

FINAL TRANSCRIPT

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ELNK - Q1 2006 EarthLink Earnings Conference Call

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Apr. 20. 2006 / 8:30AM, ELNK - Q1 2006 EarthLink Earnings Conference Call

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Keith Dalrymple
Halpern Capital - Analyst

PRESENTATION

Operator

Good morning. My name is Jocelyn and I will be your conference operator today.

At this time, I would like to welcome everyone to the EarthLink first quarter 2006 earnings conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question and answer session. [OPERATOR INSTRUCTIONS] Thank you. Mr. Kevin Dotts, Chief Financial Officer of EarthLink, you may begin your conference.

Kevin Dotts - EarthLink - CFO

Thanks and welcome, everyone, to our call. This morning I'm joined by EarthLink's CEO, Garry Betty, and our Vice President of Investor Relations, Mike Gallentine, to discuss our first quarter results. Following our comments, there will be an opportunity for questions.

Before we continue, I would like to point out that certain statements contained in our earnings release and on this conference call are forward-looking statements rather than historical facts that are subject to risks and uncertainties that could cause actual results to differ materially from those described.

With respect to such forward-looking statements, the Company seeks the protections afforded by the Private Securities Litigation Reform Act of 1995. These risks include a variety of factors, including competitive developments and risk factors listed in the Company's SEC reports and public releases. Those lists are intended to identify certain principal factors that could cause actual

Apr. 20. 2006 / 8:30AM, ELNK - Q1 2006 EarthLink Earnings Conference Call

results to differ materially from those described in the forward-looking statements, but are not intended to represent a complete list of all risks and uncertainties inherent to the Company's business.

In an effort to provide useful information to investors, our comments today also include non-GAAP financial measures. For details on those measures, including why we use them and reconciliations to the most comparable GAAP measures, please refer to our earnings release and the form 8-K, which has been furnished to the SEC, both of which are available on our website at www.earthlink.net.

Now I'll turn things over to Garry.

Garry Betty - *EarthLink - CEO*

Thanks, Kevin, and I also want to welcome everybody to our first quarter earnings call.

In the first quarter of 2006, EarthLink continued to execute on its strategy to become a total communications provider. During the quarter, we actively marketed our bundled home phone service and 8 meg DSL service in Dallas, Seattle, San Francisco, and San Jose, which we introduced in late December of 2005 and early 2006.

We also invested \$50 million in Covad, which will allow them to build approximately 600 additional central offices in eight markets, including L.A., New York, Atlanta, Chicago, Miami, San Diego, Philadelphia, and Washington, D.C. We expect the first of these additional markets to be completed in the third quarter of 2006, with the remaining markets targeted to launch by the end of the year. However, the current market rollout expectations have been delayed about a quarter from our initial plans and consequently, this will impact our full-year expectations, which Kevin will address later on the call. Once these markets are built out, we expect to be able to provision a bundled 8 meg DSL and home phone voice service to over 10 million households in the United States.

In the first quarter of 2006, we continued to nationally market EarthLink's True Voice Over IP solution, primarily through direct mail and e-mail. In the second quarter, EarthLink expects to expand the distribution channels to include both national and regional specialty retailers. Through the first quarter of 2006, with limited marketing and very limited footprint for some of our Voice products, EarthLink has already added 13,000 Voice subscribers. As we continue to expand our marketing efforts and footprint, EarthLink expects the number of subscribers to increase substantially.

During the first quarter, we also expanded our municipal Wi-Fi footprint by winning the city of Milpitas, California. Additionally, we announced our partnership with Google and jointly submitted a proposal to the city of San Francisco. Subsequent to the end of the quarter, EarthLink's proposal was selected by the city of San Francisco. These markets, together with the cities of Anaheim and Philadelphia, provide us with the opportunity to address over 1 million households around the country. We continue to believe that we'll successfully compete for additional cities in the coming quarters.

In addition to the progress that we've made on our strategic Voice and municipal Wi-Fi efforts during the first quarter, subsequent to quarter close, EarthLink completed the acquisition of New Edge Networks. New Edge Networks will enable EarthLink to quickly expand its business in the fast-growing small and medium enterprise market, focusing on IP VPN services. This market today is estimated at several billion dollars, and industry analysts expect the IP VPN market to grow at over 20% -- at a 20% CAGR through 2009.

Additionally, EarthLink and New Edge expect synergies by being able to package their Voice, web hosting, and enterprise protection and security tools to meet the rapidly growing demand in the small office/home office market, as well as the small and medium enterprise area.

Apr. 20. 2006 / 8:30AM, ELNK - Q1 2006 EarthLink Earnings Conference Call

For the existing access services over the past two years, we've had the fastest growing, most successful value-priced Internet service available, enabling us to gain market share in this space. During the first quarter, we grew our PeoplePC service by 125,000 net subscribers. Over the past year, our PeoplePC customer base has grown by 39% to end the quarter at 1.4 million subscribers.

We also continue to generate solid growth in our broadband services. For the quarter, EarthLink added 85,000 net broadband subscribers and ended the quarter with 1.7 million subscribers, an increase of 16% compared to the first quarter of 2005.

The trend of a declining premium narrowband market over the past couple of years continued during the first quarter. As a result, our premium narrowband subscriber base decreased by 179,000 during the quarter to end at 2.1 million subscribers.

For our core access business, EarthLink expects the trends of growth in value narrowband and broadband, and declines in premium narrowband will continue throughout 2006 and beyond.

These trends have translated into a relatively flat customer base over the past few years, but the composition of the customer base has changed dramatically. At the end of the first quarter, only 40% of our customers were premium narrowband, down from 52% just one year ago. That number is expected to continue to climb. In fact, by the end of 2006, our traditional premium narrowband subscribers could account for only about one-third of our [inaudible] subscribers. However, as Kevin will discuss in just a moment, while our revenues are down marginally for the prior year, they have not fallen precipitously, as many had predicted. In addition, our gross margin percentage remains very strong.

I'd now like to turn the call over to Kevin to discuss our financial results.

Kevin Dotts - *EarthLink - CFO*

Thanks, Garry.

Overall, the first quarter of 2006 was generally in line with our expectations, which was marked by increased investment in the form of operating and sales and marketing expenses related to our strategic growth initiatives.

Broadband revenues were \$115.5 million, a 6% increase compared to the first quarter of 2005, driven by the increase in broadband subscribers. Overall, broadband average revenue per user, or ARPU, was \$23.29, down from \$25.69 in the first quarter of 2005. The decline in ARPU was primarily due to introductory price promotions, lower retail DSL pricing, and a mix shift to lower ARPU retail, cable, and wholesale customers.

Narrowband revenues were \$164.6 million, an 18% decrease compared to the first quarter of 2005. The decrease in narrowband revenues was primarily due to the decline in premium narrowband subscribers and the transfer of EarthLink wireless subscribers to the Helio joint venture at the end of the prior year first quarter, previously included in narrowband revenues, partially offset by the subscriber growth in our value brand PeoplePC.

For the first quarter of 2006, advertising, other value-added services, and web hosting revenues increased 18.4% to \$29.6 million compared to the first quarter of 2005. This revenue growth was due primarily to an increase in search-related advertising revenues and an increase in our value-added service revenues. These value-added service revenues now generate a record \$1.27 of incremental revenue per average user per month, compared to only \$0.88 per user during the first quarter of 2005, a 45% improvement.

Additionally, during the first quarter of 2006, we signed a two-year contract extension with Google for search functionality. We've partnered with Google since February of 2002 and over this time have increased our value-added service revenue by over 470%.

Apr. 20, 2006 / 8:30AM, ELNK - Q1 2006 EarthLink Earnings Conference Call

Overall revenues for the quarter were \$310 million, a 7.5% decline from the first quarter of last year, driven primarily by the decrease in premium narrowband revenue. As EarthLink continues to evolve into a total communications company and away from a pure dial access provider, our reliance on premium narrowband revenues continues to decrease. During the first quarter of 2006, only 40% of our revenues were derived from premium narrowband services, down from 51% in the first quarter of 2005. By the end of 2006, premium narrowband revenues are only expected to account for approximately one-third of our total revenue.

Importantly, though, gross margin percentages for our narrowband and broadband services have improved significantly over the past few years. Narrowband gross margins are almost 90% and broadband gross margins are almost 40% -- excuse me, are more than 40%. However, due to the continued shift in subscriber mix to lower margin broadband, gross margins are now approximately 70.5% of revenues, a 10 basis point decline from the first quarter of 2005. Coupled with the decrease in overall revenues, gross margins declined 8% compared to the first quarter of 2005 to \$218.2 million.

Total support costs were \$91.9 million, an increase of 1.3% compared to the first quarter of 2005. However, included in the first quarter of 2006 expenses is approximately \$3.7 million of stock-based compensation expense related to FAS 123R, which was adopted on January 1, 2006. Additionally, the first quarter of 2006 also included \$5.3 million of expense related to the ramp-up of our Voice and Muni Wi-Fi initiatives. The Company expects to benefit from these growth initiatives in the coming quarters and years.

Sales and marketing expenses were \$105 million, a slight decrease from the first quarter of 2005. This decrease was driven by a decline in cost caused by lower premium narrowband and broadband gross subscriber additions, partially offset by higher PeoplePC gross additions. Additionally, included in the first quarter 2006 figure is \$11 million of expense associated with our Voice strategic growth initiative. This sales and marketing spending is expected to generate new revenue growth for our Company.

Overall, gross subscriber additions were level with the first quarter of last year. The blended subscriber acquisition cost in the first quarter of 2006 was \$137 per gross organic subscriber addition compared to \$138 in the first quarter of 2005.

Adjusted EBITDA was \$29.4 million, a decline of \$21.4 million from the first quarter of 2005, driven primarily by the decrease in gross margins. Net income in the first quarter was \$116.4 million or \$0.12 per share, a decrease of \$17 million compared to the first quarter of 2005.

The decrease in net earnings is primarily attributable to a \$21.4 million decrease in adjusted EBITDA as noted above and \$7.3 million increase in equity losses related to the Helio joint venture, as Helio continues to ramp up its operations in anticipation of its 2006 product launches.

These were partially offset by a \$5.2 million decrease in income tax expense, which was due to not accruing tax expense during the first quarter of 2006 resulting from no taxable income expected for the full year of 2006, a \$3.7 million decline in depreciation and amortization expense and a \$1.3 million increase in interest income, primarily related to higher interest rates earned on our investments in the first quarter of 2006, and \$900 million loss on investments recorded during the first quarter of 2005. No, sorry, \$900,000 -- excuse me -- those investments recorded first quarter 2005.

EarthLink generated \$21.5 million of free cash flow during the first quarter of 2006. Capital expenditures and cash payments for subscriber base acquisitions in the first quarter aggregated approximately \$7.9 million. Additionally, during the quarter, EarthLink provided a scheduled capital contribution of \$39.5 million to Helio, and as Garry previously noted, we also made a \$50 million investment in Covad.

During the first quarter of 2006, cash and marketable securities decreased \$69.4 million and we ended the quarter with \$352.8 million of cash and marketable securities.

Apr. 20. 2006 / 8:30AM, ELNK - Q1 2006 EarthLink Earnings Conference Call

Now for the outlook. The following statements are based on management's current expectations. These statements are forward-looking and actual results may differ materially. The Company undertakes no obligation to update these statements.

As a result of EarthLink completing the New Edge Networks acquisition on April 13th and a slower than initially expected buildout of certain line-powered voice markets, EarthLink now expects net subscriber additions of 50,000 to 75,000 subscribers and full-year 2006 revenue of \$1.33 billion to \$1.38 billion. Due to the revised voice market rollout schedule, EarthLink expects to generate lower sales and marketing expense related to the voice initiatives than originally planned. The lower than expected sales and marketing spend will be partially offset by increased efforts related to growing the New Edge Network subscriber base. Accordingly, EarthLink now expects adjusted EBITDA to be \$120 to \$140 million.

As a result of the New Edge acquisition, we expect to increase amortization expense approximately \$10 million. Accordingly, EarthLink now expects full-year net income to be between a loss of \$40 million to break even. This includes approximately \$14 million of FAS 123R expense and 90 to \$110 million of equity method losses associated with our proportionate share of Helio's results.

In the second quarter of 2006, EarthLink expects between zero net subscriber additions and 25,000 net subscribers. Revenues are expected to be between \$330 million to \$335 million. Adjusted EBITDA is expected to be between \$30 million and \$35 million. Net income is expected to be between break-even and income of \$5 million.

This income guidance includes our proportionate share of Helio's expected equity method loss of approximately \$20 million, as Helio is expected to launch their initial products in the second quarter.

With that, I will turn the call back over to Garry for some concluding remarks before our question and answer session.

Garry Betty - *EarthLink - CEO*

Thanks, Kevin.

EarthLink had another good quarter, with our existing business performing as expected in terms of subscribers, revenues, and profitability. We continue to make significant progress in our strategy to become a total communications provider.

During the quarter, we invested in Covad to significantly expand our voice and data bundled offer, and we successfully competed for and won two additional municipal Wi-Fi markets.

As 2006 continues to unfold, EarthLink expects to continue to add voice subscribers with additional Muni Wi-Fi markets and integrate and grow the New Edge Networks acquisition. We expect to exit 2006 on a path to achieve our 2009 goals of 10-15% compounded annual revenue growth, and 17-19% EBITDA margins.

And with that, I'll turn the call over to the operator to open the lines for questions.

QUESTIONS AND ANSWERS

Operator

[OPERATOR INSTRUCTIONS] Your first question comes from Anthony Noto.

Apr. 20. 2006 / 8:30AM, ELNK - Q1 2006 EarthLink Earnings Conference Call

Jen Connelly - *Goldman Sachs - Analyst*

Hi, this is actually Jen Connelly in for Anthony this morning. How are you?

Garry Betty - *EarthLink - CEO*

How are you?

Jen Connelly - *Goldman Sachs - Analyst*

Good, thank you. We had a question regarding the contribution of New Edge Network to the updated fiscal year '06 revenue guidance. How much is the -- because previously New Edge was not in your numbers, correct?

Garry Betty - *EarthLink - CEO*

That's right.

Kevin Dotts - *EarthLink - CFO*

That's correct.

Jen Connelly - *Goldman Sachs - Analyst*

So are you guys providing any breakout of the contribution that you expect from New Edge?

Kevin Dotts - *EarthLink - CFO*

Jen, I think the way to look at this, as we said last year, that they would be about approximately \$120 million in 2005 or revenues. This year we thought that would grow in the 8 to 9 or 10% -- up to 10% range. So that gets you to roughly in the -- you can do the math, in the \$130 million range. And we're picking up only our stub share from April 13th on.

Jen Connelly - *Goldman Sachs - Analyst*

Right. And do you expect their profitability to be basically in line with what it was last year?

Kevin Dotts - *EarthLink - CFO*

I would expect as we're investing in accelerating their growth and their lead cycle time that they'll actually be in roughly a break-even position on EBITDA, as we had indicated earlier.

Jen Connelly - *Goldman Sachs - Analyst*

Okay.

Apr. 20. 2006 / 8:30AM, ELNK - Q1 2006 EarthLink Earnings Conference Call

Garry Betty - *EarthLink - CEO*

For '06.

Kevin Dotts - *EarthLink - CFO*

For '06.

Jen Connelly - *Goldman Sachs - Analyst*

For '06, right. And their subcontribution will be on top of your numbers?

Kevin Dotts - *EarthLink - CFO*

Well, for the current period, as we integrate them, they'll be in the 60,000 [inaudible] range and then that will grow by about 10% over the year.

Jen Connelly - *Goldman Sachs - Analyst*

Okay. Great.

And then, if I could just ask a follow-up question, well, it's not really related. But it's with regard to Helio, as far as the timing of that launch and how that's tracking relative to your expectations.

Garry Betty - *EarthLink - CEO*

Well, we're a little -- they've bitten off a big bite, doing all the stuff they've got going on, but we're in line to launch our first handset to the Korean-American segment at the end of this month and should launch our first Helio handsets targeted for these tech-savvy youth early in May.

Jen Connelly - *Goldman Sachs - Analyst*

Early in May.

Garry Betty - *EarthLink - CEO*

So we are really close.

Jen Connelly - *Goldman Sachs - Analyst*

Okay. Great. Thank you.

Operator

Your next question comes from Youssef Squali.

Apr. 20. 2006 / 8:30AM, ELNK - Q1 2006 EarthLink Earnings Conference Call

Youssef Squali - *Jefferies & Co. - Analyst*

Good morning, everybody.

Garry Betty - *EarthLink - CEO*

Good morning, Youssef.

Youssef Squali - *Jefferies & Co. - Analyst*

A couple of questions. First, with the line-powered Voice. Could you go through and explain to us why there is a delay there? And I have a --

Garry Betty - *EarthLink - CEO*

Well, the Covad deal took longer to do than we had expected. And we originally hoped that we would be up in some additional markets in the second quarter. That's now not going to occur until probably August or September. And if you don't have homes to sell to, Youssef, it's hard to add customers. So it's all a timing issue.

The product's performing well. Where we are marketing, we're achieving early success, particularly in upselling to our customer base. We were a little bit late getting some of our bundles done, getting into retail, but all of that is coming together, and you'll start seeing us have offerings both for an EarthLink through voice product and LPV at retail during the second quarter. But it is going to be the back half loaded, much more so than we had originally hoped as we entered 2006.

Youssef Squali - *Jefferies & Co. - Analyst*

And in those four markets, where you've been now for a few months, could you share with us any kind of quantification of what kind of penetration you've had, or at least what kind of -- ?

Garry Betty - *EarthLink - CEO*

Well, the only thing we've marketed to, really, is our customer base to a great extent. We've done a little bit of integrative marketing up in Seattle, but we haven't had retail, we haven't had any channel partners. We haven't aggressively tried to upgrade our existing DSL customers in those markets because of some system glitches. I mean, this is what you expect as you roll out a new service. But where we have marketed to customers, it's working pretty well. People are pretty satisfied with it.

I spent two different sessions listening to our call center operations in the last month, and I'm very encouraged about, one, the awareness of the product that we're offering to customers in that area and their willingness to potentially buy those products from us. So early indications, Youssef, I'm pretty encouraged. We added about 8,000 customers net Voice during the quarter.

Youssef Squali - *Jefferies & Co. - Analyst*

8,000 customers, that's for line-powered or is that --?

Apr. 20. 2006 / 8:30AM, ELNK - Q1 2006 EarthLink Earnings Conference Call

Garry Betty - *EarthLink - CEO*

In total.

Youssef Squali - *Jefferies & Co. - Analyst*

Oh, total. Okay.

And then just a clarification on the previous question. The customers, the New Edge customers, I think you talked about 60,000, is that included, is that embedded in your subscriber net adds for the year?

Garry Betty - *EarthLink - CEO*

It will be. We originally had zero to 50,000 net loss, I think, was our original guidance, or flat for the year, and now we're saying zero to 50,000 adds. So we really didn't change our guidance. We did have a pretty good first quarter with 28,000 net adds for Q1. I think it was 28, 29.

Kevin Dotts - *EarthLink - CFO*

27.

Garry Betty - *EarthLink - CEO*

27.

Kevin Dotts - *EarthLink - CFO*

So Youssef, yes. I mean, when we get a forward guidance, that does include the -- what we expect to be in the high 60s as far as New Edge.

Youssef Squali - *Jefferies & Co. - Analyst*

Okay. And then lastly, on PeoplePC, we keep getting nicely surprised there. You guys keep pushing the envelope at 125,000. Just how sustainable is that? I mean, do you -- at some point United Online just hit a glass ceiling and just there -- just to be able to add enough customers to replace the churners got to become a monstrous problem. How far are we from getting there for you guys?

Garry Betty - *EarthLink - CEO*

We don't expect that happen this year, for sure. We continue to expect pretty robust growth. We are seeing customer growth from all areas. I think we've benefited a little bit in Q1 from AOL's price changes that they made on the premium dial side. We may also be benefiting, Youssef, from the fact that United seems to be focused more on their content business than on their access business. All of those things are positive for PeoplePC continuing to take share, and they had a blowout quarter.

Youssef Squali - *Jefferies & Co. - Analyst*

Yes. That's great. Okay. Well, congratulations. Nice quarter.

Apr. 20. 2006 / 8:30AM, ELNK - Q1 2006 EarthLink Earnings Conference Call

Kevin Dotts - *EarthLink - CFO*

Thank you.

Operator

Your next question comes from Scott Kessler.

Kevin Dotts - *EarthLink - CFO*

Hi, Scott.

Scott Kessler - *Standard & Poor's - Analyst*

Hi. I was wondering if you could provide an update. I think at the investor gathering you talked a little bit about a number of municipalities across the country where you are essentially in the final stages related to either an RFP or an actual announcement. If you could just maybe provide us with some information about that.

And also, if you could talk a little bit about why you think things didn't work out before, when I think that would be interesting to know about .

Garry Betty - *EarthLink - CEO*

Sure. We're in a bake-off with one other company up in Minneapolis, we're building out one square mile that they will be doing tests on. That's happening this month. We're a finalist in Aurora, Colorado. We were selected as a finalist in Long Beach, I think against one or two other candidates. We're a finalist in Arlington, Virginia. We're a finalist in Milwaukee, Wisconsin. And we are negotiating, as I said earlier, with San Francisco, to [inaudible]. And New Orleans has filed a -- I don't know exactly what they call it, but a certificate or something to provide us a franchise agreement in New Orleans. That's going to happen in early May. So we could get some good news from New Orleans sometime perhaps in May. It's not really a competition, per se.

We have lost, so far, two deals that we went after. One was up at Brookline, Mass. The principal reason we lost is they were very interested in the person doing it supporting 4.9 megahertz spectrum for public safety. We didn't think that was consistent with what we were trying to do. It increases your cost three to four times and as such, we were somewhat nonresponsive to what they wanted to do.

Up in Portland, we lost to a company called MetroFi, who's a startup company out of the west coast. They are trying to provide services that are just ad supported. Again, we don't think that model is one consistent with what we want, and ultimately, Portland went with what sounds to be a great deal, free for their citizens, but time will tell whether that model is going to work or not.

So, I think you'll see some municipalities trying to do that. I don't think there's going to be unlimited amounts of capital that will chase those kinds of models until it works, and we clearly aren't going to do that on a comprehensive basis, although we are doing something on a limited front with Google in San Francisco.

Apr. 20. 2006 / 8:30AM, ELNK - Q1 2006 EarthLink Earnings Conference Call

Scott Kessler - Standard & Poor's - Analyst

And if I could follow up, Garry. If -- obviously, you guys referenced during the meeting about a month or two ago, about the fact that you might be participating with Google in another endeavor for another municipality and there has been some press speculation along those lines. Do you care to comment on whether or not --?

Garry Betty - EarthLink - CEO

Well, it's not so much on a buildout. What I said was Google will work with us in a second market, where we are going to provide a free low-speed wireless offering in San Francisco of 300K that Google is going to help fund. And in another market, Google is going to provide us with the equivalent of free local search. So what we're going to try so see is which model works best. Let's say we pick market X that we win, we build it out, and anyone who has access to Wi-Fi could do a free local search like online yellow pages via Wi-Fi, but they couldn't do anything else. That was what I was referring to in the secondary market.

Scott Kessler - Standard & Poor's - Analyst

Right. So --

Kevin Dotts - EarthLink - CFO

As part of our agreement.

Garry Betty - EarthLink - CEO

As part of our agreement.

Scott Kessler - Standard & Poor's - Analyst

What that implies, then, is that you guys, with Google, will choose the city. It's not necessarily that Google is a primary participant.

Garry Betty - EarthLink - CEO

That's right.

Scott Kessler - Standard & Poor's - Analyst

Okay. Thank you.

Garry Betty - EarthLink - CEO

And they're a great partner of ours. As Kevin indicated, we just signed our second extension of an agreement we originally signed in 2002. That relationship has gone well. Our revenues are doing fine. We've worked with them on a number of fronts to do a better job monetizing the traffic we do have with our customer base.

Apr. 20. 2006 / 8:30AM, ELNK - Q1 2006 EarthLink Earnings Conference Call

Scott Kessler - *Standard & Poor's - Analyst*

Great. Thanks a lot.

Operator

Our next question comes from Heath Terry.

Garry Betty - *EarthLink - CEO*

Hi, Heath.

Kevin Dotts - *EarthLink - CFO*

Good morning, Heath.

Heath Terry - *CSFB - Analyst*

Good morning, guys. I was wondering if you could talk a little bit more, you know, as we get closer to the physical buildout of some of your Muni Wi-Fi cities. Are you learning anything more about what the costs are going to be like?

Garry Betty - *EarthLink - CEO*

No changes. We actually went soft. We did a soft launch yesterday in Anaheim for 3.5 square miles. I think we had 30 customers that were using the network, but we had it all interconnected. Interesting, the one thing that we did find pretty funny, as soon as we turned it up, 500 people the first day tried to access it for occasional use.

So, we will start getting some learnings. We're pulling up the first square mile in Minneapolis this month. We've got the 3.5 square miles in Anaheim, which will grow to 10 pretty quickly. And we'll start -- we'll actually have a little bit of revenue for Muni Wi-Fi in Q2. And you'll start seeing that ramp as we bring on Philly and Milpitas and, hopefully, get the San Francisco agreement completed and maybe even have something in New Orleans.

Heath Terry - *CSFB - Analyst*

That's great. Are you -- have you --?

Garry Betty - *EarthLink - CEO*

No changes on the cost front. I mean, it's doing about what we expected.

Heath Terry - *CSFB - Analyst*

Have you been surprised one way or the other in terms of the amount of time or effort that it's taking the physical buildout?

Apr. 20. 2006 / 8:30AM, ELNK - Q1 2006 EarthLink Earnings Conference Call

Garry Betty - *EarthLink - CEO*

Actually, no. I mean, the radios, once they do it, you can put -- they're pretty efficient in getting these things up on those poles.

Kevin Dotts - *EarthLink - CFO*

The pace of the buildout, I think, we're fine with. The amount of time is very variable. Some cities, obviously, Heath, are very quick and some are very protracted.

Heath Terry - *CSFB - Analyst*

As you guys -- obviously, you guys are capturing a lot of headlines with this as you win more cities. As you start new processes, are you seeing more competition, or how much more competition?

Garry Betty - *EarthLink - CEO*

It's funny. In Grand Rapids, there were 20 people responded to the Grand Rapids request to build out a Muni Wi-Fi network. In Houston, where we went to the bidders' conference, there were only three. So, it's very funny. It's hard to say how people are going to respond. But in Long Beach, we're competing against two very small companies. In Houston, it's three large -- two other large companies. And Grand Rapids, it's all over the place. So there's no set pattern yet.

Heath Terry - *CSFB - Analyst*

Great. Thank you very much.

Garry Betty - *EarthLink - CEO*

You bet.

Operator

Your next question comes from Keith Dalrymple.

Garry Betty - *EarthLink - CEO*

Hi, Keith.

Keith Dalrymple - *Halpern Capital - Analyst*

Hi. Good morning. I have a couple of clarifying questions. First, can you tell me, with New Edge Networks, those subs are going to be bundled in with your broadband line?

Garry Betty - *EarthLink - CEO*

That's right.

Apr. 20. 2006 / 8:30AM, ELNK - Q1 2006 EarthLink Earnings Conference Call

Keith Dalrymple - *Halpern Capital - Analyst*

Okay. And can you tell me what the approximate ARPU is there, or has been?

Garry Betty - *EarthLink - CEO*

\$170 or so -- Yes, it's between \$150 to \$170. 150 to 170.

Keith Dalrymple - *Halpern Capital - Analyst*

Okay. Very good. And can you tell me the total number of RFPs for Wi-Fi that you're participating in right now?

Garry Betty - *EarthLink - CEO*

Well, we're finalists in six. We've submitted RFPs additionally in Denver, Grand Rapids, Pasadena, and Houston. I think there was one more. And then there's interest on a number of fronts, Atlanta, Boston, Chicago, Honolulu, Houston, and L.A.

Keith Dalrymple - *Halpern Capital - Analyst*

Okay. Very good.

Garry Betty - *EarthLink - CEO*

There's a boat load in the pipeline. Between now and next year, there's probably going to be 20 or 30.

Keith Dalrymple - *Halpern Capital - Analyst*

Okay. Can you give me a little clarification on the Voice? I thought you mentioned you had 13,000 voice subs and then there was I think an 8,000 customer number mentioned. What's the split?

Garry Betty - *EarthLink - CEO*

It was 6,000 paying subs at the end of Q4. Now we have about 14,000.

Keith Dalrymple - *Halpern Capital - Analyst*

And do you have a split between line-powered voice and the ATA-based service?

Garry Betty - *EarthLink - CEO*

It's mostly ATA-based services right now.

Keith Dalrymple - *Halpern Capital - Analyst*

Okay.

Apr. 20. 2006 / 8:30AM, ELNK - Q1 2006 EarthLink Earnings Conference Call

Kevin Dotts - *EarthLink - CFO*

Just about a thousand LPV.

Keith Dalrymple - *Halpern Capital - Analyst*

All right. And lastly, it appears that Helio is on track to launch. Can you comment on the financial position of the company? Do they have adequate cash to execute on their plans?

Kevin Dotts - *EarthLink - CFO*

Yes, at this point, no change from what we've been saying since the start, or the launch last year. We said, we'll take our share of their equity losses, that will be \$90 to \$110 million on our income statement. By the end of 2006, they'll have been funded roughly \$360 million worth of cash. There'll be another \$40 million that will be funded by both partners next year. And as we see that right now, that will be adequate capital.

And again the only caveat to all that discussion will be how quickly they actually grow. So if they grow faster, it may require more capital. That would be a good problem to have. If they're growing slower, then certainly it's not going to require more capital.

Keith Dalrymple - *Halpern Capital - Analyst*

Okay. So at this point, to build out the initial sales channels into launch, they have adequate cap.

Garry Betty - *EarthLink - CEO*

I think they're fine.

Kevin Dotts - *EarthLink - CFO*

That's correct.

Garry Betty - *EarthLink - CEO*

The product looks great. I'm really excited about what they've done and they're anxious to get some of these in the hands of consumers and 14 months of a lot of hard work is going to culminate in the next two or three weeks.

Keith Dalrymple - *Halpern Capital - Analyst*

Great. Thank you.

Kevin Dotts - *EarthLink - CFO*

Thanks.

Apr. 20. 2006 / 8:30AM, ELNK - Q1 2006 EarthLink Earnings Conference Call

Operator

[OPERATOR INSTRUCTIONS] Your next question comes from Jim Friedland.

Jim Friedland - *SG Cowan - Analyst*

Just a couple financial questions. First, it looks like a small amount, \$3.9 million, was spent on subacquisitions in the quarter. What was the total amount of subs and were they value and premium?

And the second question is on stock-based comp. Could you break out where those expenses are allocated in the P&L and the different expense line items? And then I have one quick follow-up.

Kevin Dotts - *EarthLink - CFO*

Yes. Of the 3.9 on the acquisition front, I'm believing there's probably some payments from some prior period acquisitions that were made, number one, as we were able to realize in the subscriber's state. And I'm thinking that was probably a mix of both narrowband premium, as well as some PeoplePC subscriber additions. And then any recent acquisition activity to happen in this quarter, I think is primarily --

Garry Betty - *EarthLink - CEO*

Small.

Kevin Dotts - *EarthLink - CFO*

Yes, very small.

Garry Betty - *EarthLink - CEO*

It might have been 5,000 subs. I mean --

Kevin Dotts - *EarthLink - CFO*

Less than 5,000, yes.

Jim Friedland - *SG Cowan - Analyst*

Okay. And just -- the stock based comp breakout.

Kevin Dotts - *EarthLink - CFO*

Yes, stock-based, we're absorbing all that in one line within general and administrative expense.

Jim Friedland - *SG Cowan - Analyst*

Okay. That makes it easy.

Apr. 20. 2006 / 8:30AM, ELNK - Q1 2006 EarthLink Earnings Conference Call

And then just on the EBITDA. The change in the EBITDA guidance. Just given your comments, I just want to confirm that pretty much all the upside in the change in EBITDA is really not due to the New Edge acquisition, since that's going to be break even. It's just due to the slower rollout with Covad so the marketing expense is going to be a bit lower?

Garry Betty - *EarthLink - CEO*

That's right.

Jim Friedland - *SG Cowan - Analyst*

Okay. Great. Thanks a lot.

Kevin Dotts - *EarthLink - CFO*

We'll take one more question.

Operator

Your next question comes from Bryan Goldberg.

Kevin Dotts - *EarthLink - CFO*

Hi, Bryan.

Bryan Goldberg - *Bear Stearns - Analyst*

Good morning. Just two quick questions. First, it looks like your proportionate share of Helio losses in the first quarter was about half of what you were guiding to, and I was just wondering if you could comment on what was driving the variance there. And also, going forward --

Garry Betty - *EarthLink - CEO*

Quickly, we're just a couple months behind what we originally thought we were going to do in terms of rolling out the handsets.

Bryan Goldberg - *Bear Stearns - Analyst*

Okay. And just going forward, as you add voice customers, from a reporting standpoint, should we expect to see those in the broadband subscriber category?

Kevin Dotts - *EarthLink - CFO*

I'm apologize. I'm sorry, I did not hear --

Apr. 20. 2006 / 8:30AM, ELNK - Q1 2006 EarthLink Earnings Conference Call

Garry Betty - *EarthLink - CEO*

As we add voice to the future, where will it show up. Will it show up in broadband?

Kevin Dotts - *EarthLink - CFO*

They're showing up in broadband, Voice is, at this point.

Bryan Goldberg - *Bear Stearns - Analyst*

Okay. So of your 85,000 net ads for the first quarter, embedded in that number are 13,000 Voice customers?

Kevin Dotts - *EarthLink - CFO*

8,000 of incremental ads.

Bryan Goldberg - *Bear Stearns - Analyst*

Okay. Thank you.

Kevin Dotts - *EarthLink - CFO*

Okay.

Garry Betty - *EarthLink - CEO*

Thank you very much for joining us. We look forward to sharing with you our continued progress as we go through this exciting year.

Kevin Dotts - *EarthLink - CFO*

Thanks.

Operator

This concludes today's conference. You may now disconnect.

Apr. 20. 2006 / 8:30AM, ELNK - Q1 2006 EarthLink Earnings Conference Call

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