Recent Sales of Unregistered Securities

During 1997, the Registrant issued (i) an aggregate of 2,100,000 shares of Class A Common Stock in connection with the acquisition of CERFnet, (ii) 2,757,083 shares of Class A Common Stock in connection with the acquisition of ETC, and (iii) 1,667,624 whole shares of Class A Common Stock in connection with the acquisition of BizTel. See "Business—Other Recent Developments." The issuance of Class A Common Stock in each acquisition was deemed exempt from the registration requirements of the Securities Act pursuant to Section 4(2) of the Securities Act of 1933, as amended. The recipients of Class A Common Stock in each transaction represented their intentions to acquire the Class A Common Stock for investment purposes only and not with a view to or for sale in connection with any distribution of Class A Common Stock.

Item 6. *Selected Financial Data*

The following tables present historical summary combined financial data for the years 1993, 1994 and 1995, derived from the combined audited historical financial statements of TCG and TCG Partners. The selected financial data set forth below for the years 1996 and 1997 have been derived from the consolidated financial statements of TCG. The financial statements for the years 1995 through 1997 have been audited by Deloitte & Touche LLP, independent auditors, whose report thereon appears elsewhere in this Form 10-K.

	Years Ended December 31,				
	1997	1996	1995	1994	1993
	(dollars in thousands, except share amounts)				
Statements of Operations Data:					
Revenues:					
Telecommunications service	S 494,304	$ 244,864	$ 134,652	S 99,983	$ 82,374
Management and royalty fees(1)	—	22,805	31,517	20,691	1,555
Total Revenues	494,304	267,669	166,169	120,674	83,929
Operating expenses	283,440	157,591	93,118	76,572	54,218
Selling, general and administrative expenses(2)	165,977	85,025	50,475	39,939	34,281
In-process research and development costs(3)	22,000	—	—	—	—
Depreciation and amortization	155,402	78,416	37,837	19,933	16,197
Operating loss	(152,515)	(53,363)	(15,261)	(15,820)	(20,767)
Interest:					
Interest income	31,111	30,219	4,067	1,711	1,072
Interest expense	(116.172)	(73,633)	(23,331)	(5,079)	(1.407)
Net Interest expense	(85,061)	(43,414)	(19,264)	(3,368)	(335)
Minority interest(4)	—	3,520	663	1,395	796
Equity in losses of unconsolidated affiliates	(3,427)	(19,400)	(19,541)	(11,763)	(2,114)
Loss before income taxes	(221,003)	(112,657)	(53,403)	(29,556)	(22.420)
Income tax (provision) benefit	(1,664)	(2,193)	(401)	(433)	4,149
Net loss	$ (222,667)	S (114,850)	$ (53,804)	$ (29,989)	S (18.271)
Net loss per share	$ (1.34)	$ (1.00)	$ (0.77)	$ (0.43)	$ (0.26)
Weighted average number of shares	165,728,059	114,443,695	70,000,140	70,000,140	70,000,140
Other Data:					
EBITDA(5)	$ 44,887	$ 25,053	$ 22,576	$ 4,113	$ (4,570)
Cash flows from operating activities	(21,211)	93,618	36,141	87,753	47,438
Cash flows from investing activities	(341,624)	(913,513)	(207,967)	(265,026)	(149,107)
Cash flows from financing activities	258,626	1,085,573	157,688	171,557	129,822
Capital expenditures(6)	501,035	308,112	154,807	143,276	155,184
Ratio of earnings to fixed charges(7)	—	—	—	—	—

(2) [illegible] selling, general, and administrative expenses are expenses incurred for services provided to the Local Market Partnerships, in the amounts of $21.4 million, $29.6 million, $19.4 million and $1.4 million for the years 1996, 1995, 1994 and 1993, respectively.

(3) In December 1997, TCG evaluated the acquired assets and liabilities of CERFnet, and as a result of the evaluation, TCG expensed acquired in-process research and development costs.

(4) Minority interest reflects Fidelity Communications Inc.'s equity interest in Teleport Communications Boston for 1993 and 1994; a Cox affiliate's interest in TCG San Diego for 1993 and 1994; and TCI and Continental affiliates' interests in TCG St. Louis for 1994 and 1995 and 1996. In 1996, after giving effect to the TCG Reorganization and the debt and equity offerings consummated in July 1996, the minority interest reflects Viacom Telecom, Inc.'s equity interests of 22.2% and 22.9% in TCG Seattle and TCG San Francisco, respectively, and InterMedia Partners' equity interest of 4.2% in TCG San Francisco. In 1997 TCG no longer recorded minority interest for the Local Market Partnerships due to the completion of the TCG Reorganization.

(5) EBITDA consists of earnings (loss) before interest, income taxes, depreciation, amortization, minority interest and equity in losses of unconsolidated affiliates. It is a measure commonly used in the telecommunications industry and is presented to assist in understanding TCG's operating results. EBITDA is not intended to represent cash flows or results of operations in accordance with U.S. GAAP for the periods indicated. TCG's use of EBITDA may not be comparable to similarly titled measures due to the use by other companies of different financial statement components in calculating EBITDA. In 1997, this amount represents Recurring EBITDA which is defined as EBITDA excluding a one-time non-recurring charge for acquired in-process research and development costs.

(6) Capital expenditures for 1996 are net of the effect of the inclusion of the Local Market Partnerships as of June 30, 1996.

(7) The ratio of earnings to fixed charges is computed by dividing pre-tax income from operations before fixed charges (other than capitalized interest) by fixed charges. Fixed charges consist of interest charges and the amortization of debt expense and discount or premium related to indebtedness, whether expensed or capitalized, and that portion of rental expense the Company believes to be representative of interest. For the years 1997, 1996, 1995, 1994 and 1993, earnings were insufficient to cover fixed charges by $221.0 million, $116.2 million, $54.1 million, $31.0 million and $23.2 million, respectively.

Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations*

Overview

TCG, the first and largest CLEC in the United States, offers comprehensive telecommunications services in major metropolitan markets nationwide. The Company competes with ILECs by providing high quality, integrated telecommunications services, primarily over fiber optic digital networks, to meet the voice, data and video transmission needs of its customers. TCG's customers are principally telecommunications intensive businesses, healthcare and educational institutions, governmental agencies, long distance carriers and resellers,

ACC CORP.
400 WEST AVENUE
ROCHESTER, NEW YORK 14611

March 27, 1998

Dear Stockholder:

You are invited to attend a Special Meeting of Stockholders (the "Special Meeting") of ACC Corp., a Delaware corporation ("ACC"), to be held at the offices of Nixon, Hargrave, Devans & Doyle LLP, 437 Madison Avenue, 24th Floor, New York, New York 10022, on Tuesday, April 21, 1998 at 11:00 a.m., local time.

The purpose of the Special Meeting is to consider and vote upon the Agreement and Plan of Merger, dated as of November 26, 1997 (the "Merger Agreement"), by and among ACC, TCG Merger Co., Inc., a Delaware corporation ("MergerCo"), and Teleport Communications Group Inc., a Delaware corporation ("TCG"), and all related transactions, including, without limitation, the merger of MergerCo with and into ACC (the "Merger"). If the Merger is consummated, ACC will survive the Merger as a wholly-owned subsidiary of TCG, and the shares of the Class A Common Stock of ACC, par value $0.015 per share (the "ACC Stock"), that are issued and outstanding at the effective time of the Merger (other than shares held in ACC's treasury, or by a wholly-owned subsidiary of ACC, which will be canceled without any consideration being issued or paid therefor) will be converted automatically into the right to receive a number of shares of the Class A Common Stock of TCG, par value $0.01 per share (the "TCG Class A Common Stock"), to be determined pursuant to the Exchange Ratio (as defined below). A copy of the Merger Agreement is included as Appendix A to the attached Proxy Statement/Prospectus.

The "Exchange Ratio" means:

(i) if the Average Price (as defined below) is less than $45.00, 1.11111;

(ii) if the Average Price is equal to or greater than $45.00, but not in excess of $55.00, a fraction, the numerator of which shall be $50.00 and the denominator of which shall be the Average Price; or

(iii) if the Average Price is greater than $55.00, 0.90909;

subject to payment of cash in lieu of any fractional share.

The "Average Price" means the average of the last reported sales prices per share of the TCG Class A Common Stock as reported on The Nasdaq National Market for the ten consecutive trading days immediately preceding the trading day immediately prior to the date on which the closing of the Merger occurs.

Approval and adoption of the Merger Agreement and approval of the Merger require the affirmative vote of a majority of the outstanding shares of ACC Stock, either in person or by proxy.

THE BOARD OF DIRECTORS OF ACC HAS UNANIMOUSLY APPROVED AND ADOPTED THE MERGER AGREEMENT AND APPROVED THE MERGER AND UNANIMOUSLY RECOMMENDS THAT YOU VOTE FOR APPROVAL AND ADOPTION OF THE MERGER AGREEMENT AND APPROVAL OF THE MERGER.

This Letter to Stockholders, the attached Notice of Special Meeting, the form of proxy and the Proxy Statement/Prospectus were first mailed to ACC's stockholders on or about March 30, 1998.

In reaching its determination regarding the Merger Agreement and the Merger, the Board considered, among other things, the opinion of Morgan Stanley & Co. Incorporated as to the fairness, from a financial point of view, of the consideration to be received by the stockholders of ACC pursuant to the Merger. The opinion of Morgan Stanley & Co. Incorporated is included as Appendix B to the attached Proxy Statement/Prospectus.

The Board of Directors has fixed the close of business on March 18, 1998 as the record date for determination of stockholders entitled to notice of and to vote at the Special Meeting.

In view of the importance of matters to be acted upon at the Special Meeting, you are invited personally to attend the Special Meeting. Regardless of whether you expect to be present in person at the Special Meeting, consents. Accordingly, there can be no assurance that the purchase of the assets of KCFN will be successfully consummated or, if successfully completed, when it might be completed.

TCI Subordinated Note. In December 1997, TCG repaid at a discounted value of approximately $25.1 million the TCI subordinated note (the "TCI Subordinated Note"), in the original principal amount of $26 million, that it had issued to TCI in the TCG Reorganization.

1997 Equity Offering. On November 13, 1997, TCG consummated a public offering of 17,250,000 shares of TCG Class A Common Stock (the "1997 Equity Offering"). Of the 17,250,000 shares, 7,304,408 shares were offered by TCG (realizing net proceeds of approximately $317.4 million to TCG) and 9,945,592 shares were offered by Continental Holding Company, a Massachusetts business trust, the shares of which are owned by MediaOne of Delaware, Inc., which is wholly owned by U S WEST, Inc. ("U S WEST"). MediaOne of Delaware, Inc. was formerly known as Continental Cablevision, Inc. ("Continental"). Continental acquired its interest in TCG in May 1993. As a result of the consummation of the 1997 Equity Offering, Continental does not hold any shares of TCG Common Stock.

BizTel Communications, Inc. On October 29, 1997, TCG acquired the remaining 50.1% equity interest in BizTel Communications, Inc. ("BizTel") not owned by TCG in exchange for the issuance of 1,667,631 shares of TCG Class A Common Stock (with cash paid in lieu of any fractional shares). TCG had previously acquired a 49.9% interest in BizTel in February 1996. BizTel holds FCC licenses to provide telecommunications services utilizing 38 GHz digital milliwave transmission in over 200 geographic areas, which include more than 95 of the 100 largest metropolitan markets and all markets where TCG operates. BizTel's 38 GHz milliwave services can be used by TCG to economically connect customers to TCG's fiber optic networks, to provide network redundancy, diverse routing or quick temporary installations and to provide stand-alone facilities where TCG does not have fiber optic networks.

Eastern TeleLogic Corporation. Effective as of March 1, 1997, TCG completed its acquisition of Eastern TeleLogic Corporation ("ETC") for 2,757,083 shares of TCG Class A Common Stock. TCG also assumed $52.6 million in ETC debt and loaned $115 million to ETC, the proceeds of which were used by ETC to redeem the stock held by certain minority shareholders. The acquisition of ETC provides TCG with access to the Philadelphia market, the nation's fifth largest market, and allows TCG to establish a contiguous network between Boston and Washington, D.C. ETC operates a Class 5 digital telephone switch on its 525-mile fiber optic network which connects to more than 360 buildings. After the acquisition, the name of ETC was changed to TCG Delaware Valley, Inc.

CERFnet Services, Inc. On February 4, 1997, TCG acquired from General Atomic Technologies Corporation and General Atomics all the outstanding capital stock of CERFnet Services, Inc. ("CERFnet"), a leading regional provider of Internet-related services to businesses, including dial-up and dedicated Internet access, World Wide Web hosting, and colocation services and Internet training. TCG issued to General Atomics, CERFnet's former controlling stockholder, 2,100,000 shares of TCG Class A Common Stock and granted to General Atomics and certain of its stockholders certain registration rights with respect to such shares. After the acquisition, the name of CERFnet was changed to TCG CERFnet, Inc.

TCG's principal executive offices are located at 437 Ridge Road, Executive Building 3, Dayton, New Jersey 08810, and its telephone number is 732-392-2000.

Business of ACC Corp.

ACC is a switch-based provider of telecommunications services in the United States, Canada, the United Kingdom (the "U.K.") and Germany. ACC primarily provides long distance telecommunications services to a diversified customer base of businesses, residential customers and educational institutions. ACC also provides local telephone service as a switch-based local exchange reseller in upstate New York and Massachusetts and as a reseller of local exchange services in Ontario and Quebec, Canada. ACC entered the German market during 1997 as a switchless reseller of long distance telecommunications services and became a switch-based provider in Germany in February of 1998. ACC operates an advanced telecommunications network, consisting of ten long distance international and domestic switches located in the U.S., Canada, the U.K. and Germany, six local exchange switches located in the U.S., leased transmission lines, indefeasible rights of use in international submarine cables ("IRUs") and network management systems designed to optimize traffic routing.

ACC's objective is to grow its telecommunications customer base in its existing markets and to establish itself in deregulating Western European markets that have high density telecommunications traffic when ACC believes that business and regulatory conditions warrant. The key elements of ACC's business strategy are: (1) to broaden ACC's penetration of the U.S., Canadian, U.K. and German telecommunications markets by expanding its long distance, local and other service offerings and geographic reach; (2) to utilize ACC's operating experience as an early entrant in deregulating markets in the U.S., Canada and the U.K. to penetrate other deregulating telecommunications markets that have high density telecommunications traffic; (3) to achieve economies of scale and scope in the utilization of ACC's network; and (4) to seek acquisitions, investments or strategic alliances involving assets or businesses that are complementary to ACC's current operations.

ACC's principal competitive strengths are: (1) ACC's sales and marketing organization and the customized service ACC offers to its customers; (2) ACC's offering of competitive prices, which ACC believes generally are lower than prices charged by the major carriers in each of its markets; (3) ACC's position as an early entrant in the U.S., Canadian and U.K. markets as an alternative carrier; (4) ACC's focus on more profitable international telecommunications traffic between the U.S., Canada and the U.K.; and (5) ACC's switched-based networking capabilities. ACC believes that its ownership of switches reduces its reliance on other carriers and enables ACC to efficiently route telecommunications traffic over multiple leased transmission lines and IRUs and to control costs, call record data and customer information. The availability of existing transmission capacity in its markets makes leasing of transmission lines attractive to ACC and enables it to grow network usage without having to incur the significant capital and operating costs associated with the development and operation of a transmission line infrastructure.

ACC primarily targets business customers with approximately $500 to $15,000 of monthly usage, selected residential customers and colleges and universities. ACC believes that, in addition to being price-driven, these customers tend to be focused on customer service, more likely to rely on a single carrier for their telecommunications needs and less likely to change carriers than larger commercial customers. The diversity of ACC's targeted customer base enhances network utilization by combining business-driven workday traffic with night and weekend off-peak traffic from student and residential customers. ACC strives to be more cost effective, flexible, innovative and responsive to the needs of its customers than the major carriers, which principally focus their direct sales efforts on large commercial accounts and residential customers.

ACC was originally incorporated in New York in 1982 under the name A.C. Teleconnect Corp. and was reincorporated in Delaware in 1987 under the name ACC Corp. ACC Corp.'s consolidated subsidiaries include ACC National Long Distance Corp., ACC National Telecom Corp. and ACC Long Distance Corp. (collectively, "ACC U.S."), ACC TelEnterprises Ltd. ("ACC Canada") and ACC Long Distance UK Limited ("ACC U.K."). ACC's principal executive offices are located at 400 West Avenue, Rochester, New York 14611 and its telephone number at that address is 716-987-3000.

ACC Recent Developments

ACC Management Changes. On December 5, 1997, ACC announced that its Chairman of the Board of Directors and Chief Executive Officer, David K. Laniak, 62, had died unexpectedly due to health-related complications. As a result, ACC's Board of Directors named Robert M. Van Degna, Chairman of the Board of

Summary Historical Financial Data of ACC

The following table presents summary historical financial data of ACC. The historical data for each of the years in the five-year period ended December 31, 1997 have been derived from the audited historical consolidated financial statements of ACC.

These data should be read in conjunction with, and are qualified in their entirety by, the consolidated financial statements of ACC and the related notes thereto, which are included herein. See "Index to Financial Statements—ACC Corp. and Subsidiaries."

	Year Ended December 31				
	1993	1994	1995(6)	1996	1997(4)
	(dollars in thousands, except per share amounts)				
CONSOLIDATED STATEMENT OF OPERATIONS DATA:					
Total revenue	$105,946	$126,444	$188,866	$306,767	$372,613
Net income (loss) from continuing operations(1)	$ 1,653	$ (11,329)	$ (5,354)	$ 7,765	$ 10,391
Net income (loss) from continuing operations after Series A Preferred Stock dividends and accretion(1)	$ 1,653	$ (11,329)	$ (5,894)	$ 5,284	$ 10,391
Net income (loss) from continuing operations after Series A Preferred Stock dividends and accretion per common and common equivalent share(2)					
—basic	$ 0.16	$ (1.09)	$ (0.52)	$ 0.37	$ 0.62
—diluted	$ 0.16	$ (1.09)	$ (0.52)	$ 0.34	$ 0.59
OTHER FINANCIAL DATA:					
Cash dividends declared per share of Class A Common Stock(2)(3)	$ 0.40	$ 0.08	$ 0.02	$ —	$ —

	December 31,				
	1993	1994	1995(6)	1996	1997(4)
CONSOLIDATED BALANCE SHEET DATA:					
Total assets(5)	$ 61,718	$ 84,448	$123,984	$204,031	$319,618
Long term debt, excluding current maturities	$ 1,795	$ 29,914	$ 28,050	$ 6,007	$ 90,221
Redeemable preferred stock	$ —	$ —	$ 9,448	$ —	$ —
Shareholders' equity	$ 31,506	$ 19,086	$ 26,407	$117,863	$137,716

(1) Includes impact of $2,160 of charges incurred in 1994 in connection with enhancement of the ACC network to prepare for equal access for its Canadian customers. Also includes an asset write-down of $12,807 in 1993.

(2) On June 14, 1996, the ACC Board of Directors authorized a three-for-two stock split in the form of a stock dividend issued on August 8, 1996 of the ACC Stock to shareholders of record as of July 3, 1996. Share and per share amounts for all prior periods have been adjusted for the stock split.

(3) The ACC financing arrangements restrict the payment of dividends on the ACC Stock. ACC anticipates that it will not pay dividends in the foreseeable future.

(4) Includes the results of operations of companies acquired by ACC during 1997: Transphone International Ltd. from June 1, 1997, United Telecom Ltd. from July 1, 1997, VISTA International Communications Inc. from August 1, 1997, and Telenational Communications Deutschland Limited Partnership from July 1, 1997.

(5) Balance sheet data from discontinued operations is excluded.

(6) Includes the results of operations of Metrowide Communications from August 1, 1995, the date of acquisition.

General

ACC is a switch-based provider of telecommunications services in the United States, Canada, the U.K and Germany. ACC primarily provides long distance telecommunications services to a diversified customer base of businesses, residential customers and educational institutions. ACC also provides local telephone service as a switch-based local exchange reseller in upstate New York and Massachusetts and as a reseller of local exchange services in Ontario and Quebec, Canada. ACC entered the German market during 1997 as a switchless reseller of long distance telecommunications services and became a switch-based provider in Germany in February of 1998. ACC operates an advanced telecommunications network, consisting of ten long distance international and domestic switches located in the U.S., Canada, the U.K. and Germany, six local exchange switches located in the U.S., leased transmission lines, IRUs and network management systems designed to optimize traffic routing.

ACC's objective is to grow its telecommunications customer base in its existing markets and to establish itself in deregulating Western European markets that have high density telecommunications traffic when ACC believes that business and regulatory conditions warrant. The key elements of ACC's business strategy are: (1) to broaden ACC's penetration of the U.S., Canadian, U.K. and German telecommunications markets by expanding its long distance, local and other service offerings and geographic reach; (2) to utilize ACC's operating experience as an early entrant in deregulating markets in the U.S., Canada and the U.K. to penetrate other deregulating telecommunications markets that have high density telecommunications traffic; (3) to achieve economies of scale and scope in the utilization of ACC's network; and (4) to seek acquisitions, investments or strategic alliances involving assets or businesses that are complementary to ACC's current operations.

ACC's principal competitive strengths are: (1) ACC's sales and marketing organization and the customized service ACC offers to its customers; (2) ACC's offering of competitive prices, which ACC believes generally are lower than prices charged by the major carriers in each of its markets; (3) ACC's position as an early entrant in the U.S., Canadian and U.K. markets as an alternative carrier; (4) ACC's focus on more profitable international telecommunications traffic between the U.S., Canada and the U.K.; and (5) ACC's switched-based networking capabilities. ACC believes that its ownership of switches reduces its reliance on other carriers and enables ACC to efficiently route telecommunications traffic over multiple leased transmission lines and IRUs and to control costs, call record data and customer information. The availability of existing transmission capacity in its markets makes leasing of transmission lines attractive to ACC and enables it to grow network usage without having to incur the significant capital and operating costs associated with the development and operation of a transmission line infrastructure.

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Recent Developments

ACC Management Changes. On December 5, 1997, ACC announced that its Chairman and Chief Executive Officer, David K. Laniak, 62, had died unexpectedly due to health-related complications. As a result, ACC's Board of Directors named Robert M. Van Degna, Chairman of the Board of Directors. Mr. Van Degna has served as an outside director of ACC since 1995. ACC's Board of Directors also established an office of the Chief Executive to jointly perform the functions of Chief Executive Officer, consisting of Christopher Bantoft, Executive Vice President, Michael R. Daley, Executive Vice President and Chief Financial Officer, and Steve M. Dubnik, Executive Vice President.

U.S. WATS Merger. On October 28, 1997, ACC entered into the USW Merger Agreement, by and among ACC, Acquisition Sub, and USW, pursuant to which Acquisition Sub would have merged with and into USW (the "USW Merger"). On March 11, 1998, for reasons beyond the control of both parties which made it impossible to conclude the USW Merger prior to the March 31, 1998 termination date, ACC and USW agreed to a mutual termination of the USW Merger Agreement.

Industry Overview

The global telecommunications industry has dramatically changed during the past several years, beginning in the U.S. with AT&T's divestiture of its RBOCs in 1984 and culminating with the 1996 amendments to the U.S. Communications Act of 1934 (the "U.S. Communications Act"), and continuing in Canada, the U.K. and other countries with various regulatory changes. Previously, the long distance telecommunications industry in the U.S., Canada and the U.K. consisted of one or a few large facilities-based carriers, such as AT&T, Bell Canada and British Telecom. As a result of the AT&T divestiture and the recent legislative changes in the U.S. and fundamental regulatory changes in Canada and the U.K., coupled with technological and network infrastructure developments which increased significantly the voice and data telecommunications transmission capacity of dominant carriers, the long distance industry has developed into a highly competitive one consisting of numerous alternative long distance carriers in each of these countries. In addition, since the AT&T divestiture in 1984, competition has heightened in the local exchange market in the U.S. and Canada. ACC anticipates that deregulatory and economic influences will promote the development of competitive telecommunications markets in other countries.

Long Distance Market. The U.S. long distance market has grown to over $93 billion in annual revenues during 1996, according to FCC estimates. AT&T has remained the largest long distance carrier in the U.S. market, retaining approximately 48% of the market, with MCI and Sprint with respective market shares of approximately 20% and 10% of the market during 1996. AT&T, MCI and Sprint constitute what generally is regarded as the first tier in the U.S. long distance market. Large regional long distance companies, some with national capabilities, such as WorldCom, Inc. (which in 1996 merged with MFS Communications, Inc.), CWI, Frontier Corp., Excel Telecommunications and LCI International, constitute the second tier of the industry, although WorldCom would become a first tier company upon consummation of its pending merger with MCI. The remainder of the U.S. long distance market share is comprised of several hundred smaller companies, including ACC U.S., known as third-tier carriers. In addition, recent U.S. legislation, which removes certain long-standing restrictions on the ability of the RBOCs to provide long distance services, and the World Trade Organization ("WTO") accord on basic services, will have a substantial impact on the long distance market.

Commencing in 1990, competition was introduced in the Canadian long distance market. The Canadian long distance market is dominated by a consortium of facilities-based local and long distance telephone companies (e.g., Bell Canada, BC Tel, Maritime Tel) operating as the "Stentor" group of companies. A second group of long distance providers, consisting principally of AT&T Canada Long Distance Services Company ("AT&T Canada"), Sprint Canada (a subsidiary of Call-Net Telecommunications Inc.) and fONOROLA Inc., own and operate transmission lines through which they provide long distance voice and data services in the Canadian markets. Other long distance providers, including ACC Canada, generally lease transmission lines through which they resell long distance services in the Canadian market.

The international, national and local markets for voice telephone services in the U.K. and Northern Ireland accounted for approximately (Pounds) 1.5 billion, (Pounds) 2.0 billion and (Pounds) 2.2 billion, respectively, in revenues during the 12 months ended March 31, 1997, according to estimates from The Office of Telecommunications ("Oftel"), the U.K. telecommunications regulatory authority. In the U.K., British Telecom historically has dominated the telecommunications market. British Telecom was the largest carrier during such 12 month period, with approximately 58.2%, 78.4% and 88.7% of the revenues from international, national and local voice telephone services, respectively. Cable & Wireless ("CWC") which owns and operates interexchange and local loop transmission facilities, is the second largest carrier of voice telecommunications in the U.K. The remainder of the U.K. long distance market is comprised of an emerging market of licensed public telephone operators, such as Energis Communications Ltd. ("Energis"), WorldCom, ACC U.K. and various cable companies, and switched-based resellers such as First Telecom and Esprit Telecom of the U.K. Ltd. ("Esprit") and Sprint.

Long distance carriers in the U.S., Canada and the U.K. can be categorized by several distinctions. One distinction is between transmission facilities-based companies and non-transmission facilities-based companies, or resellers. Transmission facilities-based carriers, such as AT&T, Bell Canada and British Telecom, own their own long distance interexchange or transmission facilities and originate and terminate calls through local exchange systems. Profitability for transmission facilities-based carriers is dependent not only upon their ability to generate revenues but also upon their ability to manage complex networking and transmission costs. All of the first- and most of the second-tier long distance companies in the U.S. markets are transmission facilities-based carriers and generally offer service nationwide. Most transmission facilities-based carriers in the third tier of the market offer their service only in a limited geographic area. Some transmission facilities-based carriers contract with other transmission facilities-based carriers to provide transmission where they have geographic gaps in their facilities. Carriers that operate primarily as switched-based resellers, such as ACC, carry their long distance traffic over transmission lines leased from transmission facilities-based carriers, originate and terminate calls through incumbent local exchange carriers or CLECs such as TCG and contract with transmission facilities-based carriers to provide transmission of long distance traffic either on a fixed rate lease basis or a call volume basis. Profitability for non-transmission facilities-based carriers is dependent largely on their ability to generate and retain sufficient revenue volume to negotiate attractive pricing with one or more transmission facilities-based carriers.

A second distinction among long distance companies is that of switch-based versus switchless resellers. Switch-based resellers, such as ACC, have one or more switches, which are sophisticated computers that direct telecommunications traffic to form a transmission path between a caller and the recipient of a call. All transmission facilities-based carriers are switch-based carriers, as are many non-transmission facilities-based carriers, including ACC. Switchless resellers, in contrast, depend on one or more transmission facilities-based carriers or switch-based resellers for transmission and switching facilities. ACC believes that its ownership of switches reduces its reliance on other carriers and enables ACC to efficiently route telecommunications traffic over multiple leased transmission lines and to control costs, call record data and customer information. The availability of existing transmission capacity in its markets makes leasing of transmission lines attractive to ACC and enables it to grow network usage without having to incur the significant capital and operating costs associated with the development and operation of a transmission line infrastructure.

Local Exchange Market. In the U.S., the existing structure of the telecommunications industry principally resulted from the AT&T divestiture. As part of the divestiture, seven RBOCs were created to offer services in specified geographic areas called Local Access and Transport Areas ("LATAs"). The RBOCs were separated from the long distance provider, AT&T, resulting in the creation of distinct local exchange and long distance markets. Since the AT&T divestiture, several factors have served to promote competition in the local exchange market, including (i) the local exchange carriers' monopoly position, which provided little incentive for the local exchange companies to reduce prices, improve service or upgrade their networks, and related regulations which required the local exchange carriers to, among other things, lease transmission facilities to alternative carriers, such as ACC, (ii) customer desire for an alternative to the local exchange carriers, which developed in part as a result of competitive activities in the long distance market and increasing demand for lower cost, high quality, reliable services, and (iii) the advancement of fiber optic and digital electronic technology, which combined the ability to transmit voice, data and video at high speeds with increased capacity and reliability.

In Canada, similar factors promoting competition in the local exchange market developed in response to regulatory developments in the Canadian long distance telecommunications market and to technological advances in the telecommunications industry. The Canadian Radio-television and Telecommunications Commission ("CRTC") has approved the introduction of competition in local exchange services in Canada.

Business Strategy

ACC was an early entrant as an alternative carrier in the U.S., Canada and the U.K. ACC's objective is to grow its telecommunications customer base in its existing markets and to establish itself in other deregulating Western European markets with high density telecommunications traffic. The key elements of ACC's business strategy are to increase penetration of existing markets, enter new markets, improve operating efficiency, and pursue acquisitions, investments and strategic alliances.

Increase Penetration of Existing Markets. ACC's consolidated revenue has grown from $126.4 million to $372.6 million over the three fiscal years ended December 31, 1997, although ACC expects its growth to decrease over time. ACC plans to further increase its revenue and customer base in the U.S., Canadian and U.K. markets by expanding its service offerings and geographic reach. The expansion of ACC's service offerings is designed to reduce the effects of price per minute decreases for long distance service and to decrease the likelihood that customers will change telecommunications carriers. Through this strategy, ACC will seek to build a broad base of recurring revenues in the U.S., Canada and the U.K. ACC also offers local telephone services in selected additional U.S. and Canadian markets, including New York, Massachusetts, Quebec and Ontario, as well as additional data communications services in the U.S. and Canada. ACC believes that offering local services will enhance its ability to attract and retain long distance customers and reduce ACC's access charges as a percentage of revenues.

Enter New Markets. ACC believes that its operating experience in deregulating markets in the U.S., Canada and the U.K. and its experience as an early entrant as an alternative carrier in those markets will assist ACC in identifying opportunities in other deregulating countries with high density telecommunications traffic. In particular, ACC believes that its position in the U.S., Canadian and U.K. telecommunications markets and its experience in providing international telecommunications service will assist it in establishing a presence in Western European markets when ACC believes that business and regulatory conditions warrant.

Improve Operating Efficiency. ACC strives to achieve economies of scale and scope in the use of its network, which consists of leased transmission facilities, ten international and domestic switches, six local exchange switches and information systems. In order to enhance the efficiency of the fixed cost elements of its network, ACC seeks to increase its traffic volume and balance business-driven workday traffic with night and weekend off-peak traffic from student and residential customers. ACC anticipates that competition among transmission facilities-based providers of telecommunications services in the U.S. and Canadian markets will afford ACC opportunities for reductions in the cost of leased line facilities. ACC seeks to reduce its network cost per billable minute by more than any reduction in revenue per billable minute. ACC also intends to acquire additional switches and upgrade its existing switches to enhance its network in anticipation of growth in ACC's customer base and provide additional telecommunications services. ACC believes that its network switches enable ACC to efficiently route telecommunications traffic over multiple transmission facilities to reduce costs, control access to customer information and grow network usage without a corresponding increase in support costs.

Pursue Acquisitions, Investments and Strategic Alliances. As ACC expands its service offerings and its network, ACC anticipates that it will seek to develop strategic alliances both domestically and internationally and to acquire assets and businesses or make investments in companies that are complementary to ACC's current operations. ACC believes that the pursuit of an active acquisition strategy is an important means toward achieving growth and economies of scale and scope in its targeted markets. Through acquisitions, ACC believes that it can further increase its traffic volume to further improve the usage of the fixed cost elements of its network.

Services

Commercial Long Distance Services. ACC offers its commercial customers in the U.S. and Canada an array of customized services and has developed a similar range of service offerings for commercial customers in the U.K.

In the U.S., although ACC historically has originated long distance voice services principally in New York and Massachusetts, ACC is currently authorized to originate intrastate long distance voice and data services in 48 states and international voice and data services in all states. ACC's U.S. services include "1+" inter-LATA long distance service, and private line service for which a customer is charged a fixed monthly rate for transmission capacity that is reserved for that customer's traffic. ACC's U.S. business services also include toll-free "800" or "888" services. In addition, ACC currently provides intra-LATA service in certain areas for customers who make a large number of intra-LATA calls. ACC installs automatic dialing equipment to enable customers to place such calls over ACC's network without having to dial an access code. However, various states, including New York, are moving to implement "equal access" for intra-LATA toll calls such that ACC's customers in such jurisdictions will be able to use ACC's network on a "1+" basis to complete intra-LATA toll calls. ACC's ability to compete in the intra-LATA toll market depends upon the margin which exists between the access charges it must pay to the local exchange company for originating and terminating intra-LATA calls, and the retail toll rates established by the local exchange carriers for the local exchange carriers' own intra-LATA toll service. ACC's commercial services generally are priced below the rates charged by the major carriers for similar services and are competitive with those of other carriers.

In Canada, ACC currently originates long distance voice and data services in the Montreal, Toronto and Vancouver metropolitan areas as well as throughout Alberta, British Columbia, Manitoba, New Brunswick, Nova Scotia, Ontario and Quebec. ACC offers its Canadian commercial customers both voice and data telecommunications services. ACC's long distance voice services are offered to its business customers in a nine-level discount structure marketed under the name "Edge." Discounts are based on calling volume and call destination and typically result in savings ranging from 10% to 20% when compared to Stentor member rates. Calls to the U.S. are priced at a flat rate regardless of the destination, and international calls are priced at a percentage discount to the rates charged by the Stentor group. ACC also offers toll-free "800" services within Canada, as well as to and from the U.S., and offers an ACC Travel Card providing substantial savings off Stentor member "Calling Card" rates. ACC Canada has introduced a frame relay network, Internet access services (including Web design/hosting) and paging services, and now provides these services in all provinces except Saskatchewan, Manitoba, New Brunswick and Newfoundland.

ACC originates long distance voice services throughout the U.K. ACC presently offers its U.K. customers voice telecommunications services. These services include indirect access (known as "ACCess 1601") through the public switched telephone network ("PSTN") and the use of direct access lines to ACC's network (known as "ACCess Direct") for higher-volume business users. Because ACCess 1601 is a mass market service, the prices offered are built around a standard price list with volume discounts for high-volume users. ACCess Direct is generally cost effective only for customers making at least (Pounds) 5,000 per month in calls.

ACC's U.S. and Canadian commercial customers are offered customized services, such as comprehensive billing packages and its "Travel Service Elite" domestic calling cards, which allow the customer to place long distance calls at competitive rates from anywhere in the U.S. and Canada. ACC's standard monthly statement includes a management summary report, a call detail report recording every long distance call and facsimile call, and a pricing breakdown by call destination. Optional calling pattern reports, which are available at no extra cost, include call summaries by account code, area or city code, LATA (for U.S. bound calls), international destination and time-of-day. This information is available to customers in the form of hard copy, magnetic tape or disk.

University Program. ACC's university program offers a variety of telecommunications services to educational institutions ranging from long distance service for administration and faculty, to integrated on-campus services, including local and long distance service; voice mail, intercom calling and operator services for students, administrators and faculty. ACC's sales, marketing and engineering professionals work directly with college and university administrators to design and implement integrated solutions for providing and managing telecommunications equipment and services to meet the current and prospective communications needs of their institutions. As part of its program, ACC often installs telecommunications equipment which, depending upon the circumstances, may include a switch or private branch exchange, voice mail, cabling and, in the U.K., pay telephones. Pay phone usage in the U.K., particularly at universities, is more prevalent than in the U.S. and Canada. To access this market directly, ACC has established a pay phone division in the U.K., which supplies pay phones that will automatically route calls from universities and other institutions over ACC U.K.'s network.

ACC's long distance rates in the U.S. for students generally are priced at a 10% discount from those charged by the largest long distance carriers. ACC's university contracts in Canada generally provide it with the exclusive right, and in the U.K. the opportunity, to market to the school's students, faculty and administration. Most of ACC's contracts in Canada also provide for exclusive university support for marketing to alumni. These arrangements allow ACC to market its services to these groups through its affinity programs.

ACC offers university customers in the U.S., Canada and the U.K. certain customized services. ACC offers academic institutions a comprehensive billing package to assist them in reviewing and controlling their telecommunications costs. For its university student customers in the U.S. and Canada, ACC provides a billing format that indicates during each statement period the savings per call (in terms of the discount from the largest long distance carrier's rates) realized during the billing period, and for all university customers ACC provides a call detail report recording every long distance call. In addition, for university student customers, ACC provides individual bills for each user of the same telephone in a dormitory room or suite so that each student in the dormitory room or suite can be billed for the calls he or she made.

Many of ACC's university customers in the U.S. are offered operator services, which are available 24 hours per day, seven days per week. ACC also offers its U.S. university customers its "Travel Service Elite" domestic calling card. In addition, ACC sells a prepaid calling card in the U.S., which allows customers to prepay for a predetermined number of "units" representing long distance minutes. The rate at which the units are used is determined by the destination of the calls made by the customer.

ACC's sales group targets university customers in the U.S., Canada and in the U.K. In the U.S. university market, ACC generally targets small to medium size universities and colleges with full time enrollments in the range of 1,000 to 5,000 students. In Canada, ACC has been able to establish relationships with several large universities. ACC believes that, while its marketing approach in Canada is similar to that in the U.S., its nationwide presence in Canada assists it in marketing to larger academic institutions. In the U.K., ACC has been able to establish long-term relationships with several large universities. ACC believes that, while its marketing approach in the U.K. is similar to that in the U.S., it is able to access larger educational institutions because of its nationwide presence and because transmission facilities-based carriers have not focused on this market. ACC believes that competition in the university market is based on price, as well as the marketing of unique programs and customizing of telecommunications services to the needs of the particular institution and that its ability to adapt to customer needs has enhanced its development of relationships with universities.

Residential Long Distance Services. ACC offers its residential customers in the U.S. and Canada a variety of long distance service plans and is currently offering and developing similar plans for its residential customers in the U.K. In the U.S., ACC's "Save Plus" program provides customers with competitively priced long distance service. In addition, U.S. customers are provided with a "Phone Home" long distance service through which, by dialing an 800 number plus an access code, callers can call home at competitive rates. In general, ACC's residential services are priced below AT&T's premium rates for similar services. In Canada, ACC offers three different residential service programs. The basic offering is a discount plan, with call pricing discounted from the Stentor companies' tariffed rates for similar services depending on the time of day and day of the week. ACC also offers its "Sunset Savings Plan," which allows calling across Canada and to the continental U.S. at a flat rate per minute. In the Toronto metropolitan area, ACC offers "Extended Metro Toronto" calling, which provides flat rate calling within areas adjacent to Toronto that are long distance from each other. Customized billing services are also offered to ACC's U.S. and Canadian residential customers. In the U.K., all residential customers use ACC's ACCess 1601 service, which provides savings off the standard rates charged for residential service by British Telecom or CWC, but requires the customer to dial a four digit access code before dialing the area code and number.

International Long Distance Services. ACC offers international products and services to both its existing customer base and to potential customers in the U.S., Canada and the U.K. ACC's international authorizations ("International Licenses") allow ACC to resell international long distance service on leased international circuits connected to the PSTN at both ends between the U.S. and Canada, the U.S. and the U.K., Canada and the U.K., and, subject to certain safeguards on non-competitive routes and destination country regulations, the U.K. and all other countries and territories, and to own interests in international submarine cable facilities for service between the U.S. and the U.K. and other international points. ACC believes it can compete effectively for international traffic because these international authorizations allow it to offer end-to-end services on certain routes and route traffic efficiently so as to price its services at cost-based rates that are lower than the international settlement-based rates that would otherwise apply to such traffic. However, numerous other carriers also have similar resale licenses. Implementation of the WTO agreement is expected to increase opportunities for alternative call routings but will also increase competition in the industry. Moreover, a recent FCC decision, currently on appeal and subject to petitions for reconsideration, is intended to accelerate reductions in international calling rates and may reduce ACC's margin on international services.

Local Exchange Services. Building on its experience in providing local telephone service to various university customers, ACC took advantage of regulatory developments in New York State and in 1994 began offering local telephone service to commercial customers in upstate New York. As a result of its August 1995 acquisition of Metrowide Communications, ACC provides local telephone service as a reseller in Ontario, Canada, and began providing such service in Quebec in 1996. ACC believes that it can strengthen its relationships with existing commercial, university and college and residential customers in New York State and Canada and can attract new customers by offering them local and long distance services, thereby providing a single source for comprehensive telecommunications services. Providing local telephone service may enable ACC to serve new local exchange customers even if they are already under contract with a different interexchange carrier for long distance service. During 1997, ACC expanded its local telephone operations by installing switches in New York City, Albany and Buffalo, New York, and Boston and Springfield, Massachusetts.

ACC has limited experience in providing local telephone services, having commenced providing such services in 1994. In order to attract local customers, ACC must offer substantial discounts from the prices charged by local exchange carriers and must compete with other alternative local companies that offer such discounts. Larger, better capitalized alternative local providers, including AT&T, among others, will be better able to sustain losses associated with discount pricing and initial investments and expenses. The local telephone service business requires significant initial investments and expenses in capital equipment, as well as significant initial promotional and selling expenses. There can be no assurance that ACC will be able to lease transmission facilities from local exchange carriers at wholesale rates that will allow ACC to compete effectively with the local exchange carriers or other alternative providers or that ACC will generate positive operating margins or attain profitability in its local telephone service business.

Sales and Marketing

ACC markets its services in the U.S., Canada, the U.K. and Germany through a variety of channels, including ACC's internal sales forces, independent sales agents, co-marketing arrangements and affinity programs, as described below. As of December 31, 1997, ACC had a total of approximately 380 internal sales personnel and approximately 580 independent sales agents serving its U.S., Canadian, U.K. and German markets. Although it has not experienced significant turnover in recent periods, a loss of a significant number of independent sales agents could have a material adverse effect on ACC's ability to generate additional revenue. ACC maintains a number of sales offices in the Northeastern U.S., Canada, and the U.K. In addition, with respect to its university and student customers in each country, ACC has designated representatives to assist in customer enrollment, dissemination of marketing information, complaint resolution and, in some cases, collection of customer payments, with representatives located on some campuses. ACC actively seeks new opportunities for business alliances in the form of affinity programs and co-marketing arrangements to provide access to alternative distribution channels.

During each of the last three years, no customer accounted for 10% or more of ACC's total revenue.

United States. ACC markets its services in the U.S. through ACC's internal sales personnel and independent sales agents as well as through attendance and representation at significant trade association meetings and industry conferences of target customer groups. ACC's sales and marketing efforts in the U.S. are targeted primarily at business customers with $500 to $15,000 of monthly usage, selected residential customers and universities and colleges. ACC also markets its services to other resellers and rebillers. ACC plans to leverage its market base in New York and Massachusetts into other New England states and Pennsylvania and to eventually extend its marketing focus to other states. ACC has obtained authorization to originate intrastate long distance voice services in 48 states.

Canada. ACC markets its long distance services in Canada through internal sales personnel and independent sales agents, co-marketing arrangements and affinity programs. ACC focuses its direct selling efforts on medium-sized and large business customers. ACC also markets its services to other resellers and rebillers. ACC uses independent sales agents to target small to medium-sized business and residential customers throughout Canada. These independent sales agents market ACC's services under contracts that generally provide for the payment of commissions based on the revenue generated from new customers obtained by the representative. The use of an independent agent network allows ACC to expand into additional markets without incurring the significant initial costs associated with a direct sales force.

In addition to marketing its residential services in Canada through independent sales agents, ACC has developed several affinity programs designed to attract residential customers within specific target groups, such as clubs, alumni groups and buying groups. The use of affinity programs allows ACC to target groups with a nationwide presence without engaging in costly nationwide advertising campaigns. For example, ACC Canada has established affinity programs with such groups as the Home Service Club of Canada, the University of Toronto and McGill and Western Universities. In addition, ACC has developed a co-marketing arrangement with Hudson's Bay Company (a large Canadian retailer) through which ACC's telecommunications services are marketed under the name "The Bay Long Distance Program" and "Zellers Long Distance."

United Kingdom. In the U.K., ACC markets its services to business and residential customers, as well as other telecommunications resellers, through a multichannel distribution plan including its internal sales force, independent sales agents, co-marketing arrangements and affinity programs.

ACC generally utilizes its internal sales force in the U.K. to target medium and large business customers, a number of which have enough volume to warrant a direct access line to ACC's switch, thereby bypassing the PSTN. ACC markets its services to small and medium-sized businesses through independent sales agents. Telemarketers also are used to market services to small business customers and residential customers and to generate leads for the other members of ACC's internal sales force and independent sales agents. ACC U.K. has established an internal marketing group that is focused on selling its service to other telecommunications resellers in the U.K. and certain European countries on a wholesale basis. ACC U.K. has entered into co-marketing arrangements with utilities, university alumni groups and other organizations.

Network

In the U.S., Canada and the U.K., ACC utilizes a network of lines leased under volume discount contracts with transmission facilities-based carriers, much of which is fiber optic cable. The selection of any particular circuit for the transmission of a call is controlled by routing software, located in the switches, that is designed to cause the most efficient use of ACC's network. ACC evaluates opportunities to install switches in selected markets where the volume of its customer traffic makes such an investment economically viable. Utilization of ACC's switches allows ACC to route customer calls over multiple networks to reduce costs.

Some of ACC's contracts with transmission facilities-based carriers contain underutilization provisions. These provisions require ACC to pay fees to the transmission facilities-based carriers if ACC does not meet minimum periodic usage requirements. ACC has not been assessed any underutilization charges in the past. However, there can be no assurance that such charges would not be assessed in the future. Other resellers generally contract with ACC on a month-to-month basis, select ACC almost exclusively on the basis of price and are likely to terminate their arrangements with ACC if they can obtain better pricing terms elsewhere. ACC uses projected sales to other resellers in evaluating the trade-offs between volume discounts and the minimum utilization rates it negotiates with transmission facilities-based carriers. If sales to other resellers do not meet ACC's projected levels, ACC could incur underutilization charges and be placed at a disadvantage in negotiating future volume discounts.

ACC generally utilizes redundant, highly automated advanced telecommunications equipment in its network and has diverse alternate routes available in cases of component or facility failure. Automatic traffic re-routing enables ACC to provide a high level of reliability for its customers. Computerized automatic network monitoring equipment facilitates fast and accurate analysis and resolution of network problems. ACC provides customer service and support, 24-hour network monitoring, trouble reporting and response, service implementation coordination, billing assistance and problem resolution.

In the U.S., ACC maintains three long distance switches and six local exchange switches. These switches and additional points of presence ("POPs") provide an interface with the PSTN to service ACC's customers. Lines leased from transmission facilities-based carriers link ACC's U.S. points of presence to its switches. ACC U.S. maintains a leased, direct trans-Atlantic link with ACC U.K. that it established in 1994 following ACC's receipt of its U.K. International Simple Resale License for U.K.-U.S. calls and international private line resale authority in the U.S. ACC has purchased an IRU to supplement such trans-Atlantic leased-lines to the U.K. and to enable ACC to reduce network costs.

In Canada, ACC maintains long distance switches in Toronto, Montreal and Vancouver. ACC also maintains frame relay nodes for switched data in Toronto, Montreal, Vancouver and Calgary. ACC uses transmission lines leased from transmission facilities-based carriers to link its Canadian POPs to its switches. This network is also linked with ACC's switches in the U.S. and the U.K. ACC Canada also maintains a leased, direct trans-Atlantic link with ACC U.K. that it established following the grant to ACC U.K. of its ISR License. This transmission line enables ACC Canada to send traffic to the U.K. at rates below those charged by Teleglobe Canada, the exclusive Canadian transmission facilities-based carrier for international calls, other than those to and from the U.S. and Mexico.

In the U.K., ACC maintains long distance switches in London, Manchester and Bristol, England. This network is also linked with ACC's switches in the U.S. and Canada. Customers can access ACC's U.K. network through direct access lines or by dial-up access using auto dialing equipment, indirect access code dialing or least cost routing software integrated in the customer's telephone equipment. In December 1996, ACC U.K. was awarded an International Facilities License, and received a Public Telecommunications Operator license in April 1997, which licenses have enabled ACC to build a microwave network in the U.K. and to begin to use the U.K. as a regional hub for international telecommunications traffic.

In February 1998, ACC installed a long distance switch in Dusseldorf, Germany and commenced offering switch-based long distance service to its customers. In 1997, ACC received a Class 4 full voice telephony license from the German Ministry of Post and Telecommunications, which became effective January 1, 1998, and which is a requirement in order to provide switch-based telecommunications services in Germany.

Network costs are the single largest expense incurred by ACC. ACC strives to control its network costs and its dependence on other carriers by leasing transmission lines on an economical basis. ACC is also considering ownership of certain transmission facilities as a means of reducing its network costs. ACC has purchased IRUs and negotiated leases of private line circuits with carriers that operate fiber optic transmission systems at rates independent of usage, particularly on routes over which ACC carries high volumes of calls such as between the U.S. and Canada and the U.S. and the U.K. ACC attempts to maximize the efficient utilization of its network in the U.S., Canada and the U.K. by marketing to commercial and academic institution customers, who tend to use its services most frequently on weekdays during normal business hours, and residential and student customers, who use these services most often during night and weekend off-peak hours.

Information Systems

ACC believes that maintaining sophisticated and reliable billing and customer services information systems that integrate billing, accounts receivable and customer support is a core capability necessary to record and process the data generated by a telecommunications service provider. While ACC believes its management information system is currently adequate, it has not grown as quickly as ACC's business and substantial investments are needed. ACC is developing and implementing new systems designed to (i) enhance ACC's ability to monitor and respond to the evolving needs of its customers by developing new and customized services, (ii) improve least-cost routing of traffic on ACC's international network, (iii) provide sophisticated billing information that can be tailored to meet the requirements of its customer base, (iv) provide high quality customer service, (v) detect and minimize fraud, (vi) verify payables to suppliers of telecommunications transmission facilities and (vii) integrate additions to its customer base. A variety of problems are often encountered in connection with the implementation of new information systems. There can be no assurance that ACC will not suffer adverse consequences or cost overruns in the implementation of the new information systems or that the new systems will be appropriate for ACC.

Competition

The telecommunications industry is highly competitive and is significantly influenced by the marketing and pricing decisions of the larger industry participants. In each of its markets, ACC competes primarily on the basis of price and also on the basis of customer service and its ability to provide a broad array of telecommunications services. The industry has relatively insignificant barriers to entry, numerous entities competing for the same customers and a high average churn rate, as customers frequently change long distance providers in response to the offering of lower rates or promotional incentives by competitors. Although many of ACC's customers are under multi-year contracts, several of ACC's largest customers (primarily other long distance carriers) are on month-to-month contracts and are particularly price sensitive. Revenues from other resellers accounted for approximately 32%, 4% and 28% of the revenues of ACC U.S., ACC Canada and ACC U.K., respectively, in 1997. With respect to these customers, ACC competes almost exclusively on price and does not have long term contracts. The industry has experienced and will continue to experience rapid regulatory and technological change. Many competitors in each of ACC's markets are significantly larger than ACC, have substantially greater resources than ACC, control transmission lines and larger networks than ACC and have longstanding relationships with ACC's target customers. There can be no assurance that ACC will remain competitive in this environment. Regulatory trends have had, and may have in the future, significant effects on competition in the industry. As ACC expands its geographic coverage, it will encounter increased competition. Moreover, ACC believes that competition in non-U.S. markets is likely to increase and become more like competition in the U.S. markets over time as such non-U.S. markets continue to experience deregulatory influences. See "Legislation and Regulation."

Competition in the long distance industry is based upon pricing, customer service, network quality, value-added services and customer relationships. The success of a non-transmission facilities-based carrier such as ACC depends largely upon the amount of traffic that it can commit to the transmission facilities-based carriers and the resulting volume discounts it can obtain. Subject to contract restrictions and customer brand loyalty, resellers like ACC may competitively bid their traffic among other national long distance carriers to gain improvement in the cost of service. The relationship between resellers and the larger transmission facilities-based carriers is twofold. First, a reseller is a customer of the services provided by the transmission facilities-based carriers, and that customer relationship is predicated primarily upon the pricing strategies of the first tier companies. The reseller and the transmission facilities-based carriers are also competitors. The reseller will attract customers to the extent that its pricing for customers is generally more favorable than the pricing offered the same size customers by larger transmission facilities-based carriers. However, transmission facilities-based carriers have been aggressive in developing discount plans which have had the effect of reducing the rates they charge to customers whose business is sought by the reseller. Thus, the business success of a reseller is significantly tied to the pricing policies established by the larger transmission facilities-based carriers. There can be no assurance that favorable pricing policies will be continued by those larger transmission facilities-based carriers.

United States. In the U.S., ACC is authorized to originate interstate and international long distance services nationwide and to originate intrastate long distance service in 48 states (although it currently derives most of its U.S. revenues principally from calls originated in New York and Massachusetts). ACC competes for customers, transmission facilities and capital resources with numerous long distance telecommunications carriers and/or resellers, some of which are substantially larger, have substantially greater financial, technical and marketing resources, and own or lease larger transmission systems than ACC. AT&T is the largest supplier of long distance services in the U.S. inter-LATA market. ACC also competes within its U.S. call origination areas with other national long distance telephone carriers, such as MCI, Sprint and regional companies which resell transmission services. RBOCs from outside the NYNEX/Bell Atlantic region, including SBC Communications, have, under the authority contained in the 1996 Act, begun to offer long distance services in the NYNEX/Bell Atlantic region. In the intra-LATA market, ACC also competes with the local exchange carriers servicing those areas. In its local service areas in New York State and Massachusetts, ACC presently competes or in the future will compete with NYNEX/Bell Atlantic, Frontier Corp., AT&T, Citizens Telephone Co. and WorldCom and with cellular and other wireless carriers. These local exchange carriers all have long-standing relationships with their customers and have financial, personnel and technical resources substantially greater than those of ACC. Furthermore, joint ventures such as those between MCI and Microsoft Corporation ("Microsoft"), under which Microsoft will promote MCI's services, the joint venture among Sprint, Deutsche Telekom AG and France Telecom, called Global One, the recently announced merger of WorldCom and MCI, and other strategic alliances could increase competitive pressures upon ACC. The recent merger between Nynex Corp. and Bell Atlantic is likely to strengthen the financial resources of the new, combined company, and its integrated networks may enhance its ability to offer long distance services in the combined NYNEX/Bell Atlantic region.

In addition to these competitive factors, recent and pending deregulation in each of ACC's markets may encourage new entrants. For example, as a result of the 1996 Act, RBOCs are allowed to enter the long distance market immediately in "out of region" states, and in the states where the RBOC is an incumbent LEC upon a showing that certain conditions related to competition have been met. AT&T, MCI and other long distance carriers, utilities and cable television companies are allowed to enter the local telecommunications market. In addition, the FCC has, on several occasions since 1984, approved or required price reductions by AT&T and, in 1995 and 1996, the FCC reclassified AT&T as a "non-dominant" carrier for domestic and international long distance services, which substantially reduces the regulatory constraints on AT&T. In the recently-completed World Trade Organization talks, the U.S. committed to allowing foreign carriers heretofore prohibited from competing in U.S. markets, to enter the U.S. local, long distance, and international markets, and the FCC has amended its rules, effective February 1998, to implement these commitments, allowing virtually open entry to the U.S. market by all entities from WTO member countries. The WTO accord will likely increase the level of competition in the U.S. local, long distance, and international markets. ACC believes that the principal competitive factors affecting its market share in the U.S. are pricing, customer service and variety of services. By offering high quality telecommunications services at competitive prices and by offering a portfolio of value-added services including customized billing packages, call management and call reporting services, together with personalized customer service and support, ACC believes that it competes effectively with other local and long distance telephone carriers and resellers in its service areas. ACC's ability to continue to compete effectively will depend on its continued ability to maintain high quality, market-driven services at prices generally below those charged by its competitors.

Canada. In Canada, ACC competes with facilities-based carriers, other resellers and rebillers. ACC's principal transmission facilities-based competitors are the Stentor group of companies, in particular, Bell Canada, the dominant suppliers of long distance services in Canada, AT&T Canada, which provides certain facilities-based and long distance services to business and residential customers, and Sprint Canada and fONOROLA Inc., which provide certain transmission facilities-based services and also act as reseller of telecommunications services. ACC also competes against London Telecom, a reseller of telecommunications services. ACC believes that, for some of its customers and potential customers, it has a competitive advantage over other Canadian resellers as a result of its operations in the U.S. and the U.K. In particular, the trans-Atlantic link that it established in June 1993 between the U.K. and Canada allows ACC Canada to sell traffic to the U.K. with a significantly lower cost structure than many other resellers.

United Kingdom. ACC U.K. currently holds a National PTO License and an International Facilities License and competes with facilities-based carriers and other resellers. ACC's principal competitors in the U.K. are British Telecom, the dominant supplier of telecommunications services in the U.K., and CWC. ACC also faces competition from other operators such as Energis and WorldCom, and from resellers including Esprit and Sprint. ACC believes the services of ACC U.K. are competitive, in terms of price and quality, with the service offerings of its U.K. competitors primarily because of its advanced network-related hardware and software systems and the network configuration and traffic management expertise employed by it in the U.K.

Acquisitions, Investments and Strategic Alliances

As ACC expands its service offerings, geographic focus and its network, ACC anticipates that it will seek to acquire assets and businesses of, make investments in or enter into strategic alliances with, companies providing services complementary to ACC's existing business. ACC believes that, as the global telecommunications marketplace becomes increasingly competitive, expands and matures, such transactions will be important in maintaining a competitive position in the industry.

ACC's ability to effect acquisitions and strategic alliances and make investments may be dependent upon its ability to obtain additional financing and, to the extent applicable, consents from the holders of debt and preferred stock of ACC. If ACC were to proceed with one or more significant strategic alliances, acquisitions or investments in which the consideration consists of cash, a substantial portion of ACC's available cash could be used to consummate the acquisitions or investments. If ACC were to consummate one or more significant strategic alliances, acquisitions or investments in which the consideration consists of stock, shareholders of ACC could suffer a significant dilution of their interests in ACC.

Many business acquisitions must be accounted for as purchases. Most of the businesses that might become attractive acquisition candidates for ACC are likely to have significant goodwill and intangible assets, and the acquisitions of these businesses, if accounted for as a purchase, would typically result in substantial amortization charges to ACC. In the event ACC consummates additional acquisitions in the future that must be accounted for as purchases, such acquisitions would likely increase ACC's amortization expenses. In connection with acquisitions, investments or strategic alliances, ACC could incur substantial expenses, including the fees of financial advisors, attorneys and accountants, the expenses of integrating the business of the acquired company or the strategic alliance with ACC's business and any expenses associated with registering shares of ACC's capital stock, if such shares are issued. The financial impact of such acquisitions, investments or strategic alliances could have a material adverse effect on ACC's business, financial condition and results of operations and could cause substantial fluctuations in ACC's quarterly and yearly operating results.

The Merger Agreement contains restrictions on the conduct of ACC's business prior to the consummation of the Merger which are likely to affect ACC's pursuit of its strategies.

Employees

As of December 31, 1997, ACC had 1,268 full-time employees worldwide. Of this total, 384 employees were in the U.S., 482 were in Canada, 369 were in the U.K. and 33 were in Germany. ACC has never experienced a work stoppage and its employees are not represented by a labor union or covered by a collective bargaining agreement. ACC considers its employee relations to be good.

Properties

ACC's principal executive offices are located at 400 West Avenue, Rochester, New York in corporate office space leased through June 2004. It also leases office space for its Canadian headquarters in Toronto, Canada, as well as office space at various other locations. For additional information regarding these leases, see Notes 7 and 9 to ACC's Consolidated Financial Statements included herein.

ACC U.K.'s headquarters are located at Adelaide House in Chiswick, London. ACC U.K. entered into an Agreement for Lease for such location in October 1997. The term is for approximately six years through March 2004. The lease for the current headquarters will also continue until September 1998.

ACC has sixteen switching centers worldwide. ACC's switching equipment for the Rochester call origination area is located at its headquarters at 400 West Avenue, Rochester, New York with additional switching equipment located in the U.S. in Albany, Buffalo, New York City and Syracuse, New York and in Boston and Springfield, Massachusetts; in Canada in Toronto, Ontario, Montreal, Quebec, and Vancouver, British Columbia; and in London, Bristol and Manchester, England; and in Dusseldorf, Germany, all of which sites are leased. Branch sales offices are leased by ACC at various locations in the northeastern U.S., Canada and the U.K. ACC also leases equipment and space located at various sites in its service areas.

ACC's financing arrangements are secured by substantially all of ACC's assets. ACC's secured lenders would be entitled to foreclose upon those assets and to be repaid from the proceeds of the liquidation of those assets in the event of a default under ACC's financing arrangements.

Legal Proceedings

ACC is a party, in the ordinary course of business, to litigation regarding services rendered, contract claims and other miscellaneous causes of action arising from its business. Management of ACC does not consider that any such matters will materially adversely affect ACC's business, results of operations or financial condition.

SELECTED HISTORICAL CONSOLIDATED FINANCIAL AND OPERATIONS DATA OF ACC

The following selected historical consolidated financial data for each of the years presented have been derived from ACC's audited consolidated financial statements. The consolidated financial statements of ACC as of December 31, 1996 and 1997 and for each of the three years in the period ended December 31, 1997 together with the notes thereto and related report of Arthur Andersen LLP, independent public accountants, are included elsewhere herein. The following data should be read in conjunction with, and is qualified by, the consolidated financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations of ACC," which are included elsewhere herein.

	Year Ended December 31,				
	1993	1994	1995(6)	1996	1997(4)
	(dollars in thousands, except per share amounts)				
Consolidated Statement of Operations Data:					
Revenue:					
Toll revenue	$ 100,646	$ 118,331	$ 175,269	$ 282,497	$ 327,490
Local exchange and other	5,300	8,113	13,597	26,270	45,123
Total revenue	105,946	126,444	188,866	308,767	372,613
Network costs	70,286	79,438	114,841	193,599	218,361
Gross Profit	35,660	47,006	74,025	115,168	154,252
Other operating expenses:					
Depreciation and amortization	5,832	8,932	11,614	16,433	23,712
Selling, general and administrative	28,807	44,228	60,865	84,511	111,027
Management restructuring	—	—	1,328	—	—
Equal access charges	—	2,160	—	—	—
Assets write-down	12,807	—	—	—	—
Total other operating expenses	47,446	55,320	73,807	100,944	134,739
Income (loss) from operations(1)	(11,786)	(8,314)	218	14,224	19,513
Other income (expense):					
Interest income	205	124	198	1,151	215
Interest expense	(420)	(2,023)	(5,131)	(5,025)	(3,729)
Merger costs	—	(200)	—	—	(4,970)
Gain on sale of subsidiary stock	9,344	—	—	—	—
Foreign exchange gain (loss)	(1,094)	169	(110)	509	(162)
Total other income (expense)	8,035	(1,930)	(5,043)	(3,365)	(8,646)
Income (loss) from continuing operations before provision for (benefit from) income taxes and minority interest	(3,751)	(10,244)	(4,825)	10,859	10,867
Provision for (benefit from) income taxes	(3,743)	3,456	396	2,185	476
Minority interest in loss (earnings) of consolidated subsidiary	1,661	2,371	(133)	(909)	—
Income (loss) from continuing operations	1,653	(11,329)	(5,354)	7,765	10,391
Loss from discontinued operations (net of income tax benefit of $667 in 1993)	(1,309)	—	—	—	—
Gain on disposal of discontinued operations (net of income tax provision of $8,350 in 1993)	11,531	—	—	—	—
Net income (loss)	$ 11,875	$ (11,329)	$ (5,354)	$ 7,765	$ 10,391
Less Series A Preferred Stock dividend	—	—	(401)	(972)	—
Less Series A Preferred Stock accretion	—	—	(139)	(1,509)	—
Income (loss) applicable to Common Stock	$ 11,875	$ (11,329)	$ (5,894)	$ 5,284	$ 10,391
Net income (loss) per share—basic:(2)					
Continuing operations	$ 0.16	$ (1.09)	$ (0.52)	$ 0.37	$ 0.62
Discontinued operations	(0.13)	—	—	—	—
Gain on disposal of discontinued operations	1.13	—	—	—	—
Net income (loss) per share—basic	$ 1.16	$ (1.09)	$ (0.52)	$ 0.37	$ 0.62
Net income (loss) per share—diluted:(2)					
Continuing operations	$ 0.16	$ (1.09)	$ (0.52)	$ 0.34	$ 0.59
Discontinued operations	(0.12)	—	—	—	—
Gain on disposal of discontinued operations	1.09	—	—	—	—
Net income (loss) per share—diluted	$ 1.13	$ (1.09)	$ (0.52)	$ 0.34	$ 0.59
Weighted average number of shares outstanding:(2)					
Basic	10,206,833	10,366,778	11,358,693	14,463,728	16,839,039
Diluted	10,537,388	10,366,778	11,358,693	15,540,115	17,690,223

	Year Ended December 31,				
	1993	1994	1995(6)	1996	1997(4)
	(dollars in thousands, except per share amounts)				
Consolidated Balance Sheet Data(5):					
Cash and cash equivalents	$ 1,467	$ 1,021	$ 518	$ 2,035	$ 3,988
Current assets	22,476	28,045	45,726	61,933	92,347
Current liabilities	23,191	32,016	56,074	77,394	89,793
Net working capital (deficit)	(715)	(3,971)	(10,348)	(15,461)	2,554
Property, plant and equipment, net	27,077	44,081	56,691	80,452	135,726
Total assets	61,718	84,448	123,984	204,031	319,618
Short-term debt, including current maturities of long-term debt	2,424	1,613	4,885	4,251	3,853
Long-term debt, excluding current maturities	1,795	29,914	28,050	6,007	90,221
Redeemable preferred stock	—	—	9,448	—	—
Shareholders' equity	31,506	19,086	26,407	117,863	$137,716
Other Financial and Operations Data:					
Net cash provided by (used in) operating activities	$(11,828)	$ 1,093	$ 3,967	$ 24,248	$ 3,691
Class A Common Stock cash dividends declared(3)	$ 4,233	$ 831	$ 243	$ —	$ —
Cash dividends declared per share of Class A Common Stock(2)(3)	$ 0.40	$ 0.08	$ 0.02	$ —	$ —
Book Value per common share(2)	$ 3.03	$ 1.84	$ 2.23	$ 7.10	$ 8.00

(1) Includes impact of $2,160 of charges incurred in 1994 in connection with enhancement of the ACC network to prepare for equal access for its Canadian customers. Also includes an asset write-down of $12,807 in 1993.

(2) On June 14, 1996, the ACC Board of Directors authorized a three-for-two stock split in the form of a stock dividend issued on August 8, 1996 of the ACC Class A Common Stock to shareholders of record as of July 3, 1996. Share and per share amounts for all prior periods have been adjusted for the stock split.

(3) The ACC financing arrangements restrict the payment of dividends on the ACC Common Stock. ACC anticipates that it will not pay dividends in the forseeable future.

(4) Includes the results of operations of companies acquired by ACC during 1997: Transphone International Ltd. from June 1, 1997, United Telecom Ltd. from July 1, 1997, VISTA International Communications Inc. from August 1, 1997, and Telenational Communications Deutschland Limited Partnership from July 1, 1997.

(5) Balance sheet data from discontinued operations is excluded.

(6) Includes the results of operations of Metrowide Communications from August 1, 1995, the date of acquisition.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS OF ACC

General

ACC's revenue is comprised of toll revenue (per minute charges for long distance services) and local service and other revenue. Toll revenue consists of revenue derived from ACC's long distance and operator-assisted services. Local service and other revenue consists of revenue derived from the provision of local exchange services, including local dial tone, direct access lines, Internet fees and monthly subscription fees, and data services. Network costs consist of expenses associated with the leasing of transmission lines, access charges, and certain variable costs associated with ACC's network. The following table shows the total revenue (net of intercompany revenue) and billable minutes of use attributable to ACC's North American and European operations during each of 1997, 1996, and 1995:

	Year Ended December 31,					
	1997		1996		1995	
	Amount	Percent	Amount	Percent	Amount	Percent
			(Amounts in 000s)			
Total Revenue:						
North America:						
United States	$ 120,627	32.4%	$ 99,461	32.2%	$ 65,975	34.9%
Canada	116,638	31.3	117,168	38.0	84,421	44.7
Total North America	237,265	63.7	216,629	70.2	150,396	79.6
Europe:						
United Kingdom	132,151	35.4	92,138	29.8	38,470	20.4
Germany	3,197	.9	—	—	—	—
Total Europe	135,348	36.3	92,138	29.8	38,470	20.4
Total	$ 372,613	100.0%	$ 308,767	100.0%	$ 188,866	100.0%
Billable Long Distance Minutes of Use:						
North America:						
United States	780,232	33.2%	590,341	32.8%	486,618	41.2%
Canada	798,458	33.9	681,200	37.9	522,764	44.2
Total North America	1,578,690	67.1	1,271,541	70.7	1,009,382	85.4
Europe:						
United Kingdom	770,151	32.7	527,905	29.3	172,281	14.6
Germany	4,343	.2	—	—	—	—
Total Europe	774,494	32.9	527,905	29.3	172,281	14.6
Total	2,353,184	100.0%	1,799,446	100.0%	1,181,663	100.0%

The following table presents certain information concerning long distance toll revenue (net of intercompany revenue) per billable minute and network cost per billable minute attributable to ACC's North American and European operations during each of 1997, 1996, and 1995:

	1997	1996	1995
Toll Revenue Per Billable Long Distance Minute:			
North America:			
United States	$.122	$.150	$.126
Canada	.122	.150	.146
Total North America	.122	.150	.137
Europe:			
United Kingdom	.171	.174	.220
Germany	.736	—	—
Total Europe	.174	.174	.220
Network Cost Per Billable Minute:			
Total North America	$.084	$.105	$.089
Total Europe	.110	.114	.149

ACC believes that its historic revenue growth as well as its historic network costs and results of operations for its Canadian and U.K. operations generally reflect the state of development of ACC's operations, ACC's customer mix, and the competitive and regulatory environment in those markets. ACC entered the U.S., Canadian, and U.K. telecommunications markets in 1982, 1985, and 1993, respectively. In 1997, ACC established a subsidiary in Germany, and commenced offering long distance service as a switchless reseller during the third quarter of 1997. For U.S. operations, 1996 revenue and network cost per minute include the effect of $9.0 million of non-recurring, higher rate per minute and lower margin international carrier sales in the second quarter. ACC believes that toll revenue per billable minute and network cost per billable minute may be lower in future periods, and heavily influenced by competitive pressures and regulatory actions.

Deregulatory influences have affected the telecommunications industry in the U.S. since 1984, and the U.S. market has experienced considerable competition for a number of years. The competitive influences on the pricing of ACC U.S.'s services and network costs have been stabilizing during the past few years. This may change in the future as a result of the 1996 Act that further opened the market to competition, particularly from the RBOCs. ACC has actively pursued growth opportunities in the U.S. market. During the third quarter of 1997, ACC acquired VISTA International Communications, Inc. ("VISTA"). VISTA, headquartered in Mount Arlington, New Jersey, provides long distance and other services to small and medium-sized commercial customers in the Northeastern U.S. with concentrations primarily in New Jersey and Pennsylvania. The VISTA acquisition represents expansion into a contiguous geographic area, with a similar targeted customer segment which is viewed as consistent with ACC's expansion strategy.

The deregulatory trend in Canada, which commenced in 1989, has increased competition. ACC Canada experienced significant downward pressure on the pricing of its services during 1994 and 1995. Although revenue per minute increased from 1995 to 1996 due to changes in customer and product mix, revenue per minute fell during 1997, and ACC expects downward pressure to continue. The impact of this pricing pressure on revenues of ACC Canada is being offset by an increase in the Canadian commercial and student billable minutes of usage as a percentage of total Canadian billable minutes of usage, and introduction of new products and services including 800 service, local exchange resale, Internet services, and, since February 1997, paging services.

ACC believes that, because deregulatory influences have only fairly recently begun to impact the U.K. telecommunications industry, ACC will continue to experience a significant increase in revenue from that market, but the rate of growth is expected to decline. The foregoing belief is based upon expectations of actions that may be taken by U.K. regulatory authorities and ACC's competitors; if such third parties do not act as expected, ACC's opportunities for revenue growth could be impacted. If ACC U.K. were to experience increased revenues, ACC believes it should be able to enhance its economies of scale and scope in the use of the fixed cost elements of its network. Nevertheless, the deregulatory trend in that market is expected to result in competitive pricing pressure on ACC's U.K. operations, which could adversely affect revenues and margins. Since the U.K. market for transmission facilities is dominated by British Telecom and Cable & Wireless, the downward pressure on prices for services offered by ACC U.K. may not be accompanied by a corresponding reduction in ACC U.K.'s network costs in the short term and, consequently, could adversely affect ACC's business, results of operations and financial condition, particularly in the event revenue derived from ACC's U.K. operations accounts for an increasing percentage of ACC's total revenue. Moreover, ACC's U.K. operations are highly dependent upon the transmission lines leased from British Telecom. As each of the telecommunications markets in which it operates continues to mature, the rate of growth in its revenue and customer base in each such market is likely to decrease over time. ACC has actively pursued growth opportunities and alternate network solutions in the U.K. market. During the second quarter of 1997, ACC acquired Transphone International Ltd. ("Transphone"). Transphone provides domestic and international long distance service as a reseller, and is based in London, U.K. In acquiring Transphone, ACC obtained what it believes is a strong base of commercial customers in a desirable geographic area. During the third quarter of 1997, ACC also acquired United Telecom Ltd. ("UT"). UT provides domestic and international long distance services through a pre-paid calling card platform in retail telephone shops. UT is based in London, U.K. In acquiring UT, ACC obtained what it believes is a new delivery channel in a growing niche market. The acquisition is also expected to create network cost efficiencies, as UT's customers have peak calling activity at night and on weekends. This calling pattern will enable ACC to facilitate routing of off-peak traffic over ACC's switch based network, thereby adding to economies of scale. The Transphone and UT acquisitions are expected to be accretive to earnings commencing in 1998. During the first quarter of 1998, ACC anticipates putting into operations its own microwave facility, linking its three U.K. switching centers. This microwave facility will provide ACC with its own domestic redundant network alternative access to ACC's network for its customers and a lower cost network platform. The foregoing forward looking statements are based upon expectations with respect to customer behavior, market trends and ACC's ability to successfully integrate and develop the businesses acquired. If such expectations are not realized, actual results may differ materially from the foregoing discussion.

The German telecommunications market substantially deregulated in January 1998, as a result of the European Union ("EU") mandate to open telecommunications markets to competition. Most significantly, the German market opened for interconnection in January 1998. ACC has established a subsidiary in Germany, and signed a resale agreement with Deutsche Telekom ("DT") on May 20, 1997. Further, ACC received a Class 4 full voice telephony license from the Germany Ministry of Post and Telecommunications which became effective January 1, 1998. This license is a requirement for ACC to become a switch-based provider of telecommunications services in Germany. In October 1997, ACC signed a network interconnect agreement with DT, which permits utilization of DT's network to link ACC with its customers. With this agreement in place, ACC has installed a switch which it placed in service in February 1998. ACC achieved a small amount of revenue in the fourth quarter of 1997 as a switchless reseller and anticipates potentially more substantial revenue growth in 1998 as a switch-based reseller. The foregoing forward looking statement is based upon expectations with respect to regulatory actions and cooperation from DT which ACC is unable to control. If such expectations are not realized, the expected revenue growth from the German market may not materialize. In addition to the core growth expected from switch-based resale, ACC has actively pursued other growth opportunities in Germany. During the third quarter of 1997, ACC acquired Telenational Communications Deutschland Limited Partnership ("TNC"), a privately held telecommunications service provider headquartered in Hamburg, Germany. TNC provides prepaid calling cards through affinity programs with large commercial customers including Lufthansa, Citibank and Diners Club. The TNC acquisition provides ACC an existing customer base, proven management team and facilitates the start-up efforts in Germany.

Since the commencement of ACC's operations, ACC has undertaken a program of developing and expanding its service offerings, geographic focus, and network. In connection with this development and expansion, ACC has made significant investments in telecommunications circuits, switches, equipment, and software. These investments generally are made significantly in advance of anticipated customer growth and resulting revenue. ACC also has increased its sales and marketing, customer support, network operations, and field services commitments in anticipation of the expansion of its customer base and targeted geographic markets. ACC expects to continue to expand the breadth and scale of its network and related sales and marketing, customer support, and operating activities. These expansion efforts are likely to cause ACC to incur significant increases in expenses from time to time, in anticipation of potential future growth in ACC's customer base and targeted geographic markets.

In 1997, ACC announced the creation of two continental operating divisions in North America and Europe. In conjunction with this new structure, ACC plans to further expand its European operations as business activity more fully develops in the deregulating German market and by entering other telecommunications marketplaces when regulatory and market conditions warrant. While ACC has had a successful history of entering into newly deregulated markets, there can be no assurances that the same successes will be experienced in the future.

ACC has also expanded operations in the U.S. local exchange business and anticipates that a significant portion of its future growth will come from this business. The local exchange business is highly competitive and includes several larger, better capitalized local service providers, including AT&T, among others, who can sustain losses associated with discount pricing, and the high initial investment and expenses typically incurred to attract local customers. ACC's U.S. local service commenced operations in 1994 and generated an operating profit for 1997 and 1996. However, there can be no assurances that ACC will continue to achieve positive operating cash flow or profitability in this business in the future.

ACC's operating results have fluctuated in the past and they may continue to fluctuate significantly in the future as a result of a variety of factors, some of which are beyond ACC's control. ACC expects to focus in the near term on building and increasing its customer base, service offerings, and targeted geographic markets, which will require it to increase significantly its expenses for marketing and development of its network and new services, and may adversely impact operating results from time to time. ACC's sales to other long distance carriers have been increasing due to ACC's marketing efforts to promote its lower international network costs. Revenue from other resellers accounted for approximately 18% and 27% of the revenues of ACC North America and ACC Europe, respectively, in 1997. Included in 1996 was $9 million of U.S. non recurring carrier revenue, or 3% of consolidated revenue. Additionally, in 1997 ACC realized significantly reduced revenue from two Canadian carriers of $10.8 million compared to 1996. With respect to these customers, ACC competes almost exclusively on price, does not have long term contracts, and generates lower gross margins as a percentage of revenue. ACC's primary interest in carrier revenue is to utilize excess capacity on its network. Carrier revenue in 1997 was 21% of consolidated total revenue compared to 24% in 1996. Management believes that carrier revenue will continue to average 20% to 25% of consolidated total revenue as the core businesses continue to grow. The foregoing forward looking statement is based upon expectations with respect to growth in ACC's customer base and total revenues. If such expectations are not realized, ACC's actual results may differ materially from the foregoing discussion.