus Telecommunications Group, Incorporated ("Primus" or the "Company") common stock trades on the Nasdaq Stock Market under the symbol "PRTL." On March 28, 2002, the last sale price of the Company's common stock was \$0.51. The following table sets forth, for the period indicated, the high and low sales prices of the Company's common stock.

Period	High	Low
<b>2001</b>		
1 <sup>st</sup> Quarter	\$ 6.94	\$ 2.16
2 <sup>nd</sup> Quarter	\$ 3.19	\$ 0.80
3 <sup>rd</sup> Quarter	\$ 1.48	\$ 0.24
4 <sup>th</sup> Quarter	\$ 0.91	\$ 0.44
<b>2000</b>		
1 <sup>st</sup> Quarter	\$ 51.75	\$ 30.50
2 <sup>nd</sup> Quarter	\$ 49.88	\$ 19.50

3 <sup>rd</sup> Quarter	\$	26.75	\$	9.16
4 <sup>th</sup> Quarter	\$	9.75	\$	1.63

## Dividend Policy

The Company has not paid any cash dividends on its common stock to date. The payment of dividends, if any, in the future is within the discretion of the Board of Directors and will depend on the Company's earnings, its capital requirements and financial condition. Dividends are currently restricted by the senior note indentures, and may be restricted by other credit arrangements entered into in the future by the Company. It is the present intention of the Board of Directors to retain all earnings, if any, for use in the Company's business operations, and accordingly, the Board of Directors does not expect to declare or pay any dividends in the foreseeable future.

## Holdings

As of March 31, 2002, the Company had approximately 584 holders of record of its common stock. The Company believes that it has in excess of 400 beneficial owners.

## Recent Sales of Unregistered Securities

In March 2002, the Company settled its outstanding equipment lease obligations of approximately \$15.0 million with CISCO Systems Capital Corporation for \$6.5 million in cash and 1,200,000 shares of the Company's common stock. \$5.0 million was paid in March 2002. \$1.5 million remains payable as of March 31, 2002 and is due April 2, 2003. The Company issued the shares in reliance upon Section 4(2) of the Securities Act of 1933.

In November 2001, the Company exchanged 10,870,668 shares of the Company's common stock for the extinguishment of \$62.9 million in principal amount of the 2000 Convertible Debentures. The Company issued the shares in reliance upon Section 3(a)(9) of the Securities Act of 1933.

In May 2000, the Company acquired 90.1% of A-Tel GmbH ("A-Tel"), a German reseller of voice traffic to SMEs for \$1.4 million in cash. Subsequently, in December 2000, the Company acquired the remaining 9.9% for \$0.2 million, comprised of \$0.1 million in cash and 19,498 shares of the Company's

common stock, which were subsequently issued in August 2001. The Company issued the shares in reliance upon Section 4(2) of the Securities Act of 1933.

In June 2000, the Company acquired 100% of CTE Networks ("CTE"), a long distance reseller, for \$10.7 million. The Company paid \$8.7 million in cash and 192,106 shares of the Company's common stock; of which 141,837 shares were issued in May 2001. The Company issued the shares in reliance upon Section 4(2) of the Securities Act of 1933.

In February 2000, the Company acquired over 96% of the common stock of LCR Telecom Group, Plc ("LCR Telecom"), a reseller of telecommunication services on other carriers in European markets, and subsequently the Company acquired the remaining shares for a total of 100%, in exchange for 2,278,258 shares of the Company's common stock valued at \$93.4 million, of which 61,626 shares were issued in April 2001. The Company issued the shares in reliance upon Regulation D and Regulation S of the Securities Act of 1933.

In January 2001, the Company received from Inktomi Corporation an investment, which was a part of a strategic alliance created between the two companies in June 2000, of \$10 million in exchange for 2,862,254 restricted shares of the Company's common stock. The Company issued the shares in reliance upon Section 4(2) of the Securities Act of 1933.

In January 2001, the Company exchanged 8,308,258 shares of the Company's common stock for the extinguishment of \$129.6 million in principal amount of the 2000 Convertible Debentures and purchased \$38.2 million of principal amount of its high yield debt and convertible debentures. The Company issued the shares in reliance upon Section 3(a)(9) of the Securities Act of 1933.

## ITEM 6. SELECTED FINANCIAL DATA

The following sets forth selected consolidated financial data of the Company for the years ended December 31, 2001, 2000, 1999, 1998 and 1997 as derived from the historical financial statements of the Company:

### Statement of Operations Data:

	For the Period Ended December 31,				
	2001	2000	1999	1998	1997
	(in thousands, except per share data)				
Net revenue	\$ 1,082,475	\$ 1,199,422	\$ 832,739	\$ 421,628	\$ 280,197
Gross margin	\$ 314,634	\$ 338,241	\$ 208,140	\$ 68,612	\$ 27,466
Selling, general and administrative expenses	\$ 303,026	\$ 330,411	\$ 199,581	\$ 79,532	\$ 50,622
Asset impairment write-down	\$ 526,309	\$ —	\$ —	\$ —	\$ —
Loss from operations	\$ (672,297)	\$ (112,865)	\$ (46,398)	\$ (35,105)	\$ (29,889)
Loss before extraordinary item	\$ (792,947)	\$ (215,616)	\$ (112,736)	\$ (63,648)	\$ (36,239)
Gain on early extinguishment of debt	\$ 486,771	\$ 40,952	\$ —	\$ —	\$ —
Net loss	\$ (306,176)	\$ (174,664)	\$ (112,736)	\$ (63,648)	\$ (36,239)
Basic and diluted net loss per share:					
Loss before extraordinary item	\$ (14.84)	\$ (5.43)	\$ (3.72)	\$ (2.61)	\$ (1.99)

Gain on early extinguishment of debt	9.11	1.03	—	—	—
Net loss	\$ (5.73)	\$ (4.40)	\$ (3.72)	\$ (2.61)	\$ (1.99)

As of December 31, 2001, 2000, 1999, 1998 and 1997, the Company's earnings were insufficient to cover the fixed charges by approximately \$301.3 million, \$174.7 million, \$113.0 million, \$63.6 million and \$36.4 million, respectively.

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#### Balance Sheet Data:

	As of December 31,				
	2001	2000	1999	1998	1997
	(in thousands)				
Total assets	\$ 816,214	\$ 1,748,126	\$ 1,450,746	\$ 673,963	\$ 355,393
Total long-term obligations	\$ 667,587	\$ 1,256,453	\$ 929,944	\$ 420,174	\$ 231,211
Total stockholders' equity (deficit)	\$ (178,484)	\$ 83,695	\$ 190,859	\$ 114,917	\$ 42,526

#### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS OVERVIEW

##### Overview

Primus is a global facilities-based Total Service Provider offering bundled voice, data, Internet, DSL, e-commerce, Web hosting, enhanced application, VoIP, virtual private network (VPN) and other value-added services. Primus's customers are primarily in North America, Europe and selected markets within the Asia-Pacific region. The Company provides services over its network, which consists of:

- 21 carrier-grade switches, including 14 international gateway switches in the United States, Australia, Canada, France, Germany, Japan, Puerto Rico and the United Kingdom, three domestic switches in the United States and four domestic switches in Australia;
- more than 300 POPs and Internet access nodes in additional markets within its principal service regions;
- both owned and leased transmission capacity on undersea and land-based fiber optic cable systems; and
- an international satellite earth station located in London, together with the capacity the Company leases on an Intelsat satellite.

Utilizing this network, along with resale arrangements and foreign carrier agreements, Primus offers service to approximately 2.4 million customers as of December 31, 2001.

Primus was incorporated in February 1994, and through the first half of 1995 the Company was a development stage enterprise involved in various start-up activities. It began generating revenue during March 1995. On March 1, 1996, it acquired Axicorp Pty. Ltd., the fourth largest telecommunications provider in Australia. Primus then entered the Japanese and German markets with its October 1997 acquisition of TelePassport/USFI and expanded its service offerings in Australia with the March 1998 acquisition of a controlling interest in Hotkey Internet Services Pty. Ltd., an Australia-based ISP, and the April 1998 acquisition of Eclipse Telecommunications Pty. Ltd., an Australia-based data communications service provider.

On June 9, 1998, Primus acquired the operations of TresCom. The TresCom merger expanded the scope and coverage of the Company's communications network, thereby providing additional opportunities to migrate traffic onto the network.

In 1999, among other things, Primus:

- acquired London Telecom, a Canadian long distance provider, and certain related companies;
- purchased a residential long distance customer base, customer support assets and residential Internet customers and network from AT&T Canada and ACC Telenterprises;
- purchased Telegroup's global retail customer businesses, which included retail customers primarily in North America and Europe; and

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- organized its Internet and data services business into a new subsidiary, iPRIMUS.com, acquired GlobalServe, a Canadian ISP, Matrix, a Brazilian ISP, TCP/IP and TouchNet, two independent German ISPs, and the remaining interest in Hotkey Internet Services, entered into agreements with Covad Communications and NorthPoint Communications to offer DSL services, acquired Digital Select, a provider of DSL Internet access and Web content, and 1492 Technologies, a Web site development, consulting and service firm and began to build an IP-based network platform in Australia.

In 2000, among other things, Primus:

- acquired LCR Telecom Group, Plc, an international telecommunications company operating principally in European markets, providing least cost routing, international callback and other value-added services primarily to SMEs;



- purchased CTE Networks, a Canadian long distance reseller;
- purchased A-Tel GmbH, a German reseller of voice traffic to SMEs; and
- expanded its Internet and data services business, enhanced by acquisitions such as Eco Software, Inc., a United States-based business-focused ISP, Bekkoame Internet, Inc., a Japanese facilities-based ISP, InterNeXt S.A., a value-added ISP with national facilities in France, Seker BBS S.A. and Nexus Comunicaciones S.A., two Spanish ISPs, and Infinity Online Systems, a Canada-based ISP.

In 2001, the Company focused on debt restructuring, cost containment and EBITDA growth. These efforts resulted in the following:

- Debt was reduced to \$667.6 million at December 31, 2001 from \$1.3 billion in 2000, with an after-tax gain on early extinguishment of debt of \$486.8 million for the year;
- Selling, general and administrative expenses were reduced \$27.4 million from the previous year;
- EBITDA increased to \$11.6 million for 2001, a \$3.8 million increase over the prior year; and
- \$38.7 million in interest expense was saved over the prior year from the principal reduction of senior notes and convertible debentures.

Prices in the long distance industry in the United States and the United Kingdom have declined in recent years, and as competition continues to increase, the Company believes that prices are likely to continue to decrease. Additionally, Primus believes that because deregulatory influences have begun to affect telecommunications markets outside the United States and the United Kingdom, including Australia, the deregulatory trend will result in greater competition which could adversely affect Primus's net revenue per minute and gross margin as a percentage of net revenue. However, the Company believes that such decreases in prices will be offset by increased communications usage and decreased costs. Through the first part of 2001, the Company experienced these declines in per minute net revenue and gross margin but has witnessed price stabilization in the latter part of the year.

As the portion of traffic transmitted over leased or owned facilities increases, cost of revenue increasingly will be comprised of fixed costs. In order to manage such costs, Primus pursues a flexible approach with respect to the expansion of its network. In most instances, Primus initially obtains transmission capacity on a variable-cost, per-minute leased basis, then acquires additional capacity on a fixed-cost basis when traffic volume makes such a commitment cost-effective, and ultimately purchases and operates its own facilities when traffic levels justify such investment. The Company also seeks to lower the cost of revenue through:

- optimizing the routing of calls over the least cost route;

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- increasing volumes on the fixed cost leased and owned lines, thereby spreading the allocation of fixed costs over a larger number of minutes;
  - negotiating lower variable usage based costs with domestic and foreign service providers and negotiating additional and lower cost foreign carrier agreements with the foreign incumbent carriers and others; and
  - continuing to expand the network when traffic volumes justify such investment.

The Company generally realizes a higher gross margin as a percentage of net revenue on its international long distance as compared to its domestic long distance services and a higher gross margin as a percentage of net revenue on its services to both business and residential customers compared to those realized on its services to other telecommunications carriers. In addition, Primus generally realizes a higher gross margin as a percentage of net revenue on long distance services as compared to those realized on local switched and cellular services. Carrier services, which generate a lower gross margin as a percentage of net revenue than retail business and residential services, are an important part of net revenue because the additional traffic volume of such carrier customers improves the utilization of the network and allows the Company to obtain greater volume discounts from its suppliers than it otherwise would realize. Primus's overall gross margin as a percentage of net revenue may fluctuate based on the relative volumes of international versus domestic long distance services, carrier services versus business and residential long distance services and the proportion of traffic carried on Primus's network versus resale of other carriers' services.

Selling, general and administrative expenses are comprised primarily of salaries and benefits, commissions, occupancy costs, sales and marketing expenses, advertising and administrative costs. All selling, general and administrative expenses are expensed when incurred, with the exception of direct-response advertising, which is expensed in accordance with Statement of Position 93-7, "Reporting on Advertising Costs." Through various cost-cutting programs, Primus has realized significant savings in sales and marketing expenses, salaries and benefits, occupancy costs and other administrative expenses.

Foreign currency—A significant portion of the Company's net revenue is derived from sales and operations outside the United States. The reporting currency for the Company's consolidated financial statements is the United States dollar. The local currency of each country is the functional currency for each respective entity. In the future, Primus expects to continue to derive the majority of net revenue and incur a significant portion of its operating costs from outside the United States, and therefore changes in exchange rates have had and may continue to have a significant, and potentially adverse, effect on Primus's results of operations. Primus historically has not engaged in hedging transactions and does not currently contemplate engaging in hedging transactions to mitigate foreign exchange risks.

### **Critical Accounting Policies**

To aid in the understanding of the Company's financial reporting, the Company's most critical accounting policies are described below. These policies have the potential to have a more significant impact on the Company's financial statements, either because of the significance of the

financial statement item to which they relate, or because they require judgment and estimation due to the uncertainty involved in measuring, at a specific point in time, events which are continuous in nature.

Revenue recognition—Net revenue is earned based on the number of minutes during a call and is recorded upon completion of a call, adjusted for allowance for doubtful accounts receivable, service credits and service adjustments. Revenue for a period is calculated from information received through the Company's network switches. Customized software has been designed to track the information from the switch and analyze the call detail records against stored detailed information about revenue rates. This software provides the Company the ability to do a more timely and accurate analysis of revenue earned in a period. Net revenue is also earned for the provision of data/Internet services. The

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Company generally prices its services at a savings compared to the major carriers operating in Primus's principal service regions. Net revenue is derived from carrying a mix of business, residential and carrier long distance traffic, data and Internet traffic, and also from the provision of local and cellular services. Primus expects to continue to generate net revenue from internal growth through sales and marketing efforts focused on customers with significant international long distance usage, including SMEs, multinational corporations, ethnic residential customers and other telecommunications carriers and resellers.

Allowance for doubtful accounts receivable—Determining the Company's allowance for doubtful accounts receivable requires significant estimates. Due to the large number of customers that the Company serves, it is impractical to review the credit-worthiness of each of its customers, although a credit review is performed for larger carrier and retail business customers. The Company considers a number of factors in determining the proper level of the allowance including historical collection experience, current economic trends, the aging of the accounts receivable portfolio and changes in the credit-worthiness of the Company's customers. Systems to detect fraudulent call activity are in place within the network of the Company, but if these systems fail to identify such activity, the Company may realize a higher degree of uncollectible accounts.

Cost of revenue—Cost of revenue is comprised primarily of costs incurred from other domestic and foreign telecommunications carriers to originate, transport and terminate calls. The majority of Primus's cost of revenue is variable, based upon the number of minutes of use, with transmission and termination costs being the most significant expense. Call activity is tracked and analyzed with customized software that analyzes the traffic flowing through the Company's network switches and calculates the variable cost of revenue with predetermined contractual rates. If the domestic or foreign telecommunications carriers have tracked and invoiced the volume of minutes at levels different than what Primus's activity shows or have invoiced at different rates, the Company will dispute the charges invoiced. There is no guarantee that the Company will prevail in the dispute but realizes a greater success with disputes concerning contracted rates. Primus uses significant estimates to determine the level of success in dispute resolution and considers past historical experience, basis of dispute, financial status and current relationship with vendor, and aging of prior disputes.

Valuation of long-lived assets—The Company reviews intangible and other long-lived assets whenever events or changes indicate that the carrying amount of an asset may not be recoverable. In making such evaluations, the Company compares the expected future cash flows to the carrying amount of the assets. If the total of the expected future cash flows is less than the carrying amount of the assets, the Company is required to make estimates of the fair value of the long-lived assets in order to calculate the impairment loss equal to the difference between the fair value and carrying value of the assets. The Company makes significant assumptions and estimates in this process regarding matters that are inherently uncertain, such as estimating cash flows, remaining useful lives, discount rates and growth rates. The resulting cash flows are computed over an extended period of time, which subjects those assumptions and estimates to an even larger degree of uncertainty. While the Company believes that its estimates are reasonable, different assumptions regarding such cash flows could materially affect the valuation of the long-lived assets.

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## Results of Operations

The following information for the years ended December 31, 2001, 2000 and 1999 (in thousands, except percentages) is provided for informational purposes and should be read in conjunction with the Consolidated Financial Statements and Notes.

### For the Year Ended December 31, 2001

	Net Revenue	%	Minutes of Long Distance Use		
			International	Domestic	Total
North America	\$ 453,111	42%	1,855,631	2,261,219	4,116,850
Europe	357,047	33%	2,030,427	1,057,332	3,087,759
Asia-Pacific	272,317	25%	201,263	697,672	898,935
Total	\$ 1,082,475	100%	4,087,321	4,016,223	8,103,544

### For the Year Ended December 31, 2000

	Net Revenue	%	Minutes of Long Distance Use		
			International	Domestic	Total
North America	\$ 533,027	44%	1,795,139	2,116,293	3,911,432
Europe	358,986	30%	1,319,198	976,512	2,295,710

Asia-Pacific	307,409	26%	171,188	640,882	812,070
Total	\$ 1,199,422	100%	3,285,525	3,733,687	7,019,212

For the Year Ended December 31, 1999

	Minutes of Long Distance Use				
	Net Revenue	%	International	Domestic	Total
North America	\$ 406,083	49%	1,219,997	1,314,528	2,534,525
Europe	195,477	23%	600,317	300,578	900,895
Asia-Pacific	231,179	28%	150,981	450,143	601,124
Total	\$ 832,739	100%	1,971,295	2,065,249	4,036,544

The following information reflects net revenue by product line for the years ended December 31, 2001, 2000 and 1999 (in thousands, except percentages) and is provided for informational purposes and should be read in conjunction with the Consolidated Financial Statements and Notes.

	2001	%	2000	%	1999	%
Voice	930,635	86%	1,077,728	90%	802,396	96%
Data/Internet	112,836	10%	99,696	8%	30,343	4%
VoIP	39,004	4%	21,998	2%	—	—
Total	1,082,475	100%	1,199,422	100%	832,739	100%

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#### Results of operations for the year ended December 31, 2001 as compared to the year ended December 31, 2000

Net revenue decreased \$116.9 million or 9.8% from \$1,199.4 million for the year ended December 31, 2000 to \$1,082.5 million for the year ended December 31, 2001. The Company's data/Internet and VoIP revenue contributed \$112.8 million and \$39.0 million, respectively, for the year ended December 31, 2001, as compared to \$99.7 million and \$22.0 million, respectively, for the year ended December 31, 2000.

North America: The Company's North American net revenue decreased \$79.9 million or 15.0% to \$453.1 million for the year ended December 31, 2001 from \$533.0 million for the year ended December 31, 2000. The decrease is primarily attributed to the Company's effort to de-emphasize low margin businesses such as wholesale carrier services as well as reduced rates per minute caused by market pricing pressures. Carrier services revenue in the United States and Canada declined by \$42.8 million, or 24.5% from the same period last year. Additionally, the negative impact of the declining value of the Canadian dollar against the United States dollar contributed to the decrease in net revenue. \$12.5 million of the decrease is also attributed to \$7 million in additional allowance for doubtful accounts receivable recorded from "dot-com" customers with no revenue being recognized in 2001 with 1492 Technologies. 1492 Technologies, was an acquired Web design/consulting business whose operations were discontinued during the three months ended March 31, 2001. The Company's 2000 acquisitions including Shore.Net (since the March 2000 acquisition) and CTE (since the June 2000 acquisition) partially offset the total decrease in revenue by \$7.1 million.

Europe: The Company's European net revenue decreased \$2.0 million or 0.5% to \$357.0 million for the year ended December 31, 2001 from \$359.0 million for the year ended December 31, 2000. The European net revenue decrease is primarily attributed to the negative impact of declining foreign currency exchange rates against the United States dollar and decreased retail voice traffic in other European countries. The decrease is partially offset by the increase attributed to increased carrier services, primarily in France, Germany, Denmark, Spain and Italy.

Asia-Pacific: The Company's Asia-Pacific net revenue decreased by \$35.1 million or 11.4% to \$272.3 million for the year ended December 31, 2001 from \$307.4 million for the year ended December 31, 2000. \$35.1 million of the decrease is associated with the Company's Australian operation, which was primarily driven by the negative impact of the declining value of the Australian dollar against the United States dollar, and to a lesser extent, a decline in revenue from reduced residential voice traffic and reduced provisioning of local access in Australia of \$12.5 million. The decrease is partially offset by the growth in the data and Internet services in Australia. In addition, \$6.2 million of the increase is due to the acquisition of Bekko (since the March 2000 acquisition) and DIPL (since the March 2000 acquisition).

Cost of revenue decreased \$93.3 million, to \$767.8 million, or 70.9% of net revenue, for the year ended December 31, 2001 from \$861.2 million, or 71.8% of net revenue, for the year ended December 31, 2000. With the majority of the cost of revenue being variable, based on minutes of use, the decrease in the cost of revenue is primarily attributable to the decrease in net revenue. Also, contributing to the decrease was the one-time retroactive refund of interconnect charges of \$8.0 million. The net decrease of \$93.3 million was partially offset by a \$11.2 million increase attributable to the additional expense from acquired operations.

Selling, general and administrative expenses decreased \$27.4 million to \$303.0 million, or 28.0% of net revenue, for the year ended December 31, 2001 from \$330.4 million, or 27.5% of net revenue, for the year ended December 31, 2000. The decrease is primarily attributable to \$10.2 million reduction in salaries and benefits, a reduction of \$10.9 million in advertising and marketing, and a reduction of

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\$10.8 million in professional fees and travel expenses. The reduction in salaries and benefits is attributable to the cost savings from the reduction of full-time and part-time employees since December 31, 2000, partially offset by additional expenses of severance pay and employee termination costs. The reduction in advertising, marketing, professional services and travel expenses is a result of management initiatives to reduce overhead spending.

*Depreciation and amortization* increased \$36.9 million to \$157.6 million for the year ended December 31, 2001 from \$120.7 million for the year ended December 31, 2000. The increase is comprised of \$30.0 million in depreciation expense related to capital expenditures for fiber optic cable, switching, data center and other network equipment being placed into service and \$6.9 million in amortization expense related to intangible assets arising from the Company's 2000 acquisitions.

*Asset impairment write-down* for the twelve months ended December 31, 2001 was \$526.3 million. Based on the Company's evaluation, it was determined that the estimated future cash flows were less than the carrying value of its voice and data center long-lived assets. Accordingly, during the fourth quarter of 2001, the Company adjusted the carrying value of its long-lived assets, including property and equipment and intangible assets, to their estimated fair value of \$485.0 million. This adjustment resulted in an asset impairment write-down of \$526.3 million or \$9.85 per share, consisting of the following specific asset write-downs: \$357.3 million in goodwill, \$149.9 million in property and equipment and \$19.1 million in customer lists. The estimated fair value of the Company's assets was based on the present value of estimated future cash flows using a discount rate commensurate with the risks involved. See Note 18—"Asset Impairment."

*Interest expense* decreased \$31.4 million to \$100.7 million for the year ended December 31, 2001 from \$132.1 million for the year ended December 31, 2000. The decrease was driven by \$38.7 million interest saved from principal reduction of the Company's senior notes and convertible debentures. The decrease is partially offset by interest related to indebtedness and obligations incurred in 2001 associated with additional leased fiber capacity, equipment financing, accounts receivable financing arrangements and the issuance of the \$50 million Hewlett-Packard convertible note, paid in two installments in 2000.

*Interest income and other income (expense)* decreased to an expense of \$20.0 million for the year ended December 31, 2001 from income of \$29.4 million for the year ended December 31, 2000. The decrease is primarily associated with the \$15.0 million write-off of the Company's investment in Pilot Network Services because it became permanently impaired in March 2001. Other cost investments of \$5.1 million were also written-off when they became permanently impaired. Interest income decreased by \$23.1 million and is attributed to the lower cash balance during the twelve months ended December 31, 2001.

*Gain on early extinguishment of debt* increased to \$486.8 million for the year ended December 31, 2001 from \$41.0 million for the year ended December 31, 2000. The increase is attributed to \$445.8 million gain resulted from the Company's reduction of \$616.7 million in principal amount of senior notes and debentures through open market purchases and conversion, prior to maturity, for \$155.0 million in cash and 19,178,926 shares of the Company's common stock, slightly offset by the write-off of related deferred financing costs. The increase is also due to \$45.9 million gain resulted from the Company's early extinguishment of its vendor debt and related obligations to Hewlett-Packard of over \$50 million with a cash payment of \$5 million. In conjunction with the 2001 debt repurchases, the Company has recorded a \$5.0 million income tax provision.

#### **Results of operations for the year ended December 31, 2000 as compared to the year ended December 31, 1999**

*Net revenue* increased \$366.7 million or 44.0% to \$1,199.4 million for the year ended December 31, 2000, from \$832.7 million for the year ended December 31, 1999. The Company's data/Internet and

VoIP revenue contributed \$99.7 million and \$22.0 million, respectively, for the year ended December 31, 2000, as compared to \$30.3 million of data/Internet revenue for the year ended December 31, 1999. The increase in net revenue is primarily attributable to the effects of acquisitions (described in detail below) and increase in market penetration.

**North America:** The Company's North American net revenue increased \$126.9 million or 31.3% to \$533.0 million for the year ended December 31, 2000, from \$406.1 million for the year ended December 31, 1999. \$79.8 million of the increase is attributed to the Company's 1999 and 2000 acquisitions including Telegroup (since the June 1999 acquisition), CTE (since the June 2000 acquisition), Shore.Net (since the March 2000 acquisition), Matrix Internet S.A. (since the November 1999 acquisition), 1492 Technologies (since the November 1999 acquisition), TelSN (since the June 1999 acquisition), the LTN and Wintel Companies (since the March 1999 acquisition), and Digital Select (since the November 1999 acquisition). The remainder of the increase, \$47.1 million, is primarily due to increased residential and wholesale traffic.

**Europe:** Of the total net revenue increase, \$163.5 million was associated with the Company's European operations, which represents a growth rate of approximately 83.6%. The European net revenue increased to \$359.0 million for the year ended December 31, 2000, from \$195.5 million for the year ended December 31, 1999, despite the negative impact of declining foreign currency exchange rates against the United States dollar. \$68.5 million of the European net revenue increase is attributed to the Company's 1999 and 2000 acquisitions, including LCR Telecom (since the February 2000 acquisition), Cards & Parts (since the September 1999 acquisition), InterNeXt (since the May 2000 acquisition), Citrus (since the February 2000 acquisition) and A-Tel (since the May 2000 acquisition). \$50.3 million of the increase is attributed to increased carrier services, primarily in Germany, the United Kingdom and France, with the remainder of the increase, approximately \$44.7 million, attributable to increased retail voice traffic in other European countries.

**Asia-Pacific:** The Company's Asia-Pacific net revenue increased by \$76.2 million or 33.0% to \$307.4 million for the year ended December 31, 2000 from \$231.2 million for the year ended December 31, 1999, despite the negative impact of declining foreign currency exchange rates against the United States dollar. \$62.0 million of the Asia-Pacific region net revenue increase is primarily attributable to the provision of local access, and to a lesser extent, growth in the data and Internet services in Australia. \$11.3 million of the increase is due to the acquisition of Bekko (since the March 2000 acquisition) and DIPL (since the March 2000 acquisition). Also, the remainder of the increase is due to efforts made during 2000 to focus on higher margin SMEs and data and Internet customers.

*Cost of revenue* increased \$236.6 million, from \$624.6 million, or 75.0% of net revenue, for the year ended December 31, 1999 to \$861.2 million, or 71.8% of net revenue, for the year ended December 31, 2000. Approximately \$135.8 million of the increase in the cost of revenue is primarily attributable to the increased traffic volumes associated with net revenue growth. \$100.8 million of the increase is attributable to the additional expense from acquired operations. The cost of revenue as a percentage of net revenue decreased by 320 basis points from 75.0% to 71.8% as a result of expansion of the Company's global Network, a greater mix of retail versus carrier traffic, the continuing migration of existing and newly generated customer traffic onto the Company's Network and new higher margin product offerings such as data and Internet services.

*Selling, general and administrative expenses* increased \$130.8 million to \$330.4 million, or 27.5% of net revenue, for the year ended December 31, 2000 from \$199.6 million, or 24.0% of net revenue, for the year ended December 31, 1999. \$75.3 million of the increase represents the increase in salaries and benefits and sales and marketing expenses, unrelated to acquisitions, of which the increase is mainly

attributable to the additional spending to grow the Company's data and Internet business, particularly technical sales and engineering personnel staffing to expand the Company's managed hosting and applications services. \$26.6 million of the increase from prior year also reflects the impact of the Company's SME and Internet acquisitions which include LCR Telecom, CTE, Shore.Net and Bekko. The remainder of the increase is due to increased general and administrative, professional services and other overhead expenses.

*Depreciation and amortization* increased \$65.7 million from \$55.0 million for the year ended December 31, 1999 to \$120.7 million for the year ended December 31, 2000. The increase is comprised of \$37.3 million in depreciation expense related to capital expenditures for fiber optic cable, switching, data center and other network equipment being placed into service and \$28.4 million in amortization expense related to intangible assets arising from the Company's acquisitions.

*Interest expense* increased \$52.5 million to \$132.1 million for the year ended December 31, 2000 from \$79.6 million for the year ended December 31, 1999. \$42.7 million of the increase is attributable to the interest expense associated with the \$300 million 5<sup>3</sup>/<sub>4</sub>% Convertible Subordinated Debentures due 2007 ("2000 Convertible Debentures"), and approximately nine additional months of interest expense associated with the Company's October 1999 \$250 million 12<sup>3</sup>/<sub>4</sub>% Senior Notes Offering due 2009, ("October 1999 Senior Notes"). The remainder of the increase, \$9.8 million, is primarily due to the increased equipment financing commitments from 2000 and 1999.

*Interest and other income* increased from \$13.3 million for the year ended December 31, 1999 to \$29.4 million for the year ended December 31, 2000. The increase is a result of the investment of the net proceeds of the Company's securities offerings.

## **Liquidity and Capital Resources**

### *Changes in Cash Flows*

The Company's liquidity requirements arise from cash used in operating activities, purchases of network equipment including switches, related transmission equipment and international and domestic fiber optic cable transmission capacity, satellite earth stations and satellite transmission capacity, interest and principal payments on outstanding indebtedness, and acquisitions of and strategic investments in businesses. The Company has financed its growth to date through public offerings and private placements of debt and equity securities, bank debt, vendor financing and capital lease financing.

Net cash used in operating activities was \$110.1 million for the year ended December 31, 2001 as compared to net cash used in operating activities of \$131.0 million for the year ended December 31, 2000. The decrease in operating cash used is primarily comprised of improvements in the net loss, which was \$306.2 million for the year ended December 31, 2001, but contained non-cash items including a gain on early extinguishment of debt of \$491.8 million, asset impairment charges of \$526.3 million, and a marketable securities write-off of \$15.0 million. These improvements resulted from initiatives to de-emphasize lower margin business, cost cutting measures implemented throughout the year as well as a one-time retroactive refund of interconnect charges and revenue settlement of \$9.0 million. The Company also experienced an increase of \$9.9 million in accounts receivable, a decrease of \$28.6 million in accounts payable and a decrease of \$17.5 million in accrued interconnection costs and accrued expenses balances resulting from the Company's effort to bring major vendors closer to contract payment terms, and a decrease of \$12.9 million in accrued interest payable due to the principal reduction of the Company's senior notes and convertible debentures during the year ended December 31, 2001.

Net cash used in investing activities was \$89.7 million for the year ended December 31, 2001 compared to net cash used in investing activities of \$240.0 million for the year ended December 31,

2000. Net cash used by investing activities during the year ended December 31, 2001 included \$87.8 million of capital expenditures primarily for the expansion of the Company's global network as compared to \$193.8 million during year ended December 31, 2000. Reduced expenditures are a reflection of the Company's completion in 2001 of many of its network build-out projects. Additionally, during the year ended December 31, 2000, \$57.2 million of cash was used to acquire Shore.Net, Infinity, Citrus, Bekko, DIPL, Global Sales, InterNeXt, A-Tel, CTE, Nexus and Seker and iO2; cash was also used to purchase \$15.0 million of marketable securities of Pilot Network Services during the year ended December 31, 2000.

Net cash used in financing activities was \$107.2 million for the year ended December 31, 2001 as compared to net cash provided by financing activities of \$307.3 million during the year ended December 31, 2000. During the year ended December 31, 2001, cash used by financing activities was \$99.8 million for the purchase of certain of the Company's debt securities, \$33.7 million of payments on capital leases, vendor financing and other long-term obligations, offset by \$12.8 million of financing received through an accounts receivable financing, \$3.0 million from a drawdown on a line of credit, and \$10.0 million in cash received from Inktomi Corporation in exchange for 2,862,254 shares of the Company's common stock. Cash provided by financing activities for the year ended December 31, 2000 resulted primarily from \$290.0 million of net proceeds from the sale of the 2000 Convertible Debentures, as well as \$50.0 million from the Hewlett-Packard investment, partially offset by \$19.2 million used for the purchase of certain of the Company's debt securities, and \$16.3 million of payments on capital leases and other long-term obligations.

As of December 31, 2001, the Company had \$667.6 million of indebtedness, as compared to \$1.3 billion in indebtedness as of December 31, 2000.

Primus is party to a number of secured loans that were arranged under a facility to fund the purchase of telecommunications equipment (the "Equipment Facility"). The lenders under the Equipment Facility, NTFC Capital Corporation and General Electric Capital Corporation, have entered into a letter of intent with Primus to amend the terms of the Equipment Facility to, among other things, defer principal payments otherwise due during the period from January 2002 through April 2003. The lenders have agreed to defer principal payments that were otherwise due in the first quarter of 2002, while the final documentation is being prepared, and it is anticipated that a definitive agreement concerning the other matters covered in the letter of intent will be entered into in April 2002. As of December 31, 2001, Primus had outstanding borrowings of \$57.7 million under the Equipment Facility.

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

The Company believes that its existing cash and cash equivalents, \$84.0 million as of December 31, 2001, accounts receivable financing, and internally generated funds will be sufficient to fund the Company's debt service requirements, capital expenditures, and other cash needs for its operations at least through year-end 2002. Nonetheless, the Company will continue to have significant debt and debt service obligations, given such obligations as of December 31, 2001. As of December 31, 2001, the Company has \$667.6 million of indebtedness with payments of principal and interest due as follows

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(includes effect of senior note purchase made in January 2002, and settlement of equipment lease obligations with Cisco in March 2002—amounts in thousands):

Year Ending December 31,	Equipment Financing	Senior Notes	Other Long-term Obligations	Convertible Subordinated Debentures	Total
2002	44,018	45,102	4,861	4,089	98,070
2003	48,655	45,102	13,847	4,089	111,693
2004	47,691	131,959	478	4,089	184,217
2005	27,002	34,853	421	4,089	66,365
2006	4,265	34,853	389	4,089	43,596
Thereafter	—	390,512	2,632	73,164	466,308
Minimum Principal & Interest Payments	171,631	682,381	22,628	93,609	970,249
Less: Amount Representing Interest	(32,098)	(292,705)	(2,263)	(22,491)	(349,557)
	139,533	389,676	20,365	71,118	620,692

The Company maintains a dialogue with certain holders of its debt securities regarding the consensual restructuring of those obligations and is currently attempting to renegotiate some of its equipment financing arrangements, which includes capital leases and vendor financing obligations with various vendors. The Company is also seeking to raise additional financing. The Company believes that any new investors, in addition to customary terms and conditions, are very likely to have their investment contingent on an overall reduction of debt through consensual restructuring, debt buy back, debt swap, or any combination thereof. There can be no assurance the Company will be successful in these efforts. If the Company is successful in either restructuring its indebtedness or in raising additional financing, it is likely that securities comprising a significant percentage of the Company's fully-diluted capital will be issued in connection with the completion of such transactions. In addition, unless the Company is able to reduce significantly its outstanding debt and/or raise sufficient additional financing, and/or significantly improve its cash flow from operations, the Company may not be able to service its debt or other obligations and could be required to seek relief from such obligations under the bankruptcy laws of the United States or other similar laws in other countries. Additionally, if the Company's plans or assumptions change, including those with respect to the development of the network and the level of the Company's operations and operating cash flow, if its assumptions prove inaccurate, if it consummates additional investments or acquisitions, if it experiences unexpected costs or competitive pressures, or if existing cash and any other borrowings prove to be insufficient, the Company may need to obtain such restructuring, financing and/or relief sooner than expected.

In light of the foregoing, the Company and/or its subsidiaries will evaluate on a continuing basis, depending on market conditions and the outcome of events described under "Special Note Regarding Forward Looking Statements," the most efficient use of the Company's capital, including purchasing, refinancing or otherwise retiring certain of the Company's outstanding debt, debt exchanges, restructuring of obligations, financings, capital expenditure investments in the Company's network, systems and lines of business, and issuances of securities in the open market or by other means to the extent permitted by its existing covenant restrictions.

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

Statements in this Annual Report on Form 10-K constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Such statements are based on current expectations, and are not strictly historical statements. Forward-looking statements include without limitation statements set forth in this document and elsewhere regarding, among other things: the Company's expectations of future liquidity, earnings before interest, taxes, depreciation and amortization (EBITDA), sales, net revenue, gross profit,

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operating profit, net income, cash flow, network development, Internet services development, traffic development, capital expenditures, selling, general and administrative expenses, service introductions and cash requirements; the Company's financing and/or debt repurchase, restructuring

or exchange plans or initiatives; liquidity and debt service forecasts; management's plans, goals, expectations, guidance, objectives, strategy, and timing for future operations, product plans and performance, predictions or expectations of future growth, results or cash flow; and management's assessment of market factors and future financial performance. Factors and risks, including certain of those described in greater detail in the captions below, that could cause actual results or circumstances to differ materially from those set forth or contemplated in forward-looking statements include: changes in business conditions, prevailing trade credit terms or revenues arising from, among other reasons, further telecommunications carrier bankruptcies or adverse bankruptcy related developments affecting our large carrier customers; the failure of certain vendors to make adequate concessions concerning the deferral of principal payments and the reduction of interest rates; the possible inability to raise capital when needed, or at all; the inability to reduce, exchange or restructure debt significantly, or in amounts sufficient to conduct regular ongoing operations; changes in the telecommunications or Internet industry or the general economy or capital markets; DSL, Internet and telecommunication competition; changes in financial, capital market and economic conditions; changes in service offerings or business strategies; inability to lease space for data centers at commercially reasonable rates; difficulty in provisioning VoIP services; changes in the regulatory schemes and regulatory enforcement in the markets in which we operate; restrictions on our ability to follow certain strategies or complete certain transactions as a result of our capital structure or debt covenants; the inability to reduce debt significantly; risks associated with the Company's limited DSL, Internet and Web-hosting experience and expertise; entry into developing markets; the possible inability to hire and/or retain qualified sales, technical and other personnel, particularly as we continue to attempt to grow our data-centric services, and manage growth; and risks associated with international operations (including foreign currency translation risks); dependence on effective information systems; dependence on third parties to enable us to expand and manage our global network and operations; and dependence on the implementation and performance of the Company's global ATM+IP communications network. As such, actual results or circumstances may vary materially from such forward-looking statements or expectations. Readers are also cautioned not to place undue reliance on these forward-looking statements which speak only as of the date these statements were made. Primus is not necessarily obligated to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Factors, which could cause results to differ from expectations, include risks described in greater detail below associated with:

**Liquidity Restrictions; Possible Inability to Obtain Necessary Financing.** The Company believes that its existing cash, accounts receivable financing, and internally generated funds will be sufficient to fund its operating losses, debt service requirements, capital expenditures, acquisitions and other cash needs for its operations at least through the end of 2002. However, there are substantial risks, uncertainties and changes that could cause actual results to differ from our current belief. See for instance information under "—Liquidity and Capital Resources—Short- and Long-Term Liquidity Considerations and Risks" and in this "Special Note Regarding Forward-Looking Statements." If adverse events referenced therein were to occur, we may not be able to service our debt or other obligations and could, among other things, be required to seek protection under the bankruptcy laws of the United States or other similar laws in other countries.

**Substantial Indebtedness; Liquidity.** The Company currently has substantial indebtedness and anticipates that it and its subsidiaries will incur additional indebtedness in the future. The level of the Company's indebtedness (i) could make it more difficult for it to make payments of interest on its outstanding debt; (ii) could limit the ability of the Company to obtain any necessary financing in the future for working capital, capital expenditures, debt service requirements or other purposes; (iii) requires that a substantial portion of the Company's cash flow from operations, if any, be

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dedicated to the payment of principal and interest on its indebtedness and other obligations and, accordingly, will not be available for use in its business; (iv) could limit its flexibility in planning for, or reacting to, changes in its business; (v) results in the Company being more highly leveraged than some of its competitors, which may place it at a competitive disadvantage; and (vi) will make it more vulnerable in the event of a downturn in its business.

**Potential Nasdaq Delisting.** On February 14, 2002, the Company received a notice of delisting from Nasdaq. If the minimum bid price per share of its common stock is not \$1.00 or greater for a period of ten consecutive trading days before May 15, 2002 (or such shorter period as Nasdaq may notify us of), the Company's common stock is likely to be delisted from Nasdaq National Market, subject to its right to appeal any such determination. If this occurs, the common stock could be listed for trading on the Nasdaq SmallCap Market for a period of approximately 90 days, and thereafter the common stock could be further delisted such that trading would only occur on the OTC Bulletin Board. The SmallCap market and the OTC Bulletin Board are substantially less liquid markets than the Nasdaq National Market. As a result, if the Company's common stock is delisted from the Nasdaq National Market, our stockholders may have greater difficulty disposing of their shares in acceptable amounts and at acceptable prices, and the Company may have greater difficulty issuing equity securities or securities convertible into common stock in such circumstances. If delisted, the Company cannot assure you when, if ever, its common stock would once again be eligible for listing on the Nasdaq National Market.

**Limited Operating History; Entry into Internet and data business; Entry into Developing Markets.** The Company was incorporated in February 1994, and began generating revenue in March 1995. The Company only recently has been targeting businesses and residential customers for Internet and data services through the Primus brand, its subsidiary iPRIMUS.com and other acquired ISPs. The Company has been expanding and intends to continue to expand its offering of data and Internet services worldwide. The Company anticipates offering a full-range of Internet protocol-based data and voice communications over the global broadband ATM+IP network which the Company has deployed. The Company has limited experience in the Internet and Web hosting business and cannot provide assurance that it will successfully establish or expand the business. Currently, the Company provides Internet services to business and residential customers in the United States, Australia, Canada, Japan, India, Brazil, Germany, France and Spain, and offers Internet transmission services in the Indian Ocean/Southeast Asia regions through its satellite earth station in London and its earth stations in India. Accordingly, the Company cannot provide assurance that its future operations will generate operating or net income or positive cash flow, and the Company's prospects must be considered in light of the risks, expenses, problems and delays inherent in establishing a new business in a rapidly changing industry.

The market for Internet connectivity and related services is extremely competitive. The Company's primary competitors include incumbent operators and other ISPs that have a significant national or international presence. Many of these carriers have substantially greater resources, capital and operational experience than the Company does. The Company also expects it will experience increased competition from traditional telecommunications carriers that expand into the market for Internet services. In addition, the Company will require substantial additional capital to make investments in its Internet operations, and it may not be able to obtain that capital on favorable terms or at all. The amount of such capital expenditures may exceed the amount of capital expenditures spent on the voice portion of its business going forward.

Further, even if the Company is able to establish and expand its Internet business, the Company will face numerous risks that may adversely affect the operations of its Internet business. These risks include:

- competition in the market for Internet services;
- the Company's limited operating history as an ISP;

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- the Company's reliance on third parties to provide maintenance and support services for the Company's ATM+IP network;
- the Company's reliance on third-party proprietary technology to provide certain services to the Company's customers, including, among others, software applications, Web hosting services and VoIP services;
- the Company's ability to recruit and retain qualified technical, engineering and other personnel;
- the Company's ability to adapt and react to rapid changes in technology related to the Internet business;
- uncertainty relating to the continuation of the adoption of the Internet as a medium of commerce and communications;
- vulnerability to unauthorized access, computer viruses and other disruptive problems due to the accidental or intentional actions of others;
- adverse regulatory developments;
- the potential liability for information disseminated over the Company's network; and
- the Company's need to manage the growth of its Internet business, including the need to enter into agreements with other providers of infrastructure capacity and equipment and to acquire other ISPs and Internet-related businesses on acceptable terms.

**Managing Growth.** The Company's history of rapid growth has placed a significant strain on the Company. In order to manage its growth effectively, the Company must continue to implement and improve its operational and financial systems and controls, purchase and utilize additional transmission facilities, and expand, train and manage its employees, all within a rapidly changing regulatory environment. Inaccuracies in the Company's forecast of traffic could result in insufficient or excessive transmission facilities and disproportionate fixed expenses.

**Historical and Future Operating Losses; Negative EBITDA; Net Losses.** Since inception, the Company had cumulative negative cash flow from operating activities and cumulative negative EBITDA. In addition, the Company incurred net losses since inception and has an accumulated deficit of \$705 million as of December 31, 2001. There can be no assurance that the Company's revenue will grow or be sustained in future periods or that it will be able to achieve or sustain operating profitability, net income or positive cash flow from operations in any future period.

**Integration of Acquired Businesses.** Acquisitions, a key element in the Company's historical growth strategy, involve operational risks, including the possibility that an acquisition does not ultimately provide the benefits originally anticipated by management. Moreover, there can be no assurance that the Company will be successful in identifying attractive acquisition candidates, completing and financing additional acquisitions on favorable terms, or integrating the acquired business or assets into its own. There may be difficulty in integrating the service offerings, distribution channels and networks gained through acquisitions with the Company's own. Successful integration of operations and technologies requires the dedication of management and other personnel which may distract their attention from the day-to-day business, the development or acquisition of new technologies, and the pursuit of other business acquisition opportunities, and there can be no assurance that successful integration will occur in light of such events.

**Intense Competition in Long Distance Telecommunications.** The long distance telecommunications and data industry is intensely competitive and is significantly influenced by the marketing and pricing decisions of the larger industry participants. Competition in all of the Company's markets is likely to stay intense, or even increase in intensity and, as deregulatory influences are experienced in markets outside the United States, competition in non-United States markets is likely to become similar to the

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intense competition in the United States. Many of the Company's competitors are significantly larger and have substantially greater financial, technical and marketing resources and larger networks than the Company, a broader portfolio of service offerings, greater control over transmission lines, stronger name recognition and customer loyalty, as well as long-standing relationships with the Company's target customers. In addition, many of the Company's competitors enjoy economies of scale that result in a lower cost structure for transmission and related costs which could cause significant pricing pressures within the industry. Many companies emerging out of bankruptcy could also end up enjoying a lower cost structure and put pricing pressure within the industry.

**Dependence on Transmission Facilities-Based Carriers.** The Company's ability to maintain and expand its business and effectuate its liquidity objectives is dependent upon whether the Company continues to maintain favorable relationships and credit terms with the transmission facilities-based carriers to carry the Company's traffic.

**International Operations.** The Company has significant international operations. In many international markets, the existing carrier will control access to the local networks, enjoy better brand recognition and brand and customer loyalty, and have significant operational economies, including a larger backbone network and correspondent agreements. Moreover, the existing carrier may take many months to allow competitors, including the Company, to interconnect to its switches within its territory. There can be no assurance that the Company will be able to obtain the permits and operating licenses required for it to operate, obtain access to local transmission facilities or to market services in international markets. In addition,



operating in international markets generally involves additional risks, including: unexpected changes in regulatory requirements, tariffs, customs, duties and other trade barriers; difficulties in staffing and managing foreign operations; problems in collecting accounts receivable; political risks; fluctuations in currency exchange rates; foreign exchange controls which restrict repatriation of funds; technology export and import restrictions; seasonal reductions in business activity. With respect to currency exchange rates risks, adverse exchange rate developments have had a negative impact on recent operating results, and there can be no assurance that currency exchange rate conditions will improve.

**Dependence on Effective Information Systems.** The Company's management information systems must grow as the Company's business expands and are expected to change as new technological developments occur. There can be no assurance that the Company will not encounter delays or cost-overruns or suffer adverse consequences in implementing new systems when required.

**Industry Changes.** The international telecommunications industry is changing rapidly due to deregulation, privatization, technological improvements, expansion of infrastructure and the globalization of the world's economies. In order to compete effectively, the Company must adjust its contemplated plan of development to meet changing market conditions. The telecommunications industry is marked by the introduction of new product and service offerings and technological improvements. The Company's profitability will depend on its ability to anticipate, assess and adapt to rapid technological changes and its ability to offer, on a timely and cost-effective basis, services that meet evolving industry standards.

**Network Development; Migration of Traffic.** The long-term success of the Company is dependent upon its ability to design, implement, operate, manage and maintain the network. The Company could experience delays or cost overruns in the implementation of the network, or its ability to migrate traffic onto its network, which could have a material adverse effect on the Company.

**Dependence on Key Personnel.** The loss of the services of K. Paul Singh, the Company's Chairman and Chief Executive Officer, or the services of its other key personnel, or the inability of the Company to attract and retain additional key management, technical and sales personnel, could have a material adverse effect upon the Company.

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**Government Regulation.** The Company's operations are subject to constantly changing regulation. There can be no assurance that future regulatory changes will not have a material adverse effect on the Company, or that regulators or third parties will not raise material issues with regard to the Company's compliance or non-compliance with applicable regulations, any of which could have a material adverse effect upon the company.

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

## **ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company's primary market risk exposures relate to changes in foreign currency exchange rates and to changes in interest rates.

*Foreign currency*—A significant portion of net revenue is derived from sales and operations outside the United States. The reporting currency for the Company's consolidated financial statements is the United States dollar. The local currency of each country is the functional currency for each respective entity. In the future, the Company expects to continue to derive a significant portion of its net revenue and incur a significant portion of its operating costs outside the United States, and changes in exchange rates have had and may continue to have a significant, and potentially adverse effect on the Company's results of operations. The Company's primary risk of loss regarding foreign currency exchange rate risk is caused primarily by fluctuations in the following exchange rates: United States dollar/Australian dollar, United States dollar/Canadian dollar, United States dollar/United Kingdom pound, and United States dollar/Euro dollar. Due to the large percentage of the Company's revenues derived outside of the United States, continuing strengthening of the United States Dollar would continue to have an adverse impact on the Company's results of operations. The operations of affiliates and subsidiaries in foreign countries have been funded with investments and other advances. Due to the long-term nature of such investments and advances, the Company accounts for any adjustments resulting from translation as a charge or credit to "accumulated other comprehensive loss" within the stockholders' equity (deficit) section of the consolidated balance sheets. The Company historically has not engaged in hedging transactions to mitigate foreign exchange risk.

*Interest rates*—A substantial majority of our long-term debt obligations are at fixed interest rates. We are exposed to interest rate risk as additional financing may be required and certain of our long-term obligations are at variable interest rates. Our primary exposure to market risk stems from fluctuations in interest rates. Our interest rate risk related to the variable interest rate long-term obligations results from changes in the United States LIBOR, British Pound LIBOR, United States prime, and Canada prime rates. We do not currently anticipate entering into interest rate swaps and/or similar instruments. The estimated fair value of the Company's 2000 Convertible Debentures, 1999, 1998 and 1997 Senior Notes (carrying value of \$493 million), based on quoted market prices, at December 31, 2001 was \$80 million.

The interest rate sensitivity table below summarizes our market risks associated with fluctuations in interest rates as of December 31, 2001 in U.S. dollars, which is the Company's reporting currency. The table presents principal cash flows and related weighted average interest rates by year of expected maturity for our senior notes, convertible subordinated debentures, leased fiber capacity, equipment financing, and other long-term obligations in

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effect at December 31, 2001. In the case of the senior notes, and convertible debentures the table excludes the potential exercise of the relevant redemption and conversion features.

Year of Maturity

	2002	2003	2004	2005	2006	Thereafter	Total
(in thousands, except percentages)							
Fixed Rate	\$ 18,925	\$ 24,503	\$ 170,385	\$ 19,919	\$ 3,291	\$ 355,764	\$ 592,787
Average Interest Rate	11%	11%	7%	8%	6%	8%	8%
Variable Rate	\$ 21,192	\$ 9,341	\$ 9,789	\$ 4,579	\$ 1,145	—	\$ 46,046
Average Interest Rate	7%	9%	9%	9%	2%	—	7%

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

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Independent Auditors' Report	F-2
Consolidated Financial Statements	
Consolidated Statements of Operations for the years ended December 31, 2001, 2000 and 1999	F-3
Consolidated Balance Sheets as of December 31, 2001 and 2000	F-4
Consolidated Statements of Stockholders' Equity (Deficit) for the years ended December 31, 2001, 2000 and 1999	F-5
Consolidated Statements of Cash Flows for the years ended December 31, 2001, 2000 and 1999	F-6
Consolidated Statements of Comprehensive Loss for the years ended December 31, 2001, 2000 and 1999	F-7
Notes to the Consolidated Financial Statements	F-8

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**PART III**

The information required by Part III will be provided in the Company's definitive proxy statement for the Company's 2002 annual meeting of stockholders (involving the election of directors), which definitive proxy statement will be filed pursuant to Regulation 14A not later than April 30, 2002 ("2002 Proxy Statement"), and is incorporated herein by this reference.

**ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT**

Information relating to directors of the Company is set forth under the caption entitled "Election of Directors" in the Company's 2002 Proxy Statement and is incorporated herein by reference. Information relating to the executive officers of the Company is set forth in the Company's 2002 Proxy Statement under the caption "Executive Officers, Directors and Key Employees" and is incorporated herein by reference.

**ITEM 11. EXECUTIVE COMPENSATION**

The information regarding compensation of officers and directors of the Company is set forth under the caption entitled "Executive Compensation" in the Company's 2002 Proxy Statement and is incorporated herein by reference.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

Information regarding ownership of certain of the Company's securities is set forth under the captions entitled "Security Ownership of Certain Beneficial Owners" and "Security Ownership of Management" in the Company's 2002 Proxy Statement and is incorporated herein by reference.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

Information regarding certain relationships and related transactions with the Company is set forth under the caption entitled "Certain Relationships and Related Transactions" in the Company's 2002 Proxy Statement and is incorporated herein by reference.

**PART IV**

**ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULE AND REPORTS ON FORM 8-K**

a) Financial Statements and Schedules

The financial statements as set forth under Item 8 of this report on Form 10-K are incorporated herein.

Financial Statement Schedules:	Page
(II) Valuation and Qualifying Accounts	S-1

All other financial statement schedules have been omitted since they are either not required, not applicable, or the information is otherwise

included.

b) Reports on 8-K

None.

c) Exhibit listing

Exhibit Number	Description
3.1	Amended and Restated Certificate of Incorporation of Primus; Incorporated by reference to Exhibit 3.1 of the Registration Statement on Form S-8, No. 333-56557 (the "S-8 Registration Statement").
3.2	Amended and Restated Bylaws of Primus; Incorporated by reference to Exhibit 3.2 of the Registration Statement on Form S-1, No. 333-10875 (the "IPO Registration Statement").
4.1	Specimen Certificate of Primus Common Stock; Incorporated by reference to Exhibit 4.1 of the IPO Registration Statement.
4.2	Form of Indenture; Incorporated by reference to Exhibit 4.1 of the Registration Statement on Form S-1, No. 333-30195 (the "1997 Senior Note Registration Statement").
4.3	Form of Indenture of Primus, as amended and restated on January 20, 1999, between Primus and First Union National Bank; Incorporated by reference to Exhibit 4.3 of the Company's Annual Report on Form 10-K for the year ended December 31, 1998 (the "1998 10-K").
4.4	Form of Warrant Agreement of Primus; Incorporated by reference to Exhibit 4.2 of the 1997 Senior Note Registration Statement.
4.5	Indenture, dated May 19, 1998, between Primus and First Union National Bank; Incorporated by reference to Exhibit 4.4 of the Registration Statement on Form S-4, No. 333-58547 (the "1998 Senior Note Registration Statement").

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4.6	Specimen 9 <sup>7</sup> / <sub>8</sub> % Senior Note due 2008; Incorporated by reference to Exhibit A included in Exhibit 4.4 of the 1998 Senior Note Registration Statement.
4.7	Indenture, dated January 29, 1999, between Primus and First Union National Bank; Incorporated by reference to Exhibit 4.3 of the 1998 Form 10-K.
4.8	Specimen 11 <sup>1</sup> / <sub>4</sub> % Senior Note due 2009; Incorporated by reference to Exhibit A of Exhibit 4.3 of the Company's 1998 10-K.
4.9	Rights Agreement, dated as of December 23, 1998, between Primus and StockTrans, Inc., including the Form of Rights Certificate (Exhibit A), the Certificate of Designation (Exhibit B) and the Form of Summary of Rights (Exhibit C); Incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form 8-A, No. 0-29092 filed with the Commission on December 30, 1998.
4.10	Form of legend on certificates representing shares of Common Stock regarding Series B Junior Participating Preferred Stock Purchase Rights; Incorporated by reference to Exhibit 4.2 to the Company's Registration Statement on Form 8-A, No. 0-29092 filed with the Commission on December 30, 1998.
4.11	Supplemental Indenture between Primus and First Union National Bank dated January 20, 1999; Incorporated by reference to Exhibit 4.3 to Amendment No. 1 to the Company's Registration Statement on Form S-4, No. 333-76965, filed with the Commission on May 6, 1999.
4.12	Intentionally left blank.
4.13	Specimen 11 <sup>3</sup> / <sub>4</sub> % Senior Note Due 2004; Incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-4, No. 333-90179, filed with the Commission on November 2, 1999 (the "November S-4").
4.14	Indenture, dated October 15, 1999, between the Company and First Union National Bank; Incorporated by reference to the November S-4.
4.15	Specimen 12 <sup>3</sup> / <sub>4</sub> % Senior Note due 2009; Incorporated by reference to Exhibit A to Exhibit 4.14 to the November S-4.
4.16	Indenture, dated February 24, 2000, between the Company and First Union National Bank; incorporated by reference to Exhibit 4.16 to the Company's Annual Report on Form 10-K for the year ended December 31, 2000 (the "2000 10-K").
4.17	Specimen 5 <sup>3</sup> / <sub>4</sub> % convertible subordinated debenture due 2007; Incorporated by reference to Exhibit A to Exhibit 4.16 to the 2000 10-K.
10.1	Amendment No. 1 to Stockholder Agreement among Warburg, Pincus, K. Paul Singh, Primus, and TresCom, dated as of April 16, 1998; Incorporated by reference to Exhibit 10.1 of the Form 8-K for Amendments.
10.2	Switched Transit Agreement, dated June 5, 1995, between Teleglobe USA, Inc. and Primus for the provision of services to India; Incorporated by reference to Exhibit 10.2 of the IPO Registration Statement.
10.3	Hardpatch Transit Agreement, dated February 29, 1996, between Teleglobe USA, Inc. and Primus for the provision of services to Iran; Incorporated by reference to Exhibit 10.3 of the IPO Registration Statement.
10.4	Employment Agreement, dated June 1, 1994, between Primus and K. Paul Singh; Incorporated by reference to Exhibit 10.5 of the IPO Registration Statement.**
10.5	Primus 1995 Stock Option Plan, as amended.*

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- 10.6 Primus 1995 Director Stock Option Plan; Incorporated by reference to Exhibit 10.7 of the IPO Registration Statement. \*\*
  - 10.7 Registration Rights Agreement, dated July 31, 1996, among Primus, Quantum Industrial Partners LDC, S-C Phoenix Holdings, L.L.C., Winston Partners II LDC and Winston Partners LLC; Incorporated by reference to Exhibit 10.11 of the IPO Registration Statement.
  - 10.8 Service Provider Agreement between Telstra Corporation Limited and Axicorp Pty., Ltd., dated May 3, 1995; Incorporated by reference to Exhibit 10.12 of the IPO Registration Statement.
  - 10.9 Dealer Agreement between Telstra Corporation Limited and Axicorp Pty., Ltd. dated January 8, 1996; Incorporated by reference to Exhibit 10.13 of the IPO Registration Statement.
  - 10.10 Hardpatch Transit Agreement dated October 5, 1995 between Teleglobe USA, Inc. and Primus regarding the provision of services to India; Incorporated by reference to Exhibit 10.14 of the IPO Registration Statement.
  - 10.11 Master Lease Agreement dated as of November 21, 1997 between NTFC Capital Corporation and Primus Telecommunications, Inc.; Incorporated by reference to Exhibit 10.17 of Primus's Annual Report on Form 10-K for the year ended December 31, 1997, as amended on Form 10-K/A dated April 30, 1998 (the "1997 10-K").
  - 10.12 Primus Employee Stock Purchase Plan; Incorporated by reference to Exhibit 10.15 of the 1997 Senior Note Registration Statement. \*\*
  - 10.13 Primus 401(k) Plan; Incorporated by reference to Exhibit 4.4 of the Primus Registration Statement on Form S-8 (No. 333-35005).
  - 10.14 Registration Rights Agreement, dated May 19, 1998, among Primus Telecommunications Group, Incorporated, Primus Telecommunications, Incorporated, Primus Telecommunications Pty. Ltd. and Lehman Brothers, Inc.; Incorporated by reference to Exhibit 10.23 of the 1998 Senior Note Registration Statement.
  - 10.15 Primus Telecommunications Group, Incorporated-TresCom International Stock Option Plan; Incorporated by reference to Exhibit 4.1 of the S-8 Registration Statement. \*\*
  - 10.16 Warrant Agreement between the Company and Warburg, Pincus Investors, L.P.; Incorporated by reference to Exhibit 10.6 to the TresCom Form S-1.
  - 10.17 Form of Indemnification Agreement between the Company and its directors and executive officers; Incorporated by reference to Exhibit 10.23 to the TresCom Form S-1.
  - 10.18 The Company's 1998 Restricted Stock Plan; Incorporated by reference to Exhibit 10.33 to Amendment No. 1 to the Company's Registration Statement on Form S-3, No. 333-86839, filed with the Commission on September 17, 1999.
  - 10.19 Agreement for the Reciprocal Purchase of Capacity On the Systems of Each of the Company and Global Crossing Holdings Ltd. Effective as of May 24, 1999; Incorporated by reference to Exhibit 10.19 of the Company's Annual Report of Form 10-K for the year ended December 31, 1999.
  - 10.20 Indefeasible Right of Use Agreement between Primus Telecommunications, Inc. and Qwest Communications Corporation dated December 30, 1999; Incorporated by reference to Exhibit 10.20 of the Company's Annual Report of Form 10-K for the year ended December 31, 1999.

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- 10.21 Common Stock Purchase Agreement between the Company and Pilot Network Services, Inc. dated December 28, 1999; Incorporated by reference to Exhibit 10.21 of the Company's Annual Report of Form 10-K for the year ended December 31, 1999.
  - 10.22 Warrant to purchase up to 200,000 shares of common stock of Pilot Network Services, Inc. dated December 28, 1999; Incorporated by reference to Exhibit 10.22 of the Company's Annual Report of Form 10-K for the year ended December 31, 1999.
  - 10.23 Loan Agreement between Primus Telecommunications, Inc. and NTFC Capital Corporation dated November 22, 1999; Incorporated by reference to Exhibit 10.23 of the Company's Annual Report of Form 10-K for the year ended December 31, 1999.
  - 10.24 Resale Registration Rights Agreement among the Company, certain of its subsidiaries, Lehman Brothers Inc., Merrill Lynch, Pierce, Fenner & Smith, Incorporated and Morgan Stanley & Co. Incorporated dated February 24, 2000; Incorporated by reference to Exhibit 10.24 of the Company's Annual Report of Form 10-K for the year ended December 31, 1999.
  - 10.25 Form of Loan Agreement between the Company and GE Capital Corporation; Incorporated by reference to Exhibit 10.25 to the Company's 2000 10-K.
  - 10.26 Form of Promissory Note issued by the Company to GE Capital Corporation; Incorporated by reference to Exhibit 10.26 to the Company's 2000 10-K.
  - 10.27 Cisco Systems Capital Corporation \$50 million Letter of Commitment to the Company dated November 2000.
  - 10.28 Form of Promissory Note issued by certain officers to the Company; Incorporated by reference to Exhibit 10.28 to the Company's 2000 10-K.
  - 10.29 Form of Security Agreement issued by certain officers to the Company; Incorporated by reference to Exhibit 10.29 to the Company's 2000 10-K.
  - 21.1 Subsidiaries of the Registrant. \*
  - 23.1 Independent Auditors' Consent. \*

\* Filed herewith

\*\* Compensatory benefit plan

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**Consolidated Financial Statements:**

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Consolidated Statements of Stockholders' Equity (Deficit) for the years ended December 31, 2001, 2000 and 1999	F-5
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**Consolidated Financial Statement Schedule:**

Schedule II. Valuation and Qualifying Accounts Financial Statement Schedule	S-1
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**INDEPENDENT AUDITORS' REPORT**

To the Board of Directors and Stockholders  
of Primus Telecommunications Group, Incorporated

We have audited the accompanying consolidated balance sheets of Primus Telecommunications Group, Incorporated and subsidiaries (the "Company") as of December 31, 2001 and 2000, and the related consolidated statements of operations, stockholders' equity (deficit), comprehensive loss and cash flows for each of the three years in the period ended December 31, 2001. Our audits also included the financial statement schedule on page S-1. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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, such consolidated financial statements present fairly, in all material respects, the financial position of Primus Telecommunications Group, Incorporated and subsidiaries as of December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

DELOITTE & TOUCHE LLP  
McLean, Virginia  
April 11, 2002

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**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED****CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except per share amounts)

	For the Year Ended December 31,		
	2001	2000	1999
NET REVENUE	\$ 1,082,475	\$ 1,199,422	\$ 832,739
COST OF REVENUE	767,841	861,181	624,599
GROSS MARGIN	314,634	338,241	208,140
OPERATING EXPENSES			
Selling, general and administrative	303,026	330,411	199,581
Depreciation and amortization	157,596	120,695	54,957
Asset impairment write-down	526,309	—	—
Total operating expenses	986,931	451,106	254,538
LOSS FROM OPERATIONS	(672,297)	(112,865)	(46,398)

INTEREST EXPENSE	(100,700)	(132,137)	(79,629)
INTEREST INCOME AND OTHER INCOME (EXPENSE)	(19,950)	29,386	13,291
LOSS BEFORE INCOME TAXES	(792,947)	(215,616)	(112,736)
INCOME TAXES	—	—	—
LOSS BEFORE EXTRAORDINARY ITEM	(792,947)	(215,616)	(112,736)
GAIN ON EARLY EXTINGUISHMENT OF DEBT (Net of \$5,000, \$0 and \$0 in income taxes)	486,771	40,952	—
NET LOSS	\$ (306,176)	\$ (174,664)	\$ (112,736)
NET LOSS PER COMMON SHARE:			
Basic and diluted:			
Loss before extraordinary item	\$ (14.84)	\$ (5.43)	\$ (3.72)
Gain on early extinguishment of debt, net of income taxes	9.11	1.03	—
Net loss	\$ (5.73)	\$ (4.40)	\$ (3.72)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	53,423	39,691	30,323

See notes to consolidated financial statements.

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**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**

**CONSOLIDATED BALANCE SHEETS**

(in thousands, except share amounts)

	December 31, 2001	December 31, 2000
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 83,953	\$ 393,812
Marketable securities	538	747
Restricted cash	4,961	5,066
Accounts receivable (net of allowance for doubtful accounts receivable of \$22,389 and \$34,464)	190,293	228,877
Prepaid expenses and other current assets	34,170	46,051
Total current assets	313,915	674,553
PROPERTY AND EQUIPMENT—Net	375,464	466,704
GOODWILL AND OTHER INTANGIBLE ASSETS—Net	109,500	559,551
OTHER ASSETS	17,335	47,318
TOTAL ASSETS	\$ 816,214	\$ 1,748,126
<b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 118,176	\$ 146,536
Accrued interconnection costs	105,872	124,854
Accrued expenses and other current liabilities	74,754	90,324
Accrued interest	20,746	37,933
Current portion of long-term obligations	51,996	14,404
Total current liabilities	371,544	414,051
LONG-TERM OBLIGATIONS	615,591	1,242,049
OTHER LIABILITIES	7,563	8,331
Total liabilities	994,698	1,664,431

COMMITMENTS AND CONTINGENCIES

STOCKHOLDERS' EQUITY (DEFICIT):

Preferred stock, \$.01 par value—authorized 2,455,000 shares; none issued and outstanding	—	—
Common stock, \$.01 par value—authorized 150,000,000 shares; issued and outstanding 63,457,554 and 40,635,701 shares	635	406
Additional paid-in capital	607,123	540,321
Accumulated deficit	(705,229)	(399,053)
Accumulated other comprehensive loss	(81,013)	(57,979)
<b>Total stockholders' equity (deficit)</b>	<b>(178,484)</b>	<b>83,695</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>	<b>\$ 816,214</b>	<b>\$ 1,748,126</b>

See notes to consolidated financial statements.

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**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)**  
(in thousands)

	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Stockholders' Equity (Deficit)
	Shares	Amount				
<b>BALANCE, DECEMBER 31, 1998</b>	28,059	\$ 281	\$ 234,549	\$ (111,653)	\$ (8,260)	\$ 114,917
Common shares issued for secondary equity offering, net	8,000	80	169,230	—	—	169,310
Common shares issued for business acquisitions	457	5	7,845	—	—	7,850
Common shares issued for 401(k) Plan	20	—	372	—	—	372
Common shares issued upon exercise of stock options	355	4	3,277	—	—	3,281
Common shares issued for employee stock purchase plan	39	—	494	—	—	494
Common shares issued upon exercise of warrants	41	—	376	—	—	376
Common shares issued for Restricted Stock Plan	130	1	290	—	—	291
Foreign currency translation adjustment	—	—	—	—	6,704	6,704
Net loss	—	—	—	(112,736)	—	(112,736)
<b>BALANCE, DECEMBER 31, 1999</b>	37,101	371	416,433	(224,389)	(1,556)	190,859
Common shares issued for business acquisitions	2,946	29	120,677	—	—	120,706
Common shares issued for 401(k) Plan	2	—	80	—	—	80
Common shares issued upon exercise of stock options	489	5	2,067	—	—	2,072
Common shares issued for employee stock purchase plan	89	1	985	—	—	986
Common shares issued upon exercise of warrants	6	—	55	—	—	55
Common shares issued for Restricted Stock Plan	3	—	24	—	—	24
Foreign currency translation adjustment	—	—	—	—	(42,170)	(42,170)
Unrealized loss on marketable securities	—	—	—	—	(14,253)	(14,253)
Net loss	—	—	—	(174,664)	—	(174,664)
<b>BALANCE, DECEMBER 31, 2000</b>	40,636	406	540,321	(399,053)	(57,979)	83,695
Common shares issued for business acquisitions	265	3	587	—	—	590
Common shares issued upon exercise of employee stock options, net of note receivable	229	2	(2)	—	—	—
Common shares cancelled upon rescission of employee stock options	(229)	(2)	509	—	—	507
Common shares issued for employee stock purchase plan	529	5	572	—	—	577
Common shares issued for Restricted Stock Plan	18	—	132	—	—	132
Common shares cancelled for Restricted Stock Plan	(81)	(1)	1	—	—	—



Common shares sold	2,862	30	9,971	—	—	10,001
Common shares issued for payment on capital lease liability	50	—	35	—	—	35
Common shares issued for debenture conversion	19,179	192	54,997	—	—	55,189
Foreign currency translation adjustment	—	—	—	—	(37,287)	(37,287)
Unrealized loss on marketable securities	—	—	—	—	(747)	(747)
Reclassification adjustment for loss on marketable securities included in net loss	—	—	—	—	15,000	15,000
Net loss	—	—	—	(306,176)	—	(306,176)
<b>BALANCE, DECEMBER 31, 2001</b>	<b>63,458</b>	<b>\$ 635</b>	<b>\$ 607,123</b>	<b>\$ (705,229)</b>	<b>\$ (81,013)</b>	<b>(178,484)</b>

See notes to consolidated financial statements.

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**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

	For the Year Ended December 31,		
	2001	2000	1999
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net loss	\$ (306,176)	\$ (174,664)	\$ (112,736)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation, amortization and accretion	157,796	121,058	55,319
Asset impairment write-down	526,309	—	—
Allowance for doubtful accounts receivable	40,235	17,756	27,908
Stock issuance—401(k) Plan and Restricted Stock Plan	132	99	328
Minority interest share of loss	(132)	(72)	(291)
Marketable securities write-off	15,000	—	—
Unrealized loss on trading marketable securities	275	—	—
Cost investment write-down	5,142	—	—
Gain on early extinguishment of debt	(491,771)	(40,952)	—
Changes in assets and liabilities, net of acquisitions:			
Increase in accounts receivable	(9,875)	(79,707)	(64,835)
(Increase) decrease in prepaid expenses and other current assets	11,311	9,553	(34,049)
(Increase) decrease in other assets	1,618	(2,065)	(11,749)
Increase (decrease) in accounts payable	(28,622)	37,600	56,167
Increase (decrease) in accrued expenses, other current liabilities and other liabilities	(17,530)	(25,263)	9,145
Increase (decrease) in accrued interest payable	(12,896)	5,637	19,223
Purchase and sale of trading marketable securities	(872)	—	—
Net cash used in operating activities	(110,056)	(131,020)	(55,570)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchase of property and equipment	(87,771)	(193,772)	(110,582)
Sale of restricted investments	—	25,933	24,691
Purchase of marketable securities	—	(15,000)	—
Cash used for business acquisitions, net of cash acquired	(1,584)	(57,175)	(114,282)
Restricted cash	(295)	—	—
Net cash used in investing activities	(89,650)	(240,014)	(200,173)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Proceeds from issuance of long-term obligations	15,802	350,000	450,000
Deferred financing costs	—	(10,265)	(15,125)
Purchase of the Company's debt securities	(99,845)	(19,168)	—
Principal payments on capital leases, vendor financing and other long-term obligations	(33,744)	(16,342)	(21,927)
Proceeds from sale of common stock and exercise of stock options	10,578	3,123	173,587

Cash received from minority interest holder	—	—	4,479
Net cash (used in) provided by financing activities	(107,209)	307,348	591,014
<b>EFFECTS OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS</b>	<b>(2,944)</b>	<b>(8,681)</b>	<b>(282)</b>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>(309,859)</b>	<b>(72,367)</b>	<b>334,989</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<b>393,812</b>	<b>466,179</b>	<b>131,190</b>
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<b>\$ 83,953</b>	<b>\$ 393,812</b>	<b>\$ 466,179</b>
<b>SUPPLEMENTAL CASH FLOW INFORMATION</b>			
Cash paid for interest	\$ 114,276	\$ 126,623	\$ 60,076
<b>Non-cash investing and financing activities:</b>			
Capital leases for acquisition of equipment	\$ 10,404	\$ 12,510	\$ 1,987
Equipment financing for acquisition of equipment	\$ 14,122	\$ 37,338	\$ 24,394
Leased fiber capacity additions	\$ 64,288	\$ —	\$ —
Conversion of debentures to common stock	\$ 55,189	\$ —	\$ —
Common stock issued for business acquisitions	\$ 590	\$ 120,706	\$ 7,850
Common stock issued for payment on capital lease liability	\$ 35	\$ —	\$ —

See notes to consolidated financial statements.

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**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**

(in thousands)

	For the Year Ended December 31,		
	2001	2000	1999
<b>NET LOSS</b>	<b>\$ (306,176)</b>	<b>\$ (174,664)</b>	<b>\$ (112,736)</b>
<b>OTHER COMPREHENSIVE INCOME (LOSS):</b>			
Foreign currency translation adjustment	(37,287)	(42,170)	6,704
Unrealized gain (loss) on marketable securities:			
Unrealized holding loss arising during period	(747)	(14,253)	—
Reclassification adjustment for loss included in net loss	15,000	—	—
<b>COMPREHENSIVE LOSS</b>	<b>\$ (329,210)</b>	<b>\$ (231,087)</b>	<b>\$ (106,032)</b>

See notes to consolidated financial statements.

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**PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. ORGANIZATION AND BUSINESS**

Primus Telecommunications Group, Incorporated ("Primus" or the "Company") is a global facilities-based Total Service Provider offering bundled voice, data, Internet, DSL, e-commerce, Web hosting, enhanced application, Voice over Internet Protocol (VoIP), virtual private network (VPN) and other value-added services to retail business and residential customers and other carriers located in the United States, Canada, Brazil, the United Kingdom, continental Europe, Australia, India and Japan. The Company is incorporated in the state of Delaware and operates as a holding company of wholly-owned operating subsidiaries in North America, Europe and the Asia-Pacific region.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Principles of Consolidation*—The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries and all other subsidiaries over which the Company exerts control. The Company owns 51% of the common stock of Matrix Internet, S.A. ("Matrix"), 51% of Cards & Parts Telecom GmbH ("Cards & Parts"), 51% of CS Communications Systems GmbH and CS Network GmbH ("Citrus"), 37% of Bekkoame

Internet, Inc. ("Bekko"), and 60% of Direct Internet Private Limited ("DIPL"), in all of which the Company has a controlling interest. All material intercompany profits, transactions and balances have been eliminated in consolidation. All other investments in affiliates are carried at cost, as the Company does not have significant influence.

*Revenue Recognition and Deferred Revenue*—The Company records revenue from the sale of telecommunications services at the time of customer usage primarily based upon minutes of use. Service activation and certain installation fees are recorded as deferred revenue and amortized over the longer of the average customer life or the contract term. The Company records payments received in advance for prepaid calling card services and services to be provided under contractual agreements, such as Internet broadband and dial-up access, as deferred revenue until such related services are provided. Deferred revenue is reported in accrued expenses and other current liabilities. Net revenue represents gross revenue net of allowance for doubtful accounts receivable, service credits and service adjustments.

*Cost of Revenue*—Cost of revenue includes network costs that consist of access, transport and termination costs. The majority of the Company's cost of revenue is variable, primarily based upon minutes of use, with transmission and termination costs being the most significant expense. Such costs are recognized when incurred in connection with the provision of telecommunications services.

*Foreign Currency Translation*—The assets and liabilities of the Company's foreign subsidiaries are translated at the exchange rates in effect on the reporting date. The net effect of such translation gains and losses are reflected within accumulated other comprehensive loss in the stockholders' equity section of the balance sheet. Income and expenses are translated at the average exchange rate during the period.

*Cash and Cash Equivalents*—Cash and cash equivalents are comprised principally of amounts in money market accounts, operating accounts, certificates of deposit, and overnight repurchase agreements with original maturities of three months or less. Cash and cash equivalents are stated at cost which approximates market value.

*Marketable Securities*—Marketable securities consist of a mutual fund and equity security. Marketable securities which are bought and held principally for the purpose of selling them in the near-term are classified as trading securities; these securities are recorded at current market value with net unrealized gains and losses included in earnings. All other marketable securities are classified as

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available-for-sale. Available-for-sale securities are recorded at current market value; net unrealized gains and losses are excluded from earnings and are reported as other comprehensive income/(loss) until realized. The basis of cost used in determining realized gains and losses is specific identification.

*Restricted Cash*—Restricted cash consists of bank guarantees and a certificate of deposit. Restricted cash is stated at cost which approximates market value.

*Advertising Costs*—In accordance with Statement of Position 93-7, "Reporting on Advertising Costs," costs for advertising are expensed as incurred except for direct-response advertising costs, which are capitalized and amortized over the lesser of the life of the customers obtained from these efforts or twelve months following the provisioning of the customer.

*Property and Equipment*—Property and equipment is recorded at cost less accumulated depreciation, which is provided on the straight-line method over the estimated useful lives of the assets. Cost includes major expenditures for improvements and replacements which extend useful lives or increase capacity of the assets as well as expenditures necessary to place assets into readiness for use. Expenditures for maintenance and repairs are expensed as incurred. The estimated useful lives of property and equipment are as follows: network equipment, including fiber optic and submarine cable—5 to 25 years, furniture and equipment—5 years, leasehold improvements and leased equipment—shorter of lease or useful life. In accordance with Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," costs for internal use software that are incurred in the preliminary project stage and in the post-implementation stage are expensed as incurred. Costs incurred during the application development stage are capitalized and amortized over the estimated useful life of the software.

*Fiber Optic and Submarine Cable Arrangements*—The Company obtains capacity on certain fiber optic and submarine cables under three types of arrangements. The Indefeasible Right of Use ("IRU") basis provides the Company the right to use a cable for the estimated economic life of the asset according to the terms of the IRU agreement with most of the rights and duties of ownership. The Minimum Assignable Ownership Units ("MAOU") basis provides the Company an ownership interest in the fiber optic cable with certain rights to control and to manage the facility. The Company accounts for both IRU and MAOU agreements under network equipment and depreciates the recorded asset over the term of the agreement which is generally 25 years. The Company also enters into shorter-term arrangements with other carriers which provides the Company the right to use capacity on a cable but without any rights and duties of ownership. Under these shorter-term arrangements, the costs are expensed in the period the services are provided.

*Goodwill and Other Intangible Assets*—Goodwill is amortized over 5 to 30 years on a straight-line basis, and customer lists over the estimated run-off of the customer bases, not to exceed five years.

*Impairment of Long-Lived Assets*—The Company reviews intangible and other long-lived assets whenever events or changes indicate that the carrying amount of an asset may not be recoverable. In making such evaluations, the Company compares the expected future cash flows to the carrying amount of the assets. An impairment loss, equal to the difference between the assets' fair value and their carrying value, is recognized when the estimated future cash flows are less than the carrying amount. See Note 18—"Asset Impairment."

*Deferred Financing Costs*—Deferred financing costs incurred in connection with the 2000 Convertible Debentures, the October 1999 Senior Notes, the January 1999 Senior Notes, the 1998 Senior Notes, the 1997 Senior Notes, and other financing arrangements are reflected within other assets and are being amortized over the life of the respective debentures and senior notes.

*Stock-Based Compensation*—The Company follows Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation." Under the provisions of SFAS No. 123, the Company continues to measure compensation expense for its stock-based employee

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compensation plans using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and has provided in Note 13 pro forma disclosures of the effect on net loss and loss per share as if the fair value-based method prescribed by SFAS No. 123 had been applied in measuring compensation expense.

*Use of Estimates*—The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of net revenue and expenses during the reporting period. Actual results may differ from these estimates. Significant estimates include the asset impairment write-down, allowance for doubtful accounts receivable, purchase price allocations, accrued interconnection costs, market assumptions used in estimating the fair values of certain assets and liabilities such as marketable securities and long-term obligations, and the assumptions used in determining the fair value of the Company's stock options for use in the pro forma disclosures required by SFAS No. 123.

*Concentration of Credit Risk*—Financial instruments that potentially subject the Company to concentration of credit risk principally consist of trade accounts receivable. The Company performs ongoing credit evaluations of its customers but generally does not require collateral to support customer receivables. The Company maintains its cash with high quality credit institutions, and its cash equivalents are in high quality securities.

*Income Taxes*—The Company recognizes income tax expense for financial reporting purposes following the asset and liability approach for computing deferred income taxes. Under this method, the deferred tax assets and liabilities are determined based on the difference between financial reporting and tax bases of assets and liabilities based on enacted tax rates. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

*Net Loss Per Share*—Basic loss per share is computed using the weighted average number of shares of common stock outstanding during the year. Diluted loss per share is computed using the weighted average number of shares of common stock, adjusted for the dilutive effect of potential common stock. Potential common stock, computed using the treasury stock method or the if-converted method, includes options, warrants, convertible securities and contingently issuable shares. The effect of potential common stock has been excluded from the computation of diluted loss per share as the effect would be antidilutive. Accordingly, there is no reconciliation between basic and diluted loss per share for each of the years presented.

*New Accounting Pronouncements*—In October 2001, SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," was issued and is effective for fiscal years beginning after December 15, 2001. This statement supercedes SFAS No. 121, "Impairment for Long-Lived Assets and for Long-Lived Assets to be Disposed of," and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions" for the disposal of a segment of a business. SFAS No. 144 retains many of the provisions of SFAS No. 121, but addresses certain implementation issues associated with that statement. The Company will adopt the provisions of SFAS No. 144 effective January 1, 2002. The Company believes that the adoption of SFAS No. 144 will not have a material effect on the Company's consolidated financial statements.

In August 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated

asset retirement costs. SFAS No. 143 is effective for fiscal years beginning after June 15, 2002. The Company is in the process of evaluating the impact of implementing SFAS No. 143.

In July 2001, the FASB issued two new statements: SFAS No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 will require business combinations entered into after June 30, 2001 to be accounted for using the purchase method of accounting. Specifically identifiable intangible assets acquired, other than goodwill, will be amortized over their estimated useful economic life. SFAS No. 142 will require that goodwill not be amortized, but should be tested for impairment at least annually. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001 and applies to all goodwill and other intangible assets recognized in an entity's balance sheet at that date, regardless of when those assets were initially recognized. The Company will adopt the provisions of SFAS No. 141 and SFAS No. 142 effective January 1, 2002 and is in the process of evaluating the impact of implementing these statements. At December 31, 2001, the Company had \$63.4 million of net goodwill and recorded \$24.8 million of goodwill amortization expense during the year ended December 31, 2001.

In June 1998, SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," was issued. SFAS No. 133 established standards for the accounting and reporting of derivative instruments and hedging activities and requires that derivative financial instruments, including certain derivative instruments embedded in other contracts, be measured at fair value and recognized as assets or liabilities in the financial statements. The Company adopted SFAS No. 133 on January 1, 2001. The adoption of SFAS No. 133 did not have a material effect on the consolidated financial position or results of operations of the Company.

*Reclassifications*—Certain previous year amounts have been reclassified to conform with current year presentation.

### **3. ACQUISITIONS**

In August 2000, the Company acquired 100% of Seker BBS S.A. ("Seker"), a Spanish ISP, for \$1.1 million. The Company paid \$0.6 million in cash and 21,953 shares of the Company's common stock, of which the final payment was made in August 2001.

In August 2000, the Company acquired 100% of Nexus Comunicaciones S.A. ("Nexus"), a Spanish ISP, for \$0.9 million. The Company paid \$0.4 million in cash and 16,618 shares of the Company's common stock; \$0.1 million remained payable in cash at December 31, 2000, of which a small portion was paid in August 2001. The terms of the acquisition agreement provide for additional consideration to be paid if the acquired company's results of operations exceed certain targeted levels and certain other business requirements are met. The maximum amount of remaining consideration payable at December 31, 2001 is approximately \$0.1 million, and will be recorded as additional cost of the acquired

company when the amount to be paid, if any, becomes probable.

The Company acquired a 19% interest in Liquor Industry Services Technology (Australia) Pty Ltd ("LIST"), an Australian B2B business, for \$0.6 million in cash during the year ended December 31, 2000. In March 2001, the Company received the remaining 81% of LIST for no additional monetary consideration; LIST desired to be a part of a larger organization to sustain its operations. In the three months ended September 30, 2001, the Company subsequently wrote-off the goodwill, net of accumulated amortization, of \$0.4 million associated with the acquisition because of anticipated future negative net cash flows. The impairment loss is recorded as depreciation and amortization.

In September 2000, the Company acquired 100% of the assets of iO2Group, Inc. ("iO2"), an Internet services firm, for approximately \$0.4 million in cash. In the three months ended March 31, 2001, the Company subsequently wrote-off the goodwill, net of accumulated amortization, of

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\$0.5 million associated with the acquisition due to the discontinuance of iO2's operation. The impairment loss is recorded as depreciation and amortization.

In June 2000, the Company acquired 100% of CTE Networks ("CTE"), a long distance reseller, for \$10.7 million. The Company paid \$8.7 million in cash and 192,106 shares of the Company's common stock, of which 141,837 shares were issued in May 2001.

In May 2000, the Company acquired 90.1% of A-Tel GmbH ("A-Tel"), a German reseller of voice traffic to small- and medium-sized enterprises for \$1.4 million in cash. Subsequently, in December 2000, the Company acquired the remaining 9.9% for \$0.2 million, comprised of \$0.1 million in cash and 19,498 shares of the Company's common stock, which were subsequently issued in August 2001.

In May 2000, the Company acquired 100% of InterNeXt S.A. ("InterNeXt"), an ISP with national facilities in France, for \$12.9 million, comprised of \$11.9 million in cash and 33,446 shares of the Company's common stock.

In May 2000, the Company acquired 100% of Global Sales Pty., Ltd. ("Global Sales"), an agent serving the Company's retail operations in Australia, for \$1.3 million in cash.

In April 2000, the Company acquired a controlling interest in Direct Internet Private Limited ("DIPL"), an India-based company providing Internet services, for \$2.6 million in cash.

In March 2000, the Company acquired 37% and control of Bekkoame Internet, Inc. ("Bekko"), a Japanese facilities-based ISP, for \$11.0 million in cash.

In March 2000, the Company acquired 100% of Eco Software, Inc. ("Shore.Net"), a business-focused ISP based in the United States, for \$44.5 million, comprised of \$22.9 million in cash and 477,886 shares of the Company's common stock.

In February 2000, the Company acquired 51% of each of CS Communications Systems GmbH and CS Network GmbH ("Citrus"), a reseller of voice traffic and seller of telecommunications equipment and accessories in Germany, for \$1.0 million, comprised of \$0.9 million in cash and 2,092 shares of the Company's common stock.

In February 2000, the Company acquired over 96% of the common stock of LCR Telecom Group, Plc ("LCR Telecom"), a reseller of telecommunication services on other carriers in European markets, and subsequently the Company acquired the remaining shares for a total of 100%, in exchange for 2,278,258 shares of the Company's common stock valued at \$93.4 million, of which 61,626 shares were issued in April 2001. Acquisition expenses increased the total purchase price to \$96.3 million.

In January 2000, the Company acquired 100% of Sensitel Communications Inc. ("Sensitel"), a Canadian reseller of local services to small- and medium-sized business customers, for \$0.1 million in cash.

In January 2000, the Company acquired 100% of Infinity Online Systems ("Infinity Online"), an ISP based in Ontario, Canada, for \$2.3 million, comprised of \$1.2 million in cash and 29,919 shares of the Company's common stock.

The Company has accounted for all of these acquisitions using the purchase method of accounting and accordingly, the net assets and results of operations of the acquired companies have been included in the Company's financial statements since the respective acquisition dates. The purchase price, including direct costs, of the Company's acquisitions was allocated to the net assets acquired, including intangible assets and liabilities assumed, based on their respective fair values at the acquisition dates.

The following reflects the December 31, 2001 gross balances of goodwill and customer lists for the acquisitions of the companies that were acquired in 2000 (in thousands), net of the asset impairment

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write-down taken in the fourth quarter of 2001. See Note 18—"Asset Impairment." The Company did not have any significant acquisitions in 2001.

2000 Acquisitions	Goodwill	Customer List
LCR Telecom	\$ 89,572	\$ 26,332
Shore.Net	31,300	11,500
CTE	6,827	4,471
InterNeXt	13,473	—

Bekko	2,056	8,438
Infinity Online	1,992	302
A-Tel	2,272	—
Seker	1,077	353
Other acquisitions	1,943	733
	<u>150,512</u>	<u>52,129</u>
Total	150,512	52,129
Less: Accumulated amortization at December 31, 2001	(18,667)	(24,476)
Less: Asset impairment write-down for 2000 acquisitions	(89,479)	(4,128)
	<u>42,366</u>	<u>23,525</u>
Net	\$ 42,366	\$ 23,525

The following represents the actual results of operations of the Company for 2001 and unaudited pro forma results of operations of the Company for 2000 as if the acquisitions were consummated on January 1, 2000. The unaudited pro forma results of operations include certain pro forma adjustments, including the amortization of intangible assets relating to the acquisitions. The unaudited pro forma results of operations do not necessarily reflect the results that would have occurred had the acquisitions occurred at January 1, 2000 or the results that may occur in the near future.

	Year Ended December 31, 2001	Year Ended December 31, 2000
		(unaudited)
	(in thousands, except per share amounts)	
Net revenue	\$ 1,082,475	\$ 1,225,264
Loss before extraordinary item	\$ (792,947)	\$ (224,212)
Net loss	\$ (306,176)	\$ (183,260)
Basic and diluted net loss per common share	\$ (5.73)	\$ (4.58)

#### 4. MARKETABLE SECURITIES

In connection with a strategic business arrangement with Pilot Network Services ("Pilot"), in January 2000, the Company made a \$15.0 million strategic investment in Pilot pursuant to which the Company purchased 919,540 shares, or 6.3%, of Pilot's common stock at a price of \$16.3125 per share, and received a warrant to purchase an additional 200,000 shares at \$25.00 per share. This investment was classified as available-for-sale. At December 31, 2000, the current market value was \$0.7 million and the unrealized loss on this investment was \$14.3 million. In March 2001, the Company wrote-off the investment of \$15.0 million which is reported in interest income and other income (expense). Based on current market quotes, the Company considered the decline in fair value to be permanent.

In connection with the Company's trading marketable securities, the Company recorded an unrealized loss of \$0.3 million in interest income and other income (expense) for the year ended December 31, 2001. There were no trading securities held by the Company during the years ended December 31, 2000 and 1999.

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#### 5. ADVERTISING

The Company expenses advertising costs as incurred except for direct-response advertising costs, which are capitalized and amortized over the expected period of future benefits. Direct-response advertising consists primarily of direct-mail advertisements, newspaper and television advertising. These costs are amortized over the lesser of the life of the customers obtained from these efforts or twelve months following the provisioning of the customer. The types of costs capitalized as of December 31, 2001 and December 31, 2000 include production and design, newspaper and magazine space, telephone solicitation, television and radio airtime, and payroll and payroll-related costs for the direct-response advertising activities of employees who are directly associated with and devote time to direct-response advertising. At December 31, 2001 and 2000, capitalized advertising costs of \$7.6 million and \$16.5 million, respectively, were included in prepaid expenses and other current assets. Advertising expense for the years ended December 31, 2001, 2000 and 1999 was \$36.1 million, \$43.0 million and \$24.8 million, respectively.

#### 6. PROPERTY AND EQUIPMENT

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

	December 31,	
	2001	2000
Network equipment	\$ 622,975	\$ 483,140
Furniture and equipment	59,379	57,350
Leasehold improvements	20,628	14,592
Construction in progress	4,198	24,938
	<u>707,180</u>	<u>580,020</u>
Subtotal	707,180	580,020
Less: Accumulated depreciation	(331,716)	(113,316)

Total property and equipment, net	\$	375,464	\$	466,704
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Depreciation and amortization expense for property and equipment including equipment under capital leases and vendor financing obligations for the years ended December 31, 2001, 2000 and 1999 was \$97.7 million, \$67.7 million and \$30.4 million, respectively. An asset impairment charge of \$149.9 million was recorded in the fourth quarter of 2001 and is reflected in the accumulated depreciation balance for property and equipment at December 31, 2001.

At December 31, 2001, the total equipment under capital lease and vendor financing obligations consisted of \$190.2 million network equipment and \$0.3 million administrative equipment, with accumulated depreciation of \$30.8 million and \$0.02 million, respectively. At December 31, 2000, all equipment under capital lease and vendor financing obligations was network equipment and totaled \$43.5 million with accumulated depreciation of \$12.3 million.

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## 7. GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill and other intangible assets consisted of the following (in thousands):

	December 31,	
	2001	2000
Goodwill (net of accumulated amortization of \$413,033 and \$33,474)	\$ 63,385	\$ 461,168
Customer lists (net of accumulated amortization of \$96,955 and \$51,587)	42,816	94,514
Other intangible assets (net of accumulated amortization of \$1,662 and \$791)	3,299	3,869
Total goodwill and other intangible assets, net	\$ 109,500	\$ 559,551

Amortization expense for goodwill and other intangible assets for the years ended December 31, 2001, 2000 and 1999 were \$59.9 million, \$53.0 million and \$24.6 million, respectively. An asset impairment charge of \$376.4 million was recorded in the fourth quarter of 2001 and is reflected in the accumulated amortization balance for goodwill and other intangible assets for the year ended December 31, 2001. See Note 18 — "Asset Impairment."

## 8. LONG-TERM OBLIGATIONS

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

	December 31,	
	2001	2000
Obligations under capital leases	\$ 28,754	\$ 29,378
Leased fiber capacity	53,713	4,243
Equipment financing	71,492	60,054
Senior notes	422,144	812,439
Other long-term obligations	20,365	3,729
Convertible note	—	50,000
Convertible subordinated debentures	71,119	296,610
Subtotal	667,587	1,256,453
Less: Current portion of long-term obligations	(51,996)	(14,404)
Total long-term obligations	\$ 615,591	\$ 1,242,049

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Future minimum principal payments for senior notes, other long-term obligations and convertible subordinated debentures for the years ended December 31, 2002, 2003, 2004, 2005, 2006 and thereafter are \$4.5 million, \$12.8 million, \$87.3 million, \$0.3 million, \$0.3 million, and \$408.5 million, respectively.

The indentures governing the senior notes and convertible debentures, as well as other credit arrangements, contain certain financial and other covenants which, among other things, will restrict the Company's ability to incur further indebtedness and make certain payments including the payment of dividends.

*Senior Notes and Convertible Debentures*

In February 2000, the Company completed the sale of \$250 million in aggregate principal amount of 5 <sup>3</sup>/<sub>4</sub>% convertible subordinated debentures due 2007 ("2000 Convertible Debentures") with semi-annual interest payments due on February 15th and August 15th. On March 13, 2000, the Company announced that the initial purchasers of the 2000 Convertible Debentures had exercised their \$50 million over-allotment option granted pursuant to a purchase agreement dated February 17, 2000. The debentures were convertible into approximately 6,025,170 shares of the Company's common stock based on a conversion price of \$49.7913 per share. During the years ended December 31, 2001 and 2000, the Company has reduced the principal balance of the debentures through open market purchases and conversion to the Company's common stock as illustrated in the table below.

In October 1999, the Company completed the sale of \$250 million in aggregate principal amount of 12<sup>3</sup>/<sub>4</sub>% senior notes due 2009 ("October 1999 Senior Notes"). The October 1999 Senior Notes are due October 15, 2009, with semi-annual interest payments due on October 15<sup>th</sup> and April 15<sup>th</sup>. The Company may redeem up to 35% of the original principal amount of the October 1999 Senior Notes at 112.75% of the principal amount thereof, plus accrued and unpaid interest through the redemption date prior to October 15, 2002. During the years ended December 31, 2001 and 2000, the Company has reduced the principal balance of these senior notes through open market purchases as illustrated in the table below. See Note 20—"Subsequent Events."

In January 1999, the Company completed the sale of \$200 million aggregate principal amount of 11<sup>1</sup>/<sub>4</sub>% senior notes due 2009 ("January 1999 Senior Notes") with semi-annual interest payments due on January 15<sup>th</sup> and July 15<sup>th</sup>. The January 1999 Senior Notes are due January 15, 2009 with early redemption at the option of the Company at any time after January 15, 2004. The Company may redeem up to 35% of the original principal amount of the January 1999 Senior Notes at 111.25% of the principal amount thereof, plus accrued and unpaid interest through the redemption date prior to January 15, 2002. In June 1999, in connection with the Telegroup acquisition, the Company issued \$45.5 million in aggregate principal amount of the Company's 11<sup>1</sup>/<sub>4</sub>% senior notes due 2009 pursuant to the January 1999 Senior Notes indenture. During the year ended December 31, 2001, the Company has reduced the principal balance of these senior notes through open market purchases as illustrated in the table below. See Note 20—"Subsequent Events."

On May 19, 1998, the Company completed the sale of \$150 million 9<sup>7</sup>/<sub>8</sub>% senior notes due 2008 ("1998 Senior Notes") with semi-annual interest payments due on May 15<sup>th</sup> and November 15<sup>th</sup>. The 1998 Senior Notes are due May 15, 2008 with early redemption at the option of the Company at any time after May 15, 2003. In addition, prior to May 15, 2001, the Company may redeem up to 25% of the originally issued principal amount of the 1998 Senior Notes at 109.875% of the principal amount thereof, plus accrued and unpaid interest through the redemption date. During the year ended December 31, 2001, the Company has reduced the principal balance of these senior notes through open market purchases as illustrated in the table below.

On August 4, 1997, the Company completed the sale of \$225 million 11<sup>3</sup>/<sub>4</sub>% senior notes due 2004 ("1997 Senior Notes") and warrants to purchase 392,654 shares of the Company's common stock, with semi-annual interest payments due on February 1<sup>st</sup> and August 1<sup>st</sup>. The 1997 Senior Notes are due

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August 1, 2004 with early redemption at the option of the Company at any time after August 1, 2001, at a premium to par value. During the years ended December 31, 2001 and 2000, the Company has reduced the principal balance of these senior notes through open market purchases as illustrated in the table below.

The following table illustrates the changes in the balances of the Company's senior notes and debentures for the years ended December 31, 2001 and 2000. See Note 19—"Gain on Early Extinguishment of Debt."

For the Year Ended December 31, 2001

	Balance at December 31, 2000	Principal Purchases	Conversion to Common Stock	Warrant Amortization	Balance at December 31, 2001	Value of Shares Issued and Cash Paid for Purchase of Principal
2000 5 <sup>3</sup> / <sub>4</sub> % Convertible Debentures due 2007	296,610,000	(33,027,000)	(192,464,000)	—	71,119,000	65,147,343
October 1999 12 <sup>3</sup> / <sub>4</sub> % Senior Notes due 2009	239,350,000	(112,670,000)	—	—	126,680,000	25,806,250
January 1999 11 <sup>1</sup> / <sub>4</sub> % Senior Notes due 2009	245,467,000	(105,880,000)	—	—	139,587,000	24,032,724
1998 9 <sup>7</sup> / <sub>8</sub> % Senior Notes due 2008	150,000,000	(80,980,000)	—	—	69,020,000	18,694,158



1997 11 <sup>3</sup> / <sub>4</sub> % Senior Notes due 2004	177,622,321	(91,700,000)	—	935,024	86,857,345	21,353,812
<b>Total</b>	<b>1,109,049,321</b>	<b>(424,257,000)</b>	<b>(192,464,000)</b>	<b>935,024</b>	<b>493,263,345</b>	<b>155,034,287</b>

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For the Year Ended December 31, 2000

	Balance at December 31, 1999	Principal Additions	Principal Purchases	Warrant Amortization	Balance at December 31, 2000	Value of Shares Issued and Cash Paid for Purchase of Principal
2000 5 <sup>3</sup> / <sub>4</sub> % Convertible Debentures due 2007	—	300,000,000	(3,390,000)	—	296,610,000	599,350
October 1999 12 <sup>3</sup> / <sub>4</sub> % Senior Notes due 2009	250,000,000	—	(10,650,000)	—	239,350,000	2,951,188
January 1999 11 <sup>1</sup> / <sub>4</sub> % Senior Notes due 2009	245,467,000	—	—	—	245,467,000	—
1998 9 <sup>7</sup> / <sub>8</sub> % Senior Notes due 2008	150,000,000	—	—	—	150,000,000	—
1997 11 <sup>3</sup> / <sub>4</sub> % Senior Notes due 2004	223,340,179	—	(46,080,000)	362,142	177,622,321	15,657,591
<b>Total</b>	<b>868,807,179</b>	<b>300,000,000</b>	<b>(60,120,000)</b>	<b>362,142</b>	<b>1,109,049,321</b>	<b>19,208,129</b>

*Capital Leases, Leased Fiber Capacity, Equipment Financing and Other Long-Term Obligations*

In December 1999, the Company agreed to purchase \$23.2 million of fiber capacity from Qwest Communications which provides the Company with an asynchronous transfer mode (ATM) + Internet protocol (IP) based international broadband backbone. The backbone is comprised of nearly 11,000 route miles of fiber optic cable in the United States and overseas as well as private Internet peering at select sites in the United States and overseas. In March 2000, the Company agreed to purchase an additional \$20.8 million of fiber capacity. As of June 30, 2001, the Company had fulfilled the total purchase obligation. As of December 31, 2001, the Company had made cash payments of \$27.1 million. At December 31, 2001 the Company had a liability recorded in the amount of \$16.9 million, which reflects a promissory note payable over three and one-half years bearing interest at a rate equal to the Prime Rate plus 3.5% per annum (8.25% at December 31, 2001).

During the three months ended June 30, 2001, the Company accepted delivery of fiber optic capacity on an IRU basis from Southern Cross Cables Limited ("SCCL"). The Company and SCCL entered into an arrangement financing the capacity purchase. During the three months ended December 31, 2001, the Company renegotiated the payment terms with SCCL. Under the new terms, the payments for each capacity segment will be made over a five-year term bearing an interest rate of 8.44%. At December 31, 2001, the Company had a liability recorded under this agreement in the amount of \$11.6 million.

In December 2000, the Company entered into a financing arrangement to purchase fiber optic capacity on an IRU basis in Australia for \$26.1 million (51.1 million Australian dollars ("AUD")) from Optus Networks Pty. Limited. As of December 31, 2001, the Company had fulfilled the total purchase obligation with cash payments of \$6.6 million (13 million AUD). At December 31, 2001, the Company had a liability recorded in the amount of \$19.5 million (38.1 million AUD), which reflects a promissory note payable over a four-year term bearing interest at a rate of 14.29%.

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During the year ended December 31, 2000, Cisco Systems Capital Corporation provided the Company with \$50.0 million in financing to fund the purchase of network equipment, secured by the equipment purchased. At December 31, 2001 and 2000, \$18.3 million and \$4.4 million, respectively, were utilized under this facility and are categorized as obligations under capital lease. Borrowings under this credit facility are payable over terms ranging from one to four years and bear a weighted average rate of 10.55%. See Note 20—"Subsequent Event."

During the years ended December 31, 2000 and 1999, NTFC Capital Corporation provided the Company with \$15.0 million and \$30.0 million,

respectively, in financing to fund the purchase of network equipment, secured by the equipment purchased. At December 31, 2001 and 2000, \$45.0 million and \$43.6 million, respectively, were utilized by the Company. The Company had liabilities recorded at December 31, 2001 and 2000 of \$45.0 million and \$43.6 million, respectively. Borrowings under this credit facility are payable over a five-year term and are each priced at the date of drawdown at a 495 basis point spread off of the five-year United States Treasury rate; the interest rates range from 9.94% to 11.56%.

During the year ended December 31, 1999, Ericsson Financing Plc ("Ericsson") provided the Company with \$30.9 million (21.3 million British pounds) in financing to fund the purchase of network equipment, secured by the equipment purchased. At December 31, 2001 and 2000, \$17.6 million (12.1 million British pounds) and \$12.3 million (8.5 million British pounds), respectively, were utilized under this facility. Borrowings under this credit facility accrue interest at rates equal to LIBOR of the relevant currency plus 5.8% (10.31% at December 31, 2001) for 50% of the capital and at 3.8% above LIBOR (8.31% at December 31, 2001) for the other 50%, and are payable over a five-year term. The Company had liabilities recorded at December 31, 2001 and 2000 of \$13.8 million and \$11.2 million, respectively. During the three months ended December 31, 2001, the Company renegotiated payment terms with Ericsson. Under the new terms, the principal of the borrowings is to be deferred until May 15, 2003. Interest until commencement of repayment will be accrued at 3.8% above LIBOR per annum for 50% of the capital and at 1.8% above LIBOR for the other 50%. All obligations under this credit facility will be fulfilled by February 15, 2006.

During the year ended December 31, 2000, General Electric Capital Corporation provided the Company with \$20.0 million in financing to fund the purchase of network equipment, secured by the equipment purchased. At December 31, 2001 and 2000, \$12.7 million and \$5.3 million, respectively, were utilized under this facility. The Company had liabilities recorded at December 31, 2001 and 2000 of \$12.7 million and \$5.3 million, respectively. Borrowings under this facility are priced at the date of drawdown at a 500 basis point spread off of the five-year United States Treasury rate and are payable over a five-year term; the interest rates range from 9.72% to 9.95%.

In March 2000, the Company entered into a strategic business alliance agreement with Hewlett-Packard Company ("Hewlett-Packard") pursuant to which Hewlett-Packard would provide products and services to enable the Company to develop data centers in Europe, Australia, Japan and Brazil. Hewlett-Packard also agreed to purchase up to \$50 million in convertible debt. During the year ended December 31, 2000, Hewlett-Packard funded the entire \$50 million under the agreement; the convertible note was due in March 2005, and the debt would bear interest at a rate of 9.25% per annum. The outstanding principal and unpaid accrued interest were convertible into the Company's common stock at a price of \$60 per share. In October 2001, the Company fully extinguished its vendor debt and related obligations to Hewlett-Packard with a cash payment of \$5 million. This transaction resulted in an extraordinary gain of \$45.9 million for the period ended December 31, 2001.

#### Other

In July 2001, the Company consummated a transaction financing accounts receivables of its wholly-owned Canadian subsidiary, Primus Canada, with Textron Financial Canada Limited, an affiliate of

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RFC Capital Corporation. Under the terms of the financing arrangement, the Company can obtain cash proceeds of up to \$19.8 million depending upon the level of customer receivables. The Company pledged \$17.4 million of its accounts receivable as collateral as of December 31, 2001 and recorded a liability of \$12.4 million, which is included in current portion of long-term obligations. This financing will terminate in July 2003 and bears fees at a rate of Canada Prime Rate plus 3.25% (7% at December 31, 2001), plus an additional \$282,823 (450,000 Canadian dollars) per annum.

## 9. INCOME TAXES

The following does not include the effect of the enactment of the Job Creation and Workers Assistance Act in March 2002. See Note 20—"Subsequent Events."

Effective and Statutory Rate Reconciliation—The differences between the tax provision calculated at the statutory federal income tax rate and the actual tax provision for each period is shown in the table below (in thousands):

	For the Year Ended December 31,		
	2001	2000	1999
Tax benefit at federal statutory rate	\$ (104,150)	\$ (61,132)	\$ (39,458)
State income tax, net of federal benefit	—	(3,700)	(3,996)
Effect of rate differences outside the United States	14,628	251	—
Increase in valuation allowance	93,368	61,293	36,767
Goodwill amortization	1,791	2,703	—
Other	(637)	585	6,687
<b>Income taxes</b>	<b>\$ 5,000</b>	<b>\$ —</b>	<b>\$ —</b>

Deferred Income Taxes—The significant components of the Company's deferred tax assets and liabilities are as follows (in thousands):

	December 31,	
	2001	2000
Deferred tax assets (non-current):		
Accrued expenses	—	325
Net operating loss carryforwards	91,330	196,452
Bad debt reserve	1,913	5,467

Basis difference in intangibles	15,389	4,218
Basis difference in fixed assets	3,192	—
Basis difference in fixed assets-impairment	167,119	—
AMT credit carryforward	5,000	—
Other	1,202	3,157
Valuation allowance	(255,637)	(182,463)
	<u>29,508</u>	<u>27,156</u>
Deferred tax liabilities (current):		
Other	2,754	11
Depreciation	26,754	27,145
	<u>29,508</u>	<u>27,156</u>
Net deferred taxes	\$ —	\$ —

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During the year ended December 31, 2001, the valuation allowance increased by approximately \$73.2 million primarily due to the asset impairment write-down during the fourth quarter of 2001. At December 31, 2001, the Company's net deferred tax assets are fully offset by a valuation allowance.

At December 31, 2001, the Company had United States operating loss carryforwards of \$79.7 million available to reduce future United States taxable income which expire in 2020.

As of December 31, 2001, the Company had foreign operating loss carryforwards of approximately \$173.9 million that expire at various times and some of which carryforward without expiration.

No provision was made in 2001 for United States income taxes on the undistributed earnings of the foreign subsidiaries as it is the Company's intention to utilize those earnings in the foreign operations for an indefinite period of time or to repatriate such earnings only when tax effective to do so. It is not practicable to determine the amount of income or withholding tax that would be payable upon the remittance of those earnings.

#### 10. FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, restricted cash, accounts receivable, marketable securities and accounts payable approximate fair value. The estimated fair value of the Company's 2000 Convertible Debentures, 1999, 1998 and 1997 Senior Notes (carrying value of \$493 million and \$1,109 million, at December 31, 2001 and 2000, respectively), based on quoted market prices, was \$80 million and \$285 million, respectively, at December 31, 2001 and 2000.

#### 11. COMMITMENTS AND CONTINGENCIES

Future minimum lease payments under capital lease and vendor financing obligations ("Equipment Financing") and non-cancelable operating leases as of December 31, 2001 are as follows (in thousands):

Year Ending December 31,	Equipment Financing	Operating Leases
2002	\$ 50,667	\$ 16,022
2003	54,417	10,505
2004	51,871	7,037
2005	27,184	5,762
2006	4,265	4,327
Thereafter	—	5,415
Total minimum lease payments	\$ 188,404	\$ 49,068
Less: Amount representing interest	(34,445)	—
	<u>\$ 153,959</u>	<u>\$ 49,068</u>

Rent expense under operating leases was \$18.9 million, \$16.8 million and \$9.2 million for the years ended December 31, 2001, 2000 and 1999, respectively.

During the three months ended December 31, 2001, the Company agreed to purchase approximately \$12.2 million of additional fiber optic capacity from Southern Cross Cables Limited under an IRU Agreement.

In the fourth quarter of 2001, the Company received a \$9.0 million payment for a retroactive refund of interconnect charges and revenue settlement. This refund was recorded as a reduction of cost of revenue expense and the settlement was recorded as net revenue.

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On December 9, 1999, Empresa Hondurena de Telecomunicaciones, S.A., based in Honduras, filed suit in Florida State Court in Broward County against TresCom and one of TresCom's wholly-owned subsidiaries, St. Thomas and San Juan Telephone Company, alleging that such entities failed to pay amounts due to plaintiff pursuant to contracts for the exchange of telecommunications traffic during the period from December 1996 through September 1998. The Company acquired TresCom in June 1998 and TresCom is currently the Company's subsidiary. Plaintiff is seeking approximately \$14 million in damages, plus legal fees and costs. The Company filed an answer on January 25, 2000 and discovery has commenced. The Company's ultimate legal and financial liability with respect to such legal proceeding cannot be estimated with any certainty at this time, while an adverse result for the full amount sought or some significant percentage thereof could have a material adverse effect on the Company's financial results. The Company intends to defend the case vigorously. Management believes that this suit will not have a material adverse effect on the financial condition, results of operations or cash flows of the Company.

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

## 12. STOCKHOLDERS' EQUITY

In November 2001, the Company exchanged 10,870,668 shares of the Company's common stock for the extinguishment of \$62.9 million in principal amount of the 2000 Convertible Debentures. This resulted in an extraordinary gain of \$53.3 million, or \$1.00 per basic and diluted share, slightly offset by the write-off of related deferred financing costs.

In January 2001, the Company exchanged 8,308,258 shares of the Company's common stock for the extinguishment of \$129.6 million in principal amount of the 2000 Convertible Debentures and purchased \$38.2 million of principal amount of its senior notes and convertible debentures, prior to maturity, for \$11.6 million in cash. These transactions resulted in an extraordinary gain of \$106.1 million, or \$1.99 per basic and diluted share, slightly offset by the write-off of related deferred financing costs.

On January 10, 2001, the Company received from Inktomi Corporation an investment, which was a part of a strategic alliance created between the two companies in June 2000, of \$10 million in exchange for 2,862,254 restricted shares of the Company's common stock.

At the Company's Annual Meeting of Stockholders held on June 14, 2000, the stockholders of the Company approved an amendment to the Company's Certificate of Incorporation to increase the number of authorized shares of the Company's common stock to 150,000,000 shares.

During the years ended December 31, 2001, 2000 and 1999, the Company issued 265,287 shares, 2,946,238 shares and 456,514 shares, respectively, of the Company's common stock as consideration of the purchase price for the various acquisitions.

In October 1999, the Company sold 8.0 million shares of the Company's common stock at a price of \$22.50 per share. The net proceeds from the sale were approximately \$169.3 million.

## 13. STOCK-BASED COMPENSATION

In December 1998, the Company established the 1998 Restricted Stock Plan (the "Restricted Plan") to facilitate the grant of restricted stock to selected individuals who contribute to the development and success of the Company. The total number of shares of common stock that may be

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granted under the Restricted Plan is 750,000. During the years ended December 31, 2001, and December 31, 2000, the Company issued 17,643 shares and 3,000 shares, respectively, of restricted stock under the Restricted Plan at fair value to certain eligible agents. These restricted shares vest ratably on the issue date, first anniversary and second anniversary of the issue date based on a continued relationship. Compensation expense related to the award was approximately \$0.1 million and \$24,000 for the years ended December 31, 2001 and December 31, 2000, respectively. During the year ended December 31, 2001, the Company cancelled 80,500 shares of restricted stock due to the termination of certain employees. In conjunction with the cancellation, promissory notes of approximately \$0.6 million, securing payment for the restricted shares, were forgiven. During the year ended December 31, 1999, the Company issued 130,000 shares of restricted stock under the Restricted Plan at fair value. These restricted shares vest ratably after one, two and three years of continued employment.

The Company sponsors an Employee Stock Option Plan (the "Employee Plan"). The total number of shares of common stock authorized for issuance under the Employee Plan is 9,000,000. Under the Employee Plan, awards may be granted to key employees of the Company and its subsidiaries in the form of Incentive Stock Options or Nonqualified Stock Options. The Employee Plan allows the granting of options at an exercise price of not less than 100% of the stock's fair value at the date of grant. The options vest over a period of up to three years, and no option will be exercisable more than ten years from the date it is granted.

The Company sponsors a Director Stock Option Plan (the "Director Plan") for non-employee directors. Under the Director Plan, an option is granted to each qualifying non-employee director to purchase 45,000 shares of common stock, which vests over a two-year period. The option price per share is the fair market value of a share of common stock on the date the option is granted. No option will be exercisable more than ten years from the date of grant. An aggregate of 600,000 shares of common stock was reserved for issuance under the Director Plan.

A summary of stock option activity during the three years ended December 31, 2001 is as follows:

	2001		2000		1999	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Options outstanding—Beginning of year	5,002,405	\$ 15.90	3,883,359	\$ 12.07	3,128,566	\$ 9.87

Granted	4,171,942	\$	1.63	2,465,845	\$	21.25	1,651,200	\$	16.39
Exercised	—	\$	—	(488,822)	\$	5.29	(354,327)	\$	9.22
Forfeitures	(2,684,759)	\$	10.02	(857,977)	\$	19.90	(542,080)	\$	14.25
<b>Outstanding—end of year</b>	<b>6,489,588</b>	<b>\$</b>	<b>9.16</b>	<b>5,002,405</b>	<b>\$</b>	<b>15.90</b>	<b>3,883,359</b>	<b>\$</b>	<b>12.07</b>
<b>Eligible for exercise—end of year</b>	<b>1,946,078</b>	<b>\$</b>	<b>16.14</b>	<b>2,063,123</b>	<b>\$</b>	<b>11.20</b>	<b>1,789,865</b>	<b>\$</b>	<b>7.69</b>

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The following table summarizes information about stock options outstanding at December 31, 2001:

Range of Option Prices	Options Outstanding			Options Exercisable	
	Total Outstanding	Weighted Average Remaining Life in years	Weighted Average Exercise Price	Total Exercisable	Weighted Average Exercise Price
\$0.75 to \$0.90	2,017,105	9.32	\$ 0.89	30,000	\$ 0.90
\$1.94 to \$2.38	1,489,030	9.00	\$ 2.34	40,634	\$ 1.94
\$4.16	45,000	4.10	\$ 4.16	15,000	\$ 4.16
\$7.00 to \$10.50	41,418	3.66	\$ 9.30	34,751	\$ 9.07
\$10.56 to \$15.50	1,741,639	5.30	\$ 13.17	1,228,478	\$ 13.38
\$16.00 to \$23.87	439,834	6.58	\$ 17.99	325,553	\$ 18.13
\$27.00 to \$34.13	715,562	7.80	\$ 31.75	271,662	\$ 31.58
	<b>6,489,588</b>			<b>1,946,078</b>	

The weighted average fair value at date of grant for options granted during 2001, 2000 and 1999 was \$0.83, \$9.54, and \$7.99 per option, respectively. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	2001	2000	1999
Expected dividend yield	0%	0%	0%
Expected stock price volatility	162%	109%	85%
Risk-free interest rate	4.0%	5.0%	6.3%
Expected option term	4 years	4 years	4 years

If compensation cost for the Company's grants for stock-based compensation had been recorded consistently with the fair value-based method of accounting per SFAS No. 123, the Company's pro forma net loss and pro forma basic and diluted net loss per share for the years ending December 31, would be as follows:

	2001	2000	1999
<b>Net loss (amounts in thousands):</b>			
As reported	\$ (306,176)	\$ (174,664)	\$ (112,736)
Pro forma	\$ (316,510)	\$ (187,346)	\$ (119,241)
<b>Basic and diluted net loss per share:</b>			
As reported	\$ (5.73)	\$ (4.40)	\$ (3.72)
Pro forma	\$ (5.92)	\$ (4.72)	\$ (3.93)

#### 14. EMPLOYEE BENEFIT PLANS

The Company sponsors a 401(k) employee benefit plan (the "401(k) Plan") that covers substantially all United States based employees. Employees may contribute amounts to the 401(k) Plan not to exceed statutory limitations. The 401(k) plan provides an employer matching contribution in the Company's common stock of 50% of the first 6% of employee annual salary contributions. The employees receive the employer match in common stock of the Company which is subject to three-year cliff vesting. In 2001 and 2000, the Company contributed common stock valued at \$533,000 and \$587,000, respectively. A portion of these contributions were given in the form of cash for the open market purchase of the Company's common stock.

Effective January 1, 1998, the Company adopted an Employee Stock Purchase Plan ("ESPP"). The ESPP allows employees to contribute up to 15% of their compensation to purchase the Company's

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common stock at 85% of the fair market value. An aggregate of 2,000,000 shares of common stock were reserved for issuance under the ESPP. During the years ended December 31, 2001 and 2000, the Company issued 528,243 shares and 87,942 shares under the ESPP, respectively.

## 15. RELATED PARTIES

In January 2001, the Company loaned an officer of the Company the principal amount of \$0.8 million in the form of a full recourse note. The loan was made in connection with the exercise of options which were expiring and was payable five years from the date of agreement (subject to earlier repayments upon the termination of the officer's employment under certain circumstances) and was secured by shares of the Company's common stock obtained upon exercise of such options. Interest was compounded quarterly at a rate of 6% per annum and payable upon maturity. The transaction was conducted at arm's length. The portion of this note related to the issuance of stock was reflected as a reduction of stockholders' equity (deficit). In November 2001, the Company's Board of Directors approved a rescission of the exercise of this officer's options and as a result, the note was cancelled, the options expired and compensation expense of \$0.5 million was recorded based upon the fair value of the stock.

In June 1999, the Company contracted with a vendor to provide one satellite earth station in Australia and to provide, operate and maintain a satellite link between the Company's router in Los Angeles, California and the earth station. A Director of the Company is the Chairman and a stockholder of the vendor providing such services. The Company paid the vendor an approximately \$100,000 one-time charge in 2000 and pays a monthly charge of \$144,000.

At December 31, 2001, the Company held three notes receivable with balances totaling \$1.0 million from three officers of the Company. These notes arose during the year ended December 31, 2000 and were in connection with a loan from the Company to each of these officers for the exercise of options which were about to expire. The notes bear interest at the rate of 6% per annum and are payable in full five years from the date of agreement. The transactions were conducted at arm's length. These notes receivable are secured by shares of the Company's common stock acquired upon exercise of such options and are full recourse notes. The portion of the notes related to the issuance of stock is reflected as a reduction of stockholders' equity (deficit). In February 2002, the Company entered into a Retention Agreement with each of these officers which provided that the personal recourse feature of the notes would be removed if such officer remained employed with the Company through May 1, 2003. The shares of the Company's common stock acquired upon exercise of the officer's options will continue to be held by the Company as collateral for the note.

## 16. OPERATING SEGMENT AND RELATED INFORMATION

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

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

	Year Ended December 31,		
	2001	2000	1999
<b>Net Revenue</b>			
North America			
<i>United States</i>	\$ 271,588	\$ 343,027	\$ 279,025
<i>Canada</i>	172,647	179,372	125,708
<i>Other</i>	8,876	10,628	1,350
Total North America	453,111	533,027	406,083
Europe			
<i>United Kingdom</i>	141,297	159,683	96,321
<i>Germany</i>	99,189	98,053	42,545
<i>Other</i>	116,561	101,250	56,611
Total Europe	357,047	358,986	195,477
Asia-Pacific			
<i>Australia</i>	248,173	283,311	221,269
<i>Other</i>	24,144	24,098	9,910
Total Asia-Pacific	272,317	307,409	231,179
Total	\$ 1,082,475	\$ 1,199,422	\$ 832,739
<b>Operating Income/(Loss)</b>			
North America	\$ (411,135)	\$ (59,064)	\$ (32,656)
Europe	(202,406)	(40,313)	(6,778)
Asia-Pacific	(58,756)	(13,488)	(6,964)

Total	\$ (672,297)	\$ (112,865)	\$ (46,398)
<b>Capital Expenditures</b>			
North America	\$ 40,023	\$ 85,952	\$ 34,171
Europe	17,496	53,244	58,539
Asia-Pacific	30,252	54,576	17,872
Total	\$ 87,771	\$ 193,772	\$ 110,582

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

	December 31,		
	2001	2000	1999
<b>Assets</b>			
North America			
<i>United States</i>	\$ 264,149	\$ 919,089	\$ 767,089
<i>Canada</i>	112,483	199,556	284,349
<i>Other</i>	10,379	12,834	17,651
Total North America	387,011	1,131,479	1,069,089
Europe			
<i>United Kingdom</i>	143,582	214,912	100,299
<i>Germany</i>	62,892	73,839	53,434
<i>Other</i>	29,319	108,672	45,176
Total Europe	235,793	397,423	198,909
Asia-Pacific			
<i>Australia</i>	158,902	178,381	171,068
<i>Other</i>	34,508	40,843	11,680
Total Asia-Pacific	193,410	219,224	182,748
Total	\$ 816,214	\$ 1,748,126	\$ 1,450,746

The Company offers three main products—Voice, Data/Internet (which includes e-commerce, Web hosting, enhanced application and virtual private network), and VoIP in all three segments. Summary net revenue information with respect to the Company's products is as follows (in thousands):

	For the Year Ended December 31,		
	2001	2000	1999
Voice	\$ 930,635	\$ 1,077,728	\$ 802,396
Data/Internet	112,836	99,696	30,343
VoIP	39,004	21,998	—
Total	\$ 1,082,475	\$ 1,199,422	\$ 832,739

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## 17. QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The following is a tabulation of the unaudited quarterly results of operations for the two years ended December 31, 2001 and 2000:

For the quarter ended



	March 31, 2001	June 30, 2001	September 30, 2001	December 31, 2001
(in thousands)				
Net Revenue	\$ 280,005	\$ 271,083	\$ 272,244	\$ 259,143
Gross Margin	\$ 71,643	\$ 76,020	\$ 77,217	\$ 89,754
Loss before Extraordinary Item	\$ (92,397)	\$ (69,557)	\$ (52,547)	\$ (578,446)
Net Income (Loss)	\$ 13,698	\$ 116,105	\$ 46,143	\$ (482,122)
Basic and Diluted Net Income (Loss) per Share:				
Loss before Extraordinary Item	\$ (1.84)	\$ (1.33)	\$ (1.00)	\$ (9.93)
Net Income (Loss)	\$ 0.27	\$ 2.21	\$ 0.88	\$ (8.28)

For the quarter ended

	March 31, 2000	June 30, 2000	September 30, 2000	December 31, 2000
(in thousands)				
Net Revenue	\$ 287,953	\$ 300,136	\$ 301,130	\$ 310,203
Gross Margin	\$ 80,518	\$ 84,886	\$ 85,198	\$ 87,639
Loss before Extraordinary Item	\$ (43,252)	\$ (50,794)	\$ (56,376)	\$ (65,194)
Net Loss	\$ (43,252)	\$ (50,794)	\$ (56,376)	\$ (24,242)
Basic and Diluted Net Loss per Share:				
Loss before Extraordinary Item	\$ (1.14)	\$ (1.27)	\$ (1.40)	\$ (1.61)
Net Loss	\$ (1.14)	\$ (1.27)	\$ (1.40)	\$ (0.60)

## 18. ASSET IMPAIRMENT

Pursuant to SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," the Company identified certain long-lived assets for which there were indications of impairment. The overall deterioration in economic conditions within the telecommunications industry during 2001 led the Company to believe that the market value of certain long-lived assets had decreased significantly. As a result, the Company evaluated the following asset groupings, which included any corresponding goodwill: voice, data/Internet, and data centers. The Company's voice business provides international long distance services terminating in over 240 countries, and domestic long distance services within selected countries in its principal service regions. The Company's data/Internet business provides Internet access and data transfer services over ATM and frame relay networks to customers located in North America, Europe, and Australia. The Company's data centers offer Web design, Web hosting, co-location and e-commerce services in its primary operating regions, including the United States, Canada, the United Kingdom, France, and Australia.

Based on the Company's evaluation, it was determined that the estimated future cash flows were less than the carrying value of its voice and data center long-lived assets. Accordingly, during the fourth quarter of 2001, the Company adjusted the carrying value of its long-lived assets, including property and equipment and intangible assets, to their estimated fair value of \$485.0 million. This adjustment resulted in an asset impairment write-down of \$526.3 million, or \$9.85 per share, consisting of the following specific asset write-downs: \$357.3 million in goodwill, \$149.9 million in property and equipment, and \$19.1 million in customer lists. The estimated fair value of the Company's assets was

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based on the present value of estimated future cash flows using a discount rate commensurate with the risks involved.

The following table outlines the Company's asset impairment write-down by segment (in thousands):

	Year Ended December 31, 2001
North America	
United States	\$ 230,661
Canada	84,717
Other	—
Total North America	315,378
Europe	
United Kingdom	103,683
Germany	13,549
Other	40,427
Total Europe	157,659
Asia-Pacific	
Australia	43,437



Other	9,835
	<hr/>
Total Asia-Pacific	53,272
	<hr/>
Total	\$ 526,309
	<hr/>

## 19. GAIN ON EARLY EXTINGUISHMENT OF DEBT

In January 2001, the Company exchanged 8,308,258 shares of the Company's common stock for the extinguishment of \$129.6 million in principal amount of the 2000 Convertible Debentures and purchased \$38.2 million of principal amount of its senior notes and convertible debentures, prior to maturity, for \$11.6 million in cash. These transactions resulted in an after-tax extraordinary gain of \$106.1 million, or \$1.99 per basic and diluted share, slightly offset by the write-off of related deferred financing costs.

During the three month period ended June 30, 2001, the Company purchased \$244.8 million of principal amount of its senior notes, prior to maturity, for \$52.2 million in cash. This resulted in an after-tax extraordinary gain of \$185.7 million, or \$3.48 per basic and diluted share, slightly offset by the write-off of related deferred financing costs.

In July 2001, the Company purchased \$141.3 million of principal amount of its senior notes, prior to maturity, for \$36.0 million in cash. This resulted in an extraordinary gain of \$100.7 million, or \$1.86 per basic and diluted share, slightly offset by the write-off of related deferred financing costs.

In October 2001, the Company fully extinguished its vendor debt and related obligations to Hewlett-Packard by over \$50 million with a cash payment of \$5 million. The long-term debt eliminated by the Company was due in March 2005 and bore an interest rate of 9.25% per annum. This transaction resulted in an extraordinary gain of \$45.9 million, or \$0.86 per basic and diluted share.

In November 2001, the Company exchanged 10,870,668 shares of the Company's common stock for the extinguishment of \$62.9 million in principal amount of the 2000 Convertible Debentures. This resulted in an extraordinary gain of \$53.3 million, or \$1.00 per basic and diluted share, slightly offset by the write-off of related deferred financing costs.

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In conjunction with the extraordinary gain recorded above, the Company has recorded a \$5.0 million income tax provision as the Company is subject to alternative minimum taxes based on the enacted laws and rates for the year ended December 31, 2001. See Note 20—"Subsequent Events."

The senior notes and convertible debentures purchased by the Company have not been cancelled as of December 31, 2001. These are held as treasury bonds and are recorded as a reduction of long-term obligations.

## 20. SUBSEQUENT EVENTS

In January 2002, the Company made open market purchases of \$32.5 million principal amount of high yield debt securities for which it paid \$4.4 million in cash. In particular, the following high yield debt securities were purchased: \$21.5 million principal amount of the January 1999 Senior Notes and \$11.0 million principal amount of the October 1999 Senior Notes. This transaction will result in an extraordinary gain of \$27.3 million during the three months ending March 31, 2002.

In February 2002, the Company retired \$36.4 million in principal amount of the 2000 Convertible Debentures that had been previously purchased by the Company in December 2000 and January 2001. The retired principal had been held by the Company as treasury bonds and had been recorded as a reduction of long-term obligations.

In March 2002, the Company settled its outstanding equipment lease obligations of approximately \$15 million with CISCO Systems Capital Corporation for \$6.5 million in cash and 1,200,000 shares of the Company's common stock. \$5.0 million was paid in March 2002. \$1.5 million remains payable as of March 31, 2002 and is due April 2, 2003. This transaction will result in an extraordinary gain of approximately \$7 million during the three months ending March 31, 2002.

In March 2002, the Company consummated a transaction financing accounts receivables of a certain wholly-owned subsidiary, with RFC Capital Corporation, a division of Textron Inc. This transaction and a separate transaction consummated in July 2001 with RFC Capital Corporation are bound by a common allowable amount for financing of \$29.8 million, depending on the level of customer receivables.

On March 9, 2002, President Bush signed into law the Job Creation and Workers Assistance Act of 2002. The new law suspends the 90% limitation of net operating loss carryforward (NOL) for alternative minimum taxes (AMT). In accordance with SFAS No. 109, "Accounting for Income Taxes," any changes in tax laws or rates should be reflected in the year of enactment. Accordingly in the first quarter of 2002, the \$5 million tax provision recorded for the alternative minimum taxes at December 31, 2001 and the AMT credit carryforward will be reversed.

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Activity in the Company's allowance accounts for the years ended December 31, 2001, 2000 and 1999 was as follows (in thousands):

**Doubtful Accounts Receivable**

Period	Balance at Beginning of Period	Charged to Costs and Expenses	Deductions	Other(1)	Balance at End of Period
1999	\$ 14,976	\$ 27,908	\$ (19,843)	\$ 13,412	\$ 36,453
2000	\$ 36,453	\$ 17,756	\$ (23,713)	\$ 3,968	\$ 34,464
2001	\$ 34,464	\$ 40,235	\$ (52,310)	\$ —	\$ 22,389

**Deferred Tax Asset Valuation**

Period	Balance at Beginning of Period	Charged to Costs and Expenses	Deductions	Other	Balance at End of Period
1999	\$ 38,268	\$ 90,354	\$ —	\$ —	\$ 128,622
2000	\$ 128,622	\$ 53,841	\$ —	\$ —	\$ 182,463
2001	\$ 182,463	\$ 73,174	\$ —	\$ —	\$ 255,637

(1) Other additions represent the allowance for doubtful accounts receivable, which were recorded in connection with business acquisitions.

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[PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY \(DEFICIT\) \(in thousands\)](#)

[PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED CONSOLIDATED STATEMENTS OF CASH FLOWS \(in thousands\)](#)

[PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS \(in thousands\)](#)

[PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS](#)

[SCHEDULE II PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED VALUATION AND QUALIFYING ACCOUNTS](#)

PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED  
STOCK OPTION PLAN  
ORIGINALLY EFFECTIVE JANUARY 2, 1995  
AMENDED AND RESTATED EFFECTIVE JULY 9, 2001

PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED  
STOCK OPTION PLAN

Section 1. PURPOSES.  
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The purposes of the Plan are (a) to recognize and compensate selected employees and consultants of the Company and its Subsidiaries who contribute to the development and success of the Company and its Subsidiaries; (b) to maintain the competitive position of the Company and its Subsidiaries by attracting and retaining employees and consultants; and (c) to provide incentive compensation to such employees and consultants based upon the Company's performance as measured by the appreciation in Common Stock. The Options granted pursuant to the Plan are intended to constitute either incentive stock options within the meaning of Section 422 of the Code, or non-qualified stock options, as determined by the Board or the Committee at the time of grant. The type of Options granted will be specified in the Option Agreement between the Company and the recipient of the Options. The terms of this Plan shall be incorporated in the Option Agreement to be executed by the Optionee.

Section 2. DEFINITIONS.  
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(a) "Board" shall mean the Board of Directors of the Company, as constituted from time to time.

(b) "Change of Control" shall mean the occurrence of any of the following events:

(i) The acquisition in one or more transactions by any "Person" (as the term person is used for purposes of Sections 13(d) or 14(d) of the Securities Exchange Act of 1934, as amended (the "1934 Act")) of "Beneficial Ownership" (as the term beneficial ownership is used for purposes of Rule 13d-3 promulgated under the 1934 Act) of fifty percent (50%) or more of the combined voting power of the Company's then outstanding voting securities (the "Voting Securities"), provided that for purposes of this Section 2(b)(i), the Voting Securities acquired directly from the Company by any Person shall be excluded from the determination of such Person's Beneficial Ownership of Voting Securities (but such Voting Securities shall be included in the calculation of the total number of Voting Securities then outstanding); or

(ii) Approval by shareholders of the Company of (A) a merger, reorganization or consolidation involving the Company if the shareholders of the Company immediately before such merger, reorganization or consolidation do not or will not own directly or indirectly immediately following such merger, reorganization or consolidation, more than fifty percent (50%) of the combined voting power of the outstanding voting securities of the corporation resulting from or surviving such merger, reorganization or consolidation in substantially the same proportion as their ownership of the Voting Securities immediately before such merger, reorganization or consolidation, or (B) (1) a complete liquidation or dissolution of the Company or (2) an agreement for the sale or other disposition of all or substantially all of the assets of the Company; or

(iii) Acceptance by shareholders of the Company of shares in a share exchange if the shareholders of the Company immediately before such share exchange do not or will not own directly or indirectly immediately following such share exchange more than fifty percent (50%) of the combined voting power of the outstanding voting securities of the corporation resulting from or surviving such share exchange in substantially the same proportion as the ownership of the Voting Securities outstanding immediately before such share exchange.

(c) "Code" shall mean the Internal Revenue Code of 1986, as amended.

(d) "Committee" shall mean the Committee appointed by the Board in accordance with Section 4(a) of the Plan, if one is appointed, in which event, in connection with this Plan, the Committee shall possess all of the power and authority of, and shall be authorized to take any and all actions required to be taken hereunder by, and make any and all determinations required to be made hereunder by, the Board.

(e) "Company" shall mean, Primus Telecommunications Group, Incorporated, a Delaware corporation.

(f) "Common Stock" shall mean common stock of the Company, \$.01 par value per share.

(g) "Disability" or "Disabled" shall mean the inability of a Participant or Optionee, as the case may be, to perform his or her normal employment duties for the Company resulting from a mental or physical illness, impairment or any other similar occurrence which can be expected to result in death or which has lasted or can be expected to last for a period of twelve (12) consecutive months, as determined by the Board of Directors.

(h) "Employee" shall mean any person (including officers) employed by the Company or any Subsidiary. Additionally, solely for purposes of determining the persons eligible under the Plan to be granted Options, which Options shall be limited to non-qualified stock options, and not for the purpose of affecting the status of the relationship between such person and the Company, the term "Employee" shall include consultants to the Company; provided, however, that a director of the Company or any Subsidiary shall not be considered to be an Employee of the Company or any Subsidiary for purposes of this Plan solely by reason of serving as such director or receiving compensation from the Company or any Subsidiary for serving as such director.

(i) "Exchange Act" shall mean the Securities Exchange Act of 1934, as in effect from time to time.

(j) "Fair Market Value" shall mean the fair market value of a share of Common Stock, as determined pursuant to Section 7 hereof.

(k) "Non-Employee Director" shall have the meaning set forth in Rule 16b3(b)(3)(i) promulgated by the Securities and Exchange Commission under the Exchange Act, or any successor definition adopted by the Securities and Exchange Commission; provided, however, that the Board or the Committee may, in its sole discretion, determine from time to time

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time whether the regulations under Section 162(m) of the Code shall apply for purposes of determining which individuals are "Non-Employee Directors."

(l) "Option" shall mean an incentive stock option or non-qualified stock option to purchase Common Stock that is granted pursuant to the Plan.

(m) "Option Agreement" shall mean a written agreement in such form or forms as the Board (subject to the terms and conditions of this Plan) may from time to time approve evidencing and reflecting the terms of an Option.

(n) "Optionee" shall mean a Participant to whom an Option is granted.

(o) "Participant" shall mean each Employee.

(p) "Plan" shall mean the Primus Telecommunications Group, Incorporated Stock Option Plan, as amended from time to time.

(q) "Proprietary Information" shall mean any and all confidential, proprietary, business and technical information or trade secrets of the Company or of any Subsidiary or affiliate of the Company revealed, obtained or developed in the course of Optionee's employment with the Company or in the course of Optionee's performance of services for the Company in any other capacity. Such Proprietary Information shall include but shall not be limited to, methods of production and manufacture, research, marketing and development plans and efforts, cost information, pricing information, marketing methods and plans, identities of customers and suppliers, the Company's relationship with actual or potential customers and the needs and requirements of any such actual or potential customers, and any other confidential information relating to the business of the Company. Proprietary Information shall not include (i) such information as may be necessary or appropriate for an Optionee to disclose in the course of his employment or engagement for the effective and efficient discharge of his duties as an employee or consultant of the Company or as may be required by law to be disclosed; and (ii) such information as is readily available to the general public so long as such information did not become available to the general public as a direct or indirect result of Optionee's breach of his obligation to maintain confidentiality.

(r) "Securities Act" shall mean the Securities Act of 1933, as in effect from time to time.

(s) "Shares" shall mean shares of Common Stock.

(t) "Stock Purchase Agreement" shall mean an agreement in such form as the Board may from time to time approve, which an Optionee may be required to execute as a condition of purchasing Shares upon exercise of an Option.

(u) "Subsidiary" shall mean a subsidiary corporation of the Company, whether now or hereafter existing, as defined in Sections 424(f) and (g) of the Code.

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### Section 3. PARTICIPATION.

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The Board may grant Options at any time and from time to time to Participants who shall be selected by the Board. Options may be granted only to Participants. Any grant of Options may include or exclude any Participant, as the Board shall determine in its sole discretion. A Participant who has been granted an Option, if he or she is otherwise eligible, may be granted additional Options.

### Section 4. ADMINISTRATION.

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(a) PROCEDURE. The Plan shall be administered by the Board or a Committee consisting of not less than two persons appointed by the Board. Members of the Board or the Committee who are eligible for Options or have been granted Options may vote on any matters affecting the administration of the Plan or the grant of any Options pursuant to the Plan, except that no such member shall act upon the granting of an Option to himself or herself, but any such member may be counted in determining the existence of a quorum at any meeting of the Board or Committee during which action is taken with respect to the granting of Options to himself or herself.

If a Committee is appointed by the Board, the Committee shall have the power to administer the Plan on behalf of the Board, subject to such terms and conditions as the Board may prescribe. Members of the Committee shall serve for such period of time as the Board may determine. From time to time the Board may increase the size of the Committee and appoint additional members thereto, remove members (with or without cause) and appoint new members in substitution therefor, fill vacancies however caused, or remove all members of the Committee and thereafter directly administer the Plan.

In the event the Company has a class of equity securities registered under

Section 12 of the Exchange Act, the Plan shall be administered either by the Board, or by a Committee, appointed in the same manner and subject to the same terms as provided in this subsection (a), provided that said Committee shall consist of not less than two persons, each of whom is a Non-Employee Director.

(b) POWERS OF THE BOARD AND THE COMMITTEE. Subject to the provisions of the Plan, the Board or its Committee shall have the authority, in its discretion: (i) to grant Options; (ii) to determine the Fair Market Value per Share in accordance with Section 7 of the Plan; (iii) to determine the exercise price of the Options to be granted in accordance with Sections 6 and 7 of the Plan; (iv) to determine the Participants to whom, and the time or times at which, Options shall be granted, and the number of Shares to be subject to each Option; (v) to prescribe, amend and rescind rules and regulations relating to the Plan; (vi) to determine the terms and provisions of each Option granted under the Plan, each Option Agreement and each Stock Purchase Agreement (which need not be identical with the terms of other Options, Option Agreements and Stock Purchase Agreements), (vii) to modify or amend any Option, Option Agreement or Stock Purchase Agreement, including, without limitation, to accelerate the exercise date of any Option or to change the termination date of any Option, (viii) to determine whether any Participant will be required to execute a Stock Purchase Agreement or other agreement as a condition to the exercise of an Option, and to determine the terms and provisions of any such agreement (which

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need not be identical with the terms of any other such agreement) and, with the consent of the Optionee, to amend any such agreement; (ix) to interpret the Plan or any agreement entered into with respect to the grant or exercise of Options; (x) to authorize any person to execute on behalf of the Company any instrument required to effectuate the grant of an Option previously granted by the Board or to take such other actions as may be necessary or appropriate with respect to the Company's rights pursuant to Options or agreements relating to the grant or exercise thereof; and (xi) to make such other determinations and establish such other procedures as it deems necessary or advisable for the administration of the Plan.

(c) EFFECT OF THE BOARD'S OR COMMITTEE'S DECISION. All decisions, determinations and interpretations of the Board or the Committee shall be final and binding on all Optionees and any other holders of any Options granted under the Plan.

(d) LIMITATION OF LIABILITY. Notwithstanding anything herein to the contrary, no member of the Board or of the Committee shall be liable for any good faith determination, act or failure to act in connection with the Plan or any Option granted hereunder.

#### Section 5. STOCK SUBJECT TO THE PLAN.

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Subject to this Section 5 and to the provisions of Section 8 of the Plan, the maximum aggregate number of Shares which may be optioned and sold under the Plan is 5,500,000. Options may be either incentive stock options or non-qualified stock options, as determined by the Board. If an Option expires or becomes unexercisable for any reason without having been exercised in full, the Shares subject to such Option shall, unless the Plan shall have been terminated, return to the Plan and become available for future grant under the Plan. Notwithstanding the foregoing, no individual shall receive, over the term of the Plan, Options for more than an aggregate of twenty-five percent (25%) of the Shares authorized for grant under the Plan.

#### Section 6. TERMS AND CONDITIONS OF OPTIONS.

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Each Option granted pursuant to the Plan shall be authorized by the Board and shall be evidenced by an Option Agreement. Each Option Agreement shall incorporate by reference all other terms and conditions of the Plan, and shall contain the following terms and conditions:

(a) NUMBER OF SHARES. The number of shares subject to the Option.

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(b) OPTION PRICE. The price per share payable on the exercise of any Option shall be stated in the Option Agreement and shall be no less than the Fair Market Value per share of the Common Stock on the date such option is granted,

without regard to any restriction other than a restriction which will never lapse. Notwithstanding the foregoing, if an Option which is an incentive stock Option shall be granted under this Plan to any person who, at the time of the grant of such Option, owns capital stock possessing more than 10% of the total combined voting power of all classes of the Company's capital stock, the price per share payable upon exercise of such incentive stock Option shall be no less than 110 percent (110%) of the Fair Market Value per share of the Common Stock on the date such Option is granted.

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(c) CONSIDERATION. The consideration to be paid for the Shares to be issued upon exercise of an Option, including the method of payment, shall be determined by the Board and may consist entirely of cash, check, promissory notes or Shares having a Fair Market Value on the date of surrender equal to the aggregate exercise price of the Shares as to which said Option shall be exercised, or any combination of such methods of payment, or such other consideration and method of payment permitted under any laws to which the Company is subject which is approved by the Board. In making its determination as to the type of consideration to accept, the Board shall consider if acceptance of such consideration may be reasonably expected to benefit the Company.

(i) If the consideration for the exercise of an Option is a promissory note, it may, in the discretion of the Board, be either full recourse or nonrecourse and shall bear interest at a per annum rate which is not less than the applicable federal rate determined in accordance with Section 1274(d) of the Code as of the date of exercise. In such an instance, the Company may, in its sole discretion, retain the Shares purchased upon exercise of the Option in escrow as security for payment of the promissory note.

(ii) If the consideration for the exercise of an Option is the surrender of previously acquired and owned Shares, the Optionee will be required to make representations and warranties satisfactory to the Company regarding his title to the Shares used to effect the purchase (the "Payment Shares"), including without limitation, representations and warranties that the Optionee has good and marketable title to such Payment Shares free and clear of any and all liens, encumbrances, charges, equities, claims, security interests, options or restrictions, and has full power to deliver such Payment Shares without obtaining the consent or approval of any person or governmental authority other than those which have already given consent or approval in a manner satisfactory to the Company. The value of the Payment Shares shall be the Fair Market Value of such Payment Shares on the date of exercise as determined by the Board in its sole discretion, exercised in good faith. If such Payment Shares were acquired upon previous exercise of incentive stock options granted within two years prior to the exercise of the Option or acquired by the Optionee within one year prior to the exercise of the Option, such Optionee shall be required, as a condition to using the Payment Shares in payment of the exercise price of the Option, to acknowledge the tax consequences of doing so, in that such previously exercised incentive stock options may have, by such action, lost their status as incentive stock options, and the Optionee may have to recognize ordinary income for tax purposes as a result.

(iii) To the extent permitted under the Section 16b-3 of the Exchange Act, and in the sole discretion of the Committee, the Company may cooperate in a "cashless exercise" of an Option. The cashless exercise shall be effected by the Participant delivering to a securities broker, who is a registered securities broker acceptable to the Company and who agrees to effect such cashless exercise, instructions to sell a sufficient number of Shares to cover the costs and expenses associated therewith.

(d) FORM OF OPTION. The Option Agreement will state whether the Option granted is an incentive stock option or a non-qualified stock option, and will constitute a binding determination as to the form of Option granted.

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(e) EXERCISE OF OPTIONS. Any Option granted hereunder shall be exercisable at such times and under such conditions as shall be set forth in the Option Agreement (as may be determined by the Board and as shall be permissible under

the terms of the Plan), which may include performance criteria with respect to the Company and/or the Optionee, and as shall be permissible under the terms of the Plan.

An Option may be exercised in accordance with the provisions of this Plan as to all or any portion of the Shares then exercisable under an Option from time to time during the term of the Option. An Option may not be exercised for a fraction of a Share.

An Option shall be deemed to be exercised when written notice of such exercise has been given to the Company at its principal executive office in accordance with the terms of the Option Agreement by the person entitled to exercise the Option and full payment for the Shares with respect to which the Option is exercised has been received by the Company, accompanied by any agreements required by the terms of the Plan and/or Option Agreement, including an executed Stock Purchase Agreement. Full payment may consist of such consideration and method of payment allowable under Section 6 of the Plan. No adjustment shall be made for a dividend or other right for which the record date is prior to the date the Option is exercised, except as provided in Section 8 of the Plan.

As soon as practicable after any proper exercise of an Option in accordance with the provisions of the Plan, the Company shall, without transfer or issue tax to the Optionee, deliver to the Optionee at the principal executive office of the Company or such other place as shall be mutually agreed upon between the Company and the Optionee, a certificate or certificates representing the Shares for which the Option shall have been exercised. The time of issuance and delivery of the certificate(s) representing the Shares for which the Option shall have been exercised may be postponed by the Company for such period as may be required by the Company, with reasonable diligence, to comply with any applicable listing requirements of any national or regional securities exchange or any law or regulation applicable to the issuance or delivery of such Shares.

Exercise of an Option in any manner shall result in a decrease in the number of Shares which thereafter may be available, both for purposes of the Plan and for sale under the option, by the number of Shares as to which the Option is exercised.

(f) TERM AND VESTING OF OPTIONS.  
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(i) Notwithstanding any other provision of this Plan, no Option shall be (A) granted under this Plan after ten (10) years from the date on which this Plan is adopted by the Board, or (B) exercisable more than ten (10) years from the date of grant.

(ii) No Option granted to any Optionee shall be treated as an incentive stock option, to the extent such Option would cause the aggregate Fair Market Value (determined as of the date of grant of each such Option) of the Shares with respect to which incentive stock Options are exercisable by such Optionee for the first time during any calendar year to exceed \$100,000. For purposes of determining whether an incentive stock Option would cause the aggregate Fair Market Value of the stock to exceed the \$100,000 limitation, such

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incentive stock Options shall be taken into account in the order granted. For purposes of this subsection, incentive stock Options include all incentive stock options under all plans of the Company that are incentive stock option plans within the meaning of Section 422 of the Code.

Except as provided in Section 6(g) (iv), Options granted hereunder shall mature and become exercisable in whole or in part, in accordance with such vesting schedule as the Board shall determine, which schedule shall be stated in the Option Agreement. Options may be exercised in any order elected by the Optionee whether or not the Optionee holds any unexercised Options under this Plan or any other plan of the Company.

(g) TERMINATION OF OPTIONS.  
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(i) Unless sooner terminated as provided in this Plan, each Option shall be exercisable for the period of time as shall be determined by the



Board and set forth in the Option Agreement, and shall be void and unexercisable thereafter.

(ii) Except as otherwise provided herein or in the Option Agreement, upon the termination of the Optionee's employment or other relationship with the Company for any reason, Options exercisable on the date of termination of employment or such other relationship shall be exercisable by the Optionee (or in the case of the Optionee's death subsequent to termination of employment or such other relationship, by the Optionee's executor(s) or administrator(s)) for a period of three (3) months from the date of the Optionee's termination of employment or such other relationship.

(iii) Except as otherwise provided herein or in the Option Agreement, upon the Disability or death of an Optionee while employed or otherwise engaged by the Company, Options held by such Optionee which are exercisable on the date of Disability or death shall be exercisable for a period of twelve (12) months commencing on the date of the Optionee's Disability or death, by the Optionee or his legal guardian or, in the case of death, by his executor(s) or administrator(s); provided, however, that if such disabled Optionee shall commence any employment during such one (1) year period with a competitor of the Company (including, but not limited to, full or part-time employment or independent consulting work), as determined solely in tire judgment of the Board, all Options held by such Optionee which have not yet been exercised shall terminate immediately upon the commencement thereof.

(iv) Options may be terminated at any time by agreement between the Company and the Optionee.

(h) FORFEITURE. Notwithstanding any other provision of this Plan, if the Optionee's employment or engagement is terminated by the Company and the Board makes a determination that the Optionee (i) has engaged in any type of disloyalty to the Company, including without limitation, fraud, embezzlement, theft, or dishonesty in the course of his employment or engagement, or (ii) has been convicted of a felony or (iii) has disclosed any Proprietary Information without the consent of the Company or (iv) has breached the terms of any written confidentiality agreement or any non-competition agreement with the Company in any material respect, all unexercised Options held by such Optionee shall terminate upon the

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earlier of the date of termination of employment or engagement for "cause" or the date of such a finding.

Section 7. DETERMINATION OF FAIR MARKET VALUE OF COMMON STOCK.  
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(a) Except to the extent otherwise provided in this Section 7, the Fair Market Value of a share of Common Stock shall be determined by the Board in its sole discretion.

(b) In the event that Shares are traded in the over-the-counter market, the Fair Market Value of a share of Common Stock shall be the mean of the bid and asked prices for a share of Common Stock on the relevant valuation date as reported in THE WALL STREET JOURNAL (or, if not so reported, as otherwise reported by the National Association of Securities Dealers Automated Quotation System ("NASDAQ")), as applicable or, if there is no trading on such date, on the next preceding trading date. In the event Shares are listed on a national or regional securities exchange or traded in the NASDAQ National Market System, the Fair Market Value of a share of Common Stock shall be the closing price of a share of Common Stock on the exchange or on NASDAQ/NMS, as reported in THE WALL STREET JOURNAL on the relevant valuation date, or if there is no trading on that date, on the next preceding trading date.

(c) "Adjusted Fair Market Value" shall mean in the event of a Change of Control, the greater of (A) the highest price per share of Common Stock paid or payable to holders of the Common Stock in any transaction (or series of transactions) constituting or resulting (or as to which approval by shareholders of the Company constitutes or results) in the Change of Control or (B) the highest Fair Market Value of a share of Common Stock on any business day during the ninety (90) day period ending on the date of the Change of Control.

Section 8. ADJUSTMENTS.

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(a) Subject to required action by the shareholders, if any, the number of shares of Common Stock as to which Options may be granted under this Plan and the number of shares subject to outstanding Options and the option prices thereof shall be adjusted proportionately for any increase or decrease in the number of outstanding shares of Common Stock of the Company resulting from stock splits, reverse stock splits, stock dividends, reclassifications and recapitalizations.

(b) No fractional shares of Common Stock shall be issuable on account of any action mentioned in paragraph 8(a) above, and the aggregate number of shares into which Shares then covered by the Option, when changed as the result of such action, shall be reduced to the number of whole shares resulting from such action, unless the Board, in its sole discretion, shall determine to issue scrip certificates with respect to any fractional shares, which scrip certificates, in such event, shall be in a form and have such terms and conditions as the Board in its discretion shall prescribe.

Section 9. RIGHTS AS A SHAREHOLDER.

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The Optionee shall have no rights as a shareholder of the Company and shall have neither the right to vote nor receive dividends with respect to any Shares subject to an Option until such Option has been exercised.

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Section 10. TIME OF GRANTING OPTIONS.

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The date of grant of an Option shall, for all purposes, be the date on which the Board authorizes the granting of such Option. Notice of the grant shall be given to each Participant to whom an Option is so granted within a reasonable time after the date of such grant.

Section 11. MODIFICATION, EXTENSION AND RENEWAL OF OPTION.

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Subject to the terms and conditions of the Plan, the Board may modify, extend or renew an Option, or accept the surrender of an Option (to the extent not theretofore exercised) Notwithstanding the foregoing, (a) no modification of an Option which adversely affects an Optionee shall be made without the consent of such Optionee, and (b) no incentive stock Option may be modified, extended or renewed if such action would cause it to cease to be an "incentive stock option" under the Code, unless the Optionee specifically acknowledges and consents to the tax consequences of such action.

Section 12. CONDITIONS TO ISSUANCE OF SHARES UPON EXERCISE.

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(a) The obligation of the Company to issue and sell Shares to an Optionee upon the exercise of an Option granted under the Plan is conditioned upon (i) the Company obtaining any required permit or order from appropriate governmental agencies, authorizing the Company to issue and sell such Shares, and (ii) such issuance and sale complying with all relevant provisions of law; including, without limitation, the Securities Act, the Exchange Act, the rules and regulations promulgated thereunder, and the requirements of any stock exchange upon which the Shares may then be listed.

At the option of the Board, the obligation of the Company to issue and sell Shares to an Optionee upon the exercise of an Option granted under the Plan may be conditioned upon obtaining appropriate representations, warranties and agreements of the Optionee set forth in the Stock Purchase Agreement. Among other representations, warranties, restrictions and agreements, the Optionee may be required to represent and agree that the purchase of Shares of Common Stock under the Option Agreement shall be for investment, and not with a view to the public resale or distribution thereof, unless the Shares subject to the Option are registered under the Securities Act and the issuance and sale of the Shares complies with all other laws, rules and regulations applicable thereto. Unless the issuance of such Shares is registered under the Securities Act, the Optionee

shall acknowledge that the Shares purchased on exercise of the Option are not registered under the Securities Act and may not be sold or otherwise transferred unless such Shares have been registered under the Securities Act in connection with the sale or other transfer, or counsel satisfactory to the Company has issued an opinion satisfactory to the Company that the sale or other transfer is exempt from registration under the Securities Act, and unless said sale or other transfer is in compliance with any other applicable laws, rules and regulations including all applicable federal and state securities laws, rules and regulations. Unless the Shares subject to an Option are registered under the Securities Act, the certificates representing all Shares issued upon exercise of such Option shall contain the following legend:

THE SHARES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS

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AMENDED OR ANY APPLICABLE STATE SECURITIES LAWS. THESE SHARES HAVE NOT BEEN ACQUIRED WITH A VIEW TO DISTRIBUTION OR RESALE, AND MAY NOT BE SOLD, ASSIGNED, EXCHANGED, MORTGAGED, PLEDGED, HYPOTHECATED OR OTHERWISE TRANSFERRED OR DISPOSED OF, BY GIFT OR OTHERWISE, OR IN ANY WAY ENCUMBERED WITHOUT AN EFFECTIVE REGISTRATION STATEMENT FOR SUCH SHARES UNDER THE SECURITIES ACT OF 1933, AS AMENDED, AND ANY APPLICABLE STATE SECURITIES LAWS, OR A SATISFACTORY OPINION OF COUNSEL SATISFACTORY TO PRIMUS TELECOMMUNICATIONS GROUP, INCORPORATED THAT REGISTRATION IS NOT REQUIRED UNDER SUCH ACT AND UNDER APPLICABLE STATE SECURITIES LAWS.

Section 13. TRANSFERABILITY.  
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No Option shall be assignable or transferable otherwise than by will or by the laws of descent and distribution. During the lifetime of the Optionee, the Optionee's Options shall be exercisable only by such Optionee, or in the event of his or her legal incapacity, then by the Optionee's legal representative.

Section 14. OTHER PROVISIONS.  
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The Option Agreement and Stock Purchase Agreement may contain such other provisions as the Board of Directors in its discretion deems advisable and which are not inconsistent with the provisions of this Plan.

Section 15. CHANGE OF CONTROL.  
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(a) For purposes of the Plan, "Option Cancellation Date" shall mean, as to each Option, the later of: (i) the first business day after the expiration of a period of six (6) months from the date of grant of the Option; (ii) in the event of a Change of Control as defined in Section 2(b)(ii)(A) or 2(b)(ii)(B)(2), the date on which the transaction approved by shareholders of the Company (as provided in Section 2(b)(ii)) is consummated; and (iii) in the event of a Change of Control as defined in Section 2(b)(i) or 2(b)(iii), the first business day after the expiration of a period of sixty (60) days after the occurrence of such event.

(b) Upon a Change of Control, all Options (whenever granted) outstanding on the date of such Change of Control shall be or become immediately and fully exercisable.

(c) In the event of a Change of Control as defined in Section 2(b)(i), 2(b)(ii)(A), 2(b)(ii)(B)(2) or 2(b)(iii), all Options (whenever granted) outstanding on the Option Cancellation Date which are not exercised on or before the Option Cancellation Date shall be cancelled on such date by the Company, and the Company shall on such date pay to each holder of each such cancelled Option a cash amount equal to the excess, if any, in respect of each Option cancelled, of (i) the greater of (A) the Fair Market Value of the shares of Common Stock subject to the Option on the business day immediately preceding the Option Cancellation Date or (B) the Adjusted Fair Market Value of the Common Stock subject to the Option over (ii) the

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aggregate purchase price which would have been payable for such shares of Common Stock pursuant to the Option had the Option not been canceled.

Section 16. AMENDMENT OF THE PLAN.  
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Insofar as permitted by law and the Plan, the Board may from time to time suspend, terminate or discontinue the Plan or revise or amend it in any respect whatsoever with respect to any Shares at the time not subject to an Option; provided, however, that without approval of the shareholders, no such revision or amendment may change the aggregate number of Shares for which Options may be granted hereunder, change the designation of the class of employees eligible to receive Options or decrease the price at which Options may be granted.

Any other provision of this Section 16 notwithstanding, the Board specifically is authorized to adopt any amendment to this Plan deemed by the Board to be necessary or advisable to assure that the incentive stock Options or the non-qualified stock Options available under the Plan continue to be mated as such, respectively, under the law.

Section 17. APPLICATION OF FUNDS.  
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The proceeds received by the Company from the sale of shares pursuant to the exercise of Options shall be used for general corporate purposes or such other purpose as may be determined by the Company.

Section 18. NO OBLIGATION TO EXERCISE OPTION.  
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The granting of an Option shall impose no obligation upon the Optionee to exercise such Option.

Section 19. RESERVATION OF SHARES.  
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The Company, during the term of this Plan, shall at all times reserve and keep available such number of Shares as shall be sufficient to satisfy the requirements of the Plan.

The Company, during the term of this Plan, shall use its best efforts to seek to obtain from appropriate regulatory agencies any requisite authorization in order to issue and sell such number of Shares as shall be sufficient to satisfy the requirements of the Plan. The inability of the Company to obtain from any such regulatory agency having jurisdiction the requisite authorization(s) deemed by the Company's counsel to be necessary for the lawful issuance and sale of any Shares hereunder, or the inability of the Company to confirm to its satisfaction that any issuance and sale of any Shares hereunder will meet applicable legal requirements, shall relieve the Company of any liability in respect to the failure to issue or sell such Shares as to which such requisite authority shall not have been obtained.

Section 20. TAXES, FEES, EXPENSES AND WITHHOLDING OF TAXES.  
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(a) The Company shall pay all original issue and transfer taxes (but not income taxes, if any) with respect to the grant of Options and/or the issue and transfer of Shares pursuant to the exercise thereof, and all other fees and expenses necessarily incurred by the

Company in connection therewith, and will from time to time use its best efforts to comply with all laws and regulations which, in the opinion of counsel for the Company, shall be applicable thereto.

(b) The grant of Options hereunder and the issuance of Shares pursuant to the exercise thereof is conditioned upon the Company's reservation of the right to withhold in accordance with any applicable law, from any compensation or other amounts payable to the Optionee, any taxes required to be withheld under federal, state or local law as a result of the grant or exercise of such Option

or the sale of the Shares issued upon exercise thereof. To the extent that compensation or other amounts, if any, payable to the Optionee is insufficient to pay any taxes required to be so withheld, the Company may, in its sole discretion, require the Optionee, as a condition of the exercise of an Option, to pay in cash to the Company an amount sufficient to cover such tax liability or otherwise to make adequate provision for the Company's satisfaction of its withholding obligations under federal, state and local law.

Section 21. NOTICES.

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Any notice to be given to the Company pursuant to the provisions of this Plan shall be addressed to the Company in care of its Secretary (or such other person as the Company may designate from time to time) at its principal executive office, and any notice to be given to an Optionee shall be delivered personally or addressed to him or her at the address given beneath his or her signature on his or her Option Agreement, or at such other address as such Participant or his or her transferee (upon the transfer of the Shares purchased upon exercise) may hereafter designate in writing to the Company. Any such notice shall be deemed duly given when enclosed in a properly sealed envelope or wrapper addressed as aforesaid, registered or certified, and deposited, postage and registry or certification fee prepaid, in a post office or branch post office regularly maintained by the United States Postal Service. It shall be the obligation of each Optionee and each transferee holding Shares purchased upon exercise of an Option to provide the Secretary of the Company, by letter mailed as provided herein, with written notice of his or her direct mailing address.

Section 22. NO ENLARGEMENT OF OPTIONEE RIGHTS.

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This Plan is purely voluntary on the part of the Company, and the continuance of the Plan shall not be deemed to constitute a contract between the Company and any Optionee, or to be consideration for or a condition of the employment or service of any Optionee. Nothing contained in this Plan shall be deemed to give any Optionee the right to be retained in the employ or service of the Company or any Subsidiary, or to interfere with the right of the Company or any such corporation to discharge or retire any Optionee thereof at any time, subject to applicable law. No Optionee shall have any right to or interest in Options authorized hereunder prior to the grant thereof to such Optionee, and upon such grant he shall have only such rights and interests as are expressly provided herein, subject, however, to all applicable provisions of the Company's Certificate of Incorporation, as the same may be amended from time to time.

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Section 23. INVALID PROVISIONS.

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In the event that any provision of this Plan is found to be invalid or otherwise unenforceable under any applicable law, such invalidity or unenforceability shall not be construed as rendering any other provisions contained herein as invalid or unenforceable, and all such other provisions shall be given full force and effect to the same extent as though the invalid or unenforceable provision was not contained herein.

Section 24. APPLICABLE LAW.

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This Plan shall be governed by and construed in accordance with the laws of the State of Delaware.

Section 25. EFFECTIVE DATE.

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This Plan shall become effective on the date that it is adopted by the Board; PROVIDED, HOWEVER that it shall not be an incentive stock option plan if it is not approved, within one year (365 days) of its adoption by the Board, by a majority of the votes cast at a duly held shareholder meeting at which a quorum representing a majority of Company's outstanding voting shares is present, either in person or by proxy. The Board may make grant Options

hereunder prior to approval of the Plan or approval of any material amendment thereto; PROVIDED HOWEVER that any and all incentive stock Options so granted automatically shall be converted into nonqualified stock Options if tire Plan or any material amendment is not approved by shareholders within 365 days of its adoption.

**Subsidiaries of Primus Telecommunications Group, Incorporated**

Primus Telecommunications, Inc.	[Delaware]
Primus Telecommunications de Mexico SA de CV	[Mexico]
Primus Telecommunications of Virginia, Inc.	[Virginia]
3362426 Canada, Inc.	[Canada]
Primus Telecomm Canada, Inc.	[Canada]
3694798 Canada, Inc.	[Canada]
Primus Telecommunications International, Inc.	[Delaware]
Primus Telecommunications (Australia) Pty Ltd	[Australia]
Hotkey Internet Service Pty Ltd	[Australia]
Eclipse TeleCommunications Pty. Ltd	[Australia]
Primus Japan KK	[Japan]
Telegroup Japan KK	[Japan]
Telepassport LLC	[New Jersey]
PRIMUS Telecomm. KK	[Japan]
Bekkaome KK	[Japan]
PRIMUS Telecom SA de C.V.	[El Salvador]
Global Access Pty Ltd.	[South Africa]
Stubbs, Ltd.	[Hong Kong]
P1do Brasil LTDA	[Brazil]
Matrix Internet, S.A.	[Brazil]
Direct Internet Private Limited	[India]
Primus Telecom India Limited	[India]
Primus Telecommunications Europe BV	[Netherlands]
Primus Telecommunications S.A.	[France]
Primus Telecommunications S.r.l.	[Italy]
Primus Telecommunications AG	[Switzerland]
Primus Telecommunications Netherlands BV	[Netherlands]
Primus Telecommunications S.A.	[Spain]
Primus Telecommunications GmbH	[Austria]
Primus Telecommunications Ltd	[Ireland]
Telegroup Deutschland GmbH	[Germany]
Primus Telecom A/S	[Denmark]
Telecontinent SA	[France]
Telegroup Network Services SA	[Switzerland]
Telegroup Network Services Deutschland GmbH	[Germany]
Telegroup Italia S.r.l.	[Italy]
Telegroup International B.V.	[Netherlands]
Telegroup Nederland B.V.	[Netherlands]
Telegroup Sweden	[Sweden]
Primus Telecommunications GmbH	[Germany]
Delta One	[Liechtenstein]
Easy Call	[United States]
CS Communications GmbH	[Germany]
Cards & Parts	[Germany]
CS Network GmbH	[Germany]
InterNeXt S.A.	[France]
Primus Telecommunications Ltd.	[United Kingdom]
South East Telecom Ltd.	[United Kingdom]
Corporate Network Ltd.	[United Kingdom]
Telegroup UK Ltd.	[United Kingdom]
Phone Centre Communications (Service) Ltd.	[United Kingdom]
TresCom International Inc.	[Florida]
Rockwell Communications Corporation	[Florida]
TresCom U.S.A. Inc.	[Florida]
Global Telephone Holding Inc.	[US Virgin Islands]
Interisland Telephone Corp.	[US Virgin Islands]
St. Thomas & San Juan Telephone Co., Inc.	[US Virgin Islands]
STSJ Network Assets Inc.	[US Virgin Islands]
STSJ Overseas Telephone Company Inc.	[Puerto Rico]
Least Cost Routing, Inc.	[Florida]
Rate Reductions Center, Inc.	[Florida]
Puerto Rico Telecom Corp.	[New York]
OTC Network Assets, Inc.	[Puerto Rico]
TresCom Network Services Inc.	[Florida]

IPRIMUS.com, Inc.	[Delaware]
LCR Telecom Group Plc	[United Kingdom]
LCR Telecom Group Inc.	[British Virgin Islands]
LCR Telecom Offshore (Holdings) Limited	[United Kingdom]
Virtual Technology Holdings Inc.	[United Kingdom]
LCR Telecom Switzerland	[Switzerland]
Goldenline Brazil	[Brazil]
Commsol International Holdings Inc.	[British Virgin Islands]
LCR Telecom (Jersey) Limited	[Jersey]
Binoche Holdings Pte	[Madeira]
LCR Telecom Limited	[United Kingdom]
Virtual Technology Telecom (UK) Limited	[United Kingdom]
Phonetrack Limited	[United Kingdom]
Discount Calls Limited	[United Kingdom]
LCR France SA	[France]
LCR Telecom Espana SA	[Spain]
LCR Telecom Europe NV	[Belgium]
LCR Telecom Luxembourg	[Luxembourg]
LCR Telecom Belgium bvba	[Belgium]
LCR Telecom do Brasil LTDA	[Brazil]
LCR Telecom Sucursal	[Paraguay]
Virtual Technology Inc.	[British Virgin Islands]
LCR Telecom (Kenya) Limited	[Kenya]
Justice Telecom Switzerland	[Switzerland]
PRIMUS Telecommunications Pty Ltd.	[Australia]
LCR Telecom International, Inc.	[United States]
IPrimus USA, Inc.	[Delaware]

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**INDEPENDENT AUDITORS' CONSENT**

We consent to the incorporation by reference in the Registration Statements of Primus Telecommunications Group, Incorporated (the "Company") on Form S-8 (Nos. 333-35005, 333-56557, 333-73003, 333-70514 and 333-39526) and Form S-3 (Nos. 333-89539 and 333-39096) of our report dated April 11, 2002, appearing in the Company's Annual Report on Form 10-K for the year ended December 31, 2001.

Deloitte & Touche LLP  
McLean, Virginia  
April 16, 2002

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