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business

Qwest stock drops by 14%

New CEO Ed Mueller says Qwest will boost spending to increase home broadband speed.

By Tom McGhee
The Denver Post

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Qwest will increase spending to upgrade its network by up to \$300 million next year, accelerating a plan to boost broadband speed to homes, Qwest chief executive Ed Mueller said Tuesday.

But Mueller disappointed analysts who wanted more information on the company's strategy and were hoping he would announce a dividend during a conference call on Qwest's third-quarter earnings.

Qwest's stock dropped to a 52-week low, sinking to \$6.94 before closing at \$7.06, down 13.7 percent.

Later in a phone interview, Mueller said customers want faster Internet speeds and that that's why lines are being upgraded.

"We think speed is absolutely critical for our customers. We wouldn't do it just to spend

money," he said.

He told analysts who peppered him with questions that Qwest was not announcing a new video strategy.

"We're staying with DirecTV," he said. "We will take advantage of any products or services that will come over higher speed."

Qwest doesn't have its own wireless or video offering. Instead, it resells Sprint Nextel wireless service and DirecTV satellite-TV service to compete against cable.

Mueller urged analysts to be patient while Qwest completes a strategic review he began after taking over for former chief executive Richard Notebaert in the summer.

"I understand the frustration, but I think a complete holistic plan from a new CEO is the right thing to do," he said.

Mueller said Qwest's board has decided to defer any decision on dividends or a stock-buyback plan until the review is completed at the end of the year.

"This is a prudent course to follow," he said.

Stifel Nicolaus analyst Chris King said he didn't understand where Qwest was going.

"They were a little unclear as to what the ultimate business model is going to be," he said. "It is not going to be video, because they are still

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committed to reselling their satellite service for video product. (So) why are they investing this money? There is a worry that the incremental investment is going to take (a dividend) away."

He said shareholders want a dividend.

"At the end of the day, they want some significant remuneration back to shareholders of the free cash flow the company is generating," he said.

Other Baby Bells such as AT&T and Verizon are aggressively moving to provide integrated Internet, television, wireless and telephone to customers who can turn to cable providers for such packages, said telecommunications analyst Jeff Kagan.

Such a move requires expensive upgrades of networks but should give the companies high returns, he said.

Qwest reported that it continued to lose customers as total phone lines fell 7.2 percent, reflecting a move by consumers away from traditional land-line phones. Qwest also saw a 19 percent drop in wholesale long-distance services.

Mueller attributed the wholesale revenue decline to consolidation in the industry and said the company is looking to replace those losses with high-speed products.

For the quarter ended Sept. 30, Qwest reported net income of \$2.07 billion, or \$1.08 per share,

compared with \$194 million, or 9 cents per share, in the third quarter of 2006.

The \$2 billion profit came thanks to a one-time tax gain. Excluding the gain and a charge to earnings for legal costs, earnings would have been \$269 million, or 14 cents a share, chief financial officer John Richardson said.

Operating revenue declined 1.5 percent to \$3.43 billion from \$3.49 billion a year earlier.

Analysts polled by Thomson Financial had forecast, on average, net income of 15 cents per share on \$3.49 billion in revenue for the period.

The Associated Press contributed to this report. Tom McGhee: 303-954-1671 or tmcghee@denverpost.com

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Qwest investors rattled over Q3 report

By Jeff Smith, Rocky Mountain News

Tuesday, October 30, 2007

Qwest's third-quarter profits soared on a one-time tax gain today, but revenues were down 1.5 percent and shares fell by more than 10 percent in early trading amid investor concerns over the Denver telco's strategy.

The stock decline also appeared to be driven by the fact that Qwest's board has delayed a decision on a possible stockholder dividend until new CEO Edward Mueller has completed his strategic review of the company.

"I understand the frustration. But I think a complete holistic plan from a new CEO is the right thing to do," Mueller told analysts in a conference call. "We are going to produce. We are going to have a great company."

Mueller did announce plans to set aside up to \$300 million next year to expand Qwest's fiber network into neighborhoods. That will help Qwest deliver higher Internet speeds and perhaps video services in competition against cable TV (although Mueller said Qwest plans to stick to reselling DirecTV).

Donna Jaegers, a telecommunications analyst with Janco Partners in Greenwood Village, liked the initial glimpse of Mueller's thinking.

"I think strategically Mueller is putting the company in a better position, but he's disappointing the short-term bulls that were hoping for a payout," Jaegers said. "He has people spooked that Qwest is going to spend all of its free cash flow and none will go to shareholders (in the form of a dividend)."

She said investors also may be anxious about reports that Qwest bid for Covad Communications, an indication Qwest could get more aggressive in the mergers and acquisition front under Mueller.

But Jaegers said she thinks Mueller is doing the right thing for the long-term future of the company, and said she was comfortable with her decision Monday to upgrade Qwest from a "sell" to a "market perform."

The third-quarter results represented the first quarter under Mueller, who replaced the retiring Dick Notebaert in August.

Qwest reported third-quarter net income of \$2.07 billion, or \$1.08 a share, compared with \$194 million, or 9 cents a share, for the same period of 2006.

The results included a one-time tax gain of \$2.1 billion. Earnings were affected negatively by a \$353 million charge related to settling shareholder litigation that stems from the era of former CEO Joe Nacchio.

Revenues were off 1.5 percent to \$3.43 billion and included declines in Qwest's wholesale business.

Qwest, which is a local telephone provider in 14 states, continues to lose traditional land lines, a trend exacerbated by the housing slowdown. Total land lines were down 7.2 percent year-over-year to 13 million.

The company reported that it had 37,026 employees as of Sept. 30, a 5.5 percent decline from 39,163 a year ago.

On the positive side, Qwest's high-speed Internet business continues to post strong growth, up 27.5 percent since last year to 2.5 million subscribers. And the average monthly customer bill is up 10 percent to \$55 in the past year.

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