57) First, both cable and wireless encounter substantial technical and economic challenges in attempting to compete with Ameritech in the local exchange market. Most cable systems are not currently outfitted to provide telephone service and the technology that will allow them to do so has been slow in coming. Before any CATV provider could effectively compete with Ameritech, it would be required to retrofit its system and improve the existing transmission quality of the system. This would not be easy, and would likely be very expensive to accomplish. Perhaps the best evidence of this difficulty is the fact that, although several ventures involving the provision of local exchange service through cable systems have been announced, and some trials of such service have been held even in Michigan, provision of exchange service over cable in the United Stated is exceedingly rare. In fact, a recent article in the Wall Street Journal discussed the abandonment of telephony plans by CATV giant TCI.[21]

58) Similarly, wireless service would require a substantial improvement in quality before it could be considered a reasonable substitute to the local exchange services of Ameritech. Anyone who uses a wireless service understands that its utility, while substantial, presently rests in its mobility, not in its transmission quality or its ability to replace a land-line local exchange access line.

59) In terms of the publicly stated intention of the major IXC's to aggressively enter the local exchange market as evidence of competition, the ability of a carrier to advertise

[21] See Appendix N, *Bad Call: Malone Says TCI Push Into Phones, Internet Isn't Working for Now*, Wall Street Journal, Thursday, January 2, 1997, p. 1.

intentions to provide services is in no way an indication of the success or progress that it will attain in the local exchange market. This type of hypothetical "evidence" is useless in measuring the actual competitiveness of a market and should be rejected. It falls far short of meeting the convincing demonstration of competition that I believe is required.

CONCLUSION

60) In summary, the criteria described herein can and should be used to test whether and to what extent competition exists in Ameritech Michigan' local exchange marketplace. Further, the evidence in the record herein demonstrates by any test that competition is practically non-existent in these markets and due to the fact that significant barriers are still in place, competition is not likely to develop for quite sometime. Finally, the existence of a resale tariff and a limited number of resold services does not in any way constitute the kind of full and effective competition that can serve to discipline Ameritech in the marketplace.

61) What Ameritech has suggested is that a number of carriers are certificated to provide some level of telecommunications services within the state of Michigan, and that several others are seeking similar authority. Furthermore, it has suggested that several carriers already have, or will have, agreements with Ameritech Michigan by which they may eventually gain access to interconnection services, unbundled network elements, and Ameritech's wholesale offerings.

62) This information provides the Commission with no indication of when, or if, these carriers will eventually overcome Ameritech's monopoly power in the marketplace or the extent to which they will be successful in providing customers with alternative services. This is accentuated by the fact that only five of the carriers mentioned by Ameritech (MCImetro, MFS, TCG, AT&T and USN) currently have final tariffs on file with the Commission and, hence, are the only carriers currently able to generally even offer services to Michigan customers. In addition, four of these carriers had those tariffs approved only recently and are unlikely to have made significant progress at this time.

63) Ultimately, Ameritech's performance in meeting its requirements under the competitive checklist cannot be measured and confirmed without a corresponding examination of the growth and health of competition in Ameritech's local exchange markets. For this reason, the Michigan Commission should seriously consider the actual level of competition -- especially that which is provided by facilities based competitors -- in both its decisions regarding the "non-discriminatory" nature of Ameritech's checklist compliance and its measure of the "public interest, convenience and necessity."

VERIFICATION

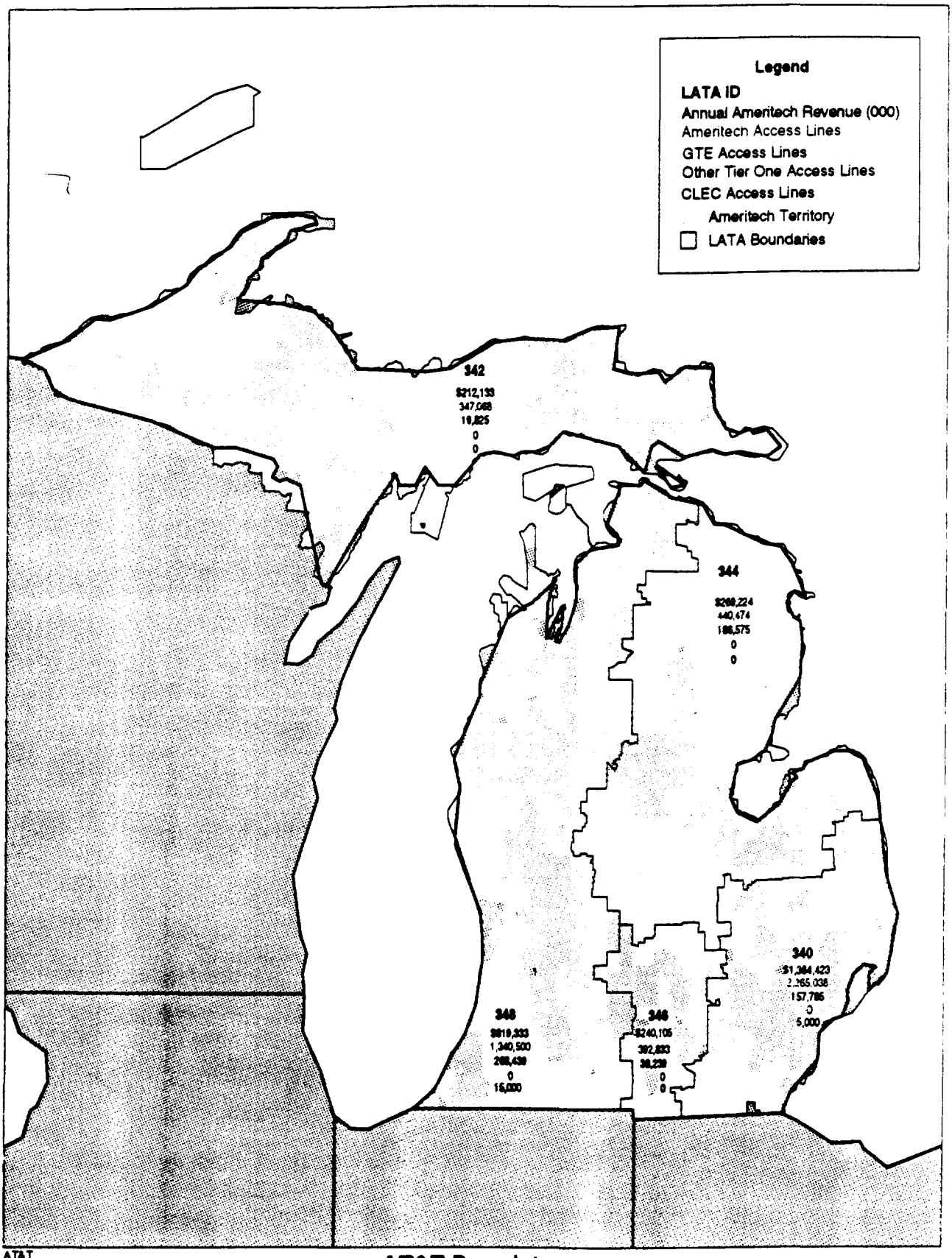
I, Michael Starkey, do on oath depose and state that the facts contained in the foregoing affidavit are true and correct to the best of my knowledge and belief.

SUBSCRIBED AND SWORN to
before me this 6th day of
January, 1997.

Notary Public

"OFFICIAL SEAL"
Margaret M. Plucinsky
Notary Public, State of Illinois
My Commission Expires 05/11/99

Revenue and Access Lines by LATA -- Michigan



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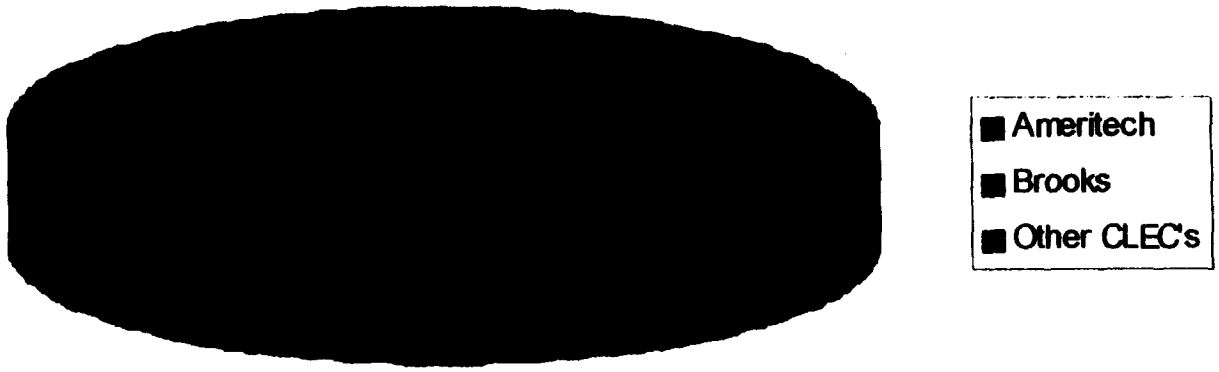
CLEC Presence in Ameritech-MI Service Territory



TOTAL ACCESS LINES*

Ameritech-MI = 4,972,505
Brooks Fiber = 15,000
Other CLEC's = 5,000

TOTAL CLEC PRESENCE
20,000/4,972,505 = .40%

* Source: Ameritech November 12, 1996, Informational Filing in MPSC Docket No. U-11104

MPSC
Case No. U-11104

Absence Of Local Competition In Ameritech Territory -- Michigan

Total Tier One LEC Switched Access Lines For This State: 5,458,112

Ameritech Serves 87.68% Of These Switched Access Lines

Total Ameritech Switched Access Lines: 4,785,914

Residence:	3,202,387
Business	
Single-Line:	216,308
Multi-Line:	1,367,219
Total Business:	1,583,527

CLECs (Switch-based)

Name:	Target Market:	End Office Switches:
Brooks Fiber	Business	1
MCImetro	Business	1
MFS	Business	1
TCG	Business	1
Total CLEC End Office Switches:		**4**

Total CLEC Access Lines: 20,000

Average Access Lines Per CLEC End Office Switch: 5,000

Total Ameritech Switches*:	**442**
End Office:	434
Tandem:	8

CLEC Percentage Of Total End Office Switches: 0.91%

Average Access Lines Per Ameritech End Office Switch: 11,027

*Some End Office switches can be used for both local and tandem switching therefore, the sum of End Office and Tandem switches may not equal the total.

Legend

- ● Brooks Fiber switch location
- ■ MCImetro switch location
- ◆ MFS switch location
- ▲ TCG switch location
- RBOC Territory

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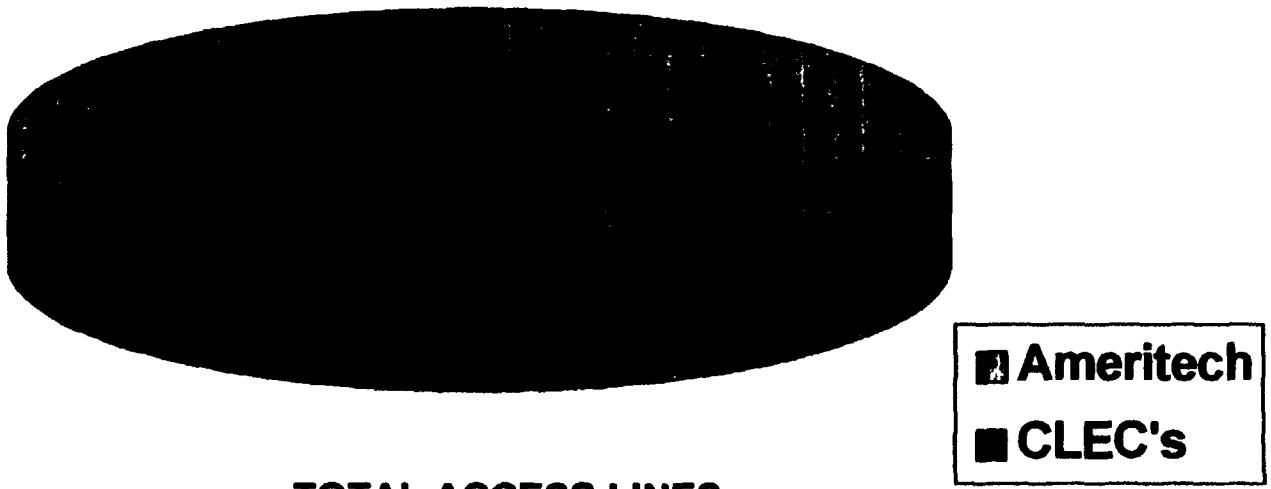
CLEC Presence in Detroit LATA



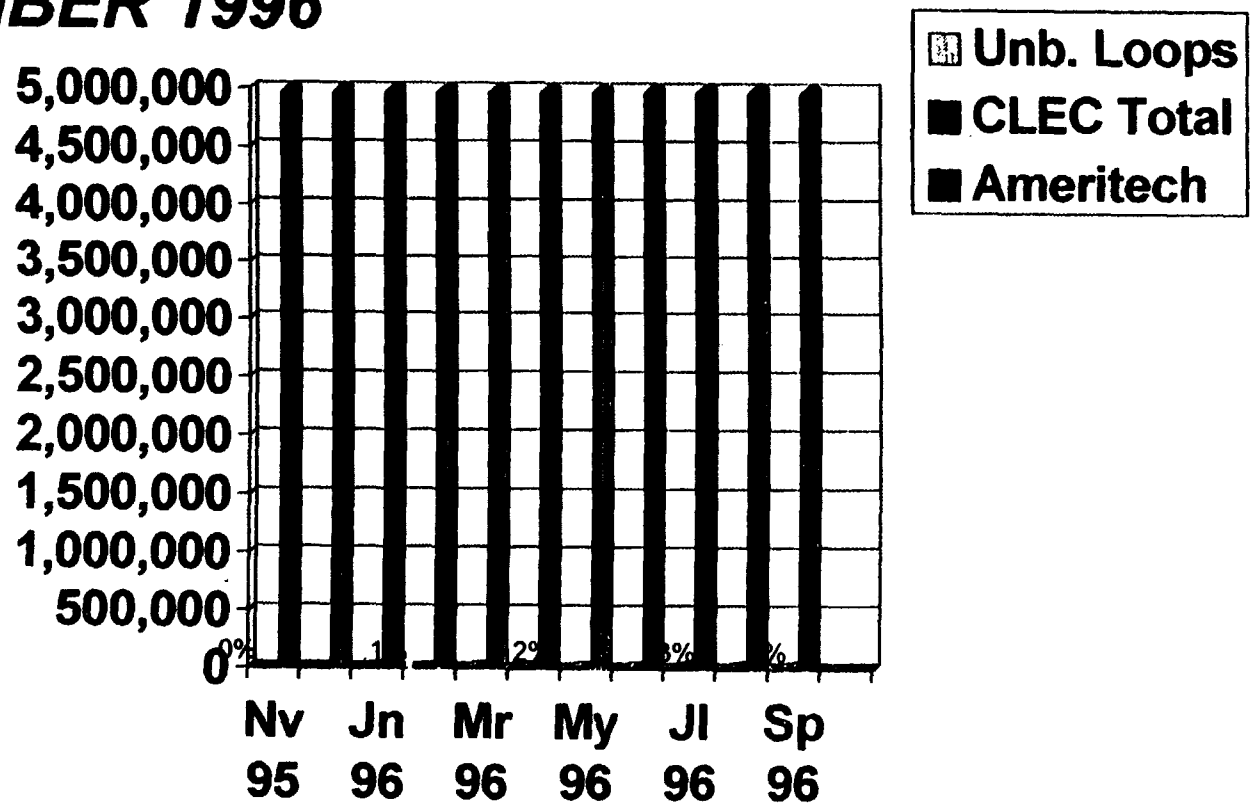
TOTAL ACCESS LINES

Ameritech-MI = 2,265,000
CLEC = 5,000

CLEC Presence = .22%

MPSC
Case No. U-11104

GROWTH OF CLEC PRESENCE IN AMERITECH-MI TERRITORY DECEMBER 1995 TO SEPTEMBER 1996

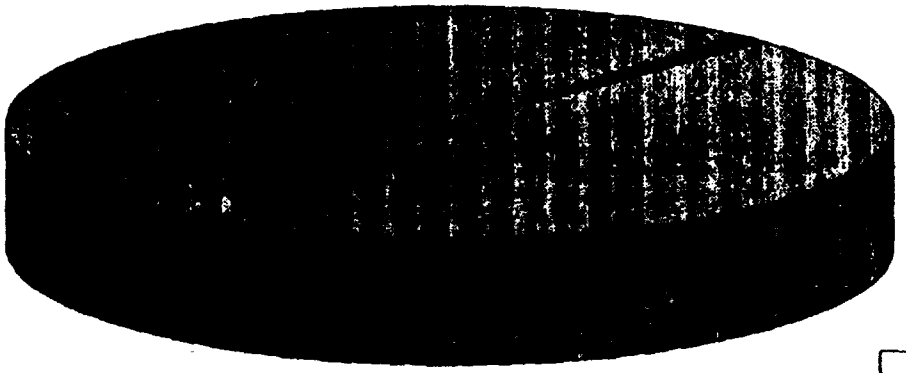


COMPARISON OF AMERITECH-MI ACCESS LINES TO CLEC ACCESS LINES

Total Ameritech-MI Access Lines	=	4,972,505
Total CLEC Access Lines	=	20,000
Total Unbundled Loops	=	11,774
TOTAL CLEC PRESENCE	=	0. 4%
TOTAL UNBUNDLED	=	0. 23%

MPSC
Case No. U-11104

CLEC Presence in Grand Rapids LATA



Ameritech-MI
Brooks Fiber

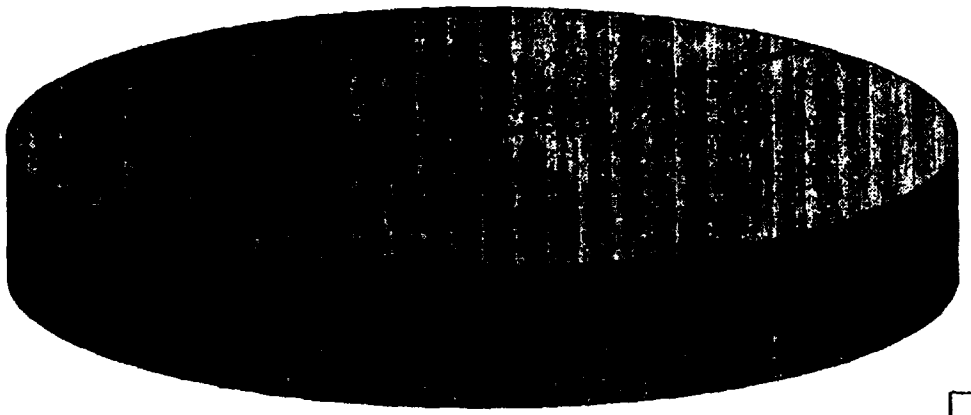
TOTAL ACCESS LINES

Ameritech-MI = 1,340,000
Brooks Fiber = 15,000

CLEC Presence = 1.1%

MPSC
Case No. U-11104

Competition for Residential Customers In Ameritech-MI Service Territory



Ameritech
Brooks

TOTAL RESIDENTIAL ACCESS LINES

Ameritech-MI = 3,202,000
Brooks Fiber = 5,000
Other CLEC's = 0

Percentage MI Residential subscribers With Competitive Choice = 0.15%

MPSC
Case No. U-11104

BROOKS
FIBER COMMUNICATIONS

Attachment H

December 30, 1996

Katherine Brown, Anti-Trust Division
Telecommunications Task Force
U.S. Department of Justice
555 - 4th Street NW, Room 8104
Washington, DC 20001

via OVERNIGHT COURIER

Dear Ms. Brown:

As follow-up to our meeting on November 25th we are forwarding additional information describing some continuing operational issues with Ameritech that affect our ability to deliver excellent customer service. Even though we have over 18 months of actual in-service experience and have an operational interconnection agreement with Ameritech, coordination problems still exist.

The introduction of competition into the local exchange arena is a very complex undertaking. The complexity is compounded by the simple fact that facilities-based providers, such as Brooks, require an extraordinary high degree of cooperation from a supplier who, in fact, is in direct competition with the new entrant. Traditional supplier/buyer business relationships are simply not relevant. The ground rules and operational procedures for introducing competition must be completely thorough and rigid to prevent monopoly abuse. We hope that the attached examples illustrate this condition.

Since late July, when we signed our interconnection agreement with Ameritech, there has been a noted improvement in Ameritech's service delivery to Brooks. Ameritech is certainly aware of these current issues, and has agreed to work with Brooks to find a satisfactory resolution. We are forwarding these examples to your attention, to illustrate that additional work is still necessary in this very fragile area.

In addition, at your request, we are also enclosing some examples of our media advertising.

If you have any questions or wish to discuss any issue please call me at (616) 224-4359.

Sincerely,

Martin W. Clift, Jr.
Director of Regulatory Affairs

enclosures

2555 Oak Industrial Drive NE • Grand Rapids, Michigan 49506-1277 • 616-224-4300 • Fax 616-224-5100

Brooks Fiber Communications of Michigan
Service Affecting Examples with Ameritech

Inability Of Loops To Be Reconnected At Customer Premise

Description: For a variety of reasons, including at the request of Brooks or due to the unavailability of existing facilities, new loops are provisioned in lieu of reusing the current loop. Such provisioning requires that an Ameritech technician be dispatched to the customer's premise to *disconnect* the existing inside wire to the "old" loop. During this visit however, the Ameritech technician does not ***reconnect*** the inside wire to the new loop. Instead, a Brooks technician must be dispatched to reconnect the service. In the meantime, the customer is left without service. This, we believe, causes unnecessary customer dissatisfaction and requires an unnecessary field trip by Brooks to the customer's premise. In these instances, Ameritech should reconnect the inside wire to the new loop while at the customer's premise.

Inability For Brooks Customers To PIC Ameritech IntraLATA Toll

Description: Brooks local exchange customers are currently unable to "PIC" to Ameritech for intralata toll service. Ameritech does not accept "PIC'd" intralata toll traffic from a Brooks' customer. In order for these customers to switch their local service to Brooks, these customers must switch their existing Ameritech intralata toll service to another carrier. This restriction precludes certain customers from switching to Brooks' local service because they have term contracts with Ameritech for intralata toll. (See Attachment 1). These customers cannot terminate their term agreements with Ameritech without penalty. Ameritech should either waive these customer termination liabilities, or enable Brooks to pass the intralata traffic to Ameritech. A "fresh look" provision would enable customers choose the carrier of their choice without penalty.

Unreliable Electronic Interfaces With Ameritech

Description:

1. *Unbundled Loop Provisioning:* There is currently no reliable electronic means of interfacing with Ameritech's loop order system. Brooks' service orders are entered into a "satellite" Ameritech database which is entirely

separate from Brooks' internal ordering system (AS400). Consequently, service orders are input twice--once in the Brooks' system, and again in the Ameritech system. The service orders are "collected" and reinput via modem to Ameritech several times a day. *As a backup measure, a daily summary listing order #'s is manually created and faxed to Ameritech*. Every day, the provisioning department manually double checks the previous day's orders to see if they were rejected, received or not received by Ameritech's system. It's a common occurrence for orders to get lost in transit so these orders are, again, input into the Ameritech system for processing. There is a great need for a standard, reliable ordering system which can easily be interfaced between companies, where there is no manual checks & balances and no duplicated effort. Ameritech needs to establish further internal controls and edits between the two electronic data systems.

2. *Number Portability:* Unlike the unbundled loops, the porting orders can not be transmitted to Ameritech electronically. Each order is entered into the Brooks AS400, printed, and manually faxed to Ameritech. Ameritech needs to establish an electronic means to process orders for number portability.

3. *Billing:* Currently, Ameritech is sending invoices for unbundled loops, number portability, and interconnection usage to Brooks in paper form. These bills literally contain many thousands of separate data entries. This data in paper format cannot be easily cross-referenced to check for accuracy before payment is made. Brooks has requested that these invoices be sent in electronic format so that the necessary auditing can be performed by our computer system. (See Attachment 2). Ameritech needs to establish an electronic means of submitting invoices.

Inability Of Potential Brooks Customers To Obtain Service Information

Description: *Payphone Contracts.* Signed letters of authorization (LOA's) from potential Brooks customers are submitted to Ameritech to obtain a copy of applicable terms and compensation plan, i.e. customer contract. Ameritech has not produced this information, even though a signed LOA has been submitted. Ameritech should supply this information.

Examples: Cornerstone College and Ottawa Hills High School.

Poor Coordination Of Customer Cutovers:

Description: Poor coordination with Ameritech technicians during customer cutovers causes extreme customer dissatisfaction and displacement. Customer cutovers, on a regular basis, are taking 5 to 10 times longer than necessary. There are a variety of reasons for these delays, as can be shown in the attached examples (Attachment 3). The reasons can be generally attributable to incomplete records of existing service and/or insufficient up-front preparation. Brooks has worked with Ameritech to minimize customer down time, but excessive down time continues to occur. A common occurrence involves "cutting" the existing service on customer lines when incoming calls are currently in process. Brooks has proposed one technical solution, as shown on Attachment 4, and is waiting on a response from Ameritech. Ameritech needs to improve its internal operational procedures to avoid lengthy customer cutovers.

Improvements In Customer Service Commitments:

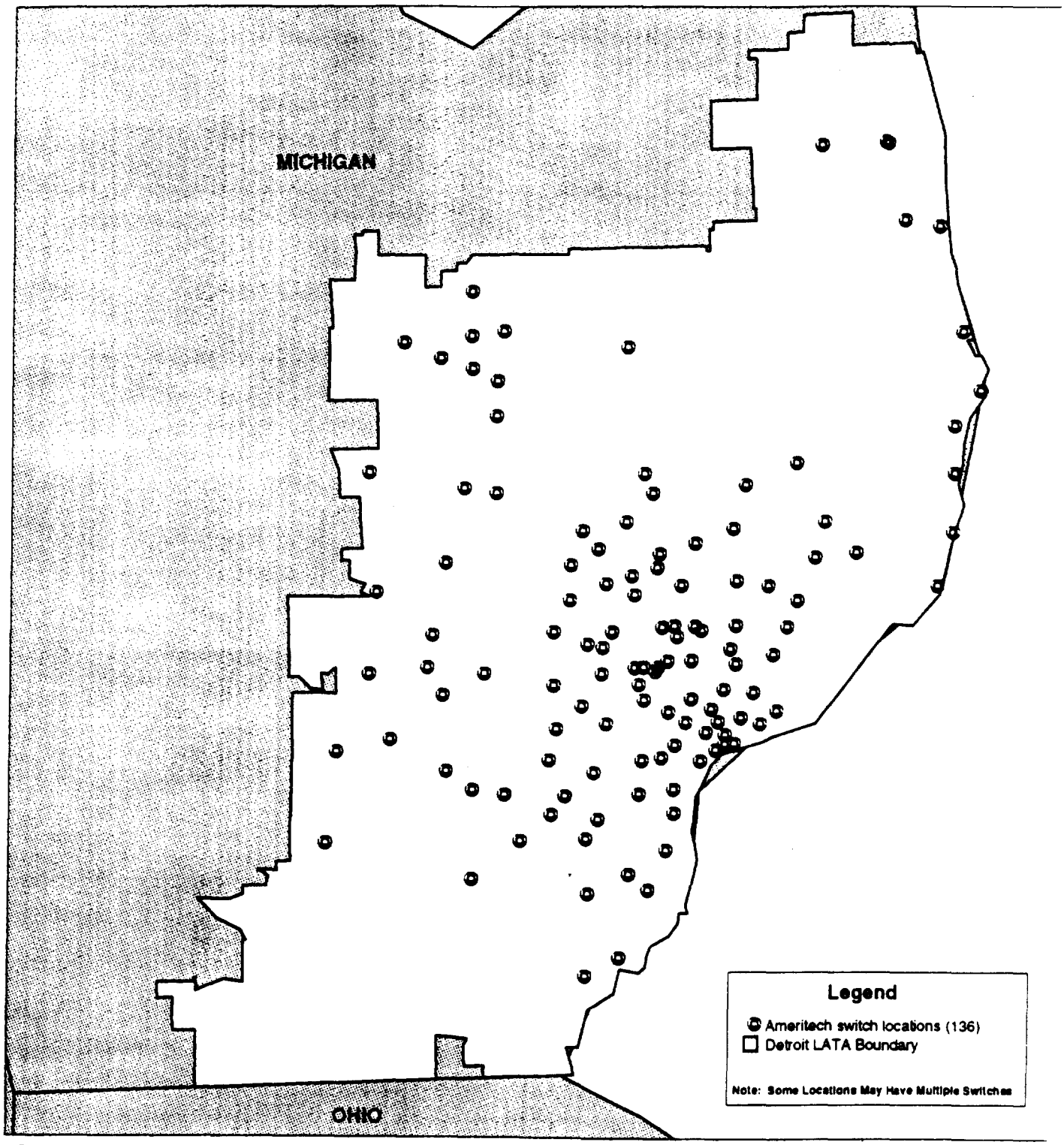
Description:

1. *"The Customer Comes First":* Both Brooks and Ameritech should adhere to this standard, and develop operational procedures with the customer in mind. Instances where customers are inconvenienced behind the jest of "company policy" are unacceptable. Most of the above issues clearly create an inconvenience to the customer, who is merely trying to execute its option to choose the carrier of its choice.

2. *Lack of Sufficient Resources After Hours:* Often times, an order must be completed after regular business hours. In many instances, Ameritech does not employ sufficient technicians to complete these orders. This inconveniences the customer by postponing their service cutover to the next business day. Ameritech should not be able to create a bottleneck for service installation, within limited business hours, which is contrary to the best interests of the customer.

3. *Lack of Professionalism:* There have been numerous situations where Ameritech technicians have made disparaging and inaccurate remarks about Brooks' service while on the customers' premises. Such conduct is unprofessional, and Ameritech should train and discipline their personnel accordingly.

Ameritech Switches in the Detroit LATA



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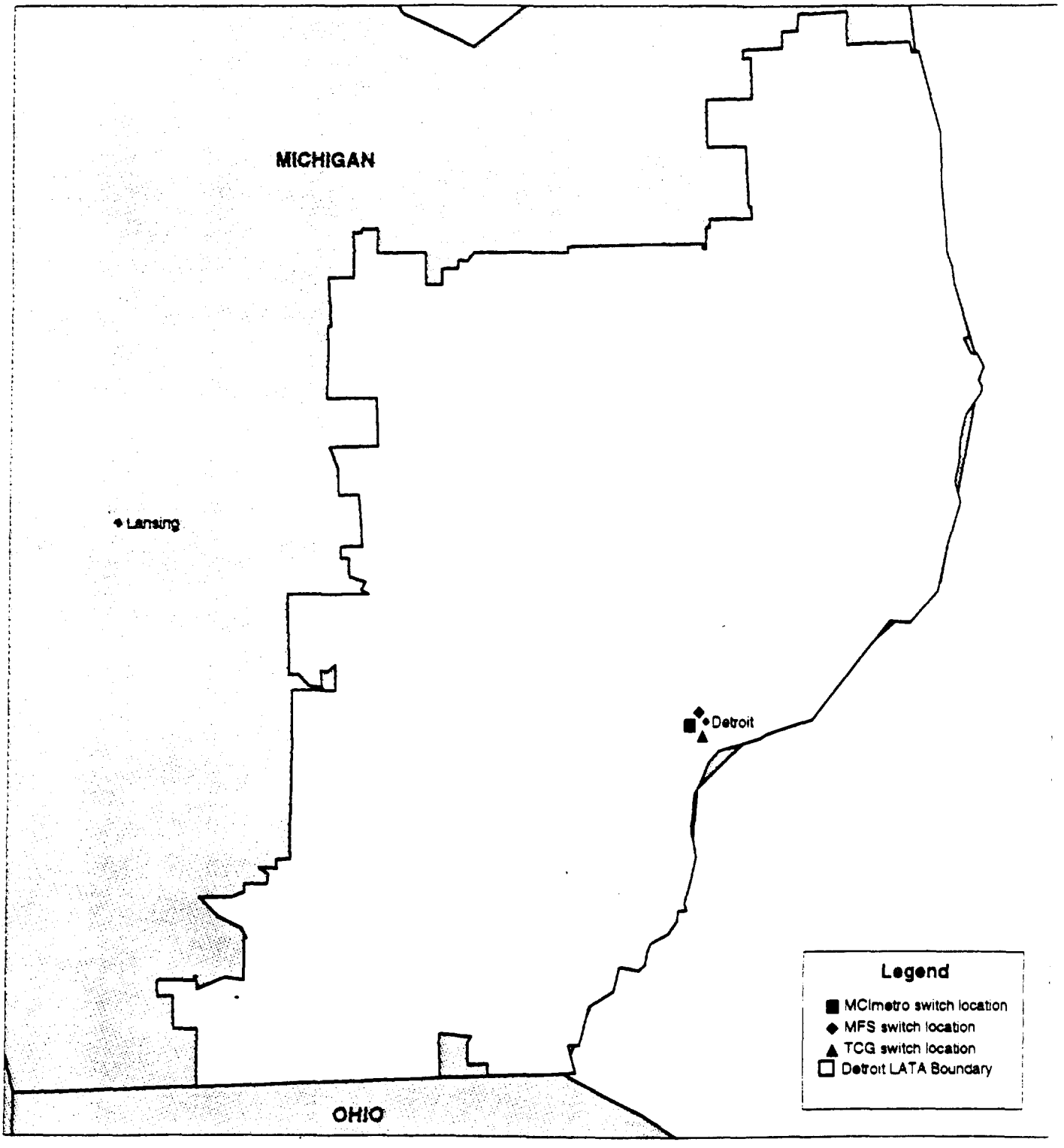
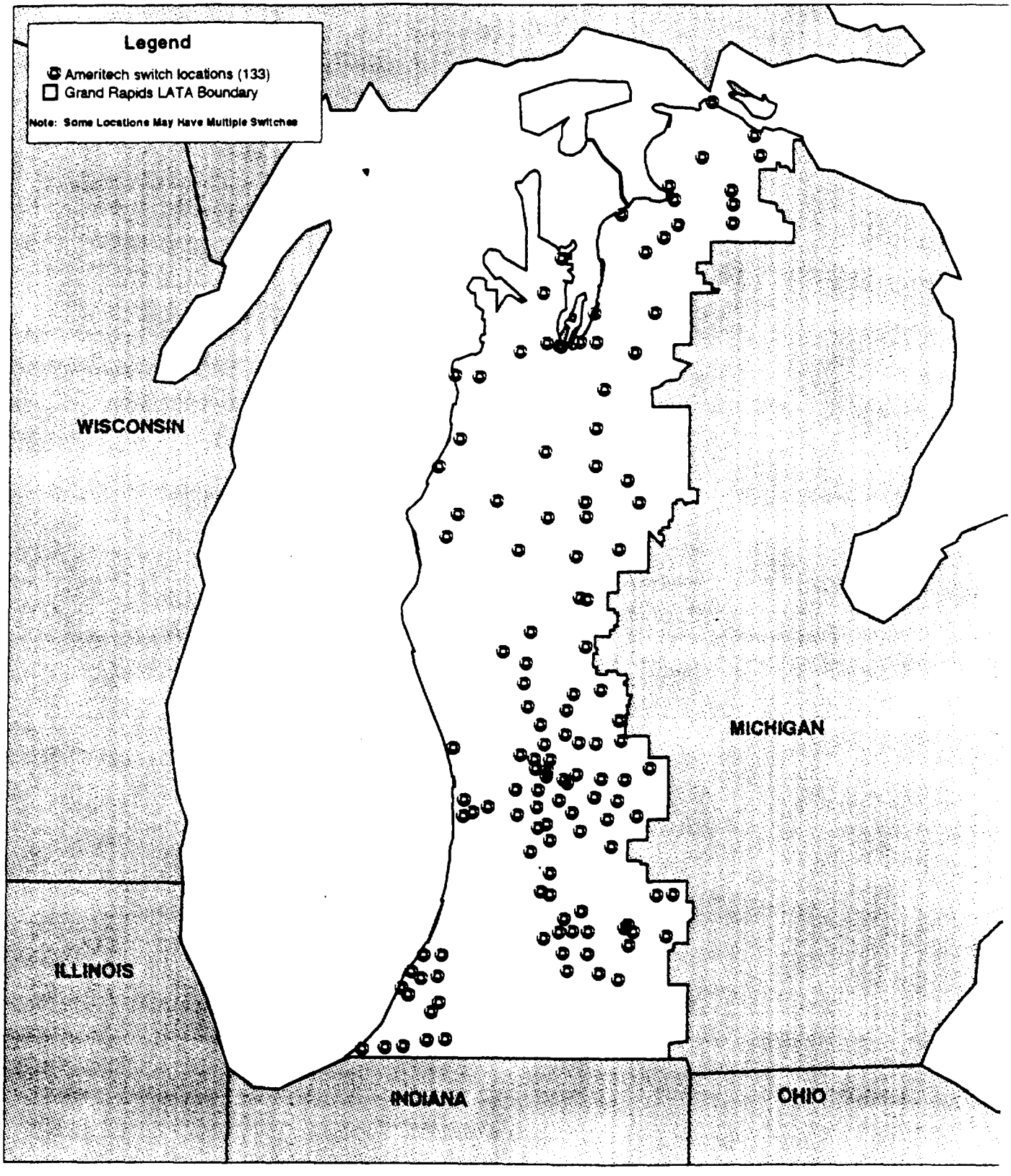
CLEC Switches in the Detroit LATA



Ameritech Switches in the Grand Rapids LATA



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08/09/96

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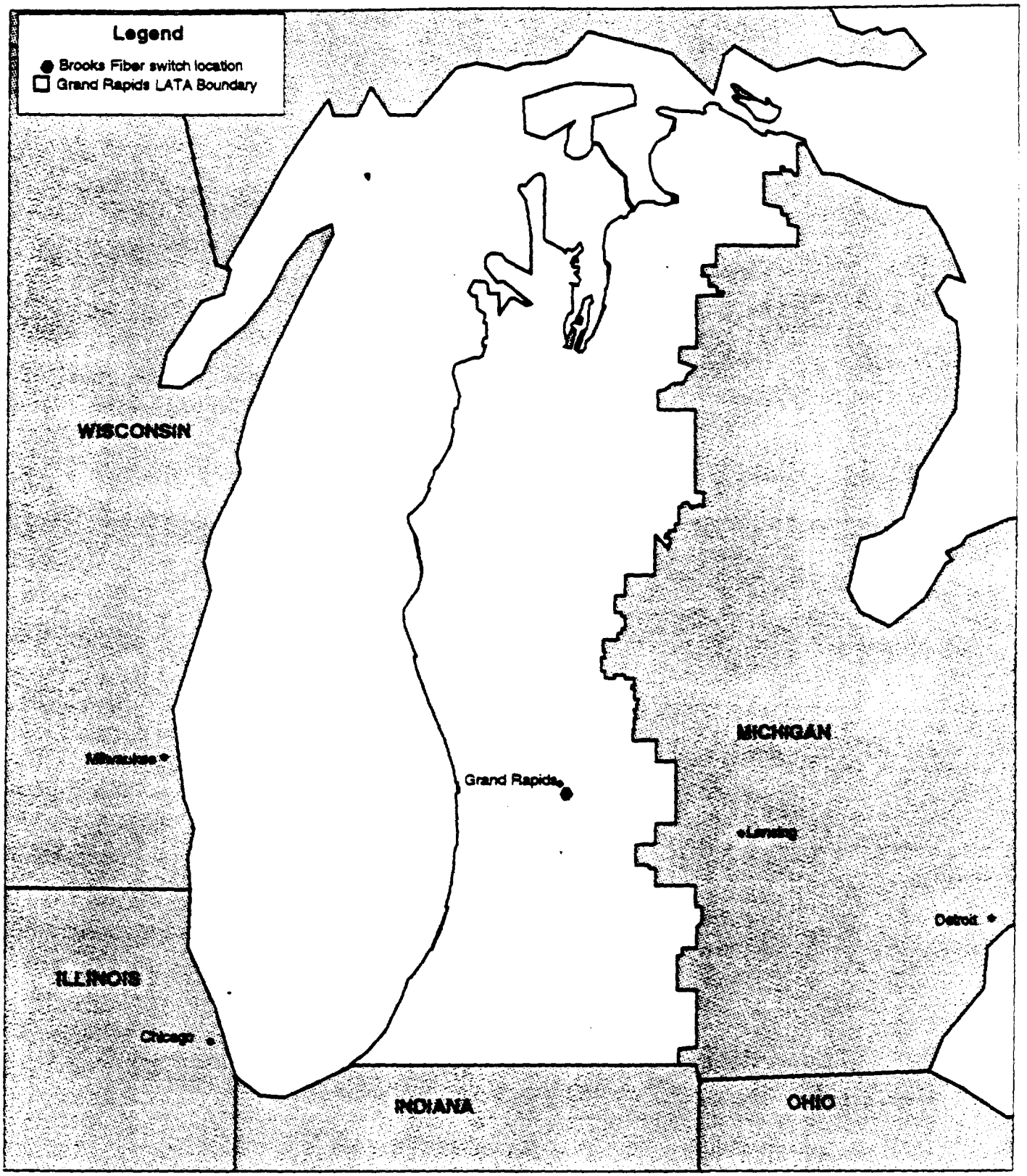
CLEC Switches in the Grand Rapids LATA



Attachment M

Status of CLEC Applications in the Ameritech Region*

MICHIGAN

Company Name (CLEC)	Status of Application	Local Exchange Tariff Filed		Interoffice Transmission Facilities	Switches Deployed	Interconnection Agreement Reached	Agreement Approved by Comm.
Ameritech Communications Inc. (ACI)	Granted						
AT&T	Granted					Arbitration 1/26/96	Pending
Climax Telephone Company	Granted						
Continental Telecomm. of MI, Inc.	Granted						
ComCast MH Telephony Communications of Michigan, Inc.	Granted						
ComCast Telephony Communications of Michigan, Inc.	Granted						
LCI	Granted						
Phone Michigan	Granted						
Sprint	Granted					In Arbitration	
Winstar Wireless	Granted					12/18/96	Pending
USN Communications, Inc.	Granted	Yes				11/1/95 (Resale Only)	Pending
Coast to Coast	Pending						
Tele-Phone-Communications (TPC)	Pending						
Cytel	Pending						
BCI	Pending						
MCI Metro	Granted	Yes		Detroit	Detroit	Arbitration 12/20/96	Pending
TCG	Granted	Yes		Detroit	Detroit	Arbitration 11/1/96	11/12/96
Brooks Fiber Communications	Granted	Yes		Grand Rapids	Grand Rapids	9/12/96	11/26/96
MFS Intelenet of Michigan, Inc.	Granted	Yes		Detroit	Detroit	10/8/96	12/20/96
19	15 = Granted 4 = Pending	5		4	4	7	3

*None of the foregoing provides detail on the operational status of entities, the nature of the services offered, the class of customers served, the underlying facilities used, or the geographic scope of the services offered. All information has been compiled from public sources.

Merrill Lynch

23 February 1996

United States

Telecom Services — RBOCs & GTE

Fourth Quarter Review: Federal Law Will Bring End to Long Distance Prohibition and New Opportunities... On Price, We Have Moderately Lowered Our Exposure

- After 13 years of lobbying, the RBOCs finally won a new Federal Telecom law eliminating Judge Greene's long distance prohibition and bottleneck concept. The law allows RBOCs to quickly provide long distance out-of-region and to cellular customers anywhere. For in-region approval, the RBOCs must meet open inteconnection, competition and public interest tests — which we estimate could take another 1 1/2 to 2 years for many RBOCs.

- The net effect of the legislation will be earlier and more powerful RBOC/GTE entry into long distance, providing RBOCs a welcome offset to accelerating local competition. Combined with earnings power unleashed by price cap regulation, their outlook has improved substantially. We see the opposite for the larger long distance companies.

- A new "80/20" rule has been born: RBOCs will buy long distance capacity at as much as 80% discounts while long distance carriers will buy local capacity at 20-30% discounts off retail — meaning the RBOCs and GTE face far higher incremental margins on long distance and far lower real (net of wholesale recovery) profit losses in local than perceived.

- Though we moderately reduced our exposure to the RBOC/GTE group by lowering long-term ratings on BellSouth and US West, we continue to see market outperformance for the group. Our favorites now are SBC, Ameritech and BellSouth.

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Merrill Lynch & Co.
Global Securities Research & Economics Group
Global Fundamental Equity Research Department

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Table of Contents

Fourth Quarter Highlights 1
Investment Conclusion: 2
How the Telecom Act of 1996 Works: 4
Details on Rules for Local Resale 5
The New Law Will Continue to Lead to Announcements that Support Our Conclusions: 6
Fourth Quarter Results In Line with Expectations 11
Line Growth and Minute Growth Accelerate 11
4Q Cellular Results Better Than Expected 14

Company Profiles:
Ameritech 19
Bell Atlantic 23
BellSouth 25
NYNEX 29
Pacific Telesis 31
SBC Communications 33
U S WEST Communications 37
GTE 39

Table 1 - Company Comparisons 1
Table 2 - Target Multiples 2
Table 3 - Recent Stock Performance 7
Table 4 - 5 Year EPS Growth Forecast and Potential Dividend Growth 8
Table 5 - Total Return Potential 9
Table 6 - RBOCs and GTE 4Q Comparisons 1995 vs. 1994 10
Table 7 - RBOCs and GTE Recurring Annual EPS 1994-1997E 10
Table 8 - Access Line and Minute Growth 13
Table 9 - Access Line Growth by Segment 13
Table 10 - Cellular Penetration Gains 16
Table 11 - Cellular Revenue Per Subscriber Trend 16
Table 12 - Domestic Cellular Subscriber Trend 17
Table 13 - Domestic Cellular Revenues 17
Chart 1 - Total Return Potential 8
Chart 2 - Average RBOC Line Growth 12
Chart 3 - Average RBOC Business Line Growth 12
Chart 4 - Average RBOC Minute of Use Growth 12
Chart 5 - Cellular Penetration Gains 15
Chart 6 - Revenue per Subscriber Decline 15

Appendix 1 - RBOCs/GTE: Weakness Overdone; Positives Intact 41
Appendix 2 - RBOCs/GTE: Lowering Rating for BellSouth and U S WEST 44
Appendix 3 - New Telecom Law: Why Bullish for MFS, RBOCs and GTE? 45
Appendix 4 - RBOCs/GTE: Thoughts 6 Months and 27% Later 50
Appendix 5 - Gore Says OK, Pro-RBOC Bill Moving Forward Fast 51
Appendix 6 - Some Questions and Answers. 53
Appendix 7 - Leg. Update: Conf Committee to Continue Into 1996 59
Appendix 8 - Leg. Update: Steps Forward, Pace Quickens 60
Appendix 9 - Ameritech: Another Positive Dividend Surprise 61
Appendix 10 - Bell Atlantic: Analyst Meeting Highlights Long Distance Opportunity 62
Appendix 11 - PacTel: Why Last Week's 10% Drop & Why Other RBOCs Not Guilty by Association 64
Appendix 12 - PacTel: CPUC Decision Positive - No Changes 65
Appendix 13 - GTE Meeting Upbeat - Stock Action Not Justified 66

Table 1

Company Comparisons

Company	ORC Rating	Price @ 2/13/96	EPS * 1995A	EPS * 1996E	EPS * 1997E	P/E Ratio 1995A	P/E Ratio 1996E	P/E Ratio 1997E	Quarterly EPS * 4Q94	Quarterly EPS * 4Q95	Quarterly EPS * % chg	5Yr EPS Growth	Div Yield	96E Div Payout	1996 % Internally Financed	1996E EBITDA Mult.
Ameritech (AIT)	B-2-1-7	$59.63	$3.41	$3.75	$4.15	17.5	15.9	14.4	0.81	0.90	11.2%	10%	3.8%	57%	132%	6.8
Bell Atlantic (BEL)	B-2-2-7	$68.38	$3.88	$4.20	$4.55	17.6	16.3	15.0	0.76	0.90	18.4%	10%	4.1%	67%	121%	6.8
BellSouth (BLS)*	B-2-2-7	$40.38	$2.24	$2.45	$2.67	18.1	16.5	15.1	0.52	0.57	8.7%	10%	3.6%	54%	121%	5.9
NYNEX (NYN)	B-2-2-7	$52.13	$3.28	$3.55	$3.85	15.9	14.7	13.5	0.78	0.88	12.3%	8%	4.5%	66%	108%	5.8
Pacific Telesis (PAC)**	B-2-2-8	$30.25	$2.46	$2.50	$2.35	12.3	12.1	12.9	0.62	0.54	-12.6%	5%	7.2%	87%	81%	4.5
SBC Comm.(SBC)	B-2-1-7	$55.75	$3.08	$3.42	$3.80	18.1	16.3	14.7	0.77	0.83	8.0%	11%	3.0%	48%	137%	7.0
U S WEST Comm. (USW)	B-2-2-7	$34.00	$2.35	$2.45	$2.60	14.5	13.9	13.1	0.60	0.57	-5.2%	7%	5.3%	87%	95%	5.1
RBOC Average						16.3	15.1	14.1			5.8%	9%	4.6%	67%	114%	6.0
GTE	B-2-2-7	$45.00	$2.61	$2.87	NA	17.2	15.7	NA	0.67	0.74	10.0%	10%	4.2%	66%	104%	5.8
S&P 500		648	$37.25	$39.50	$40.25	17.4	16.4	16.1				7%	2.2%	36%		

*Adjusted to exclude non-recurring items.
% Internally financed = (Net Income + Depreciation)/(CAPX + Dividends)

Fourth Quarter Highlights

- The RBOCs' recurring 4Q EPS growth averaged 5.8%, in line with 3Q's 5.9%. Bell Atlantic led the RBOCs with an EPS gain of 18.4%, followed by Ameritech, NYNEX, GTE, SBC and BellSouth. Pacific Telesis showed the weakest 4Q results with a recurring EPS decline of 12.6%. U S WEST Communications' 4Q EPS were down 5.2% from the year ago quarter. Excluding Pacific Telesis and U S WEST, EPS growth averaged an impressive 9.0% in 4Q, down from 10.3% in the third quarter. We raised our estimates for Bell Atlantic and NYNEX and we lowered our estimates for Pacific Telesis and U S WEST Communications. For full year 1995, the RBOCs recurring EPS growth averaged 5.0%, down from 6.4% in 1994. Excluding Pacific Telesis and U S WEST, which both went through a transition in 1995, EPS growth averaged 9.8%. We now forecast average recurring EPS growth of 7.5% in 1996 and 6.4% in 1997. Excluding Pacific Telesis and U S WEST, we forecast average growth of 9.4% in both 1996 and 1997.

- Access line growth averaged 3.9% in 4Q, better than our forecast and the third quarter's 3.8%. High usage business line growth accelerated slightly to 6.6%, up from the third quarter's 6.3%, while residential line growth accelerated to 2.8% from the third quarter's 2.7% due to continued aggressive second line marketing campaigns by all of the RBOCs and increasing second line penetration. Average long distance minutes of use grew 9.6% year-over-year in the fourth quarter, down 20 basis points from the third quarter's 9.8%.

- The RBOCs' cellular operations had a better than expected 4Q, with an average annual penetration gain of 3.4% vs. our forecast of 3.1%, and up significantly from the year ago fourth quarter's 2.6%. RBOC subscriber growth averaged 39% year-over-year, down from 42% in the prior quarter and cellular revenues grew an average 28.5% annually, down from the third quarter's 30% — the gap reflects an average 9% year-over-year decline in revenue per subscriber in 4Q, better than the 3Q's 10% decline.

Investment Conclusion

Though We Lowered Our Exposure, We Continue to Believe the Group Can Moderately Outperform the Market ... Especially If It Turns Defensive

Though we have moderately reduced our recommended exposure to shares of the seven Regional Bell Operating Companies (RBOCs) and GTE as a result of significant market out-performance over the past 7 months, we continue to believe these shares can outperform the S&P 500 over the next 12 months.

Our valuation screens indicate average price appreciation potential of 18%, plus an average dividend yield of 4.6%. (See Table 2 for price objectives and relative multiples.)

Though our call is a group call, our screens show the greatest upside in shares of Ameritech (22% to $73, plus 3.6% yield); and SBC (25% to $70, plus 3.0% yield); and BellSouth (19% to $48 1/2, plus 3.5% yield). Our price objectives assume the RBOC/GTE group trades near a 10% P/E premium to the S&P's 16.4x estimated 1996 EPS, with AIT, BLS and SBC at 8%, 10% and 14% premiums to the group, respectively, given best-of-group growth prospects (10%+), lowest dividend payout ratios, and 100% movement away from rate of return regulation at AIT and SBC (70% at BellSouth).

Table 2

RBOCs/GTE Target Multiples
(as of February 16, 1996)

	Current Price	1996E EPS	Current P/E Multiple: x Est 1996 EPS	Current P/E Multiple: Relative to S&P	Targeted Premium	Targeted P/E Multiple: x Est 1996 EPS	Targeted P/E Multiple: Relative to S&P	Price Objective	Price Appreciation Potential [1]
Ameritech	$59.63	$3.75	15.9	0.97	18%	19.4	1.18	$72.59	22%
Bell Atlantic	$68.38	$4.20	16.3	0.99	15%	18.9	1.15	$79.23	16%
BellSouth	$40.38	$2.45	16.5	1.00	20%	19.7	1.20	$48.23	19%
NYNEX	$52.13	$3.55	14.7	0.90	2%	16.7	1.02	$59.40	14%
Pacific Telesis	$30.25	$2.50	12.1	0.74	-15%	13.9	0.85	$34.86	15%
SBC Comm.	$55.75	$3.42	16.3	0.99	24%	20.3	1.24	$69.57	25%
U S WEST Comm.	$34.00	$2.45	13.9	0.85	-5%	15.5	0.95	$38.86	14%
RBOC Average			15.1	0.92	8%	17.8	1.08		18%
GTE	$45.00	$2.87	15.7	0.96	10%	18.0	1.10	$51.79	15%
S&P 500	$647.98	$39.50	16.4	1.00					

[1] Additional return from dividends not included.

After 13 Years of Debate, Judge Greene's Rules Are Gone With the Passage of a New Telecom Act

The New Law on February 6, President Clinton signed into law the Telecommunications Act of 1996, a comprehensive and very pro-RBOC rewrite of telecommunications regulation. The Act eliminates the MFJ and Judge Greene's rules — rules that, at their core, had prohibited the RBOCs from offering customers long distance service anywhere in the U.S. until their so-called "bottleneck" control over local access to the end user was eliminated by alternative local suppliers.

That Act, Combined With A Dramatic Regulatory Shift Away from ROR Regulation, Means A Fundamental Improvement in Growth Prospects for the RBOCs and GTE ..

The new law significantly reduces that hurdle, as it does not activate a bottleneck concept nor does it require much reduction in the RBOCs' share of the local telephone and access markets as a precondition to entry into long distance. Instead, the new law acknowledges the RBOCs' disincentive to open local markets and networks to competitors and thus it offers the RBOCs long distance entry as a quid pro quo. In effect, the new law *entices the Regional Bell companies (RBOCs) to open up their local networks to competitors in exchange for the opportunity to enter the long distance market.* — a tradeoff

we consider quite attractive for the RBOCs given the fact that state regulators were rapidly moving to facilitate local competition anyway.

Long Distance Opportunity Will Offset the One Negative in the Act: Accelerated Local Competition

How the Competitive Risk is Less than Meets the Eye: Much is made in the press of the long distance carriers' aggressive plans to compete in the local telephone market. We certainly foresee accelerated local competition as a result of state and, now, Federal legal changes. Indeed, this explains *our bullish view of shares of MFS* (MFST, $59 3/4, D-2-1-9), a startup alternative local phone company serving approximately 0.5% of the U.S. local telephone market today.

These articles fail to point out, however, how difficult it will be for long distance companies to gain enough local telephone profits soon enough to offset the losses we expect them to incur in the long distance market. This is because, for the most part, the long distance carriers have few direct paths to the end user customer — except via purchase of services or assets from alternative networks such as MFS or, to some extent, MCI Metro; or via resale of local exchange company (LEC), including RBOC and GTE, facilities.

The New Math is an 80/20 Rule..

Long distance will get only 20-30% discounts on local capacity. And here's the problem: When long distance carriers buy local capacity from the RBOCs on a bundled resale basis, they are likely to get only a 20-30% discount off retail rates. And, if they buy unbundled local loops (the so-called "last mile"), under the law they will be required to pay "cost plus a reasonable profit" — which is usually higher than today's subsidized local monthly retail rate. (See below for more detailed discussion of distinction between bundled and unbundled resale under the Act.)

So, except to the extent the RBOCs lose share to facilities-based local competitors such as MFS, Teleport, other so-called CAPS, and eventually the cable companies — which we expect to evolve over time as those networks are built out and market share grows from today's 1.2% market share to 20-25% by 2005 — long distance revenue share gains of, say, 10% in the local market will translate into only 2-3% revenue losses for the RBOCs and GTE. (We are assuming 20-30% wholesale discounts because some important state PUCs have already indicated discounts between 10-25%. Quite surprisingly, 25% discounts have been described as adequate by AT&T).

In contrast, when RBOCs or GTE take retail share in the long distance market, they will either (a) use their substantial volumes to bargain (remember there are 4 competing national fiber optic capacity suppliers) for discounts that we estimate at close to 70-80% off retail long distance rates (e.g., an estimated 2 or 3 cents per minute, vs. 10 cents net of both ends of access) or (b) selectively upgrade their own in-region networks to carry long distance calls between heavily trafficked city pairs, thereby entirely bypassing the long distance networks and reducing long distance transport costs from 2-3 cents per minute to between a half and one cent of depreciation, maintenance and interest expenses.

Share Exchange is Asymmetric in Favor of RBOCs ... Driven by Asymmetries in Buying Power Thus Wholesale Discounts and Capital Intensity

Clearly, the 80/20 or 70/30 mathematics of share exchange between the long distance and local telephone industries are asymmetric in favor of the RBOCs and GTE. Think about it this way (all numbers are net of both ends of access): If a long distance carrier loses 10% share of its revenues, and recaptures its proportionate share of wholesale traffic (i.e., at 2 cents instead of 10 cents), it loses at least 8% (80% of 10%) of its gross margin (revenues less access). And worse, with its main variable cost (access) already backed out of the analysis, marketing costs unlikely to decline with the RBOCs intensifying the telemarketing and advertising environment, and few other costs likely to decline with reduced retail volumes (except the cost of printing and posting bills for lost