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USWEST

G. Michael Crumling
Executive Director-
Federal Regulatory

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

July 25, 1997

EX PARTE
Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Re: CC Docket 96-98 Interconnection

Dear Mr. Caton:

Today, Brenda Fox, VP, Government Relations and the undersigned met with Richard Metzger and Blaise Scinto of the Common Carrier Bureau and met also with Jim Schlichting, Tom Power, Anu Seam and Jay Atkinson of the Competitive Pricing Division to discuss the attached handout regarding MCI's press release that suggests that its worsening financial results are totally attributable to ILECs making it difficult for them to enter the local service market. Independent analysis by the Bear Stearns firm indicates that the majority of MCI's reduction in earnings per share is attributable to declining margins in its long distance business.

In accordance with 47 C.F.R. § 1.1206(a)(1) of Commission's rules, the original of this letter and one copy are being filed with your office. Acknowledgment and date of receipt are requested. A duplicate of this letter is included for this purpose.

Sincerely,

M Crumling

Attachment

cc: Richard Metzger
Blaise Scinto
Jim Schlichting
Tom Power
Anu Seam
Jay Atkinson

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JUL 25 1997

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

The Real Wolf at MCI's Door

Why is MCI reporting substantially lower earnings?

In a July 10 report on MCI, Bear Stearns analyst William N. Deatherage says that:

> **The Outlook for the Long Distance Business Has Worsened.** the news in this segment was somewhat obscured by the discussion of MCI's problems in the CLEC area. Our new Forecast has markedly lower growth in long distance volume, revenue, and operating income. In fact, a larger share of our EPS reduction relates to a shortfall in long distance than in the CLEC activities. Intense competition is the issue, including price pressure. In addition, the company is experiencing cost growth for items such as the year 2000 reprogramming effort and a new FCC plan to compensate payphone operators for dial-around traffic.

In fact, Deatherage estimates that of the 80 cents per share decline in MCI's projected 1998 earnings, 55 cents (two-thirds of the total) is due to long distance earnings erosion.

On July 16 Bloomberg noted that:

> "MCI has shared with analysts that core (long distance) operating income in 1997 will be similar to 1996...In 1998 we (MCI) have said that may be similar to 1997."
>
> Before MCI's forecast, analysts expected MCI to boost profit in their long-distance business in 1997 and 1998 by about 10 percent.

MCI's difficulties are in competing, in long distance telephone service as well as local service. MCI chose to ask for interconnection in only half of the 14 states served by U S WEST Communications. Today, MCI can serve customers in five of those seven states -- Colorado, Iowa, Minnesota, Washington, Oregon.

Don't be fooled by MCI's press releases.

Wednesday July 16 1:54 PM EDT

MCI denies profit warning a political move

EDINBURGH, July 16 (Reuter) - MCI Communications Corp denied on Wednesday that a surprise profit warning last week was a political move to force U.S. regulators to open up domestic markets more quickly.

MCI said last Thursday it expected to post significantly higher than forecast losses because of problems breaking into local U.S. markets.

The statement rocked a planned $20 billion merger with British Telecommunications Plc (BT.L).

"It would have been a whole lot easier to have gone out and placed an advertisement -- and less painful," an MCI spokeswoman said after an annual meeting of BT shareholders in Edinburgh.

MCI says regulatory restraints and footdragging by local monopoly telecom companies are preventing it from breaking into the $100 billion U.S. local markets.

Some analysts say MCI might be exaggerating the estimated investment needed and losses expected from its local business.

Other analysts believe the bearish MCI forecast may point to problems with MCI core long-distance business.

Salomon Brothers says that BT knew about MCI's plans for breaking into local markets and backed its efforts to dramatically highlight the footdragging by local operators.

BT backs MCI's call for effective action by regulators but has said it plans a thorough review of MCI's strategy following the U.S. group's surprise statement.

Few analysts think the merger, which will be the largest trans-Atlantic deal in history if passed by U.S. regulators, is likely to fall apart but BT may decide to renegotiate the terms.

MCI shareholders have been keen to point out that not all the news from BT has been good. BT has been hit by a 500 million stg windfall tax on the earnings.

BT's contributions to its pension fund also have to be raised considerably after tax changes, MCI shareholders have said.

MCI chairman Bert Roberts will be returning to Washington on Wednesday or Thursday but Jerry Taylor, the company's chief executive who also attended the meeting in Edinburgh, is likely to stay in

William N. Deatherage, CFA (212) 272-2720
Bette Massick Colombo, CFA (212) 272-2721

July 10, 1997

Subject: Change in EPS outlook, Company update, Merger/acquisitions
Industry: Telecommunications

BEAR, STEARNS & CO. INC.
EQUITY RESEARCH
MCI Communications* (MCIC - 42 3/8) - Neutral

Earnings Shock

*** MCI disclosed that greater than expected losses in competitive local exchange (CLEC) activities and other operating issues will negatively impact earnings beginning in the second half of this year.

*** Our 1997 and 1998 EPS estimates are lowered by approximately 30% to $1.15 and 45% to $1.00, respectively. As a result, EPS forecasts for the new Concert plc may come down around 10%.

*** Compared with our model, management's input actually led to a larger reduction in earnings in the long distance business than an increase in losses in the CLEC venture (see Table 1).

*** Considering the sharp and unexpected reduction in MCI's current earnings power, BT may reconsider the merits of the merger or its terms.

*** Thus, investors will be eager to hear BT reaffirm its commitment to the deal at the agreed price. However, BT has only stated that the company is studying the changes in MCI's prospects and is supportive of MCI's call for more open markets.

*** Based on trading of BT shares in London (down 9%) and the muted reaction so far from BT to MCI's announcement, MCIC may fall 15% or more. After that, the shares should move in response to more definitive statements (positive or negative) from London.

Market capitalization: $29,705M

EPS	Mar	Jun	Sep	Dec	Year	P/E	Div	Yld
1996	$0.42A	$0.43A	$0.44A	$0.44A	$1.73A	24.5x	$0.05	
1997	$0.42A	$0.40E	$0.25E	$0.08E	$1.15E	36.8x	$0.05	0.1%
Previous			*$0.39*	*$0.39*	*$1.60*			
1998					$1.00E	42.4x		
Previous					*$1.80*			

The Highlights of the MCI Press Release and Conference Call Include:

* Local market entry is company's #1 objective. "Delaying tactics" by incumbent LECs (ILECs) have caused the company to fall 12-18 months behind schedule.
* Expects to spend $100M during 1997 contesting legal/regulatory issues with ILECs.
* CLEC capital spending should approximate $800M in 1997 and $1B in 1998.

* Bear, Stearns & Co. Inc. is a market maker in the security of this company and may have a long or short position in the security.

FILE NAME: MCIC7-10.DOC

* CLEC revenue run-rate forecast: $500M exiting 1997; $2B exiting 1998.
* CLEC losses could reach $800M (pretax) in 1997, two times original plan; losses could exceed $800M in 1998.
* Long distance profits depressed by (1) competitive pricing; (2) re-deployment of marketing, operations, and product development resources from core to local business; (3) acceleration of year 2000 reprogramming efforts. Net effect -$100M in 1997; -$100-$200M in 1998.
* 2Q97 EPS outlook unchanged (in $0.40 range).
* Above-mentioned issues negatively impact expectations for second-half 1997 and 1998 EPS.
* Material charges possible in future to improve financial performance.

The Major Changes to Our Forecast Are:

Table 1	1997E		1998E	
	Before	After	Before	After
Total EPS	$1.80	$1.15	$1.80	$1.00
Long distance ($MM)				
Revenue	$18.2B	$17.8B	$20.0B	$18.8B
Revenue growth	8.0%	6.0%	10.1%	6.0%
Operating income	$2.7B	$2.45B	$3.0B	$2.45B
Operating margin	15.1%	13.8%	15.2%	13.0%
Net income	$1.7B	$1.5B	$1.85B	$1.5B
EPS	$2.40	$2.15	$2.85	$2.10
CLEC ($MM)				
Pretax income	($0.6B)	($0.8B)	($0.8B)	($0.9B)
Net income	($0.35B)	($0.5B)	($0.4B)	($0.55B)
EPS	($0.50)	($0.70)	($0.53)	($0.76)

Source: Bear, Stearns & Co. Inc. estimates

MCImetro Was Created to Hold the CLEC Operations. The company operates 67 local city networks in 35 major cities, and has installed 19 Class 5 switches serving 21 major cities. Management expects to provide local service to businesses in 30 markets by year-end 1997 and may extend service to 60 markets by year-end 1998. The total investment to date is approximately $1B. The table below exhibits selected financial information for MCImetro.

Table 2

Local ($MM)	1Q95	2Q95	3Q95	4Q95	1Q96	2Q96	3Q96	4Q96	1Q97
Revenue	$17	$22	$29	$40	$40	$44	$45	$49	$55
EBITDA	(1)	(1)	(8)	(9)	(9)	(12)	(15)	(27)	(58)
Operating income	NA	NA	NA	NA	(13)	NA	(25)	NA	(72)
Net income	NA	NA	(6)	(7)	(10)	(16)	(19)	(26)	(50)

Source: Company reports

The Problem Is a Lack of Revenue. MCImetro's facilities are grossly underutilized. Considering that MCImetro is three years old and has an extensive network, revenue is low. Further, most of the local service revenue is from sales to the core business. Even internal sales are modest given that

MCI's long distance business customers probably pay $1-$2B in access charges in MCImetro cities. The lack of facilities-based revenue is only partially explained by problems in dealing with ILECs.

MCI Stated that the Top Line Run Rate May Reach $500M by the End of 1997. This estimate is down from $700M earlier in the year. The reduced projection is still much greater than the first-quarter run rate ($260M). However, a major part of the increase comes from resale services, which have a negative margin. Overall, MCI may have underestimated the challenge of offering local service. In addition, the company was naïve to believe that the ILECs would offer much assistance.

The Outlook for the Long Distance Business Has Worsened. The news in this segment was somewhat obscured by the discussion of MCI's problems in the CLEC area. Our new forecast has markedly lower growth in long distance volume, revenue, and operating income. In fact, a larger share of our EPS reduction relates to a shortfall in long distance than in the CLEC activities. Intense competition is the issue, including price pressure. In addition, the company is experiencing cost growth for items such as the year 2000 reprogramming effort and a new FCC plan to compensate payphone operators for dial-around traffic.

Companies mentioned:
AT&T (T-35 3/4)
British Telecom[1] (BTY-81 9/16)

[1] Bear, Stearns & Co. Inc. is associated with the specialist in the stock or options of this company. That specialist (a) makes a market in a security; (b) may have a long or short position in the security; and (c) may be on the opposite side of public orders executed on the floor of the exchange.