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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter	)	
	)	
GTE CORP.	)	
	)	
Transferor,	)	
	)	
and	)	CC Docket No. 98-184
	)	
BELL ATLANTIC CORP.	)	
	)	
Transferee,	)	
	)	
For Consent to Transfer of Control	)	

AFFIDAVIT OF STEPHEN B. LEVINSON
ON BEHALF OF AT&T CORP.

I. Qualifications

1. I am Stephen B. Levinson. I am a senior economist in the Law and Government Affairs Division at AT&T Corporation, where I have worked for more than 23 years specializing in the economics of regulation in the telecommunications industry. In recent years, I have been engaged in developing and articulating the properties of Total Service Long Run Incremental Cost applied to unbundled network elements, which eventually came to be known as Total Element Long Run Incremental Cost, or TELRIC, and in developing AT&T's policy position on the meaning of the public interest standard under the Telecommunications Act of 1996. I have testified as an expert witness in state proceedings on local exchange company pricing and costing issues in Colorado, Indiana, Ohio, and Wyoming. I have filed an affidavit in the SBC-Ameritech merger case, CC

Docket No. 98-141. I have a BA, MA and Ph.D., all in Economics, from Rutgers University.

II. The Illogic of a Merger to Pursue an Out-of-Region Strategy

2. This section of the affidavit is concerned with the assertion of GTE Corporation ("GTE") and Bell Atlantic Corporation ("BA") that they need to merge in order to be of sufficient scale to permit them to conduct their strategy of local entry out of their regions. *See* Public Interest Statement at 6-9. My conclusion is that these assertions of GTE and BA are entirely without foundation and that there is no need for them to merge in order to pursue an out-of-region local entry strategy. In my view, they are each currently large enough to be able to engage in such a strategy, including entry into each other's territory, if they truly, fully intend to do so.

3. It is understandable that GTE's and BA's out-of-region ventures would have negative cash flows in the earlier periods of operation even if full cooperation were to be accorded by the incumbent local exchange companies ("ILECs"). Competitive Local Exchange Companies ("CLECs") have certainly experienced negative cash flows in their early years. Capital would flow into those ventures based on the investor's guess about prospective earnings by following its existing, home-region customers to new regions or by expanding to adjacent local territories. All else equal, it matters not whether the investor in, say, Dallas, is GTE, BA, or the new BA-GTE. Ultimately-realized earnings will either reward or punish the investor the same in absolute terms regardless of the size of the investor's other assets.

4. In addition, when the effect of the merger is to eliminate each party from entering the other's territory, then potential competition is weakened in two regions. Instead of entering the other's territory as CLECs, the parties would, in effect, be purchasing their way into each other's current monopoly, thereby eliminating any risk they would otherwise have to bear in investing in each other's regions and reducing their risk from competitive incursion in the expanded home territory. Hypothetically, suppose

individually BA wants to follow USAir into Irving, Texas and GTE wants to follow American Airlines into Pittsburgh. As individual firms, they would be in a position to compete with each other for both customers. As a merged firm, they, who are best positioned to do so, do not compete against each other for either customer.

5. Competition is not only diminished in GTE's and BA's regions, but in other regions as well. For example, in the case of Los Angeles,[1] the merger would reduce the number of competitors to SBC by one: Rather than both GTE and BA positioning themselves to be entrants, only the merged entity would do so.

6. Given that, as explained below, GTE and BA clearly have the ability to raise the capital necessary to fund out-of-region local entry, it would appear their concerns over spreading fixed costs are that their shareholders would prefer a merger that eliminates competition. Such concerns are clearly not cognizable in determining whether this merger satisfies the public interest.

7. Size of the investor in local exchange markets has apparently not been an issue so far as the financial markets have been concerned. As evidence for this, we need only look at current experience of several CLECs to see that they are much smaller than either GTE or BA and that they have been able to raise capital sufficiently to procure the assets necessary to enter local markets all across the United States. (Of course, the efforts to deploy these assets and provide local services has been met with stiff resistance by the ILECs.) In many cases, their entry strategy has been accomplished in much the same manner as, and at a size similar to, that apparently contemplated by GTE and BA.

8. Table 1 is a list of CLECs and the equity and debt capital that they have raised in the financial markets over the past few years. As Table 1 shows, the financial markets

[1] This would be true for any GTE territory abutting a large city whose area is predominantly controlled by an ILEC other than BA.

have been very forthcoming with capital for these firms to use in entering the local service markets, and these firms are midgets compared to either GTE or BA.

9. A look at a few CLEC examples will be instructive in showing how off-the-mark GTE and BA are in their assertions about not being large enough individually to enter out-of-region local markets. Selected CLEC information about recent debt issue sizes and interest rates they paid and the extent of the markets they serve are taken from their August 1998, 10-Q reports filed with the SEC. Market capitalizations are as of November 17, 1998.

GST Telecommunications Inc (GSTX) --- As of June 30, 1998, GSTX had over $1.1 billion in debt and $58.1million in preference shares. The interest rate on its most recent debt placing was 10.5%. Its digital network currently serves 41 markets in the Western states (*i.e.*, Arizona, California, Hawaii, Idaho, New Mexico, Oregon, Texas and Washington). GTSX articulates its own out-of-region strategy, very similar to that of GTE and BA, in its quarterly report (10-Q) on page 8:

> The company plans to build specific network segments or to lease capacity as economically justified and as the demands of its customers warrant. Management believes that pursuing the "smart-build" approach should permit the Company to provide for ongoing capital expenditures on a "success basis" and allow the Company to build its customer base through an increased focus on sales, marketing and operations support systems. "Smart-builds" also provide the Company with the ability to address attractive service areas selectively throughout its targeted markets.

The market capitalization of GTSX is $252 million.

WinStar Communications, Inc. (WCII) --- WCII has been able to issue $450 million in debt during 1997 and $450 million during the first quarter of 1998, when it also issued $193.1 million worth of preferred stock at a 7% rate. WCII has recently paid interest rates in the 10-11% range. WCII currently serves 27 markets, including Atlanta, Baltimore, Boston, Chicago, Columbus, Dallas, Denver, Detroit, Fort Worth, Houston, Kansas City, Los Angeles, Milwaukee, Minneapolis, New York, Newark, Oakbrook, IL, Oakland Orange County, CA, Philadelphia, Phoenix, San Diego, San Francisco, Seattle, Stamford, CT, Tampa and Washington, DC and will add Miami, St. Louis and Cleveland by year end 1998. The market capitalization of WCII is $1.17 billion.

ICG Communications INC (ICGX) --- ICGX has an outstanding indebtedness of about $1.5 billion at interest rates ranging from 9 7/8% to 13 ½%, $72.8 million in capitalized lease obligations, and various preferred stock issues at rates ranging from 6 ¾% to 14 ¼%. ICGX has 20 high capacity digital voice switches and 15 data communications switches in major metropolitan areas in California, Colorado, Ohio and the Southeast. The market capitalization of ICGX is $1.03 billion.

RCN Corp. (RCNC) --- RCNC has raised slightly over $1 billion in the debt market over the last year at rates ranging from 9.8% to 11 1/8% and raised $113, 305 from issuance of more common stock. RCNC serves Boston, New York City and Lehigh Valley, PA, and will soon serve Washington, DC, Las Vegas, Phoenix and California. The market capitalization of RCNC is $970 million.

e.spire Communications, Inc (ESPI) --- ESPI has raised approximately $978 million from equity and debt issues at interest rates ranging from 10 5/8% to 14 ¾%. It has 32 local networks in 19 states served by some 61 switches. The market capitalization of ESPI is $386 million.

Electric Lightwave, Inc (ELIX) --- ELIX has a $400 million revolving bank credit facility that is guaranteed by its 83% owner, Citizens Utilities Company. ELIX serves Portland, Seattle, Salt Lake City, Sacramento, Boise, Phoenix, Los Angeles and Las Vegas. The market capitalization of ELIX is $351 million.

McLoed USA, Inc (MCLD) --- MCLD financed debt of approximately $291.9 million in March 1998 at 8 3/8% interest. MCLD serves in Colorado, Iowa, Illinois, Indiana, Minnesota, Missouri, North Dakota, South Dakota, Wisconsin, and Wyoming. The market capitalization of MCLD is $2.17 billion.

Teligent, Inc (TGNT) --- TGNT received proceeds $241.3 million in February 1998 from debt at 11 ½% interest. TGNT has recently turned up service in a few markets but projects to serve 74 metropolitan areas. TGNT has a market capitalization of $1.61 billion.

US LEC Corp (CLEC) --- CLEC received $87.333 million from its IPO in the second quarter of 1998 and has very little debt. CLEC serves Atlanta, Charlotte, Greensboro, NC, Knoxville, Memphis, Orlando and Raleigh, NC. The market capitalization of CLEC is $353 million.

10. This sampling of CLECs indicates that they are small companies that have been aggressively raising capital to attempt to enter local markets all across the nation. It appears that they have had no difficulty in securing funding for their ventures, which are identical or very similar to those that GTE and BA claim to contemplate. Given barriers to providing local services for fledgling CLECs, these ventures are very risky as evidenced by the interest rates that the CLECs as a group have had to bear for their debt. As a group, they have not yet begun to be profitable. Some may become successful, others may not survive as going concerns and some of these may eventually be taken over by other companies, including some Regional Bell Operating Companies ("RBOCs").[2]

11. By contrast, GTE and BA are very large companies. GTE's market capitalization is $60.4 billion and BA's is $86.9 billion. GTE's debt to equity ratio is 1.81

[2] *See* "CLECs: What's Really Going On," Daniel P. Reingold, Merrill Lynch, June 19, 1998, page 28. (Attached hereto as Exhibit 1)

and that of BA is 1.44. The yield on telephone bonds is just under 7% and falling. As out-of-region entrants, their risk can be no greater than that faced by the CLECs and would most likely be less, because they are already well known to their existing customers, whom they intend to follow. They also have the back office capabilities and local exchange expertise that are unmatched by CLECs. Therefore, it is very clear that each company individually is of sufficient size and has the borrowing ability to finance entrance into local markets outside of its current region in order to follow existing customers and/or enter adjacent territories. They do not need to merge in order to pursue an entry strategy.

III. The Illogic of the Need for a Merger to Be More Efficient

12. Because the available evidence in the telecommunications industry suggests a wide range over which there are constant returns to scale -- *i.e.*, neither economies nor diseconomies of scale -- the focus should be on how efficient these companies are individually, at their respective, current scale levels.

13. GTE and BA simply assert that cost savings will arise from spreading the fixed cost of platform investments and by eliminating duplicative staff. Nowhere do they evaluate the specifics of alleged efficiencies.[3] Nor do they offer an analysis of why such candidate sources of savings could not be produced by exposing each company to competition.

14. Competition is known, after all, to drive firms to be efficient or die, and neither firm has yet been exposed to competition. Therefore, it is reasonable to question whether each firm is currently operating as efficiently as possible, given that they operated

[3] The Declaration of Doreen Toben, which is supposed to provide the factual support for GTE's and BA's "synergy" claims, merely *asserts* that overall savings from the merger will be about \$2.5 billion (*i.e.*, \$2 billion from expenses and \$0.5 billion from capital expenditures) within three years of closing. Nothing in the material submitted points to any efficiencies that would be merger-specific.

under a rate of return regime for several years. One hint might be the fact that each anticipates finding out and adopting the other's best operating practices. To the extent this is true, as they admit, it means that they individually are not operating on, but rather are above, the long run average cost curve. In plain English, it means that they are not operating efficiently.

15. Also, if they remain separate firms and pursue an out-of-region local strategy, whether into each other's territory or otherwise, would they not have incentives to take efficiency enhancing measures as they follow their home customers across regional borders? I believe the answer is "yes." Instead of merging to form a more formidable foe against competitive entry into the larger, post-merger home territory and trading "best practices," they would be forced to determine best practices or perish, if they had to compete against one another. For example, if BA is not using best practices in some significant areas, then it deserves to have competitors, including GTE, pick it apart by taking away its customers, rather than having a stock swap with GTE. The prospect of being driven out of business would, in turn, gives BA the incentive to take measures to improve its practices and, perhaps, become better than GTE. This is a crucial dynamic that would not have a chance to occur if the merger were to take place.

16. It is also at least questionable whether all of the claimed savings from redundancies will be realized. It has been well-known to AT&T in its local competition network element pricing cases, and has recently been admitted by an economic expert from LECG,[4] a firm often used by GTE and the RBOCs, that most, if not all, of the overheads of a firm are variable along with its other business activity. There is very little, if any, fixed cost in the long run. Because firms' overheads vary proportionately with their size, potential cost saving from this merger cannot be a matter of spreading fixed cost over more units of output beyond the short term. The cost savings would have to derive from

[4] *See* Affidavit of Debra Aron, Proper Recovery of Incremental Overheads for Local Number Portability, *In the Matter of Local Number Portability Before the Federal Communications Commission*, CC Docket No. 95-116, at 5-15 (FCC July 29, 1998). (Attached hereto as Exhibit 2).

correctly sizing the variable overheads and adopting best-practice standards for the operations activities of the new entity. However, this leads again to the question of whether competing as individual firms could accomplish these cost efficiencies more effectively. My view is that competition would force the firms to find the correct amounts of overheads and engage in best practices, because it would hold them accountable for doing so. Having them compete against each other would be preferable to depending on their promises of future cost savings as a merged company that would remain a monopoly.

CLEC Equity & Debt Capital

Company	Issue	Date Filed	Completed	Amount (millions)
Advanced Radio Telecom				
	10% Notes		3/96	$5
	14.75% Notes		7/96	$3
	14.75% Notes		9/96 & 10/96	$4
	Public Offering – 2,300,500 Share of Common Stock		11/96	$34.5
	14% Senior Notes		2/97	$135
	Common Stock – 6,000,000		97	$87
	Senior Notes	5/13/98		Proposed $125
	Common Stock – 3,100,000	4/15/98		Proposed $45.4
Allegiance Telecom				
	11 ¾% Senior Discount Notes – due 2008		2/98	$250
	Public Offering – 10,000,000 Common Stock		7/2/98	$150
	12 7/8% Senior Notes – due 2008		7/98	$200.9
E Spire Communications				
	Notes – Private Offering – due 2006		3/12/96	$61.6
	Common Stock – 8,000,000 and 660,000		4/15/97	$40
	14 ¾% Redeemable Preferred Stock – 75,000		7/10/97	$70
	13 ¾% Senior Notes – due 2007		7/23/97	$204.3
	12 ¾ %Preferred Stock		10/97	$146
	Common Stock – 8,100,000		4/3/98	$134.2
	Common Stock – 25,000	5/1/98		Proposed $.4
	Common Stock – 6,000,000	7/2/98		Proposed $117
	10 5/8% Senior Discounted Notes – due 2008		7/24/98	$225

	Common Stock – 75,000	7/28/98		Proposed $1.6
Electric Lightwave	Common Stock – 8,000,000		11/24/97	$128
	Common Stock – 4,170,000	8/7/98		
Frontier				
	Common Stock	1/10/96		Proposed $500
	Common Stock – 8,000,000	5/31/96		Proposed $261
	7 ¼% Notes – due 2004	5/23/97		Proposed $300
	Common Stock – 170,500,676		1997	
	Common Stock – 170,899,781		1998	
	Common Stock – 1,061,400	3/27/98		Proposed $34
	Common Stock – 1,289,612	6/18/98		Proposed $38.9
GST Telecommunications				
	13.875% Senior Discount Notes		3/96	$160
	Tomen Facility - financing and purchase of 1,074,074 common shares and warrants to purchase 546,155 additional shares		9/30/96	$34.5
	Special Warrants – 2,000,000		10/22/96	$9.7
	Tomen Facility - financing and purchase of additional common shares to be determined and warrants to purchase 75,000 additional shares		11/96	$41
	Series A Preference Shares		2/97	$50
	Secured Notes		5/97	$255.8
	Common Shares – Public Offering – 6,440,000		11/97	$211.2
	12.75% Senior Subordinated Accrual Notes		11/97	$144
	Common Stock – 352,072	1/27/98		Proposed $3.8
	Ordinary Warrants		2/98	$12.8
	10.5% Senior Secured Discount Notes – due 2008		5/98	$500
	Common Stock – 2,788,746	5/29/98		Proposed $32
Hyperion Telecommunications				
	13% Senior Discount Notes – due 2003		4/15/96	$168
	12 ¼% Senior Secured Notes – due 2004		8/30/97	$250
	12 7/8% Senior Exchangeable Redeemable		10/7/97	$200

	Preferred Stock - due 2007			
	Common Stock – 12,500,000 + 350,000		5/8/98, 6/5/98	$285
	Class B Common Stock – 1,993,638	6/12/98		
	Common Stock - 10,000,000	6/24/98		
ICG Communications				
	12 ½% Senior Discount Notes & 14 ¼% Preferred Stock		4/96	$360.2
	Common Stock – 5,484,244	12/26/96		Proposed $101.8
	11 5/8% Notes & 14% Preferred Stock		3/11/97	$192.4
	6 ¾% Preferred Securities		9/24/97 & 10/3/97	$127.6
	Common Stock – 11,866,388	11/7/97		Proposed $68
	Common Stock – 2,645,000	11/18/97		Proposed $148
	10% Senior Discount Notes		2/12/98	$291
	9 7/8% Senior Discount Notes		4/27/98	$250
Intermedia Communications				
	Common Stock – 937,500	7/16/96		Proposed $28
	Common Stock – sold from inception thru 12/31/96			$212.6
	Senior Notes – sold from inception thru 12/31/96			$324.6
	13 ½% Series A Redeemable Exchangeable Preferred Stock – due 2009		3/14/97	$300
	11.25 % Senior Discount Notes – due 2007		7/9/97	$363
	8.875 % Senior Notes – due 2007		10/30/97	$253
	Series E Depositary Shares		10/30/97	$193.8
	8.5% Senior Notes – due 2008		12/23/97	$390
	8.6% Senior Notes - due 2008		5/27/98	$450
	Depositary Shares Series F Junior Convertible Preferred Stock – 8,000,000		8/21/98	$200
McLeod				

	Public Offering – Common Stock		6/10/96	$258
	Senior Discount Notes		3/4/97	$288.9
	Senior Notes		7/21/97	$217.7
	8 3/8% Senior Notes – due 2008		3/16/98	$291.9
Nextel				
	Comcast purchased 8,155,506 shares of common stock in respect to the Dial Page Transaction		2/9/96	$99.9
	Class A Common Stock - 10,000,000	4/29/96		
	McCaw International (sub. of Nextel) - Senior Discount Notes		3/97	$500
	13% Series D Exchangeable Preferred Stock - 500,000		7/22/97	
	10.65% Senior Serial Redeemable Discount Notes - due 2007		9/22/97	$500
	9.75% Senior Serial Redeemable Discount Notes - due 2007		10/23/97	$700
	Class A Common Stock - 2,160,072	10/24/97		
	11.125% Series E Exchangeable Preferred Stock - due 2010 - 750,000 shares		2/11/98	$727.9
	9.95% Senior Serial Redeemable Discount Notes - due 2008		2/11/98	$975.9
	Nextel International - 12.125% Senior Redeemable Discount Notes - due 2008		3/12/98	$387
	Common Stock - 21,020,911	5/22/98		Proposed $519
Nextlink				
	Senior Notes		4/25/96	$190
	Preferred Shares		1/31/97	$274
	Common Stock Public Offering - 15,200,000		9/26/97	$226.8
	9 5/8% Senior Notes		9/26/97	$388.5
	9 % Senior Notes - due 2008		3/3/98	$326.5
	6 ½% Preferred Stock - 4,000,000		3/31/98	$193.8
	9.45% Senior Discount Notes - due 2008		4/1/98	$390.9
	6 ½% Cumulative Convertible Preferred Stock - 4,000,000	7/23/98		Proposed $200

	Class A Common Stock - 5,441,336	5/6/98		Proposed $164
RCN				
	10% Senior Notes & 11 1/8% Senior Discount Notes - due 2007		10/97	$575
	9.8% Senior Discount Notes - due 2008		2/98	$350.5
	11% Senior Discount Notes - due 2008		6/98	$150
	Common Stock Public Offering - 6,794,500		6/98	$113
	Common Stock - 12,921,348	6/15/98		Proposed $297.9
	Common Stock - 396,442	8/12/98		Proposed $8
Teleport Communications Group				
	Class A Common Stock - 27,025,000		7/2/96	$432.4
	Senior Discount Notes - due 2007		7/2/96	$625
	Common Stock Public Offering - 17,250,000		11/13/97	$317.4
Teligent				
	Class A Common Stock - 6,325,000		11/21/97	$125.7
	NTT purchased 11% of Teligent - Series B3 Common Stock		11/26/97	$100
	11 ½% Senior Notes - due 2007		11/97	$150
	11 ½ % Senior Discount Notes - due 2008		2//20/98	$243.1
US LEC				
	Common Stock Public Offering - 5,500,000		4/29/98	$87
	Class A Common Stock - 1,480,000	8/17/98		Proposed $26.6
USN Communications				
	14% Senior Notes & 9% Convertible Notes - due 2003, 2004 resp.		9/96	$48.5
	9% Preferred Stock		9/96	$10
	Series A Preferred Stock		8/97	$30.8
	1997 Private Placement		8/97	$96
	Series A Preferred Stock		10/97	$15
	Common Stock - 8,600,000		2/98	$127
	Common Stock - 28,861		3/98	$0.4
	9% Convertible Subordinated Notes - due 2004 -	5/12/98		

	$36M in aggregate principal amount at maturity and 9% Consent Convertible Subordinated Notes - due 2006 - $13M in aggregate principal amount at maturity			
Winstar				
	6% Series A Cumulative Convertible Preferred Stock - 4,000,000		2/97	$96
	14 ½% Senior Deferred Interest Notes - due 2005 & 12% Guaranteed Senior Secured Notes - due 2004		3/97	$290.5
	12 ½% Guaranteed Senior Secured Notes - due 2004		8/97	$48.5
	15% Senior Subordinated Deferred Interest Notes - due 2007		10/97	$94
	Series C Preferred Stock - 175,000		12/97	$175
	14 ¼% Senior Cumulative Exchangeable Preferred Stock - due 2007		12/97	$168
	7% Senior Cumulative Convertible Series D Preferred Stock - due 2010		3/98	$193.1
	10% Senior Subordinated Notes - due 2008 & 11% Senior Subordinated Deferred Interest Notes - due 2008		3/98	$436.7
Worldcom - Brooks Fiber				
	10 7/8% Senior Discount Notes - due 2006		2/26/96	$250
	Common Stock Public Offering - 7,385,331		5/2/96	$185.2
	11 7/8% Senior Discount Notes - due 2006		11/7/96	$225
	Common Stock - 1,008,414		2/4/97	$24
	Common Stock - 5,000,000	8/6/97		Proposed $183
Worldcom -MFS Communications				
	8 7/8% Senior Discount Notes		1/96	$600

I declare under penalty of perjury that the foregoing is true and accurate to the best of my knowledge and belief.

Executed on November 19, 1998

Stephen B. Levinson

SUBSCRIBED AND SWORN TO BEFORE ME this 19th day of November 1998.

Notary Public

My Commission Expires:

Terri Iannotta
Notary Public
Expires 4/08/2002

EXHIBIT 1

19 June 1998

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Telecom Services — Local

CLECs: What's Really Going On

Reason for Report: 1Q Review and Industry Overview

Industry

Investment Highlights:

- **CLECs as a group reported "core" CLEC revenues slightly ahead of expectations. EBITDA losses were mainly in line with estimates as spending on backoffice systems and support personnel offset the revenue benefit.**
- **At March 31, new entrants' revenue share of the US local telecom market stood at 3.5%, up from 3.0% on December 31, 1997. By year-end 1998, we forecast that the CLEC's share will reach 5.4%.**
- **We have introduced a new measure for tracking the pace of CLEC local share gains in terms of lines, revenues and mix — the latter reflecting the vastly different profitability of resold, unbundled and on-net lines.**
- **During 1Q98 we estimate the CLEC group captured 0.47% of the $101Bn local market, the equivalent to a 1.9% annual share gain. This was an increase of 20 basis points over 4Q97's annualized share gain of 1.7%. We expect the CLEC's sequential share gain to increase to an annualized 2.6% of the $105Bn local market by 4Q98.**
- **In 1Q, CLECs added 580,000 net lines, 11% above 4Q97's additions — a slowdown vs. 3Q97's 67% sequential growth in line additions and 4Q97's 24%. For the balance of '98, we expect sequential growth in line additions of 12%, 13% and 14% in 2Q, 3Q and 4Q, respectively. According to our estimates, average line mix for 1Q was 35% on-net, 27% unbundled network elements (UNE), and 38% total service resale (TSR).**
- **CLEC shares significantly outperformed the market by 31.5% through mid-March, but have since underperformed the market by 19.2% and are currently tracking the market year-to-date. We expect continued industry consolidation, the formation of alliances and continued operating and cash flow improvement to re-ignite investor interest in the group. Thus, we view the current weakness as an excellent buying opportunity.**
- **We maintain our bullish outlook on the CLEC group & reiterate our recommendations: e.spire (ESPI, D-2-1-9, $17.38) with 61% upside to $28; Teligent (TGNT, D-2-1-9, $28.00) with 32% upside to $37; Electric Lightwave (ELIX, D-2-2-9, $13.13) with 52% upside to $20; and ICG Communications (ICGX, D-2-2-9, $31.75) with 32% upside to $42. We are restricted from comment on Advanced Radio Telecom (ARTT, $11.75); Intermedia Communications (ICIX, $38.75); RCN Corp. (RCNC, $20.38); and Teleport Communications Group (TCGI, $58.44).**

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1. CLEC Industry 1Q98 Summary

1Q CLEC Results Showed Continued Strong Topline Growth...

1Q results for the CLEC (competitive local exchange carrier) sector continued to show strong revenue growth for the period, up 57% year over year and 27% sequentially, led by slightly stronger than anticipated "core" CLEC revenues. We estimate that the CLECs' (including local efforts by LD companies) revenue share of the local telephone market stood at 3.5% at the end of March, an approximate 50 basis point increase over the 3.0% share garnered by 4Q97. We estimate that the CLEC share will increase to 5.4% by 4Q98.

In terms of annualized share gain, we estimate that during 1Q98 CLECs (including local efforts by LD companies) captured 0.47% of the current $101Bn local market or an annualized share gain of 1.9%. This was an increase of 20 basis points over 4Q97's annualized share gain of 1.7%. We expect the CLECs' annualized share gain to increase to 2.6% of the $105Bn local market by 4Q98.

... But Local Line Growth Trends Were Somewhat Disappointing

During 1Q98, CLECs as a group added 580,000 net local lines, a sequential increase of 11%. Growth in line adds during the quarter marked a slowdown, however, vs. the 67% & 24% sequential growth rates experienced in both 3Q97 and 4Q97. The lack of automated provisioning systems and electronic interface capabilities with the ILECs (incumbent local exchange carriers) continued to restrain the sequential ramp-up of the access line installation process. However, many CLECs are currently engaged in investment initiatives designed to upgrade and expand line provisioning capacity. These initiatives should help to alleviate these problems over the next quarter or two; thus we believe that quarterly access line additions will reverse the slowing sequential growth trend seen over the past 3 quarters and increase sequentially in future quarters. In fact, our forecast assumes that sequential line additions modestly accelerate to 12%, 13% and 14% during 2Q, 3Q and 4Q, respectively.

Progress on the EBITDA Front Restrained By The Funding of Backoffice and Growth Initiatives

For most of the publicly traded CLECs, while our revenue forecasts were met or exceeded, EBITDA losses were mainly in line with expectations as profitability for the period was impacted by continued heavy spending on backoffice systems (i.e., billing, line provisioning and customer service) and expansion of customer support personnel. These initiatives resulted in a number of negative revisions to our EBITDA forecasts for full year 1998 and 1999. In addition, we view these systems investments as necessary preparation for future revenue growth opportunities — such as data services — and believe their impact on EBITDA will decrease as revenues continue to grow rapidly.

Our Bullish Stance Towards The CLEC Group Is Supported By 5 Key Value Drivers

We maintain our bullish outlook on the CLEC group as a whole due to the attractive prospects for growth — both for top line and cash flow. We forecast that the local market opportunity available to the CLECs today is approximately $105 billion and is forecast to grow at 4.0-4.5% per year. Our forecasted growth rates exceed historical levels due to rapid increases in internet usage fueling demand for second lines within the residential market and high speed data lines within the business market.

As the CLECs grow, we expect continued validation of the value creation mechanism via alliances and takeovers by other telecom companies including other CLECs, domestic local and long distance companies as well as non US-based telecom companies. These firms will be attracted to the sector given the strategic nature and scarcity of local telecom assets.

CLEC Stocks Weak, 19.2% Off Mid-March Highs

CLEC stocks have tracked the market year-to-date, significantly outperforming the market by 31.5% through mid-March but since then underperforming the market by 19.2%. We believe that the recent spate of weak relative stock price performance is as a result of the following factors:

- A period of stock price correction following an especially torrid run from December of 1997 through mid-March. As an example, on 12/5 we named Intermedia Communications our US focus stock for 1998. Following that, the stock outperformed the S&P 500 by 60.4% through the mid-March peak in the CLEC group;

- The lessening of euphoria concerning strong outlooks for data and internet traffic growth that culminated at our global telecom CEO conference in mid-March;
- Deceleration of quarterly local access line additions referred to above;
- A number of negative forecast revisions for EBITDA leading into the 1Q98 reporting season;
- Investor frustration following heated rumors that Bell Atlantic and Intermedia were close to a major out-of-region/inter-LATA data alliance, yet to be consummated; and,
- Reduced level of takeover speculation following the pending acquisition of Teleport Communications Group by AT&T (announced 1/8/98) which left many investors without an obvious "next target" given the dearth of CLECs deemed large enough to attract a suitor. This view gained further momentum through the late March-May time period as additional CLEC merger and acquisition activity failed to materialize.

Look For 2H98 Catalysts To Re-ignite CLEC Stock Performance

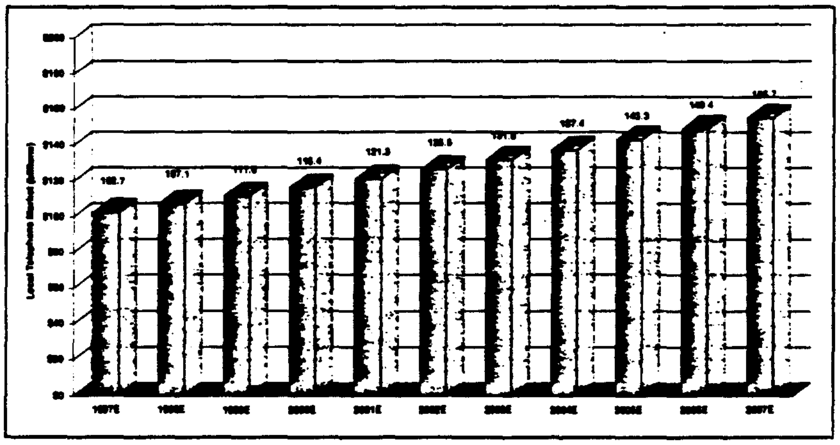
Potential catalysts for the CLEC stocks include a new wave of merger and acquisition activity, alliances with major telecom companies (i.e., Bell Atlantic and Intermedia out-of-region data alliance) and continued progress towards EBITDA breakeven for many CLECs. We view the current pull back in the CLEC group as an excellent buying opportunity and we reiterate our recommendations of Teligent (TGNT, D-2-1-9, $28.00), Electric Lightwave (ELIX, D-2-2-9, $13.13), and ICG Communications (ICGX, D-2-2-9, $31.75). We are currently restricted from comment on Intermedia Communications (ICIX, RSTR, $38.75), RCN Corporation (RCNC, RSTR, $20.38), Advanced Radio Telecom (ARTT, RSTR, $11.75) and Teleport (TCGI, RSTR, $58.44).

2. Why We're Bullish On CLECs

We view the following five elements as the key value drivers supporting the fundamental outlook for the CLEC group:

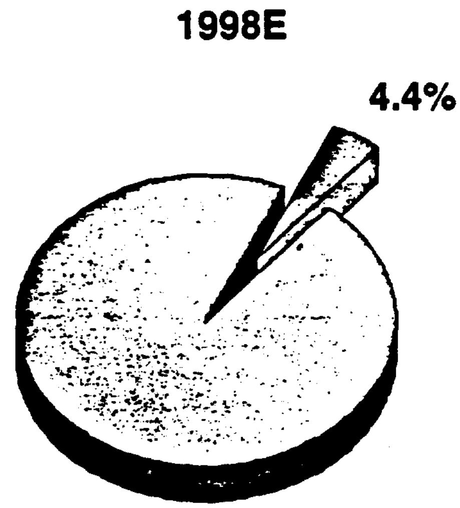
1. **A $105 Billion Market Opportunity That The CLECs Have Only Just Begun To Exploit:** The local market opportunity available to the CLECs today is approximately $105 billion and is forecast to grow at 4.0-4.5% per year (see Chart 1 below). However, the CLECs, in aggregate, have only accumulated an annualized market share of 2.1% for full-year 1997 — a market penetration that is expected to grow to 4.4% for full-year 1998, as shown in Chart 2 below.

Chart 1 — $105 Billion Local Telecom Market Expected To Grow 4.0-4.5% Annually.



Source: Merrill Lynch estimates

Chart 2: 1998E Local Market Share Takeaway By New Entrants - CLEC & LD Co's

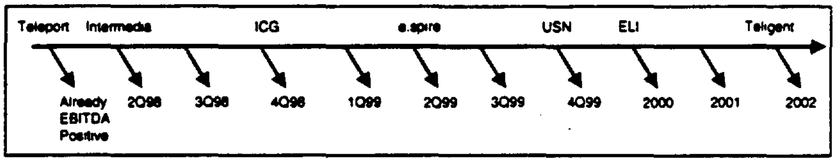


Source: Merril Lynch estimates

1. **Growth In The Local Market Continues To Exceed Forecast:** We continue to be positively surprised by the fundamental strength inherent in the local telecom market where reported year-over-year revenue growth trends in excess of 5% continue to exceed our 4.0-4.5% annual growth forecast. The key driving force underlying this observation remains the explosive demand evident in the data/internet markets with some additional support supplied by the continued strong customer demand for vertical features (e.g., voice mail and caller ID).

2. **Profit Improvement With Continued Progress Towards EBITDA Break Even:** We view the achievement of EBITDA breakeven as an important milestone for all CLECs (except Teleport which is already EBITDA positive) on the road to self-funding and eventual bottom line profits. Chart 3 below details our forecast timetable for CLEC EBITDA break even.

Chart 3: EBITDA Breakeven Timeline



Source: Merril Lynch estimates

4. **Alliances Should Provide New Growth Opportunities:** Continued aggressive pursuit of partnerships (with other CLECs, electric utilities, ILECs, etc.) should bolster top line growth and both expand and accelerate development of the geographic footprint and product portfolio of the CLECs.

5. **Consolidation, Consolidation, Consolidation:** Given the high costs and lengthy time to market delays associated with the construction of new local telecom networks, together with a highly receptive high yield bond market, we expect consolidation to remain an important theme in the CLEC group. To this point, we suspect that the smaller CLECs will consolidate amongst themselves in order to gain scale and scope, which may in turn, attract an acquirer. Likely buyers of CLECs include one of the large long distance companies in need of local facilities, other CLECs looking to increase geographic coverage, data skills and/or salesforce, or foreign-based telcos looking for "local presence" in the US and possibly, but less likely, ILECs desiring to move out of region.

Table 1: CLEC Company Comparisons

Company	Rating	Price (6/17)	1997 EPS	1998E EPS	1999E EPS	Price Obj.	% Upside	1998E CAPX	1998E EBITDA	1Q98 Lines	1998E Rev.
ART	RSTR	$11.75	($2.26)	RSTR	RSTR	RSTR	RSTR	RSTR	RSTR	NM	RSTR
Electric Lightwave	D-2-2-9	$13.13	($0.66)	($1.50)	($3.06)	$20.00	52%	270M	(49)M	41,270	100.5M
e.spire	D-2-1-9	$17.38	($4.65)	($3.61)	($2.96)	$28.00	61%	160M	(35)M	57,500	156.4M
ICG	D-2-2-9	$31.75	($9.75)	($6.34)	($6.39)	$42.00	32%	400M	(31)M	186,100	562.0M
Intermedia Comm.	RSTR	$38.75	($10.83)	RSTR	RSTR	RSTR	RSTR	RSTR	RSTR	221,000	RSTR
RCN Corp	RSTR	$20.38	($2.50)	RSTR	RSTR	RSTR	RSTR	RSTR	RSTR	40,500	RSTR
Teligent	D-2-1-9	$28.00	NA	($3.47)	($3.49)	$37.00	32%	170M	(113)M	NA	2.0M
Teleport Comm.	RSTR	$58.44	($1.34)	RSTR	RSTR	NA	RSTR	RSTR	RSTR	326,000	RSTR
USN	D-3-2-9	$8.25	($15.55)	($9.00)	($4.73)	$18.00	118%	25 M	(132)M	226,000	238.4M

Source: Merril Lynch estimates and company reports
*Access line counts adjusted to reflect profitability of lines based on transmission method (on-net, UNE, or TSR)

3. 1Q98 CLEC Review

The CLEC sector continued to show strong revenue growth during 1Q98. On average, "core" CLEC revenue growth slightly exceeded our forecasts for the quarter. Nevertheless, for most of the publicly traded CLECs, EBITDA losses did not beat our forecasts as profitability for the period was restrained by continued heavy spending on backoffice systems (i.e., billing, line provisioning and customer service) and expansion of customer support personnel. Highlights of the quarter are as follows:

Revenue Performance

Strong Sequential Growth Seen In Core CLEC Revenues

During 1Q, we were impressed with the strong growth in local switched services revenue reported by the CLECs. Although net local access line growth was below our expectations, the CLECs, on average, met or exceeded our corporate revenue estimates aided, in part, by strong customer demand for data services.

Data, Data, Data

Most CLECs view data services as serving a dual role: data expands the portfolio of services offered to customers and also helps to "jump start" commercial operations in new markets.

Data related highlights of the quarter include:

- Intermedia signed an agreement to be US West's preferred provider of data communications both in and out of US West territory on a wholesale basis (Intermedia recently signed a similar deal with Ameritech on 5/19); and
- ICG announced several new data initiatives which will be kicking off in mid-July including IP (internet protocol) long distance service and high speed internet access over DSL. "Digital subscriber line" technology permits the provision of services requiring high bandwidth capacity via twisted-pair copper wires.

Other CLECs such as Electric Lightwave and e.spire (formerly American Communication Services Inc. or ACSI) view data services as a key component in their integrated services offering and these services played important roles in 1Q98 top line performance with sequential data revenue growth of 24% for Electric Lightwave and 16% for e.spire Communications.

Table 2: Quarterly & Annual Revenue Growth ($ in millions)

			Sqt'l Growth			Full Year		
	4Q97	1Q98	3Q97	4Q97	1Q98	1997	1998E	Annual Growth
ELI	$19	$20	NA	NA	5%	$61	$101	65%
e.spire	23	28	38%	45%	22%	59	156	165%
GST*	28	30	NA	17%	7%	119	NA	NA
Hyperion	5	NA	NA	NA	NA	21	NA	NA
ICG	78	126	NA	15%	62%	273	603	121%
Intermedia	83	137	NA	16%	65%	248	RSTR	RSTR
McLeod	136	134	(18%)	176%	(1%)	268	NA	NA
NEXTLINK	23	27	NA	68%	17%	58	NA	NA
RCN	20	43	NA	NA	115%	127	RSTR	RSTR
TCG	150	160	14%	14%	7%	494	RSTR	RSTR
US LEC	5	14	NA	NA	180%	6	NA	NA
USN	20	32	NA	80%	60%	47	301	537%
WinStar	30	47	NA	49%	57%	79	NA	NA
Total	620	798	NM	NM	NM	1,860	NM	NM

*Net of NACT EBITDA contribution as NACT ownership was monetized during 2/96

Source: Merrill Lynch estimates and company reports

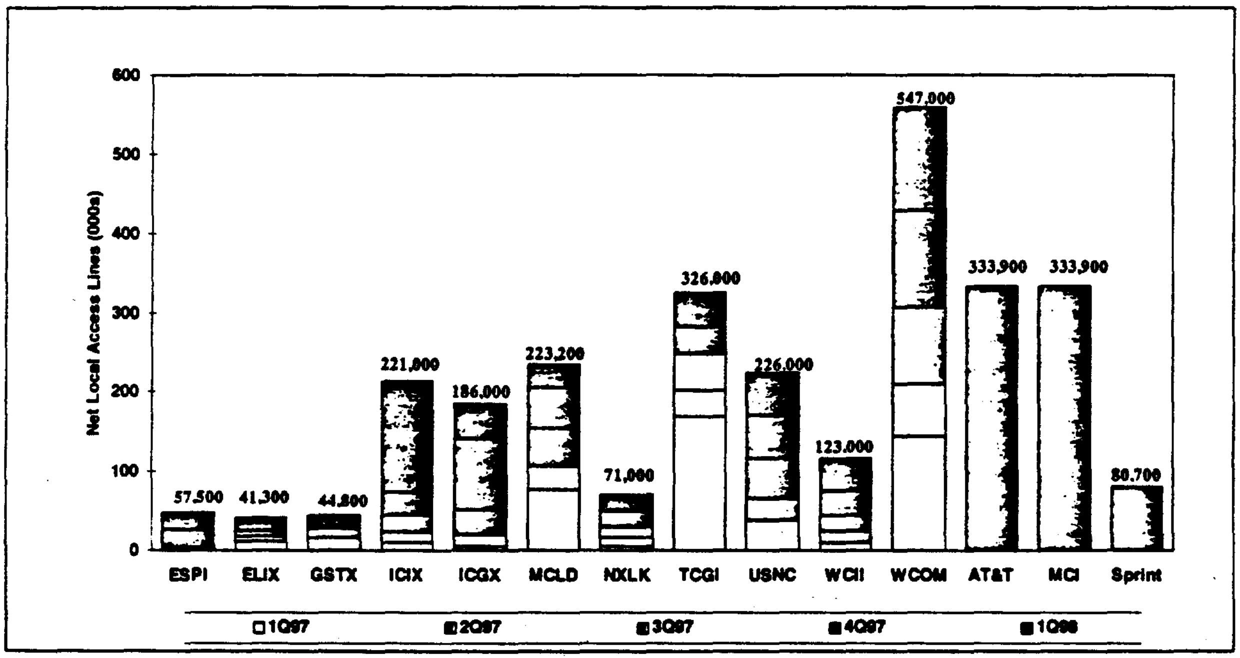
1Q Access Lines

USN Led The Independent CLECs With 54,000 Access Lines Installed During 1Q

As shown in Chart 4 below, USN and ICG had the strongest net incremental local access line installations of the independent CLECs during 1Q. USN installed 54,000 net access lines, in line with 4Q results and ended the quarter with a total of 226,000 access lines in service. ICG increased its quarterly installations from 40,000 in 4Q to 45,000 with a total of 186,000 access lines in service. e.spire Communications installed 22,400 access lines during 1Q, an increase of 49% over the 15,000 installed during 4Q, ending the quarter with 57,500 lines in service. In addition, the local divisions of WorldCom, MFS and Brooks combined to install a total of 130,000 access lines during the quarter, bringing WorldCom's total access lines in service to 547,000.

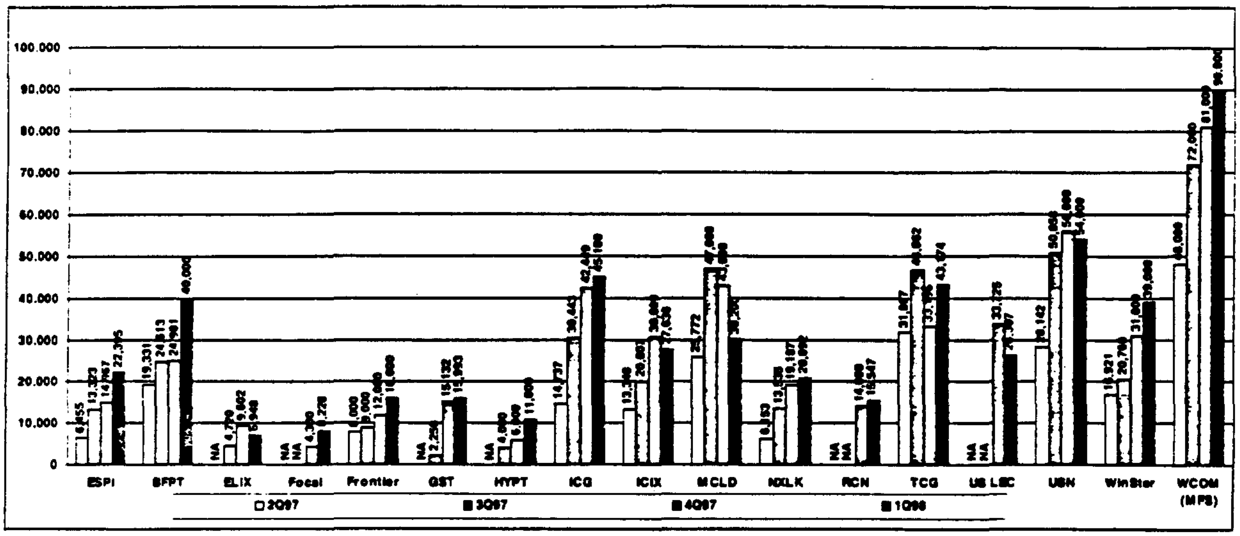
Excluding acquisitions, Intermedia installed 27,600 access lines, 11% below our expectations, ending the quarter with 221,000 access lines in service including 111,600 access lines acquired from Shared Technologies. During 1Q, Teleport installed 43,000 net access lines with a total of 326,000 in service. Electric Lightwave installed approximately 7,000 access lines, a decline from the 9,000 installed during 4Q. We attribute the slowdown in Electric Lightwave's access line installations to heavy reliance on T-1 connections leased from US West, however, the company expects that the delays will be resolved with the settlement of Electric Lightwave's anti-trust case against US West expected in the next few months.

Chart 4: Net Local Access Lines In Service At End of 1Q98*



*Includes gained through acquisitions: 1Q98 - 111,600 from Intermedia's acquisition of Shared Tech, 1,811 from NEXTLINK's acquisition of Start Technologies, 24,000 from WinStar's acquisition of Goodnet & Pacnet.; and, 4Q97 - 8,000 from McLeod's acquisition of Consolidated & 48,000 from ICG's acquisition of CBG.
LD access line count based on1997 switched revenues $100M AT&T, $100M MCI, $25M Sprint and $64 monthly revenue per line; and 1998 switched revenues $300M AT&T, $300M MCI, $75M Sprint and $65 monthly revenue per line.
Source: Merril Lynch estimates and company reports.

Chart 5: CLEC Organic Line Additions*



*Net of lines gained through acquisition including: 1Q98: 111,600 from Intermedia's acquisition of Shared Tech, 1,811 from NEXTLINK's acquisition of Start Technologies, 24,000 from WinStar's acquisition of Goodnet & Pacnet.; and, 4Q97: 8,000 from McLeod's acquisition of Consolidated & 48,000 from ICG's acquisition of CBG.
Source: Company reports and Merril Lynch estimates

RCN Ended 1Q With An Impressive 16% Penetration Into Homes Passed By Its Advanced Fiber Network

RCN is unique in the CLEC industry with its marketing focus primarily directed to the residential market instead of the business orientation of the other CLECs. To further distinguish the company from other CLECs, RCN is pursuing a facilities based strategy and building out an "advanced fiber" network of hybrid fiber coax and twisted copper pairs to its residential customers. Unit growth analysis for RCN, therefore, focuses on both customer connections and the number of homes passed by its advanced fiber network. As shown in Table 3 below, RCN exceeded our expectations in almost all categories and ended 1Q with 63,386 homes passed by its advanced fiber network with an average of 2 service connections per subscriber, this equates to 10,200 homes served or 16% penetration of the 63,386 homes passed by RCN's network (see row O in Table 2 below).

Table 3: RCN Connections & Penetration

		4Q97	1Q98	Sqt'l Growth
A	Homes Passed	44,045	63,386	44%
	On-Net			
B	Voice	3,214	4,473	39%
C	Video	11,784	15,599	32%
D	Data	150	267	78%
E (sum B:D)	**Total On-Net**	**15,148**	**20,339**	**34%**
	Off-Net			
F	Voice	24,900	40,447	62%
G	Video	227,619	227,558	NM
H	Data		370,271	NM
I (sum F:H)	**Total Off-Net**	**252,519**	**638,276**	**NM**
J (E+I)	**Total Service Connections**	**267,767**	**658,615**	**NM**
	Penetration Of Homes Passed			
K (B/A)	Voice	7%	7%	
L (C/A)	Video	27%	25%	
M (D/A))	Data	0%	0%	
N	Services Per Customer	2	2	
O (E/N/A)	**Total On-net Penetration**	**17%**	**16%**	

Source: Merril Lynch estimates and company reports.

4. Line Mix

Line Mix Is Crucial To Gross Margins

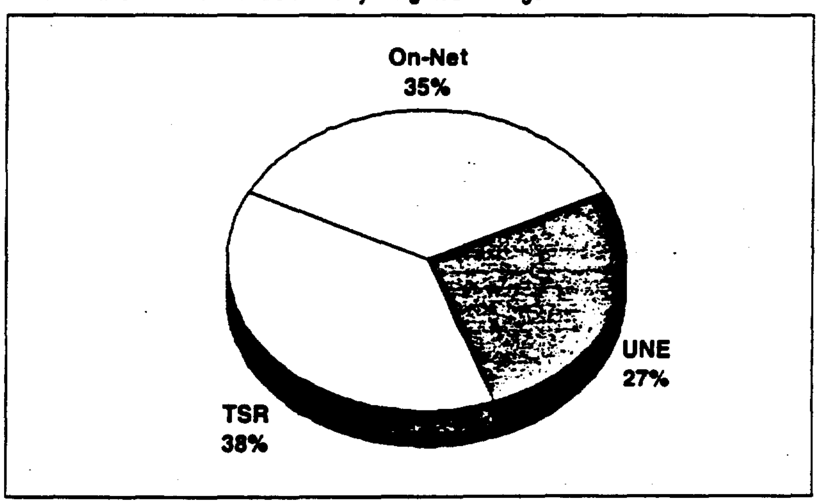
Table 4 and Chart 6 below detail our estimates of line mix for the CLECs' access lines in service at 1Q. We estimate that the average mix of lines in service during 1Q was 35% via on-net, 27% via UNE, and 38% via TSR, which compares to our estimate of 37% on-net, 28% UNE, and 35% TSR for 4Q97. We believe CLEC line mix will continue to trend more towards on-net and UNE transmission as CLEC local network reach expands due to continued facilities buildout.

Table 4: Estimated 1Q98 CLEC Line Mix

	On-net	UNE	TSR	Total
e.spire	19%	0%	81%	100%
Brooks Fiber	60%	35%	5%	100%
Electric Lightwave	74%	23%	3%	100%
Focal	0%	90%	10%	100%
Frontier	0%	2%	98%	100%
GST	10%	50%	40%	100%
Hyperion	0%	86%	14%	100%
ICG	48%	14%	38%	100%
Intermedia	40%	20%	40%	100%
McLeod	0%	10%	90%	100%
NEXTLINK	20%	75%	5%	100%
RCN	15%	0%	85%	100%
Teleport	80%	20%	0%	100%
US LEC	0%	100%	0%	100%
USN	0%	0%	100%	100%
WinStar	15%	5%	80%	100%
WorldCom (MFS)	75%	25%	0%	100%
AT&T (Local)	20%	15%	65%	100%
MCIMetro	50%	50%	0%	100%
Sprint (Local)	0%	30%	70%	100%
Weighted Average	35%	27%	38%	100%

Source: Merrill Lynch estimates

Chart 6: 1Q98 Estimated CLEC Industry Weighted Average Line Mix



Source: Merrill Lynch estimates

Line mix is a critical variable in analyzing the true fundamental performance of a CLEC because each local access method provides the ability to attain a different EBITDA margin. In general, CLECs provide local network connectivity to customers through one of the following three methods (for a graphical depiction, please see charts 7A-C below). Our derivation of potential EBITDA margins is shown in Table J.:

- **On-net**: These access lines are provided 100% over the CLEC's own facilities including last mile either through wireline or wireless transmission; with a potential 40% EBITDA margin, over time, for local switched revenues;
- **Unbundled network elements (UNE)**: These access lines are provided over a combination of CLEC owned and leased facilities (especially last mile loops) from the ILEC with a potential 25% EBITDA margin, over time, for local switched revenues; and,
- **Total service resale (TSR)**: These access lines are provided 100% over leased ILEC facilities; with a potential 5% EBITDA margin, over time, for local switched revenues.

Chart 7a: On-net Schematic

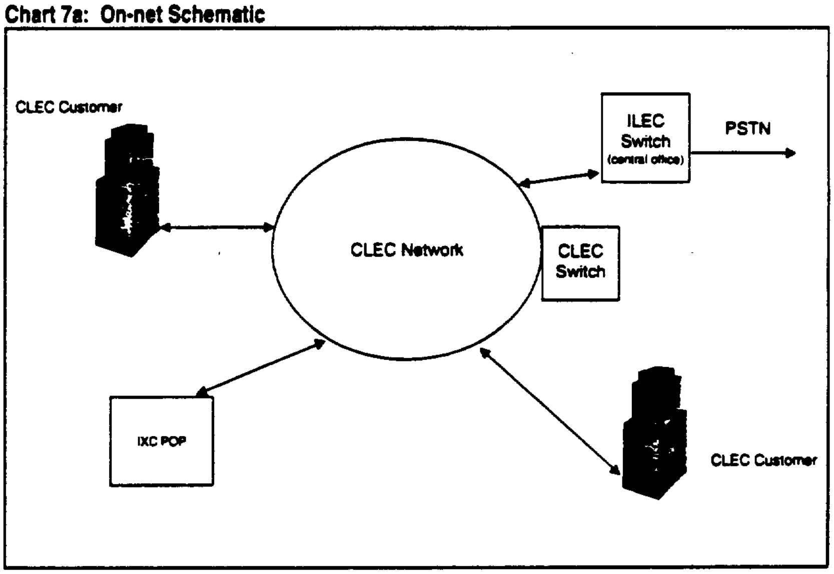


Chart 7b: Unbundled Network Element (UNE) Schematic

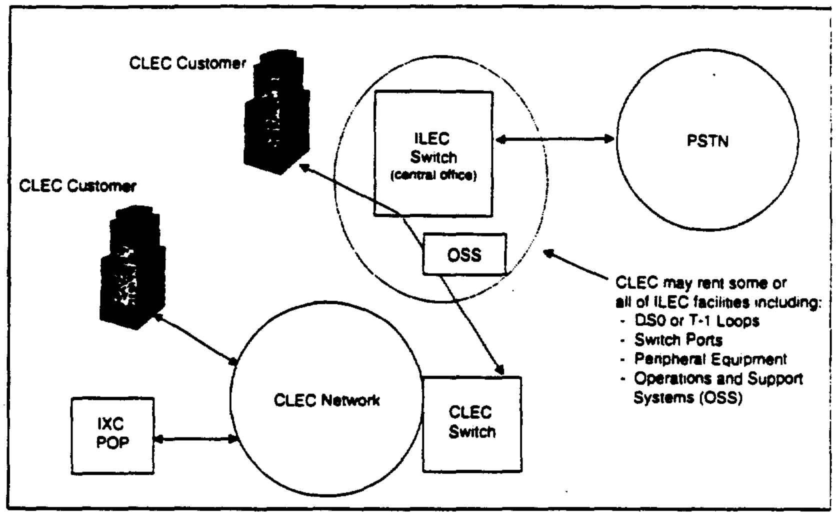
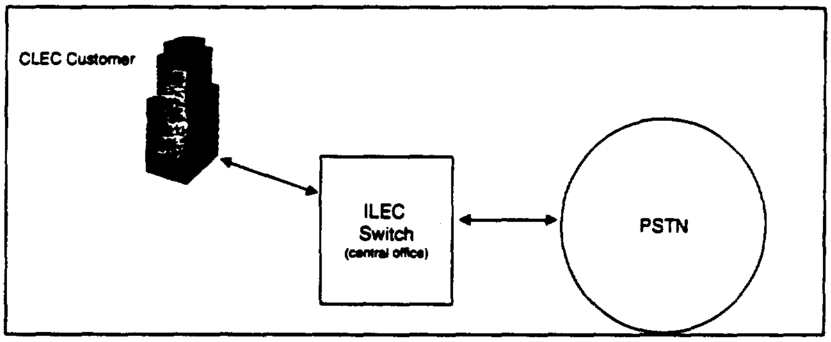


Chart 7c: Total Service Resale (TSR) Schematic



Source: Merrill Lynch

Table 5: Estimated CLEC EBITDA Margins By Method Of Local Market Entry — 2007

	TSR	USN TSR	UNE	On-net
Revenue	100%	100%	100%	100%
Discount	5%	5%	10%	15%
Network Costs	80%	61.5%	50%	25%
SG&A	10%	22%	15%	20%
EBITDA	5%	11.5%	25%	40%
Interest	-	-	4%	7%
Depreciation	-	1.5%	5%	10%
Pretax Margin	5%	10.0%	16%	23%

Source: Merrill Lynch estimates

5. Tracking/Predicting Pace Of Share Gain

■ CLEC Annualized Local Revenues and Access Line Market Share Gains

CLECs & LD Co's Accumulated An Annualized 1.9% Share Gain Of The Estimated $101 Billion Local Market During 1Q

We estimate that during 1Q98, the local competitors (that is, the CLECs and the big 3 long distance companies: AT&T, MCI and Sprint) accumulated an annualized 1.9% share gain of the estimated $101 billion US local market (see Table 6 below). This was an 18 basis point improvement over the 1.7% annualized share gained during 4Q97, but marked a deceleration vs. prior quarters. However, we expect the local competitors' annualized share gains to increase during the next few quarters as salesforce and access line provisioning productivity ramps up, with annualized share gain forecasted to reach 2.6% by 4Q98.

Methodology:

In order to determine the annual local services revenues earned by the local competitors, we divided local revenues into two categories: switched and dedicated services.

The estimates for dedicated services revenues are based on our individual 10-year company models (located in the appendix of this report) and are also detailed in Table 7 below. Our forecasts of switched services revenue are based upon our estimates of quarterly access line additions multiplied by estimated monthly revenue per line.

We use the following methodology to determine the local competitors' annualized share gain of local dedicated and switched services revenues (all calculations are shown in Table 6 below, unless otherwise noted):

1. (Row CC): Total organic access line additions (row X) x 4 x monthly revenue per line (row BB) = **local competitors monthly incremental switched revenue;**
2. (Row DD): Incremental quarterly dedicated services revenues (Table 6) ÷ 3 = **monthly incremental dedicated revenue**;
3. (Row EE): Monthly switched revenue (row CC) + monthly dedicated revenue (row DD) = **total local competitors' local revenue;**
4. (Row FF): Total local competitors local revenue (row EE) x 12 = **annualized local competitors' incremental local revenue;**
5. (Row GG): **Estimated US local revenue** (our estimate); and,
6. (Row HH): Local competitors annualized local revenue gain ÷ US local revenue = **local competitors' share gain**

Our methodology makes it possible to compare the quarterly and annual local market share gains of companies on a consistent basis, however, the forecasts within the tables may differ slightly from the forecasts within individual company models, due to the use of a "standardized" monthly revenue per line forecast.

Table 6: CLEC & LD Co's Access Line Market Share Gains

	Company	2Q97	3Q97	4Q97	1Q98	2Q98E	3Q98E	4Q98E
A	e.spire	6,455	13.323	14.967	22,395	26.105	30.000	35.000
B	Brooks Fiber	19,331	24,613	24.981	40.000	50.000	55.000	60.000
C	Electric Lightwave	5,329	4,720	9.602	6.948	9.000	12,000	15.000
D	Focal	NA	2,000E	4.300	8,228	10,000	12,500	15.000
E	Frontier	8,000	9,000	12,000	16,000	18,000	21,000	24.500
F	GST	NA	2,256	15,132	15,993	16.500	17,000	17.500
G	Hyperion	1,000E	4,000E	6.000E	11.000	14.000	19.000	24.000
H	ICG*	14,737	30,443	42,449	45.100	46.900	53.000	58.000
I	Intermedia*	13,348	20,007	30,609	27,638	40.413	43,000	45,000
J	McLeod*	25,772	47,000	43,000	30.200	32,000	34,000	36.000
K	NEXTLINK*	6,153	13,535	19,187	20,892	22.000	24,000	26.000
L	RCN*	NA	10,900	14.000	15.547	16.500	18.500	22.000
M	Teleport	31,867	46,862	33.196	43,174	46.000	50.000	55.000
N	US LEC	4,087	11,417	33.725	26.307	28.000	30.000	32.000
O	USN	28,142	50,858	56.000	54.000	50,000	70.000	80,000
P	WinStar*	16,921	20,760	31,000	39,000	45.000	50.000	57,000
Q	WorldCom (MFS)	48,000	72,000	81,000	90,000	95,000	100 000	110.000
R sum(A:Q)	Total CLEC Lines	229,142	383,694	471,148	512.422	582,418	669.000	782.000
S	AT&T (Local)**	8.000	15,000	22,000	30.000	37,500	42,500	55.000
T	MCIMetro**	8,000	15,000	22,000	30.000	37.500	42.500	55,000
U	Sprint (Local)**	6,000	6,500	7,000	7,500	9,375	10,625	13,750
V sum(S:U)	Total LD Lines	22,000	36.500	51,000	67.500	78,100	88.900	99.800
W (R-V)	**Total Organic Lines Added (excluding acquisition)**	**251,142**	**420,194**	**522,148**	**579,922**	**649,793**	**734,625**	**835,750**
	Sequential Growth		**67%**	**24%**	**11%**	**12%**	**13%**	**14%**

Sequential Growth in Line Additions Should Re-Accelerate

	US Access Line Share Gain	2Q97	3Q97	4Q97	1Q98	2Q98E	3Q98E	4Q98E
X (W)	Total Organic Line Additions	251.142	420.194	522,148	579,922	649.793	734,625	835.750
Y our est	Est. Total US Access Lines (millions)	168	169	170	172	173	175	177
Z (X/Y)	% of Total US Access Lines	0.15%	0.25%	0.31%	0.34%	0.37%	0.42%	0.47%
AA (Zx4)	**Local Competitors' Annualized Share Gain**	**0.60%**	**0.99%**	**1.23%**	**1.35%**	**1.50%**	**1.68%**	**1.89%**
	Incremental Annualized Share Gain (basis points)		**40**	**23**	**12**	**15**	**18**	**21**

	Local Competitor Local Revenue Share Gain (millions)	2Q97	3Q97	4Q97	1Q98	2Q98E	3Q98E	4Q98E
BB our est	Avg. Mo. Local Revenue/Line (0.5% sqtl. increase)	$ 63.04	$ 63.36	$ 63.68	$ 64.00	$ 64.32	$ 64.64	$ 64.96
CC (Xx4XBB)	Monthly Incremental Switched Revenue***	$63	$106	$133	$148	$167	$190	$217
DD (Table 7)	Monthly Incremental Dedicated Revenue	$6	$5	$10	$11	$11	$11	$11
EE (CC-DD)	Total Monthly Incremental Local Revenue	$70	$112	$143	$159	$178	$201	$228
FF (EEx12)	Annualized Incremental Local Revenue	836	1,340	1,717	1,913	2,134	2,407	2,734
GG our est.	Est Total US Local Switched & Dedicated Revenue	$98.000	$99.000	$100.000	$101.000	$102.000	$103.000	$105.000
HH (FF/GG)	**Local Competitors' Annlz'd Share Gain of US Local Rev.**	**0.85%**	**1.35%**	**1.72%**	**1.89%**	**2.09%**	**2.34%**	**2.60%**
	Incremental Annualized Share Gain (basis points)		**50**	**36**	**18**	**20**	**24**	**27**

*Excludes acquired lines 1Q98:111,600 from Intermedia's acquisition of Shared Tech, 1,811 from NEXTLINK's acquisition of Start Technologies, 24,000 from WinStar's acquisition of Goodnet & Pacnet.; and, 4Q97:8.000 from McLeod's acquisition of Consolidated & 48,000 from ICG's acquisition of CBG.

** LD access line count based on1997 switched revenues of $100M AT&T, $100M MCI, $25M Sprint and $64 monthly revenue per line; and 1998 switched revenues $300M AT&T, $300M MCI, $75M Sprint and $65 monthly revenue per line.

***Forecasts may differ slightly from forecasts within individual company models due to the use of "standardized" monthly revenue per line numbers.

Source: Merrill Lynch estimates and company reports

Table 7: Dedicated Access Revenues (Estimated)

Special Access	1Q97A	2Q97A	3Q97A	4Q97A	1997A	1Q98A	2Q98E	3Q98E	4Q98E	1998E
e.spire	3.8	6.0	7.0	8.2	25.0	8.5	9.3	10.1	11.0	38.9
Brooks Fiber	13.8	13.8	13.8	13.8	43.5	15.0	20.0	23.0	25.0	83.0
Electric Lightwave	5.0	5.3	6.0	7.2	23.5	6.4	6.9	7.5	8.2	29.0
Focal	0.2	0.2	0.2	0.2	0.6	0.1	0.1	0.1	0.2	0.5
GST	4.0	5.0	7.0	8.0	24.0	8.0	10.0	12.0	14.0	44.0
Hyperion	0.3	0.3	0.3	0.3	1.0	0.5	0.8	1.1	1.5	3.9
ICG	12.1	13.5	14.4	15.5	55.4	16.1	17.2	18.1	18.9	70.3
Intermedia	1.6	2.5	3.5	5.0	12.6	10.1	11.7	13.4	15.6	50.8
McLeod	-	-	-	-	-	-	-	-	-	-
NEXTLINK	2.0	2.2	3.0	3.5	10.7	7.0	11.0	13.0	15.0	46.0
RCN	-	-	-	-	-	-	-	-	-	-
Teleport	51.3	59.7	63.5	76.8	251.3	73.9	78.2	83.0	88.4	323.6
US LEC	-	-	-	-	-	-	-	-	-	-
USN	-	-	-	-	-	-	-	-	-	-
WinStar	6.5	6	6.5	7	25.0	5.0	7.5	10.0	15.0	37.5
WorldCom (MFS)	25.0	30.0	35.0	45.0	135.0	50.0	60.0	70.0	80.0	260.0
AT&T (Local)	50.0	50.0	50.0	50.0	200.0	60.0	60.0	60.0	60.0	240.0
MCIMetro	50.0	50.0	50.0	50.0	200.0	60.0	60.0	60.0	60.0	240.0
Sprint (Local)	12.5	12.5	12.5	12.5	50.0	15.0	15.0	15.0	15.0	60.0
Total	**237.9**	**257.0**	**272.6**	**302.8**	**1,057.6**	**335.6**	**367.7**	**396.3**	**427.9**	**1,527.5**

Source: Merrill Lynch estimates

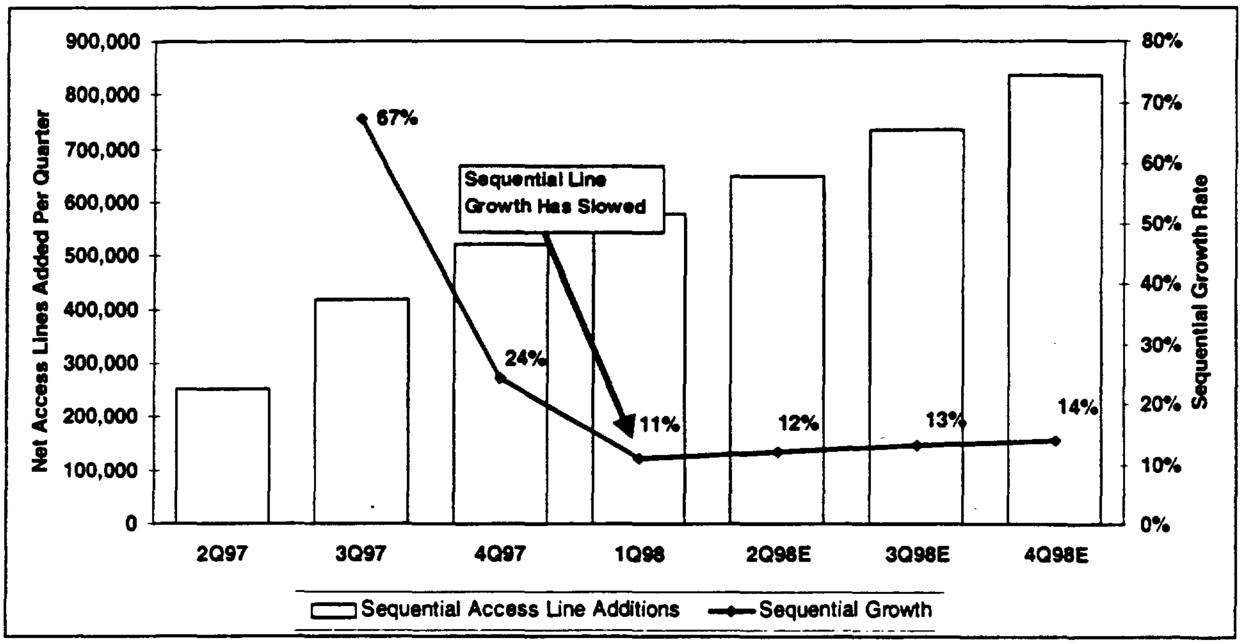
1Q Annualized Local Access Line Share Gains Totaled 1.4%

As shown in Table 6 above, we estimate that the CLECs' annualized share gain during 1Q was 1.4% of local access lines, an increase of 12 basis points over 4Q97. We forecast that the CLECs' annualized line share gain will accelerate during the next few quarters, reaching 1.9% by 4Q98.

1Q98 Saw CLEC Local Line Additions Of 579,922, Up 11% Vs. The 522,148 Lines Added During 4Q97

As detailed in Table 6 above and Chart 8 below, during 1Q, net line addition growth declined vs. 3Q and 4Q97 as CLEC line additions grew sequentially by only 11% during 1Q compared to 4Q97's 24% growth. While we were disappointed by this slowdown in sequential access line growth, we believe that the downward trend will reverse itself during the next few quarters as the CLECs ramp up functionality and capacity in installation and billing systems with the local competitors in aggregate reaching a 14% sequential growth rate in local access line additions by 4Q98.

Chart 8: Sequential Growth In CLEC Line Adds Decelerated In 1Q...But Should Modestly Accelerate Throughout 1998*



*Based on "organic" or internally generated line growth, excluding lines added via merger or acquisition
Source: Merril Lynch estimates

■ Share of US Local Revenue & Access Lines

We estimate The CLECs Share Stood at An Annualized 3.5% of US Local Revenues By 1Q98

We estimate that the CLECs (including local efforts by LD companies) accumulated a 3.5% of the US local market by 1Q, an approximate 50 basis point increase over the 3.0% share garnered by 4Q97. As shown in Table 8 below, we estimate that the CLEC share will increase to 5.4% by 4Q98.

At 1Q, We Estimate 3.1 Million Local Lines Were Served By CLECs & Big LD Carriers, Equating To 1.7% Of Total US Access Lines

As of 1Q, the local competitors in aggregate had approximately 2.9 million local lines in service, equating to 1.7% of the estimated 177 million local access lines in service in the US market. We estimate that local competitors' access lines in service will grow by over 75% over the next 3 quarters, reaching 5.1 million local lines in service by the end of 4Q98, equating to 2.9% of US local access lines. Table 8 below details the actual net access lines in service at quarter-end as well as our quarterly line forecast for 1998.

Table 8: Local Competitors' Annualized Share of Local Access Lines* & Revenues

		4Q97A	1Q98A	2Q98E	3Q98E	4Q98E
A	e.spire	35,105	57,500	83,605	113,605	148,605
B	Brooks Fiber	105,000	145,000	195,000	250,000	310,000
C	Electric Lightwave	34,322	41,270	50,270	62,270	77,270
D	Focal	6,300	14,528	24,528	37,028	52,028
E	Frontier	100,000	116,000	134,000	155,000	179,500
F	GST	28,853	44,846	61,346	78,346	95,846
G	Hyperion	25,000	36,000	50,000	69,000	93,000
H	ICG***	93,000	138,100	185,000	238,000	296,000
I	Intermedia***	81,349	108,987	149,400	192,400	237,400
J	McLeod***	193,000	223,200	255,200	289,200	325,200
K	NEXTLINK***	50,131	71,023	93,023	117,023	143,023
L	RCN*	24,900	40,447	56,947	75,447	97,447
M	Teleport	282,700	325,874	371,874	421,874	476,874
N	US LEC	49,229	75,536	103,536	133,536	165,536
O	USN	172,000	226,000	276,000	346,000	426,000
P	WinStar	82,000	121,000	166,000	216,000	273,000
Q	WorldCom (MFS)	309,000	399,000	494,000	594,000	704,000
R	Total CLEC	1,671,889	2,184,311	2,749,729	3,388,729	4,100,729
S	AT&T (Local)**	295,573	322,917	360,417	402,917	457,917
T	MCIMetro**	295,573	322,917	360,417	402,917	457,917
U	Sprint (Local)**	73,893	80,729	90,104	100,729	114,479
V sum(S:U)	Total LD	665,039	726,563	810,938	906,563	1,030,313
w (R+V)	Total Lines In Service	2,336,928	2,910,874	3,560,667	4,295,292	5,131,042
	Sequential Growth		573,945	649,793	734,625	835,750
	US Access Line Share					
X our est	**Estimated 1998 US Access Lines**	**170,000,000**	**172,000,000**	**174,000,000**	**176,000,000**	**177,000,000**
Y (X/W)	**Local Competitors' Share**	**1.4%**	**1.7%**	**2.0%**	**2.4%**	**2.9%**
	Local Competitor Switched Revenue Share of US Local Market					
Z our est	Monthly Local Switched Revenue Per Line	$63.68	$64.00	$64.32	$64.64	$64.96
AA (BB*y)	Estimated Switched Monthly Revenue ($ Millions)	148.8	186.3	229.0	277.7	333.3
BB (our est)	Estimated Dedicated Monthly Revenue ($Millions)	100.9	111.9	122.6	132.1	142.6
CC (AA+BB)	Total Monthly Revenue ($Millions)	249.8	298.2	351.6	409.8	476.0
DD (CC*12)	Total Annualized Revenue ($Millions)	2,997.1	3,578.1	4,218.9	4,917.1	5,711.6
EE (our est)	Estimated US Local Market	100,000	101,000	102,000	103,000	105,000
FF (DD/EE)	**Share of Local Market at Quarter End**	**3.0%**	**3.5%**	**4.1%**	**4.8%**	**5.4%**
II	**Incremental Share of Local Market Gained During Quarter**		**0.55%**	**0.59%**	**0.64%**	**0.67%**

*Excludes acquired lines: 1Q98:111,600 from Intermedia's acquisition of Shared Tech, 1,811 from NEXTLINK's acquisition of Start Technologies, 24,000 from WinStar's acquisition of Goodnet & Pacnet ; and. 4Q97: 8,000 from McLeod's acquisition of Consolidated & 48,000 from ICG's acquisition of CBG.

** LD access line count based on1997 switched revenues of $100M AT&T, $100M MCI, $25M Sprint and $64 monthly revenue per line; and 1998 switched revenues $300M AT&T, $300M MCI, $75M Sprint and $65 monthly revenue per line.

Source: Merrill Lynch estimates

1Q EBITDA Results

Funding For Growth Initiatives During 1Q Restrained Progress On The EBITDA Front

CLEC EBITDA losses for the quarter were generally in line with our estimates (see Table 9 below). To varying degrees, the CLECs are all spending to fund growth initiatives including expanding capacity of access line installation and billing systems and increasing the size and depth of customer service operations. These costs are reflected in our full-year 1998 EBITDA estimates detailed in Table 10 below.

Table 9: Reported EBITDA Vs. Estimates

	1Q98E	1Q98A	% Variance From Estimate
ELI	(10.0)	(9.8)	2% narrower
e.spire	NA	(11.6)	NM
ICG	(25.9)	(25.7)	1% narrower
Intermedia	(4.6)	(9.8)	113% wider
RCN	(11.6)	(9.6)	17%
TCG	RSTR	22.2	RSTR
USN	(36.0)	(36.5)	1% wider

Source: Merril Lynch estimates

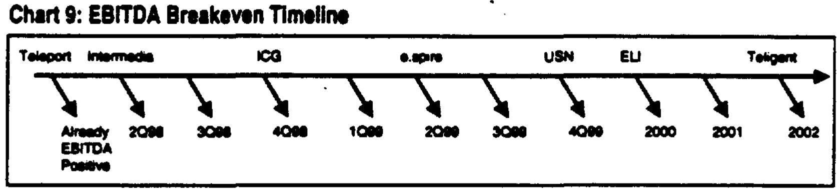
Table 10: EBITDA Full-year Estimates

	1997A	1998E
ELI	(22.9)	(48.7)
e.spire	(55.1)	(35.4)
ICG	(123.8)	(17.0)
Intermedia	(49.9)	RSTR
RCN	(7.7)	RSTR
TCG	44.9	RSTR
USN	(94.4)	(124.3)

Source: Merril Lynch estimates

We forecast EBITDA losses to lessen during the next few quarters as expenditures to support growth initiatives (i.e., enhanced back office systems and customer support personnel) taper off and the ability to leverage operating and SG&A expenses increases. As shown in Table 10 above and Chart 9 below, Teleport is currently the only CLEC we cover that is EBITDA positive, however, we forecast EBITDA breakeven to occur for Intermedia during 2Q and ICG during 4Q98.

Chart 9: EBITDA Breakeven Timeline



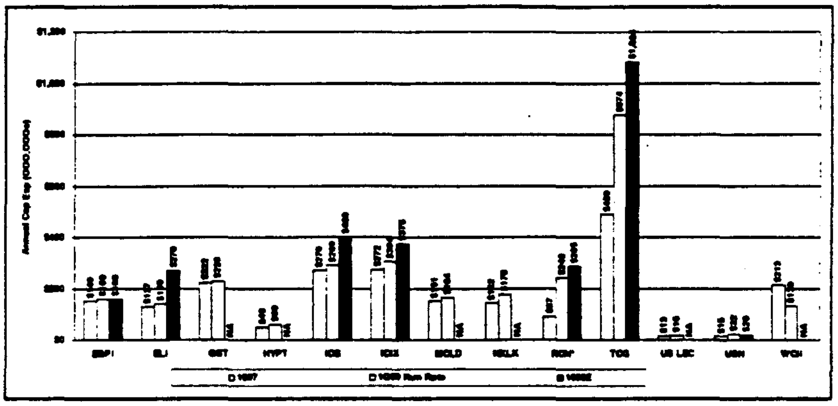
Source: Merril Lynch estimates

■ Investment In Network Facilities

Capital Expenditures

We estimate that the CLECs spent approximately $700 million on capital expenditures during 1Q, equating to an annualized run rate of approximately $2.8 billion, and we forecast that full-year capital expenditures for the group will total $3.2 billion.

Chart 10: Annual CLEC Capital Expenditure Estimates



Source: Merril Lynch estimates and company reports

As detailed in Table 11 below, we estimate combined capital expenditures on local facilities for both the CLECs and the big 3 long distance companies will be $5.2 billion for full-year 1998, an increase of 33% over the investment in local facilities made in 1997.

Table 11: Estimated CLEC Capital Expenditures

($'s in Billions)	1997	1Q98E Annualized Run Rate	1998E
CLECs	2,199	2,802	3,200
LD Co's	1,700	1,800	2,000
Total	3,899	4,602	5,200
% Change on 1997		18%	13%

Source: Merril Lynch estimates and company reports

6. Estimate Changes

We made the following changes to our forecasts after reviewing 1Q results. All have been previously published.

Electric Lightwave

We have revised our forecast of full-year 1998 revenue for Electric Lightwave due to company's indication that it is experiencing slower than anticipated provisioning of access lines from US West. As shown in Table 12 below, we have lowered our 1998 revenue estimate by 3% from $103.3 million to $100.5 million, however we are maintaining our EBITDA loss estimate for full-year 1998 of $48.7 million.

Table 12: 1998E Electric Lightwave Revised Revenue Forecast

($ in millions)	Prior	Revised	% Change
Local Switched	25.3	31.6	24%
Long Distance Switched	13.9	9.4	-32%
Data	18.0	18.0	-
Network Access			
Local	32.2	29.0	-10%
Long Haul	13.8	12.4	-10%
Total Network Access	46.0	41.5	-10%
Total Revenue	103.3	100.5	-3%

Source: Merrill Lynch estimates

e.spire Communications

We made no changes to our estimates for e.spire.

ICG Communications

Although we were impressed by the growth in ICG's core CLEC business, we were disappointed with results from NETCOM (ICG's newly acquired internet services provider or ISP) and its network services division. As a result, we have lowered our 1998 and 1999 revenue and EBITDA estimates. As shown in Table 13 below, we have lowered our 1998 full-year revenue estimate by 3% from $621.4 million to $600.6 million while we increased our estimated EBITDA losses by $14.8 million to $31.8 million. For full-year 1999, we have lowered our estimated revenue by 3% from 926.4 million to $895.8 million and our estimated EBITDA by 6% from $133.9 million to $126.1 million.

Table 13: Revised ICG Forecasts

	1998E			1999E		
($ in millions)	Prior	New Est.	% Chng.	Prior	New Est.	% Chng.
CLEC	279.7	288.7	3%	523.0	525.0	- -
NETCOM	196.7	177.3	-10%	245.9	221.7	-10%
Other*	145.0	134.6	-7%	157.5	149.1	-5%
Total Revenue	621.4	600.6	-3%	926.4	895.8	-3%
EBITDA	(17.0)	(31.8)	-87%	133.9	126.1	-6%

*Note: Includes network services, Zycom & satellite services (sale of division pending)
Source: Merrill Lynch estimates

Intermedia Communications

We are restricted from providing financial forecasts for Intermedia.

RCN Corporation

We are restricted from providing financial forecasts for RCN.

Teleport Communications Group

We are restricted from providing financial forecasts for Teleport.

USN Communications

As published on 6/10, due to slower than anticipated ramp up of telemarketing sales and enhanced services initiatives and lower direct salesforce productivity, we have lowered our 1998 and 1999 forecasts. As a result, we have lowered our private market value based price objective to $18 and our intermediate term opinion from Accumulate to Neutral and our long term opinion from Buy to Accumulate.

7. Investment Conclusion

We Remain Bullish On CLEC Stocks As A Group, Continue To Recommend Electric Lightwave, E.spire, ICG, Teligent & USN.

We reiterate our long-standing bullish stance on the CLEC group viewing the recent stretch of stock price weakness as an excellent buying opportunity. Although restricted from comment on both Intermedia and RCN, we continue to highlight both e.spire and Teligent. Our stance on these two stocks is supported by both solid operational performance reported during 1Q98 and sizable stock price appreciation potential, based on our 12-18 month price objectives. In addition, we continue to recommend Electric Lightwave and ICG Communications.

Table 14: CLEC Stock Recommendations

	Ticker	Opinion	Price 6/17/98	Price Objective*	% Upside
Advanced Radio Telecom	ARTT	RSTR	$11.75	RSTR	NA
e.spire Communications	ESPI	D-2-1-9	$17.38	$28.00	61%
ICG Communications	ICGX	D-2-2-9	$31.75	$43.00	32%
Intermedia Communications	ICIX	RSTR	$38.75	RSTR	NA
RCN Communications	RCNC	RSTR	$20.38	RSTR	NA
Teleport Communications Group	TCGI	RSTR	$58.44	RSTR	NA
Teligent	TGNT	D-2-1-9	$28.00	$37.00	32%

*Private market based valuation.
Source: Merrill Lynch estimates

e.spire, Our Newest Recommendation, With A 12-18 Month Price Objective of $28 or 76% Upside

e.spire Communications

Our most recent recommendation is e.spire Communications, a facilities-based CLEC targeting small and medium-sized businesses in the southern US. e.spire was one of the first CLECs to offer its customers a fully integrated suite of both voice and data (including high speed internet) services. A new senior management team of experienced telecom executives was installed within the past 15 months in an effort to reposition the company to better execute this bundled services strategy. We reiterate our intermediate term Accumulate and long term Buy opinions for e.spire and maintain our $28 12-18 month price objective based on our 10-year DCF model, assuming a 15% discount rate, a 9.5x multiple on terminal year EBITDA, no public market discount, and a 6.3-8.1% perpetual growth rate of unlevered free cash flow.

We Expect Teligent, To Hit Our $37 Price Objective Or 30% Upside Over The Next 12-18 Months

Teligent

We reiterate our intermediate term Accumulate and long term Buy opinions for Teligent as its commercial service rollout appears to be running ahead of expectations with more than 10 cities now likely to be in commercial operation by year-end 1998 vs. our original expectation of 10 commercial cities by year end 1998. In preparation for widespread network deployment, Teligent currently has beta-test customers up and running on its fixed wireless point-to-multipoint network in Los Angeles and is utilizing the network to streamline its process and procedures for network deployment, customer installation and support. We are extremely encouraged by this development, as it reaffirms our confidence in Teligent's network deployment schedule. We maintain our $37 12-18 month price objective based on our 10-year discounted cash flow (DCF) model, a 15% discount rate, a 9.0x multiple on terminal year EBITDA, no public market discount, and a 5.6% perpetual growth rate of unlevered free cash flow.

Electric Lightwave

We reiterate our intermediate and long term Accumulate opinion for Electric Lightwave and maintain our $20 12-month price objective based on our 10-year DCF model which assumes a 15% discount rate, a 10x multiple on terminal year EBITDA, a 7.3% perpetual growth rate of unlevered free cash flow, and a 10% "haircut" to private market value for majority (83%) ownership by Citizens Utilities (CZN, $10.44, C-3-2-9). We continue to forecast strong sequential growth for Electric Lightwave's core CLEC revenue, and expect sequential access line growth to increase during the next few quarters as local line provisioning capacity in US West territories ramps up.

ICG Communications

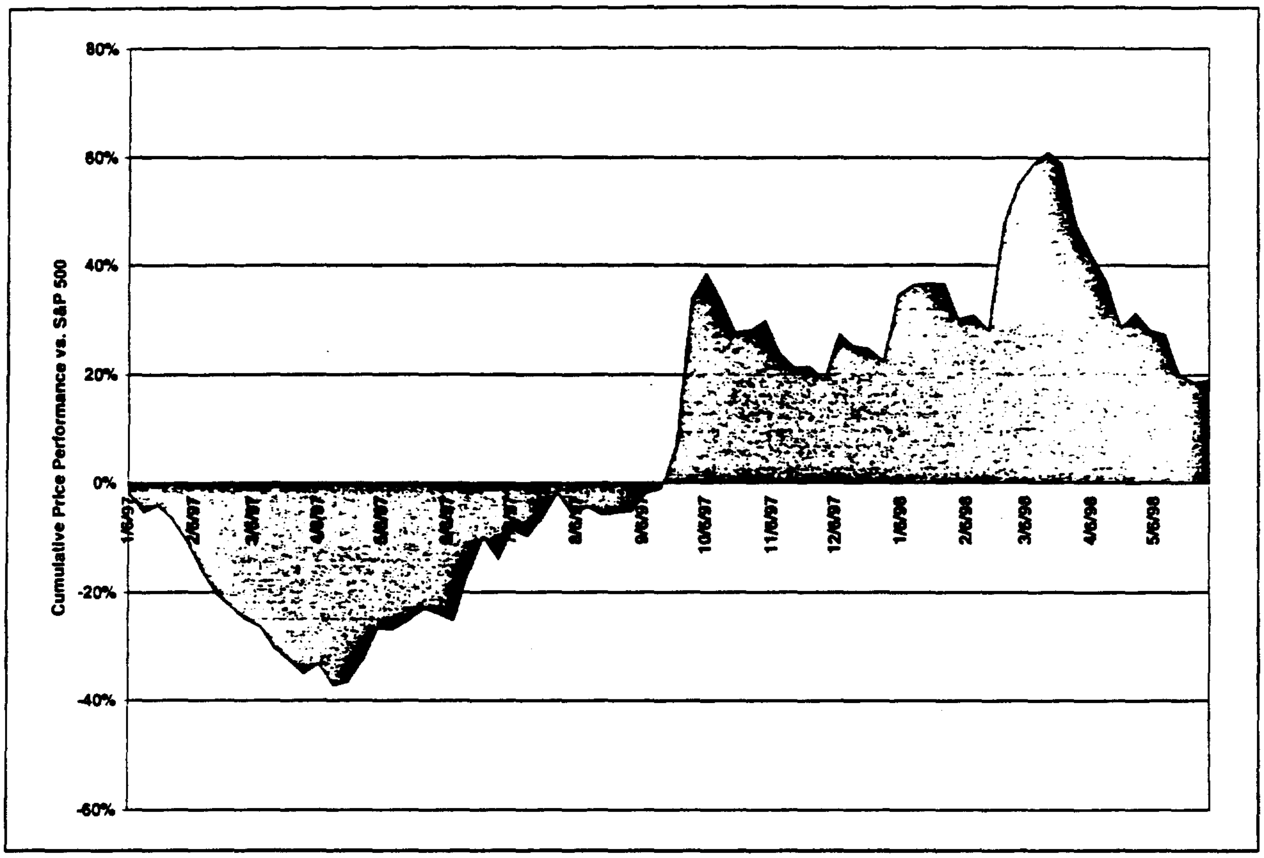
Our recommendation of ICG is supported by the continued strong growth in its core CLEC operations. Supporting this strong growth, 1Q net local access line additions for ICG of 45,100 were 13% better than our estimate which bodes well for ICG to meet our forecast of 341,000 lines by year-end 1998. ICG's improvement in core CLEC EBITDA was over-shadowed during 1Q, however, due to a wider than expected contribution to EBITDA loss from NETCOM (ICG's newly acquired internet services provider). We anticipate that EBITDA losses will decrease as the NETCOM division begins to show improvement during 3Q and that ICG will report positive EBITDA for 4Q98. We reiterate our intermediate and long term Accumulate opinion for ICG and maintain our $42 12-month price objective based on our 10-year DCF model which assumes a 15% discount rate, a 9x multiple on terminal year EBTIDA, no public market discount, and a 7.9% perpetual growth rate of unlevered free cash flow.

Recent Stock Price Trends

CLEC Stocks Have Weakened Recently After A Run Of Impressive Stock Price Performance Vs. The S&P 500

After a number of strong relative price moves by the CLEC group vs. the S&P 500 during the late summer of 1997 and 1Q98 (see Chart 11 below), the group pulled back after a number of negative EBITDA forecast revisions prior to the 1Q98 reporting season. Intermedia and ICG figured most prominently in these negative forecast revisions for vastly different reasons. For Intermedia, the issue was higher than anticipated S.G. & A. costs associated with building back office infrastructure (i.e., billing and line provisioning systems) and headcount expansion to staff customer service and support operations. In the case of ICG, the fundamental issue was weaker than anticipated results from NETCOM, a recently acquired ISP.

Chart 11: CLEC Stock Price Performance Vs. S&P 500



CLEC Stocks Have Tracked The S&P Year-To-Date

The CLEC group's recent price weakness that began in mid-March has contributed in a material way to the current negative wave of investor sentiment towards the group. As shown in Chart 12 below, CLEC stocks have declined 19.2% on average since the mid-March peak. As shown in Chart 13 below, ***year-to-date, the CLEC group has tracked the S&P 500 with the average CLEC stock up 13.4% vs. 12.7% for the S&P 500.***

Chart 12: CLEC Relative Performance Since Highpoint On March 16

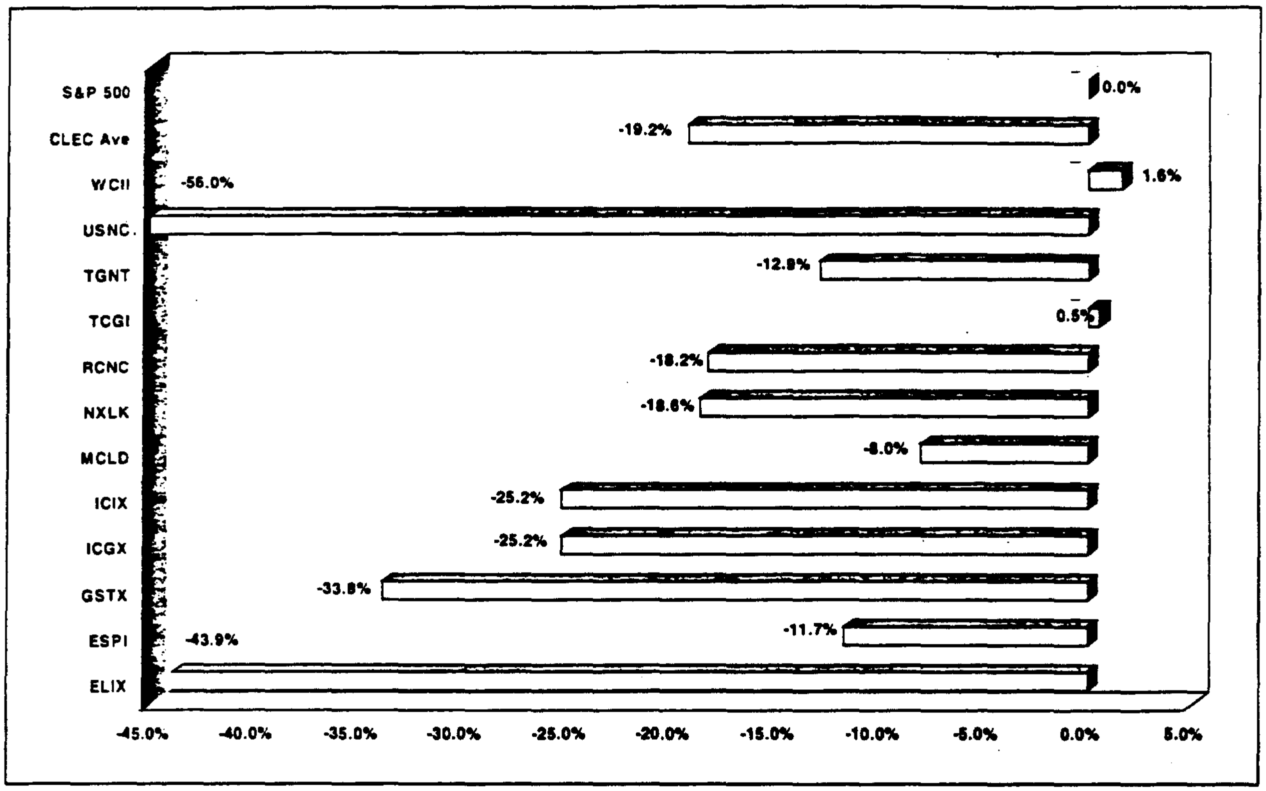
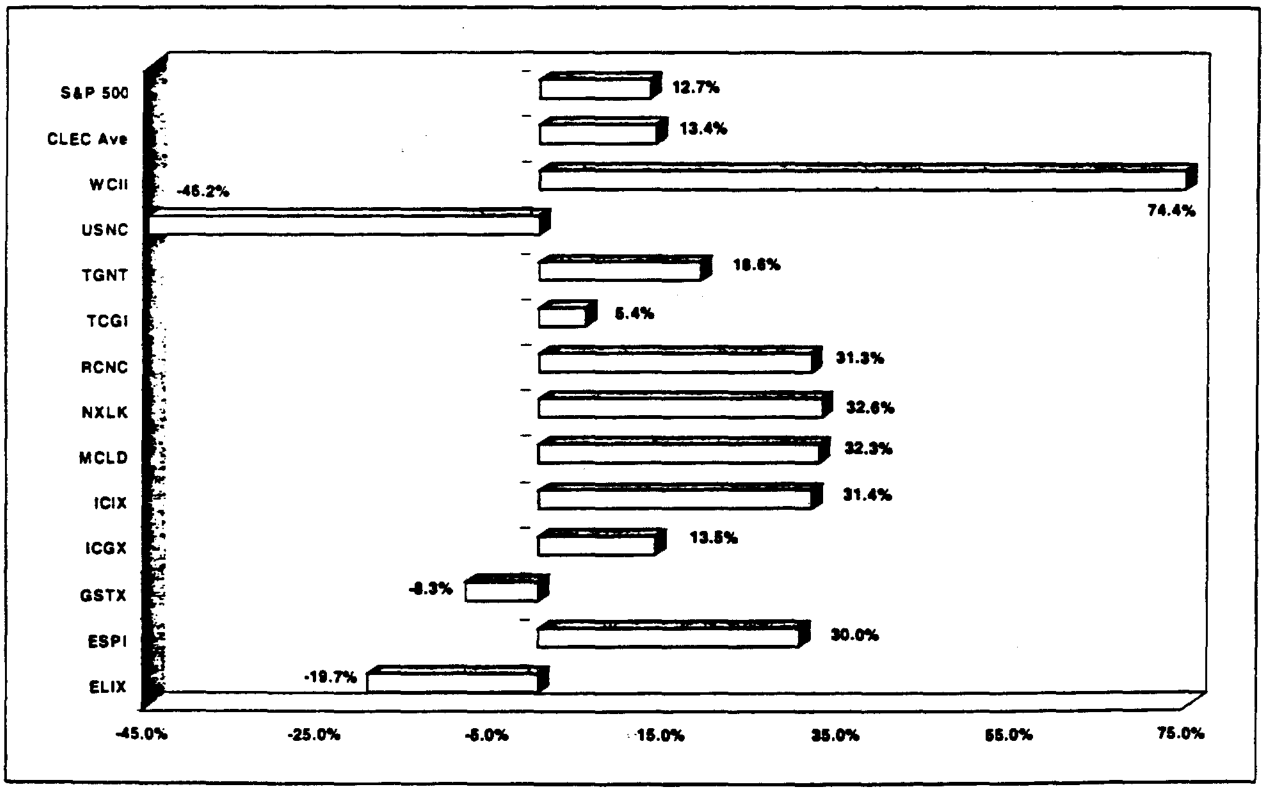


Chart 13: Year-To-Date Stock Performance as of June 12



Potential CLEC Stock Price Catalysts

What "Surprises We Expect" During The Coming Months That Could Help Reverse Recent CLEC Stock Price Weakness...

Year in, year out, one of the most difficult questions we receive from investors around the world is ***"What surprises do you expect?"*** On the surface, this question sounds like a humorous oxymoron but is instead meant to probe for potential near term stock price catalysts. Clearly, the recent CLEC stock price performance is indicative of a dearth of positive news in the group. We think this news drought is coming to an end and thus investor attention will reorient away from issues of negative forecast revisions and back towards a focus on key long-term"value drivers" such as new growth initiatives and continued operational progress at "core" CLEC operations. Below, we list our survey of ***"surprises that we expect"*** in the coming months:

■ Takeover, takeover, takeover

We continue to view the high potential for CLEC consolidation as one the most important themes underlying our long standing bullish outlook for CLEC stocks. Possible buyers of CLECs include:

1. **Other CLECs** looking to expand geographically, add new products and facilities as well as "bulking up" in the hopes of attracting a takeover bid themselves;
2. **Large long distance companies** interested in accelerating local market entry efforts as well as expanding the ability to offer customers full "end to end" product solutions;
3. **ILECs** looking to expand product expertise and to acquire "out of region" telecom facilities; and,
4. **Foreign telcos** interested in local telecom facilities in the US for the provision of multinational telecom services for large corporate customers demanding "end to end" network connectivity.

Table 15 below attempts to array key players on both sides of the takeover speculation game:

Table 15: Mergers & Acquisitions Matrix — Potential Buyers & Targets

CLEC Target	Potential Buyer	Comment
Advanced Radio Telecom	WinStar, Teligent, AT&T, IXC, Qwest, Level 3, Williams	Purchase additional spectrum for local broadband services. Quickly expand network reach into local market.
e.spire	Intermedia, NEXTLINK, WorldCom	Expand local/data service footprint in Southern US.
Electric Lightwave	GST, Intermedia, NEXTLINK	Expand local/data service footprint in Western US.
GST Communications	NEXTLINK	Expand local/data service footprint in Western US.
Hyperion	Intermedia, NEXTLINK	Expand local/data service footprint in Eastern US.
ICG Communications	Intermedia, NEXTLINK, WorldCom	Expand geographic footprint. Local facilities and Data presence.
Intermedia Communications	AT&T, WorldCom, Sprint, Bell Atlantic, US West, Ameritech	Significantly bulk up data capabilities (esp. frame relay). Service customer base and expertise. Gain access to large Southeast-based customer base.
McLeod	AT&T	Expand local customer base into upper Midwest.
NEXTLINK	AT&T, Sprint, WorldCom	Expand local network presence.
RCN Corporation	AT&T, WorldCom, Sprint, SBC	Begin competing in residential market in the Northeast and Western US.
Teligent Corporation	AT&T, Sprint, WorldCom, NTT, British Telecom, Other Foreign Telcos	Utilize wireless spectrum to significantly expand reach into local market. Provide US-based last mile section of global on-net "End-to-End" service offering.
US LEC	Intermedia, e.spire	Expand customer base in the Southeast US.
USN Communications	AT&T, Sprint, WorldCom, Teligent, WinStar, NEXTLINK	Rapidly expand customer base and salesforce in AIT and BEL region. Access to USN term and volume local resale agreements with RBOCs. Access to electronic interfaces with RBOCs.
WinStar	WinStar, Teligent, AT&T, IXC, Qwest, Level 3, Williams, Sprint, WorldCom, NTT, British Telecom, Other Foreign Telcos	Purchase additional spectrum for local broadband services. Quickly expand network reach into local market. Provide US-based last mile section of global on-net "End-to-End" service offering.

Source: Merrill Lynch

■ More Alliances

Within the CLEC group, alliances with other telecom companies have taken many forms, ranging from the licensing of specialized telecom products, up to and including major joint marketing relationships as the basis for new strategic initiatives. An example of the latter includes the well publicized national (i.e., out-of-region and inter-LATA) wholesale data relationship struck between Intermedia and US WEST on 1/29/98 as well as a similar relationship recently announced between Intermedia and Ameritech. In fact, we expect that over the balance of 1998, similar deals will be announced between CLECs (most likely involving Intermedia) and other RBOCs (most likely Bell Atlantic).

We view these CLEC alliances as serving a number of important advantages for both parties including:

Table 16: Benefits From CLEC Alliances

Benefit for the CLEC	Benefit for the telecom partner
1) New revenue opportunity	1) New revenue opportunity
2) Low SG&A support required and thus potential for high margins	2) Use alliance to stem competitive share loss via rapid new product introductions
4) Leverage facilities investment required to support alliance for other CLEC opportunities in new geographic markets	3) Use alliance to circumvent regulatory barriers 4) Obtain access to CLEC facilities, especially first/last mile infrastructure
4) Utilize alliance in marketing efforts to build credibility with potential customers	5) Possible first move towards a CLEC acquisition

Source: Merrill Lynch

■ Progress towards profitability

Although investors, for some time, have focused attention on CLEC progress towards EBITDA break-even, this focus has been especially keen as of late given both the recent spate of negative forecast revisions leading into 1Q98 reporting season and the upcoming EBITDA inflection for a number of CLECs (See Chart 3 page 8). As the visibility of 2Q and 3Q98 EBITDA progress improves, we expect that investor sentiment will also lift.

Valuation Benchmarks

Our Valuation Work Relies Heavily On DCF Analysis

Discounted Cash Flow — Merrill Lynch's Preferred Valuation Methodology

In determining our target prices for the CLEC group shown in Table 17 below, we use a 10-year DCF (discounted cash flow) model with a terminal year EBITDA multiple of 9-10x, a 15% discount rate and an implied perpetual growth rate of free cash flow of approximately 7.0-7.5%. We strongly believe that as the larger CLECs such as MFS, TCG and Brooks Fiber have been acquired, the strategic local assets which the remaining CLECs bring to the table (i.e., local loop facilities, systems infrastructure, customer base, and a salesforce trained in selling local and data products) are growing in scarcity value while the CLECs' continued gain of local market share increases the fundamental value of these companies. We suspect the smaller CLECs will consolidate amongst themselves in order to gain the scale and scope which will attract an acquirer. The most likely buyers of CLECs include one of the large long distance companies, other CLECs looking to increase their local reach, or foreign-based telcos looking for "local presence" in the US and possibly, but less likely, ILECs desiring to move out of region.

Table 17: Company Valuation & Target Prices

Company	Price (6/17)	Shares	Mkt Value of Equity	Total Debt	Cash	Enterprise Value	Discount Rate	Term. EBITDA Multiple	1/1/99 PMV	% Upside	1/1/00 PMV	% Upside	Target Price	% Upside
ELI	$13.13	51.7	678.8	60.0	47.6	691.2	15%	10.0	$20.00	52%	$28.00	113%	$20.00	52%
e.spire	$17.38	54.8	952.4	493.0	410.0	1,035.4	15%	9.5	$25.00	44%	$30.00	73%	$28.00	61%
ICG	$31.75	44.3	1,406.5	957.5	217.0	2,147.0	15%	9.0	$42.00	32%	$56.00	76%	$42.00	32%
Intermedia	$38.75	33.4	1,294.3	1,224.0	756.9	1,761.4	RSTR	RSTR	RSTR	RSTR	RSTR	RSTR	RSTR	RSTR
RCN	$20.38	55.5	1,131.1	685.0	775.0	1,041.1	RSTR	RSTR	RSTR	RSTR	RSTR	RSTR	RSTR	RSTR
Teleport	$58.44	181.0	10,577.6	1,424.0	173.3	11,828.3	RSTR	RSTR	RSTR	RSTR	RSTR	RSTR	RSTR	RSTR
Teligent	$28.00	53.6	1,500.8	300.0	424.9	1,375.9	15%	9.0	$37.00	32%	$52.00	86%	$37.00	32%
USN	$8.25	30.1	248.3	172.2	87.5	333.0	15%	9.0	$18.00	118%	NA	NA	$18.00	118%

Source: Merrill Lynch estimates

Additional Valuation Metrics

Investors utilize a variety of techniques to value the CLEC group. While our valuation work relies heavily on 10-year discounted cash flow analysis. we look at other parameters in determining our opinion on the stocks. These other valuation benchmarks include multiples of enterprise value (EV) to:

- Gross property, plant & equipment (PP&E);
- Revenues

■ Gross PP&E

CLECs Currently Trade At EV To Gross PP&E Multiples Of 2.4x For 1998 & 1.9x For 1999

As a growing base of local assets is one of the key value drivers for the CLEC group, the comparison of EV to gross PP&E multiples can prove useful. CLECs which are predominately facilities based have invested significant capital in the buildout of facilities. This should be reflected in lower gross PP&E multiples compared to other CLECs more reliant on UNEs and TSRs. For example, ICG which provides 48% of services via on-net facilities currently trades at a 1.9x multiple to 1998E gross PP&E vs. WinStar which provides only 15% of services via on-net facilities and currently trades at a 3.5x multiple. However, it is important to note that other variables such as takeover speculation, Street concerns, or financing activities may be influencing the enterprise value of companies near term. These influences may, therefore, cause the multiple to deviate from fundamentally based levels. In our analysis, we do not include either USN or McLeod as they are both primarily resellers of ILEC facilities and employ a business strategy that does not require a high level of capital expenditure which skews the observed PP&E multiple and is not reflective of their fundamental valuation. Charts 14 and 15 below, detail the current gross PP&E multiples currently accorded the CLECs.

Chart 14: CLEC Valuation: 1998E Gross PP&E Multiples (6/17/98)

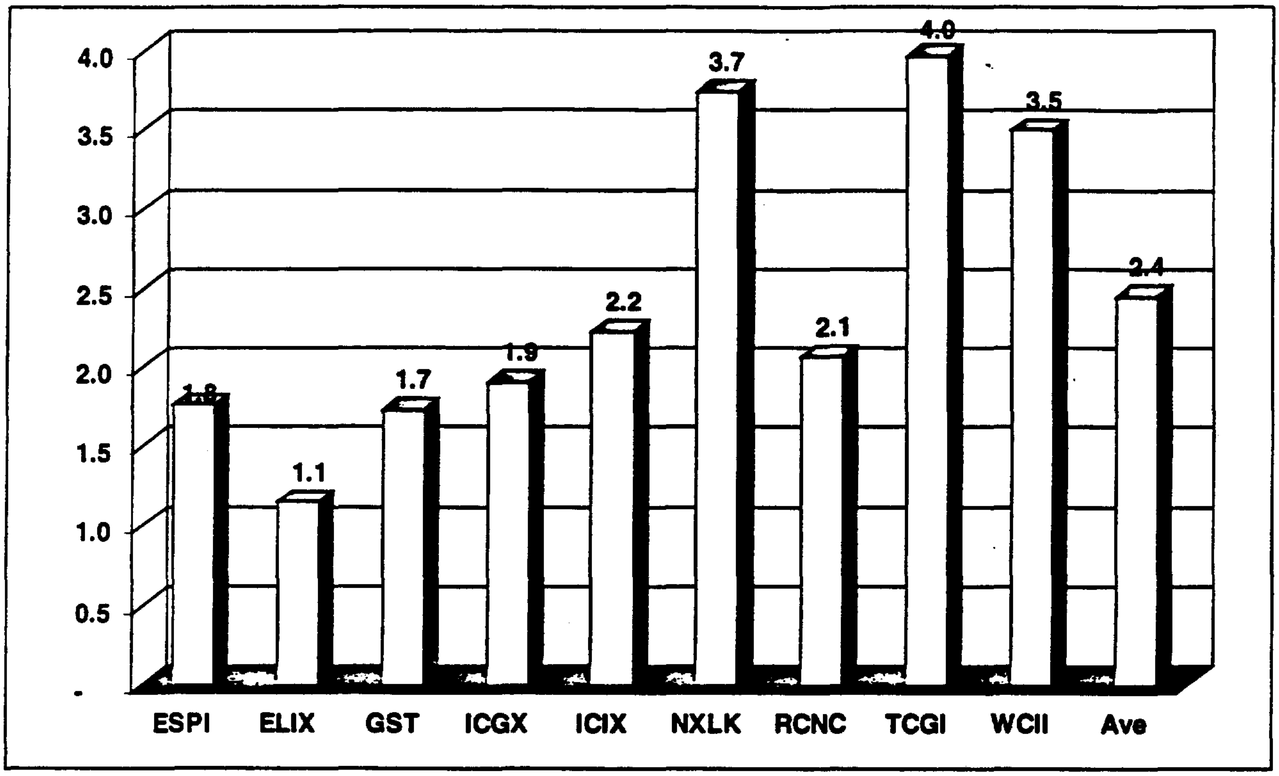
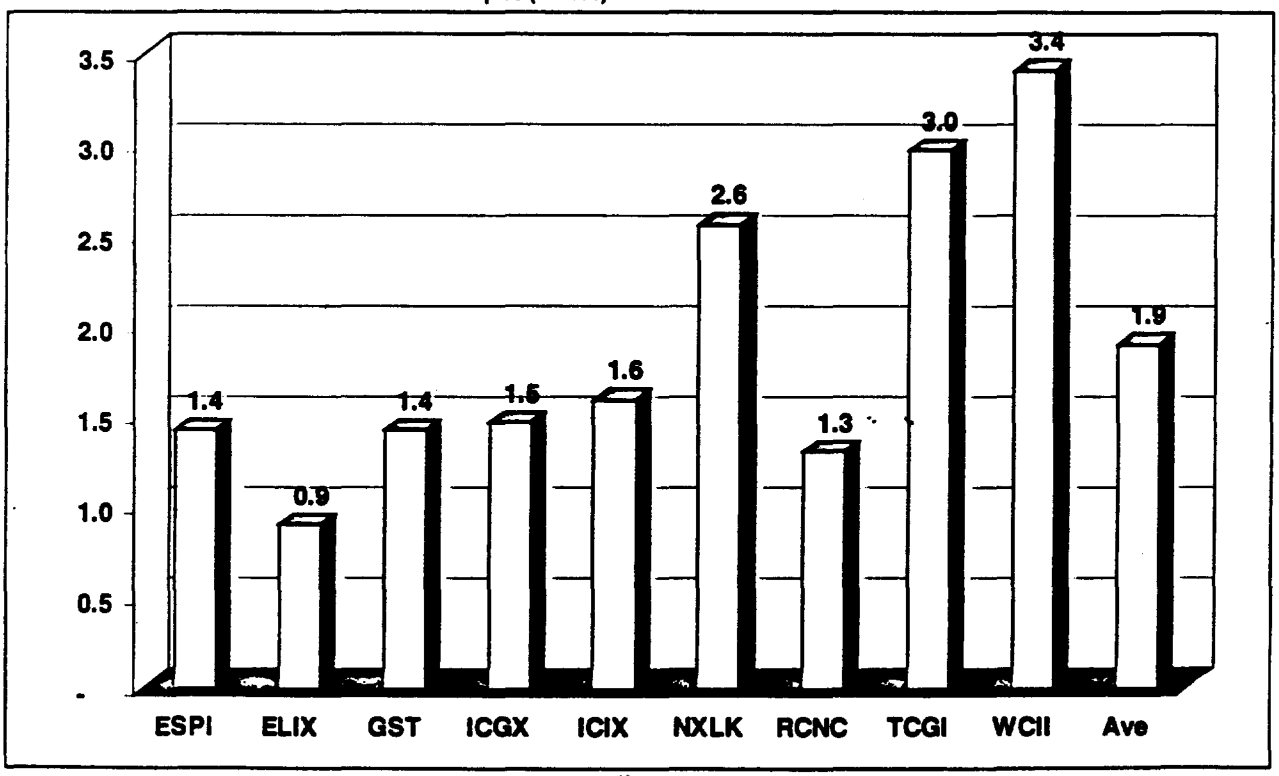


Chart 15: CLEC Valuation: 1999E Gross PP&E Multiples (6/17/98)



■ **Revenue**

CLECs Currently Trade At EV To Revenue Multiples Of 7.1x For 1998 & 4.6x For 1999

Due to the relatively nascent stage of the CLEC group and the wide variation of revenue mix (i.e., local switched services vs. long distance) within the group, there is a wide range in the revenue multiples. For instance, WinStar and McLeod, with only an estimated 35% and 33%, respectively of revenue coming from core CLEC switched local service, trade at much higher multiples than CLECs such as Electric Lightwave and e.spire whose revenue is derived predominately from local services (65% and 70%, respectively).

As with gross PP&E multiples, takeover speculation and other non-fundamental influences can impact the enterprise value of a company and skew the multiples. We believe this may be the case with WinStar, as recent takeover speculation involving British Telecom has increased its share price by over 15% in the past 2 weeks. Prior to the takeover speculation, WinStar was trading at a 6.6x multiple to 1998E revenue vs. the current 7.6x multiple

Chart 16: CLEC Valuation: 1998E Revenue Multiples (6/17/98)

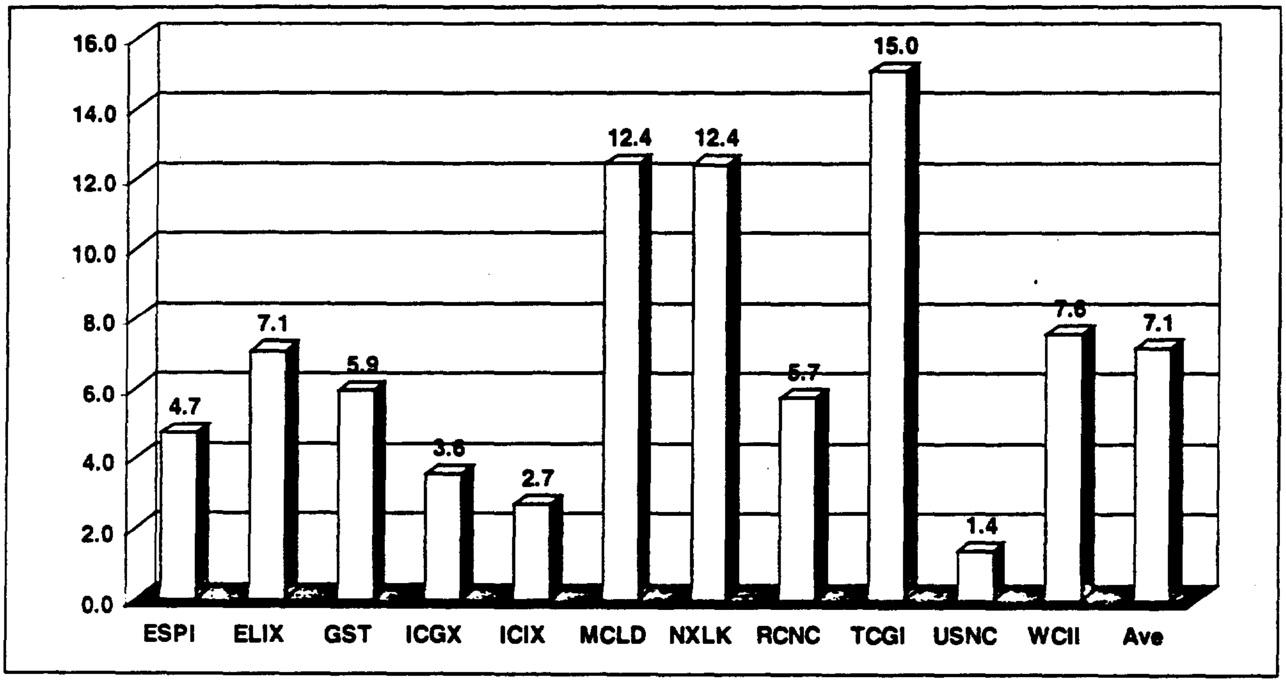
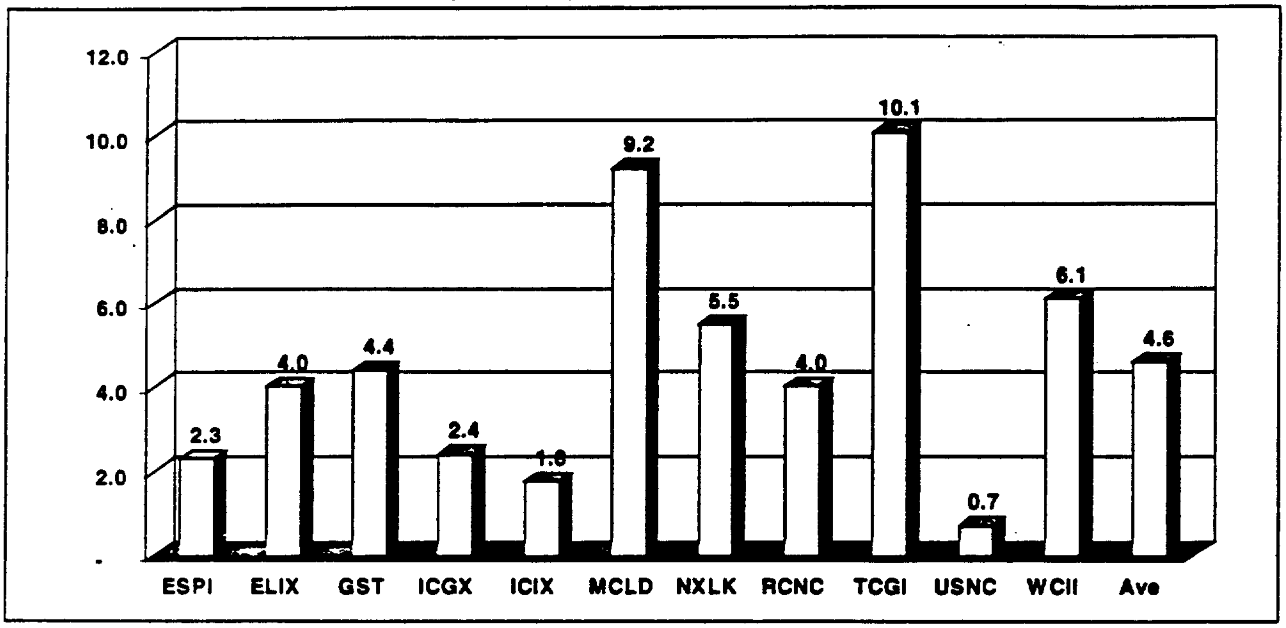


Chart 17: CLEC Valuation: 1999E Revenue Multiples (6/17/98)



■ Takeover Multiples

As shown in Tables 18 and 19 below, CLECs in our coverage universe are currently trading at a sharp discount relative to the takeout multiples obtained by MFS Communications and Brooks Fiber and Teleport. Further, our private market price objectives translate into enterprise value to 1998E gross PP&E multiples in the 1.7-2.7x range (see table 19) and enterprise value to 1998E revenues of 4.4-10.6x.

Table 18: Multiples Paid For Acquired CLECs

	Gross PP&E		Revenue	
	1998E	1999E	1998E	1999E
MFS	2.3x	1.8x	4.1x	3.1x
Brooks	3.8	2.8	10.2	6.9
Teleport*	4.0	3.0	15.1	10.1

*As of 6/17, deal estimated to close by end of June.
Source: Merrill Lynch estimates

Table 19: Estimated Takeout Multiples Implied By Our Price Objectives*

		Enterprise Value ÷			
		Revenue		Gross PP&E	
	Price Objective**	1998E	1999E	1998E	1999E
e.spire	$28	7.3	3.5	2.7	2.2
Electric Lightwave	$20	10.6	5.7	1.7	1.2
ICG	$42	4.4	2.9	2.3	1.8
Intermedia	RSTR	RSTR	RSTR	RSTR	RSTR
RCN	RSTR	RSTR	RSTR	RSTR	RSTR
Teleport	RSTR	RSTR	RSTR	RSTR	RSTR
USN***	$18	2.1	1.1	NM	NM

* Enterprise value as of 6/12/98
** Merrill Lynch private market based price objective
***USN gross PP&E multiples are not meaningful due to reseller nature of business plan which requires a low level of capital investment
Source: Merrill Lynch estimates

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7. Quarterly Reviews

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19 May 1998

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Electric Lightwave Inc.

1Q Results: Strong Core CLEC Revenue But Lower Access Line Growth

ACCUMULATE*

Reason for Report: 1Q Results Reported

Long Term ACCUMULATE

Price: **$18**

12 Month Price Objective: $20

Estimates (Dec)	1997A	1998E	1999E
EPS:	d$0.80	d$1.65	d$3.04
P/E:	NM	NM	NM
EPS Change (YoY):		NM	NM
Q1 EPS (Mar):	NM	d$0.24	
Cash Flow/Share:	NM	d$2.14	d$3.95
Price/Cash Flow:	NM	NM	NM
Dividend Rate:	Nil	Nil	Nil
Dividend Yield:	Nil	Nil	Nil

Opinion & Financial Data

Investment Opinion:	D-2-2-9
Mkt. Value / Shares Outstanding (mn):	$929.5 / 52
Book Value/Share (-97):	$5.14
Price/Book Ratio:	3.5x
LT Liability % of Capital:	59.0%
Est. 5 Year EPS Growth:	NA

Stock Data

52-Week Range:	$23 1/8-$12 3/8
Symbol / Exchange:	ELIX / OTC
Options:	None
Institutional Ownership-Spectrum:	53.3%

ML Industry Weightings & Ratings**

Strategy: Weighting Rel. to Mkt.:		
Income:	Overweight	(07-Mar-95)
Growth:	Underweight	(07-Mar-95)
Income & Growth:	Overweight	(07-Mar-95)
Capital Appreciation:	Overweight	(16-Jan-96)
Market Analysis: Technical Rating:	Above Average	(24-Dec-96)

*Intermediate term opinion last changed on 06-Feb-98.
**The views expressed are those of the macro department and do not necessarily coincide with those of the Fundamental analyst.
For full investment opinion definitions, see footnotes.

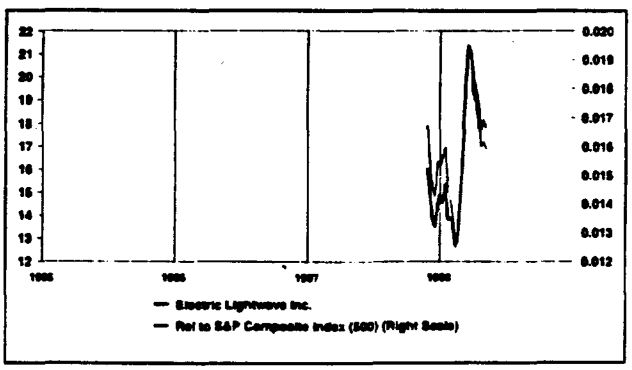
Investment Highlights:

- **On May 4, ELI reported 1Q results with revs. & EBITDA in line with our ests. Access line additions were 17% above our ests. but showed a 28% sqt'l decline vs. 4Q97.**
- **We maintain our 12 month DCF-based price objective of $20 & our Accumulate opinion.**

Fundamental Highlights:

- **1Q corporate rev. was $20.1MM, in line with our est. of $20.5MM, up 4% sqt'ly & 91% y/y. Topline growth was driven by local switched rev. of $6.0MM, 18% above our est., up 36% sqt'ly . However, the growth rate was off-set by dedicated local & LD private line rev. of $9.1MM, down 11% sqt'ly & 6% below our est. of $9.7MM & LD rev. of $1.8MM, down 10% sqt'ly & 28% below our est.**
- **ELI's 1Q EBITDA loss widened by 96% sqt'ly & 35% y/y to $9.8MM, in line with our est. of $10.0MM. W**
- **We are lowering our full-year revenue forecast by 3% from $103.3MM to $100.5MM due to delays in local access line provisioning by USW. We maintain our full-year EBITDA loss est. of $48.7MM.**

Stock Performance



- **ELI's 41,270 access lines in service at quarter-end amounted to a gain of 20% sequentially & almost 3 fold y/y. Access line additions fell short of 4Q results with almost 7,000 added during the quarter vs. 9,600 during 4Q but were 17% higher than our estimate of 6,000. ELI attributed the lower access line additions to delays obtaining leased T1 building connections from US West (USW) & expect this will be alleviated near term with the resolution of ELI's antitrust lawsuit against USW.**

On May 4, Electric Lightwave (ELI) reported 1Q results with rev.and EBITDA loss in line with our ests. Due to current delays in local line provisioning by USW, we are lowering our full-year 1998 revenue est. However, we look for higher sequential access line additions during the remainder of '98 as local line provisioning capacity in USW territories ramps up.

1Q Highlights

1. Strong Core CLEC Revenue Growth:

Corp. rev. for the quarter was $20.1MM, in line with our est. of $20.5MM, up 4% sqt'ly and 91% y/y. Normalized for the loss during 1Q of $0.8MM of long haul rev. from the expected expiration of a contract with IXC Comm., corp. rev. increased 9% sqt'ly. The solid rev. growth was driven by **local switched rev.** of $6.0MM, 18% above our est. of $5.1MM, up 36% sqt'ly and **enhanced data rev.** of $3.1MM, slightly below our est. of $3.2MM, up 24% sqt'ly. **Dedicated network access rev.**(local or long haul private line svcs.) was $9.1MM, 6% below our est. of $9.7MM, down 11% sqt'ly (a decrease of 4% when normalized for the loss of IXC Comm. revenue). We est. that approx. 70% of network access rev.($6.4MM) came from local private line and 30% ($2.7MM) came from long haul private line. Comprising the smallest rev. component, **LD switched rev.** was $1.8MM, 28% below our est., a 10% sqt'l decrease. LD switched rev. has two components, wholesale and retail, and the sqt'l decrease was due to a 25% sqt'l decline in the wholesale, lower margin portion (approx. 60% of the total or $1.2MM of 4Q97 revs.) which more than offsets a 7% sqt'l increase in retail switched LD rev.(approx. 40% of the total or $0.8MM of 4Q97 revs.).

We are lowering our total corp. rev. forecast of $103.3MM for full-year '98 by 3% to $100.5MM due to the delays in local line provisioning by USW and are reallocating divisional revs. to account for the strong growth in local switched svcs. and a more conservative view towards growth in switched LD and private line svcs.

Table 1: 1998E Revised Rev. Allocation Forecast

($ in millions)	Prior	Revised	% Change
Local Switched	25.3	31.6	24%
Long Distance Switched	13.9	9.4	-32%
Data	18.0	18.0	-
Network Access			
Local	32.2	29.0	-10%
Long Haul	13.8	12.4	-10%
Total Network Access	46.0	41.5	-10%
Total Revenue	103.3	100.5	-3%

Source: Merrill Lynch estimates

2. Lower Net Local Access Line Growth:

As shown in Table 2 below, net local access line equivalents at the end of 1Q were 41,270, a sqt'l increase of 7,000 or 20%. While net quarterly access line additions were 17% above our est. of 6,000, net line adds declined 28% from the 9,600 access lines added during 4Q97. We attribute this decline to ELI's heavy reliance on T1 connections leased from USW. According to the company, USW has been slow to provision T1's and this has led to a backlog of almost 20,000 access line equivalents at the end of 1Q. Company expects that this issue will be resolved with the settlement of ELI's anti-trust case against USW expected in the next few months.

Table 2: Access line Equivalents

	4Q97A	1Q98A	Seq'l Change
Resold Local Lines	1,136	1,770	56%
CENTREX/On-Net Access Lines	8,000	8,000	0%
ISDN Trunks*	8,809	12,000	36%
T1 Trunks**	16,377	19,500	19%
Access Line Equivalents	34,322	41,270	20%

* Assumes 23 access line equivalents per ISDN trunk
** Assumes 2.5 access line equivalents per T1 trunk
Source: Company reports

3. EBITDA Loss In Line With Expectations:

1Q EBITDA loss was $9.8MM, in line with our est. of $10.0MM, a widening of 96% sqt'ly and 35% y/y. We maintain our full-year '98 EBITDA loss est. of $48.7MM.

Net loss for the quarter (after a one time charge for a change in accounting principals) was $14.8MM, 13% lower than our est. due to lower interest and dep. & amort. expenses and a $2.4MM tax benefit.

4. Cap Exp:

At $34.4MM, cap exp for the quarter was only slightly more than half of our est. of $60MM. As the company spent 1Q gearing up for network builds during the remaining 3Q's of '98, we are maintaining our full-year '98 est. of $270MM.

Conclusion:

We maintain our 12 month price objective of $20 based on our 10-year discounted cash flow (DCF) model. Key assumptions in our analysis include a 15% discount rate, a 10x multiple on terminal year EBITDA, a 7.3% perpetual growth rate of unlevered free cash flow, and a 10% "haircut" to private market value for majority (83%) stock ownership by Citizens Utilities.

Table 3: Electric Lightwave Detailed Financial Forecast

	4Q97A	1997A	1Q98E	2Q98E	3Q98E	4Q98E	1998E	1999E	2000E	2001E	2002E	2003E	2004E	2005E	2006E	2007E
Revenue																
Local Switched	4.4	10.5	6.0	7.0	8.3	10.4	31.6	69.5	139.0	247.5	391.0	578.6	792.7	1,006.8	1,147.7	1,239.6
LD Switched	2.0	8.1	1.8	2.1	2.5	3.0	9.4	16.0	26.5	42.3	65.6	98.4	137.8	179.2	215.0	258.0
Data	2.5	8.9	3.1	3.7	4.8	6.4	18.0	36.0	68.4	109.5	158.8	206.4	262.1	327.7	403.0	443.3
Network Access																
Local	7.2	23.5	6.4	6.9	7.5	8.2	29.0	43.1	60.6	75.0	90.0	103.5	116.5	129.3	142.2	152.2
Long Haul	3.1	10.1	2.7	2.9	3.2	3.5	12.4	23.2	35.6	50.0	60.0	69.0	77.6	86.2	94.8	101.4
Total Network Access	10.2	33.5	9.2	9.8	10.7	11.8	41.5	66.3	96.2	125.0	150.0	172.5	194.1	215.5	237.0	253.6
Total Revenue	19.2	61.1	20.1	22.6	26.3	31.5	100.5	187.9	330.1	524.3	765.4	1,056.0	1,386.8	1,729.1	2,002.8	2,194.5
Expense																
Network Costs	10.3	29.5	9.2	11.3	13.1	15.6	49.2	75.2	115.5	167.8	229.6	292.3	354.1	407.2	435.1	439.8
Eng./Ops	3.8	15.2	3.9	4.4	5.0	6.0	19.4	35.7	62.7	99.6	145.4	200.6	263.5	328.5	380.5	417.0
Sales & Marketing	4.5	13.9	4.9	5.5	6.4	7.6	24.4	43.2	69.3	107.5	153.1	205.9	270.4	337.2	390.5	427.9
Admin General	4.5	20.2	10.5	11.5	12.7	14.5	49.2	65.4	85.9	115.8	155.9	198.1	225.4	244.7	256.9	279.6
Lease Payment	1.2	5.2	1.3	1.7	2.0	2.0	7.0	10.0	10.0	10.0	10.0	10.0	-	-	-	-
Dep. & Amort	3.6	11.2	3.9	5.4	6.5	7.9	23.6	46.7	66.1	85.8	106.5	120.5	134.5	148.5	162.5	176.5
Interest exp. net	0.7	1.2	0.7	2.6	3.4	4.5	11.2	69.3	117.3	162.3	206.6	246.2	282.8	306.2	311.6	311.6
Taxes	(1.3)	(1.3)	(2.4)	(2.0)	(2.0)	(2.0)	(8.4)									-
Net Profit (Loss)	(7.9)	(33.9)	(12.0)	(17.8)	(20.8)	(24.6)	(75.1)	(157.6)	(196.8)	(224.4)	(241.7)	(217.5)	(143.9)	(43.2)	65.6	142.1
EPS	$ (0.18)	$(0.80)	$ (0.24)	$ (0.36)	$ (0.41)	$ (0.49)	$ (1.50)	$ (3.06)	$ (3.71)	$ (4.10)	$ (4.29)	$ (3.75)	$ (2.41)	$ (0.70)	$ 1.03	$ 2.18
Shares O/S	44.4	42.4	49.7	49.9	50.2	50.4	50.1	51.6	53.1	54.7	56.3	58.0	59.8	61.6	63.4	65.3
EBITDA	(5.0)	(22.9)	(9.8)	(11.8)	(12.9)	(14.2)	(48.7)	(41.6)	(13.4)	23.7	71.4	149.1	273.4	411.5	539.7	630.2
Cap Exp	66.6	127.0	34.7	75.0	85.0	75.0	269.7	250.0	200.0	200.0	175.0	175.0	175.0	175.0	175.0	175.0
Free Cash Flow	NA	(162.8)	(54.4)	(55.1)	(58.2)	(60.8)	(336.5)	(370.9)	(340.7)	(348.6)	(320.2)	(282.0)	(194.3)	(79.7)	43.1	133.6
Net Debt	NA	131	78	NM	NM	NM	450	741	955	1,131	1,235	1,260	1,162	926	561	106
Margins																
Network Expense	47.0%	47.0%	45.9%	50.0%	49.9%	49.5%	49.0%	40.0%	35.0%	32.0%	30.0%	27.7%	25.5%	23.6%	21.7%	20.0%
Eng./Ops	23.0%	23.0%	19.5%	19.3%	19.2%	19.1%	19.3%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%
Sales & Marketing	24.0%	24.0%	24.6%	24.3%	24.3%	24.1%	24.3%	23.0%	21.0%	20.5%	20.0%	19.5%	19.5%	19.5%	19.5%	19.5%
Admin General	33.0%	32.0%	52.4%	51.0%	48.2%	46.0%	49.0%	34.8%	26.0%	22.1%	20.4%	18.8%	16.3%	14.2%	12.8%	12.7%
Lease Payment	10.0%	10.0%	6.2%	7.5%	7.6%	6.3%	6.9%	5.3%	3.0%	1.9%	1.3%	0.9%	0.0%	0.0%	0.0%	0.0%
Dep. & Amort	18.5%	18.3%	19.4%	23.9%	24.6%	25.0%	23.5%	24.9%	20.0%	16.4%	13.9%	11.4%	9.7%	8.6%	8.1%	8.0%
Interest exp. net	NA	1.9%	3.7%	11.6%	12.8%	14.2%	11.2%	36.9%	35.5%	31.0%	27.0%	23.3%	20.4%	17.7%	15.6%	14.2%
Pretax Profit (loss)	NA	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	-20.6%	-10.4%	-2.5%	3.3%	6.5%
Net Profit (Loss)	NA	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	-20.6%	-10.4%	-2.5%	3.3%	6.5%
EBITDA %	NA	NM	NM	NM	NM	NM	NM	NM	-4.1%	4.5%	9.3%	14.1%	19.7%	23.8%	26.9%	28.7%
Y/Y Change																
Local Revenues	NA	NA	NA	NA	NA	133.5%	140.0%	120.0%	100.0%	78.0%	58.0%	48.0%	37.0%	27.0%	14.0%	8.0%
LD Revenues	NA	NA	NA	NA	NA	46.7%	71.1%	70.0%	65.0%	60.0%	55.0%	50.0%	40.0%	30.0%	20.0%	20.0%
Data Revenues	NA	NA	NA	NA	NA	153.8%	102.3%	100.0%	90.0%	60.0%	45.0%	30.0%	27.0%	25.0%	23.0%	10.0%
Local Netwk Access	NA	NA	NA	NA	NA	15.0%	23.6%	48.6%	40.5%	23.8%	20.0%	15.0%	12.5%	11.0%	10.0%	7.0%
LD Network Access	NA	NA	NA	NA	NA	15.0%	23.6%	86.7%	53.3%	40.5%	20.0%	15.0%	12.5%	11.0%	10.0%	7.0%
Total Network Access	NA	NA	NA	NA	NA	15.0%	63.9%	60.0%	45.0%	30.0%	20.0%	15.0%	12.5%	11.0%	10.0%	7.0%
Total Revenue	NA	NA	NA	NA	NA	63.9%	64.5%	87.0%	75.7%	58.8%	46.0%	38.0%	31.3%	24.7%	15.8%	9.6%
Network Costs	NA	NA	NA	NA	NA	52.2%	66.7%	52.6%	53.7%	45.2%	36.9%	27.3%	21.1%	15.0%	6.9%	1.1%
Eng./Ops	NA	NA	NA	NA	NA	58.5%	27.3%	84.4%	75.7%	58.8%	46.0%	38.0%	31.3%	24.7%	15.8%	9.6%
Sales & Marketing	NA	NA	NA	NA	NA	68.8%	75.6%	76.9%	60.4%	55.1%	42.4%	34.5%	31.3%	24.7%	15.8%	9.6%
Admin General	NA	NA	NA	NA	NA	222.4%	144.1%	32.8%	31.4%	34.7%	34.7%	27.0%	13.8%	8.5%	5.0%	8.8%
Dep. & Amort	NA	NA	NA	NA	NA	121.1%	111.7%	97.7%	41.4%	29.8%	24.1%	13.1%	11.6%	10.4%	9.4%	8.6%
Interest exp. net	NA	NA	NA	NA	NA	NM	NM	NM	69.3%	38.4%	27.3%	19.2%	14.9%	8.3%	1.8%	0.0%
Net Profit (Loss)	NA	NA	NA	NA	NA	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
EPS	NA	NA	NA	NA	NA	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Shares O/S	NA	NA	NA	NA	NA	13.7%	18.2%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
EBITDA	NA	NA	NA	NA	NA	NM	NM	NM	NM	NM	201.6%	109.0%	83.3%	50.5%	31.2%	16.8%

Source: Merrill Lynch estimates

13 May 1998

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ICG Communications, Inc.

1Q Rpt'd: Strong CLEC Results But NETCOM Disappoints; Est's cut

ACCUMULATE*

Reason for Report: 1Q Results Reported

Long Term ACCUMULATE

Price: $33 1/4

Estimates (Dec)	1997A	1998E	1999E
EPS:	d$9.75	d$6.49	-5.48
P/E:	NM	NM	NM
EPS Change (YoY):		NM	NM
Consensus EPS: (First Call: 28-Apr-98)		d$6.55	d$5.56
Q1 EPS (Mar):	d$2.09	d$1.92	
Cash Flow/Share:	d$7.99	d$3.98	d$1.91
Price/Cash Flow:	NM	NM	NM
Dividend Rate:	Nil	Nil	Nil
Dividend Yield:	Nil	Nil	Nil

Opinion & Financial Data

Investment Opinion:	D-2-2-9
Mkt. Value / Shares Outstanding (mn):	$1.120 / 32
Book Value/Share (-97):	-8.88
Price/Book Ratio:	NM

Stock Data

52-Week Range:	$44 1/4-$11 3/8
Symbol / Exchange:	ICGX / OTC
Options:	AMEX
Institutional Ownership-Spectrum:	83.6%
Brokers Covering (First Call):	15

ML Industry Weightings & Ratings**

Strategy: Weighting Rel. to Mkt.:		
Income:	Overweight	(07-Mar-95)
Growth:	Underweight	(07-Mar-95)
Income & Growth:	Overweight	(07-Mar-95)
Capital Appreciation:	Overweight	(16-Jan-96)
Market Analysis: Technical Rating:	Above Average	(24-Dec-96)

*Intermediate term opinion last changed on 18-Sep-97.
**The views expressed are those of the macro department and do not necessarily coincide with those of the Fundamental analyst.
For full investment opinion definitions, see footnotes.

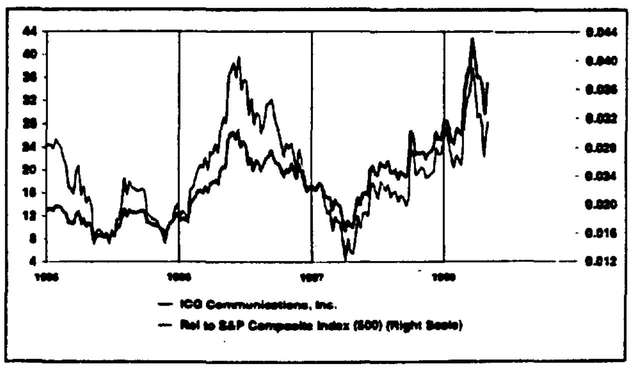
Investment Highlights:

- **On May 1, ICG announced 1Q results with strong CLEC revenue & line growth but NETCOM (the ISP subsidiary) results were disappointing.**
- **Although we lowered estimates, we maintain our $42 12-month price objective & reiterate our Accumulate opinion as the key value driver — the CLEC div. — continues to demonstrate strong fund. momentum.**

Fundamental Highlights:

- **1Q CLEC rev. was $58.5MM, 8% above our est. of $54MM, up 23% sqt'ly & 91% y/y. CLEC rev. growth was driven by switched local services rev., up 66% sqt'ly to $28.2MM & 12% higher than our est. of $25MM. Total rev. was $126MM, 4% below our est. of $131, up 61% sqt'ly & 99% y/y.**
- **1Q EBITDA loss was in line with our est. at $25.7MM, a 10% improvement over 4Q, even accounting for the impact of lower rev. The key to the improvement was SG&A control which improved sqt'ly as a percent of rev. from 49.9% in 4Q to 46%.**
- **Net local access lines increased 32% sqt'ly to 186,000 from 141,000 at 4Q quarter-end with the number of new lines added growing 6% vs. 4Q.**
- **We raisied our CLEC rev. est. for '98 by 3%, but adopted a more conservative view towards network service & NETCOM (both rev. & EBITDA). Thus, our total corporate rev. est.'s were lowered by 3% for '98 & '99 and our EBITDA est. by 87% for '98 & 6% for '99.**

Stock Performance



On May 1, ICG Communications (ICG) reported 1Q98 results. Although we were impressed by strong CLEC (competitive local exchange carrier) results — both rev. growth and line adds in the period — NETCOM, ICG's newly acquired ISP (internet service provider) and network services posted disappointing results. As a result, we lowered full year rev. and EBITDA ests. for both '98 & '99. We are, however, reiterating both our Accumulate opinion and $42 12 month private market value-based price objective (with no public market discount) as the ***key value driver*** — ICG's CLEC operation — continues to exhibit strong fundamental momentum. As a result, we have made no material change to our '07 forecast from which 90% of our $42 10 year discounted cash flow (DCF) private market value is derived. In addition, we point out that although the underperforming divisions represented 41% of rev. in the quarter, NETCOM is expected to regain momentum by 4Q and network services is a non-core business unit, whose importance should diminish over time (falling to 7% of rev. by '00 and then only 4% of rev. by '07).

Revenue: Driven by 66% sqt'l growth in switched local services rev., CLEC rev. (comprised of special access, switched local services and switched termination) was $58.5MM, 8% above our est. of $54.1MM, up 23% sqt'ly and 91% y/y. However, due to lower than anticipated rev. from network service (a non-core division which performs telecom network wiring & maintenance functions) and NETCOM, total reported 1Q rev. was $125.7MM, 4% below our ests., a 61% sqt'l increase and up 99% y/y.

Components of CLEC rev. include: a) switched local services rev. of $28.2MM, (as noted above) up 66% sqt'ly and 12% higher than our est. of $25.1MM. A portion of the improvement came from ICG's rev. per line, up 8% from $53 to $57 per line vs. our forecast of $52, fueled by LD rev. obtained from the CGB acquisition; b) switched terminating access rev. of $14.2MM, 7% lower than 4Q due to ICG's strategic decision to move away from this low margin business. However, 1Q switched terminating access rev. was 9% higher than our est. of $13MM, as the runoff of rev. is occurring more slowly than we anticipated; and, c) special access rev. of $16.1MM, in line with our est., up 4% sqt'ly and 33% y/y.

As pre-released on 4/20, NETCOM rev. was $40.5MM, flat vs. 4Q and 6% below our $43.0MM forecast. NETCOM's new sales initiatives (i.e. cross sales and initiation of new sales channels) have been developing slower than we had expected and therefore, we do not expect NETCOM to hit double digit sqt'l rev. growth until 4Q. Enhanced services (Zycom) rev. was $6.3MM, 16% lower than our est. of $7.5MM, down both 7% sqt'ly and 17% y/y. Other total rev. components included: network services rev. of $11.4MM, 38% lower than expected, down 27% sqt'ly & 37% y/y, due to seasonality.

Net Local Access Lines: ICG reported 186,156 net access lines in service at quarter-end, a sqt'l increase of 32% over 4Q's 141,035. The 45,100 net lines added represent a 6% growth in net line additions vs. the 42,499 internally generated (i.e. excluding the impact from CBG acquisition) 4Q line adds and bodes well for ICG to meet our forecast of 341,000 lines by year-end 1998. Of the total lines in service, we est. 47% were served via total service resale, 24% via unbundled network elements, and 29% via ICG owned switches and last mile loop.

EBITDA: EBITDA loss in 1Q was $25.7MM, a 10% improvement over the $28.4MM loss in 4Q and in line with our est. of $25.9MM, even with the lower than expected total rev. numbers. The improvement in margin was mainly due to SG&A which improved from 49.9% of rev. in 4Q97 to 46% in 1Q. We maintain our est. of EBITDA positive for 4Q98.

Network Buildout Update: Network route miles at quarter end were 3,194 compared to 3,043 for 4Q, up 5% sqt'ly and 29% y/y. Total buildings connected to ICG's local network and switches (either through owned or leased facilities) increased by an impressive 69% sqt'ly with 3,931 connected at quarter-end.

Estimate Changes: As shown in Table 1 below, we made the following est. changes:

Table 1: Revised ICG Forecast

	1998E			1999E		
($ in millions)	**Prior**	**New Est.**	**% Chng.**	**Prior**	**New Est.**	**% Chng.**
CLEC	279.7	288.7	3%	523.0	525.0	--
NETCOM	196.7	177.3	-10%	245.9	221.7	-10%
Other*	145.0	134.6	-7%	157.5	149.1	-5%
T'tl Revenue	621.4	600.6	-3%	926.4	895.8	-3%
EBITDA	(17.0)	(31.8)	-87%	133.9	126.1	-6%

*Note: Includes network services, Zycom & satellite services (sale of division pending)

Merrill Lynch

Comment

Telecommunications/Services - Local

Intermedia Communications Inc

5 May 1998

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1Q Results: Revenues Strong, Funding For Growth Continues

BUY*

Reason for Report: 1Q Results Reported

Long Term BUY

Price: **$73 3/8**

12 Month Price Objective: $105

Estimates (Dec)	1997A	1998E	1999E
EPS:	d$10.83	d$16.26	d$13.44
P/E:	NM	NM	NM
EPS Change (YoY):		NM	NM
Consensus EPS:		d$12.25	d$10.80
(First Call: 28-Apr-98)			
Q1 EPS (Mar):	d$1.89	d$4.16	
Cash Flow/Share:	d$7.64	d$8.32	d$2.48
Price/Cash Flow:	NM	NM	NM
Dividend Rate:	Nil	Nil	Nil
Dividend Yield:	Nil	Nil	Nil

Opinion & Financial Data

Investment Opinion:	D-1-1-9
Mkt. Value / Shares Outstanding (mn):	$1,239 / 17
Price/Book Ratio:	NM

Stock Data

52-Week Range:	$91 1/4-$19 3/4
Symbol / Exchange:	ICIX / OTC
Options:	Pacific
Institutional Ownership-Spectrum:	NA
Brokers Covering (First Call):	15

ML Industry Weightings & Ratings**

Strategy: Weighting Rel. to Mkt.:		
Income:	Overweight	(07-Mar-95)
Growth:	Underweight	(07-Mar-95)
Income & Growth:	Overweight	(07-Mar-95)
Capital Appreciation:	Overweight	(16-Jan-96)
Market Analysis: Technical Rating:	Above Average	(24-Dec-96)

*Intermediate term opinion last changed on 31-Mar-98.
**The views expressed are those of the macro department and do not necessarily coincide with those of the Fundamental analyst.
For full investment opinion definitions, see footnotes.

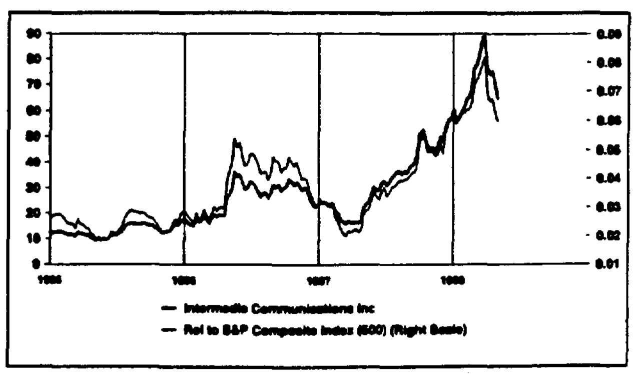
Investment Highlights:

- **ICIX reported 1Q98 results with strong topline growth, but larger than anticipated costs related to new growth initiatives & delays in moving to lower cost long haul network resulted in higher than expected EBITDA loss.**
- **Management's decision to accelerate investment in systems to support key LT. growth initiatives — especially national data contracts with RBOCs — should begin to show attractive returns within the next few quarters.**
- **No change to 12 month price objective of $105 or 43% upside. Reiterate Buy opinion.**

Fundamental Highlights:

- **1Q revenue was $136.8MM, 2% above our est., up 66% sqt'ly & 212% y/y. Net of Shared Tech acq. which added $45MM in qtr., revenue was up 11% sqt'ly & over 2 fold y/y.**
- **1Q EBITDA loss was $9.8MM, more than double our $4.6MM loss est. & flat with 4Q97's loss. Excluding $8MM in "unusual" network operating expense items (network migration delays & unprofitable int'l LD traffic), 1Q EBITDA loss would have been $1.8MM. We still expect positive EBITDA in 2Q.**
- **We maintain our full-year '98 revenue estimate of $750MM but are lowering EBITDA by 26% from $90MM to $67MM. We are lowering full-year '99 revenue by 3% from $1.2 billion to $1.15 billion & EBITDA by 12% from $211MM to $186MM.**

Stock Performance



Merrill Lynch & Co.
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RC#20112525

On April 29, ICIX reported 1Q results showing continued strong topline growth. However, reported EBITDA loss was larger than anticipated due to "unusual" expense items related to key growth initiatives and delay in migration to a new long haul network supplier which masked solid cost improvement in the quarter. We expect ICIX to reap ample returns from these investments in systems critical to support the numerous voice and data growth initiatives already underway.

1. **Revenue:** Reported rev. was $136.8MM, 2% above our est. of $133.8MM, a 66% seq'l increase and up 212% y/y. Net of rev. contribution from the Shared Tech acquisition which closed 3/10 (Shared Tech's 1Q results are included in full quarter), rev. was $92MM, an 11% seq'l improvement and more than double 1Q97's $43.9MM. Key growth drivers include: a) **Local Network Svcs.** with 1Q rev. of $33.7MM, 38% above our est. of $24.4MM, a 104% seq'l increase and up 6.5 fold y/y. Net of Shared Tech's $13MM contribution, internal rev. was $20.7MM, up 25% sequentially and 4 fold y/y; b) **Interexchange Svcs.** rev. of $44.8MM, 1% higher than our est. of $44.3MM, a 39% seq'l increase and up 76% y/y. Net of Shared Tech's $10MM contribution, internal rev. was $34.8MM, 8% higher than 4Q97 and up 36% y/y. Due to continuing low margins, ICIX announced that it would accelerate the phase out of its wholesale international long distance svcs. over the next 2 quarters, with the full effect of the approx. $2MM monthly reduction hitting during 3Q98; and, c) **Data Svcs.** rev. (including DIGEX and enhanced data svcs. "EDS") was $36.5MM, 7% below our est. of $39.1MM, but a 15% seq'l increase and up 223% y/y. We est. DIGEX rev. was $17.1MM, a 14% seq'l increase and 15% lower than our est. of $20.1MM, while EDS rev. was $19.4MM, a 15% seq'l increase and 2% higher than our est. of $19.0MM.
2. **Access Lines:** At quarter-end, ICIX reported 220,587 local access lines in service, including 111,600 from Shared Tech. Net of Shared Tech's contribution of 3,800 access lines added during the quarter, ICIX's 27,600 access line additions were 11% lower than the 31,000 lines added during 4Q97. We attribute this slowdown to time required by ICIX's salespeople to train Shared Tech's sales force. We est. 1Q line mix to be 40% total service resale, 40% on-net, and 20% via unbundled network elements.
3. **EBITDA:** 1Q EBITDA loss was $9.8MM, more than double our est. of $4.6MM and flat with $9.9MM in losses for 4Q97, but an improvement of 22% y/y. The 1Q EBITDA loss was higher than anticipated due to: a) $6MM for delays in transitioning leased long haul network to Williams; b) $3MM for incremental provisioning and customer service support costs required to serve US WEST and possibly other RBOCs (we think announcements of similar national data deals with other RBOCs are likely) as its preferred provider of out-of-region data svcs.; c) $2MM in negative gross margin impact from ICIX's soon to be phased out wholesale international LD business; and d) $2MM in SG&A costs related to upgrading and increasing capacity on ICIX's line provisioning and billing systems. Table 1 below details our ests. of the quarterly impacts these growth initiative expenditures will have on EBITDA. For 1Q, excluding the spending on company systems and headcount required for growth, we est. ICIX would have reported an EBITDA loss of $1.8MM vs. our forecast of $4.6MM. We continue to expect positive EBITDA beginning in 2Q, and estimate that by 4Q ICIX will have an annualized EBITDA run rate approaching $150MM, implying an EBITDA multiple of 24x at current prices for a company with 5-year EBITDA CAGR of 64%.

Table 1: EBITDA Impact From Expenses Related To Growth Initiatives

($ millions)	1Q98E	2Q98E	3Q98E	4Q98E	1998E
Network Migration Delay	6	3	1	0	10
Wholesale International LD	2	1	0	0	3
Total "Unusual" Expenses	**8**	**4**	**1**	**0**	**13**
G&A For RBOC Data Contract	*3*	*3*	*3*	*3*	*12*
Systems Capacity Upgrade	*2*	*2*	*2*	*2*	*8*
EBITDA Impact From Growth	**13**	**9**	**6**	**5**	**33**

Source: Merrill Lynch estimates

4. **Cap Exp:** 1Q cap exp was $76MM, 15% lower than our est. of $90MM, including approximately $4MM for expenses related to Shared Tech. We are maintaining our full-year '98 est. of $375MM and lowering full-year '99 to $375MM from $475MM.
5. **Estimate Changes**: We maintain our full-year '98 rev. est. of $750MM. We are lowering our full year '98 EBITDA forecast from $90MM to $67MM (9% margin) and our full-year '99 forecasts with revenue est. reduced by 3% from $1.2Bn to $1.15Bn and EBITDA est. reduced by 12% from $211MM to $186MM.
6. **Conclusion:** We maintain our 12 month price objective of $105 based on our 10-year DCF model. Our price objective is based on the average between our year-end '98 and year-end '99 private market values using a 15% discount rate, 9.5x terminal EBITDA multiple, and no public to private discount. Although we lowered our near term EBITDA forecasts, the impact to private market value was off-set by a $100MM reduction in cap exp for '99.

13 May 1998

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RCN Corp.

1Q Results: Strong Progress Across The Board

ACCUMULATE*

Reason for Report: 1Q Results Reported

Long Term BUY

Price: $23 1/2

Estimates (Dec)	1997A	1998E	1999E
EPS:	d$0.72	d$2.94	$3.77
P/E:	NM	NM	NM
EPS Change (YoY):		NM	NM
Consensus EPS: (First Call: 24-Apr-98)		d$2.16	d$3.08
Q1 EPS (Mar):	NA	d$0.99	
Cash Flow/Share:	$0.26	d$1.88	d$2.22
Price/Cash Flow:	98.1x	NM	NM
Dividend Rate:	Nil	Nil	Nil
Dividend Yield:	Nil	Nil	Nil

Opinion & Financial Data

Investment Opinion:	D-2-1-9
Mkt. Value / Shares Outstanding (mn):	$1,402.5 / 55
Book Value/Share (-97):	$6.73
Price/Book Ratio:	3.8x
LT Liability % of Capital:	70.0%

Stock Data

52-Week Range:	$30 5/8-$12 1/2
Symbol / Exchange:	RCNC / OTC
Options:	Pacific
Institutional Ownership-Spectrum:	25.4%
Brokers Covering (First Call):	6

ML Industry Weightings & Ratings**

Strategy: Weighting Rel. to Mkt.:		
Income:	Overweight	(07-Mar-95)
Growth:	Underweight	(07-Mar-95)
Income & Growth:	Overweight	(07-Mar-95)
Capital Appreciation:	Overweight	(16-Jan-96)
Market Analysis: Technical Rating:	Above Average	(24-Dec-96)

*Intermediate term opinion last changed on 09-Feb-98.
**The views expressed are those of the macro department and do not necessarily coincide with those of the Fundamental analyst.
For full investment opinion definitions, see footnotes.

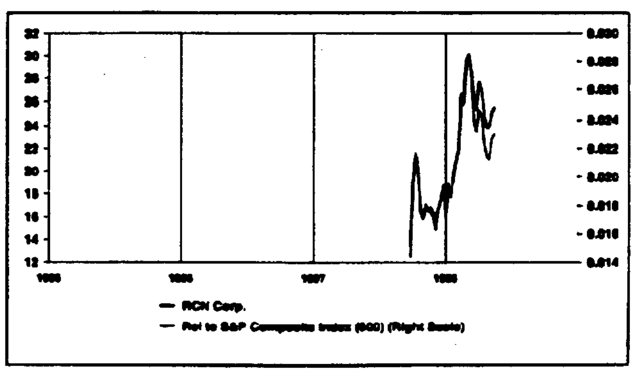
Investment Highlights:

- **On May 12, RCN Corp. reported 1Q results showing strong fundamental improvement across the board. Solid topline improvement was driven by strong sqtl. growth in customer connections (i.e. voice, video and/or data subscriptions) & sqtl. improvement in monthly rev. per customer connection.**
- **We maintain our 12-18 month price objective of $35, 49% upside, & our intermediate term Buy & long term Accumulate opinions.**

Fundamental Highlights:

- **1Q corporate revenue was $43.0MM, 1% higher than our estimate of $42.4MM, up 4% sqt'ly & 45% y/y. Internal rev., net of data rev. acquired from the Erol's & Ultranet deals grew 5% sqt'ly & 26% y/y.**
- **1Q EBITDA loss was $9.6MM, 17% better than our est. loss of $11.6MM & a 13% widening vs. 4Q.**
- **We maintain our full-year 1998 rev. est. of $216MM & EBITDA loss est. of $37MM.**
- **RCN's network buildout is on schedule with 63,386 homes passed by its advanced fiber network by quarter-end, 6% higher than our est. of 60,000. On-net customer connections at end of 1Q were 20,339, approximately 5% higher than our est. of 19,300, driven by 12% higher than est. subscription to voice svcs. RCN's penetration rate of homes passed is on track with our ests. As of 1Q, approx. 16% of total homes passed have subscribed to an average of 2 on-net svcs. (voice, video and/or data).**

Stock Performance



On May 12, RCN Corp. reported 1Q results showing strong fundamental improvement across the board. Solid topline improvement was driven by strong sqtl. growth in customer connections (i.e. voice, video or data subscriptions) and sqtl. improvement in monthly rev. per customer connection. During 1Q, RCN continued its rapid network development, beating our forecast of 60,000 homes passed by its advanced fiber network by quarter-end. 1Q Highlights were as follows:

1. **Revenue:** RCN restated its rev. into the following 3 categories: voice (resale and advanced fiber local and LD svcs.); video (advanced fiber, wireless, and traditional hybrid fiber coaxial cable svcs.); data (high speed internet svcs.); and other (dial-up internet and commercial svcs.).

1Q corporate rev. was $43.0MM, 1% higher than our estimate of $42.4MM, up 21% sqt'ly and 45% y/y. Internal rev., net of data rev. acquired from the Erol's and UltraNet deals, grew 5% sqt'ly and 26% y/y. Voice rev. was $3.5MM, up 64% sqt'ly and over 8 fold y/y. Video rev. was $26.7MM, up 1% sqt'ly and 9% y/y. Data rev. of $5.7MM was almost entirely from 1 month of internet rev. from the Erol's and UltraNet acquisitions which closed on 2/24 and 3/2, respectively. Other rev. was $7.1MM, up 4% sqt'ly and 52% y/y.

1Q monthly rev. per on-net connection showed sqtl. improvement with voice (local and LD) in the high $60's up over 25% vs. the low $50's in 4Q; video in the low $30's up over 20% vs. the high $20's in 4Q; and data of $18-19, in line with 4Q.

We maintain our full-year 1998 and 1999 rev. estimates of $215.9MM and $337.0MM, respectively.

2. **EBITDA:** 1Q EBITDA loss was $9.6MM, 17% better than our forecasted loss of $11.6MM and a 13% widening vs. 4Q. 1Q EBITDA loss was $2MM lower than anticipated due to timing issues regarding payment of expenses related to local network development. As we anticipate the $2MM in expense will be incurred during the next 2 quarters, we maintain our full year 1998 and 1999 EBITDA loss ests. of $35.7MM & $3.2MM, respectively.

3. **Network Development & Unit Growth:** RCN's network buildout is on schedule with a reported 63,386 homes passed by its advanced fiber network by quarter-end, 6% higher than our estimate of 60,000.

The company is also restating its service connection count into two categories, advanced fiber or "on-net" and other or "off-net". Within these two categories, the svcs. are further separated into voice, video or data subcategories. As shown in Table 1 below, on-net customer connections of 20,339 were approximately 5% higher than our estimate of 19,300, driven by 12% higher than est. subscription to voice svcs. In addition, RCN is right in line with our forecast regarding the penetration of sales into homes passed by its advanced fiber network. As shown in row O in Table 1 below, as of 1Q, approx. 16% of total homes passed are subscribing to an average of 2 on-net svcs. (voice, video and/or data).

Table 1: 1Q Connections & Penetration

		Our Est.	Actual	% Variance
A	*Homes Passed*	*60,000*	*63,386*	*5.6%*
	On-Net			
B	Voice	4,000	4,473	11.8%
C	Video	15,000	15,599	4.0%
D	Data	300	267	-11.0%
E (sum B:D)	**Total On-Net**	**19,300**	**20,339**	**5.4%**
	Off-Net			
F	Voice	40,000	40,447	1.1%
G	Video	225,000	227,558	1.1%
H	Data	370,000	370,271	0.1%
I (sum F:H)	**Total Off-Net**	**635,000**	**638,276**	**0.5%**
J (E+I)	**Total Service Connections**	**654,300**	**658,615**	**0.7%**
	Penetration Of Homes Passed			
K (B/A)	Voice	6.7%	7.1%	
L (C/A)	Video	25.0%	24.6%	
M (D/A))	Data	0.5%	0.4%	
N	Services Per Customer	2.0	2.0	
O (E/N/A)	**Total On-net**	**16.1%**	**16.0%**	

Source: Merrill Lynch estimates and company reports.

Conclusion - We maintain our intermediate term Accumulate and long term Buy opinion & our 12-18 month price objective of $35, 49% upside. Our price objective is based on a sum of the parts valuation including: a) our 10-yr DCF model for RCN Telecom, using a 15% discount rate, 10.0x terminal EBITDA multiple, no public to private discount and a 20% discount to reflect minority ownership in RCN Telecom by its partners; b) 11.0x '99 EBITDA of $41.5MM for the indep. cable properties; and; c) 11.0x '99 EBITDA of $13MM (adjusted to account for 40% ownership) for Megacable, the Mexico CLEC venture.

Merrill Lynch is currently acting as a financial advisor and has rendered a fairness opinion to RCN Corporation in connection with its proposed acquisition of Erol's, which was announced on January 21, 1998. RCN Corporation has agreed to pay a fee to Merrill Lynch for its financial advisory services, a significant portion of which is contingent upon the consummation of the proposed transaction.
This research report is not intended to (1) provide voting advice, (2) serve as an endorsement of the proposed transaction, or (3) result in the procurement, withholding, or revocation of a proxy.

14 May 1998

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Teligent Inc.

1Q Report: Network Deployment Moving Faster Than Expected

ACCUMULATE*

Reason for Report: 1Q98 Results Reported

Long Term BUY

Price: $30

Estimates (Dec)	1997A	1998E	1999E
EPS:	d$2.94	d$3.47	d$3.49
P/E:	NM	NM	NM
EPS Change (YoY):		NM	NM
Consensus EPS: (First Call: 07-May-98)		d$3.55	d$4.25
Cash Flow/Share:	d$2.83	d$3.29	d$3.23
Price/Cash Flow:	NM	NM	NM
Dividend Rate:	Nil	Nil	Nil
Dividend Yield:	Nil	Nil	Nil

Opinion & Financial Data

Investment Opinion:	D-2-1-9
Mkt. Value / Shares Outstanding (mn):	$1,586.3 / 54
Price/Book Ratio:	NM
LT Liability % of Capital:	57.0%

Stock Data

52-Week Range:	$35 3/8-$22 1/4
Symbol / Exchange:	TGNT / OTC
Options:	None
Institutional Ownership-Spectrum:	20.9%
Brokers Covering (First Call):	5

ML Industry Weightings & Ratings**

Strategy: Weighting Rel. to Mkt.:		
Income:	Overweight	(07-Mar-95)
Growth:	Underweight	(07-Mar-95)
Income & Growth:	Overweight	(07-Mar-95)
Capital Appreciation:	Overweight	(16-Jan-96)
Market Analysis: Technical Rating:	Above Average	(24-Dec-96)

*Intermediate term opinion last changed on 18-Dec-97.
**The views expressed are those of the macro department and do not necessarily coincide with those of the Fundamental analyst.
For full investment opinion definitions, see footnotes.

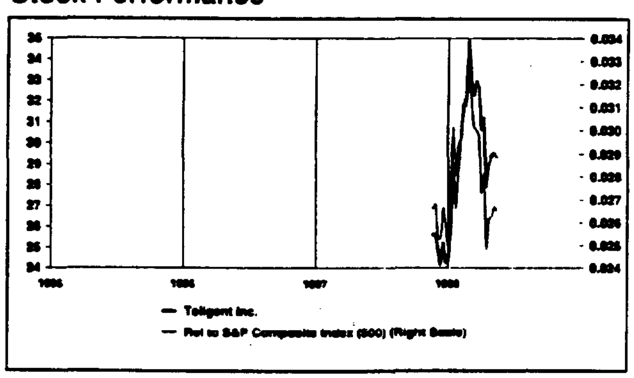
Investment Highlights:

- **1Q report indicates that network deployment is progressing faster than expected.**
- **We maintain our intermediate term Accumulate and long term Buy opinion.**
- **Our 12-18 month price objective remains $37, 23% upside, based on our 10 year discounted cash flow (DCF) model, a 15% discount rate and 9.0 multiple on terminal year EBITDA, and no public market discount.**

Fundamental Highlights:

- **Management expressed confidence that they may exceed their previously stated goal of having 10 commercial markets by year-end 1998, thereby accelerating the deployment of the 20 new markets planned for 1999.**
- **Teligent installed 7 DMS 500 local/long distance switches and has an additional 6 on order for installation later in the year.**
- **During 1Q, Teligent signed a 3 1/2 year resale agreement with Frontier for long distance services and a 2 year resale agreement with Concentric for internet access and data networking services.**

Stock Performance



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

RC#10113420

Teligent's 1Q Report & Analyst Call Reaffirms Our Confidence In Its Network Deployment Schedule. Reiterate Accumulate Opinion & $37 12-18 Month Price Objective, Or 23% Upside.

After the market close on May 12, Teligent released 1Q results and hosted a call with analysts for the purpose of providing an update on activities related to the commercial rollout of the company's wireless CLEC (competitive local exchange carrier) services. The most noteworthy announcement was the company's assertion that they may exceed their goal of having 10 commercial markets in service by year-end 1998. To this end, management stated that "with teams already deployed in 20 markets, we have the opportunity to accelerate the launch of a number of markets originally scheduled for 1999, allowing us to exceed our goal of introducing Teligent service in 10 markets this year." Additional key highlights of the quarter and the analyst call were as follows.

1. **Construction/market development update:** During 1Q, Teligent installed DMS 500 combination local/long distance switches in Dallas, Denver, Houston, Los Angeles, Orlando, San Antonio and Washington, D.C. By year-end we expect Teligent to install switches in Chicago, San Francisco, Atlanta, New York, Philadelphia, and Boston. These switch installs constitute the most time consuming requirement to provide commercial telephone service within a market, and we believe this schedule will allow management to accelerate the launch of markets originally scheduled for rollout of commercial service in 1999.

2. **Los Angeles Network:** Teligent has beta customers up and running on its fixed wireless point-to-multipoint network in Los Angeles. Currently this network is comprised of 3 hub sites and 20 customer buildings. Teligent is utilizing the Los Angeles network to streamline its process and procedures for network deployment, customer installation and support, and intends to use it as a model for the rest of the country.

3. **Long Distance & Internet Resale Contracts:** During 1Q, Teligent signed a 3 1/2 year resale contract with Frontier which will provide it access to Frontier's long distance products including domestic and international LD, calling cards, and conference calling. Teligent also signed a 2 year resale contract with Concentric which will allow it access to Concentric's nationwide ATM network and the ability to resell dedicated internet access and web hosting services.

4. **Staffing Up:** As of the analyst call (May 12), Teligent had 675 employees with approximately 450 of those employees added during the first 4 months of 1998, well on its way to its headcount goal of 1,100 to 1,200 by year-end 1998. The company stated that approximately 30% (about 200) of the current employees are in sales and marketing positions.

5. **1Q98 Financial Results:** Teligent reported quarterly revenue of $100,000 from internet access and data services provided over point-to-point wireless links in support of license perfection activities. EBITDA loss was $26.5MM with cost goods of $7.4MM and SG&A of $19.2MM. Reported net loss for the quarter was $38.6MM which included $6.6MM in non-cash, stock based compensation charges.

6. **Cap Exp:** During 1Q, Teligent's cap exp was $51MM. Until we know the extent of Teligent's acceleration of its city rollout, we maintain our full-year 1998 estimate of $170MM. However, this estimate may prove to be conservative dependent on the final number of cities in commercial service by year-end 1998.

7. **Financing Activities:** During 1Q, Teligent raised an additional $250MM in Senior Discount Notes due 2008, bringing its available funding to $1.6B (comprised of $820MM in cash and $780MM of vendor financing) at 1Q. The company stated that these funds will be sufficient to fund capital requirements through 2000.

Conclusion: Teligent's commercial service rollout appears to be running ahead of street expectations with more than 10 cities now likely to be in commercial operation by year-end 1998. We are extremely encouraged by this announcement as it reaffirms our confidence in Teligent's network deployment schedule and thus, we reiterate both our intermediate term Accumulate and long term Buy opinions as well as our $37 12-18 month price objective. Our price objective is based on our 10-year discounted cash flow (DCF) model, a 15% discount rate, a 9.0x multiple on terminal year EBITDA, and no public market discount.

13 May 1998

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USN Communications Inc

Solid 1Q: Results In Line But Slightly Lowering 1998 Estimates

ACCUMULATE*

Reason for Report: 1Q Results Reported

Long Term BUY

Price: $15 3/4

Estimates (Dec)	1997A	1998E	1999E
EPS:	d$15.55	d$8.81	d$4.61
P/E:	NM	NM	NM
EPS Change (YoY):		NM	NM
Consensus EPS: (First Call: 04-May-98)		d$8.48	d$4.19
Q2 EPS (Jun):	NA	d$1.55	
Cash Flow/Share:	d$15.67	d$5.47	-
Price/Cash Flow:	NM	NM	NM
Dividend Rate:	Nil	Nil	Nil
Dividend Yield:	Nil	Nil	Nil

Opinion & Financial Data

Investment Opinion:	D-2-1-9
Mkt. Value / Shares Outstanding (mn):	$442.5 / 30
Book Value/Share (-97):	d$1.94
Price/Book Ratio:	NM

Stock Data

52-Week Range:	$23-$13 3/4
Symbol / Exchange:	USNC / OTC
Options:	None
Institutional Ownership-Spectrum:	NA
Brokers Covering (First Call):	2

ML Industry Weightings & Ratings**

Strategy: Weighting Rel. to Mkt.:		
Income:	Overweight	(07-Mar-95)
Growth:	Underweight	(07-Mar-95)
Income & Growth:	Overweight	(07-Mar-95)
Capital Appreciation:	Overweight	(16-Jan-96)
Market Analysis: Technical Rating:	Above Average	(24-Dec-96)

*Intermediate term opinion last changed on 12-Feb-98.
**The views expressed are those of the macro department and do not necessarily coincide with those of the Fundamental analyst.
For full investment opinion definitions, see footnotes.

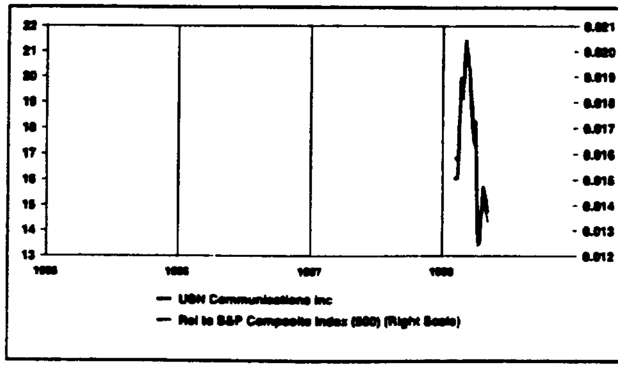
Investment Highlights:

- **On May 7, USN reported 1Q results with rev. & EBITDA in line with our ests. The solid topline was led by strong access line growth & continued improvement in revenue per line.**
- **We maintain our $24 price objective, 52% upside, based on our 10-year DCF model assuming a 15% discount rate & 9x terminal year EBITDA. We maintain our intermediate term Accumulate opinion.**

Fundamental Highlights:

- **1Q rev. was $32.4MM, in line with our est., up 60% sqt'ly & over 8 fold y/y. Topline growth was driven by direct sales rev. of $27.5MM, up 36% sqt'ly & over 7 fold y/y. Net of acquired revenue from Connecticut Telephone, core USN revenue was $27.8MM, up 38% sqt'ly. Average monthly rev. per line was $49 up 4% sqt'ly over $47 in 4Q.**
- **1Q EBITDA loss was $36.5MM, in line with our est. of $36MM. Strong SG&A cost controls offset a lower than expected gross margin.**
- **As previously reported, USN installed 54,000 net local access lines during 1Q, the 2nd highest number of local access lines of the publicly traded CLECs.**
- **Notwithstanding solid 1Q results, we are lowering our full-year 1998 rev. forecast by 3% from $310.5MM to $300.6 due to slower than expected ramp up of telemarketing. In addition, we are slightly increasing full year 1998 EBITDA loss est. from $123MM to $124MM. We expect 2Q EBITDA loss to be flat with 1Q & forecast improvement during the final 2Q's of 1998.**

Stock Performance



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Global Securities Research & Economics Group
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RC#20113327

On May 7, USN Communications (USN) reported 1Q results with revenues and EBITDA in line with our expectations. Topline growth was driven by strong sequential local access line adds and a sequential improvement in revenue per access line. In addition, strong SG&A cost controls offset a lower than expected gross margin.

Company Description: USN is a competitive local exchange carrier (CLEC) that offers telecom services to small and medium sized business customers throughout Bell Atlantic and Ameritech regions through total service resale contracts. During 1Q, USN maintained its position as having installed the 2nd highest (next to the MFS subsidiary of WorldCom) number of net local access lines vs. the rest of the CLEC industry. 1Q highlights are detailed below:

1. **Revenues:** 1Q total corporate revenue was $32.4MM, in line with our estimate, up 60% sequentially and 8 fold y/y. Direct sales revenue was $27.5MM, 1% lower than our estimate of $27.9MM, up 36% sequentially and 7 fold y/y. Although we were not expecting any enhanced service revenue during 1Q, initial sales efforts resulted in revenue of approx. $0.3MM. Net of acquired revenue from Connecticut Tel., core USN revenue of $27.8MM was a 38% sequential improvement over 4Q. At $4.6MM, Connecticut Tel. revenue was in line with our estimate.

As previously reported in our 4/13 note, there was an $880,000 impact on 1Q revenue from one-time customer discounts for problems associated with migrating to a new billing system. Net of this impact, the average revenue per line was approximately $49, a 4% increase over the average of $47 for 4Q. We maintain our estimate of $53 average revenue per access line by year-end 1998.

2. **EBITDA:** 1Q EBITDA loss was $36.5MM, in line with our estimate, a 22% widening of loss from the $30MM in loss reported for 4Q97. USN's gross margin of 17.8% was a sequential improvement of 340 basis points, but lower than our estimate of 27%. We have reallocated some expenses into SG&A from COGS, and anticipate a 2Q gross margin of 20.8% (300 basis point sequential improvement). USN's SG&A of $42.3MM was 6% lower than our estimate, decreasing as a percentage of revenue by over 20% vs. 4Q.

3. **Net Access Line Additions:** As reported on 4/13, USN installed approx. 54,000 incremental net access lines during 1Q ending the quarter with 226,000 lines installed. Although flat vs. 4Q97 adds, USN installed the second highest number of access lines of the publicly traded CLECs. We forecast USN will add an incremental 64,000 access lines during 2Q and will reach approx. 540,000 access lines by year-end 1998. While this is 4% below our prior estimate of 560,000, any effect on revenue is offset by better than anticipated sales of enhanced services.

As we reported in our 4/13 note, during 1Q USN's access line churn was approximately 2% per month, higher than our forecasted 1.5% per month, due to customer loss stemming from the billing systems issues mentioned above. We expect churn to return to approx. 1.5% during future quarters.

4. **Cap Exp:** 1Q cap exp was $5.4MM, in line with our estimate of $5.0MM. We maintain our forecast of $20.0MM for full-year 1998.

5. **Geographic Expansion:** USN began marketing in four new states during 1Q: Indiana, Wisconsin, New Hampshire and Rhode Island. In addition, USN installed an initial salesforce in the Bell Atlantic South (Bell Atlantic states prior to the merger with NYNEX) territory and is currently beta testing its provisioning systems in Maryland. Revenue from sales within this new territory should begin to have a noticeable effect by 3Q. In addition, USN has also begun exploring options within SBC's territory through a resale agreement with a large unidentified CLEC in Texas. The company announced that they are currently beta testing the systems of that CLEC.

6. **Estimate Change:** We are lowering our full-year 1998 revenue estimate by 3% from $310.5MM to $300.6MM due to the slower than expected ramp up of telemarketing sales. As reported on 4/13, USN now has 90 telemarketing "chairs" in service and we anticipate that as the telemarketers are trained and productivity increases the revenue run rate will be sufficient to meet our 1999 forecasts. In addition, we are slightly increasing our forecasted EBITDA loss for full-year 1998 from $123MM to $124MM. We forecast 2Q EBITDA loss of $36.7MM, virtually flat vs. 1Q and anticipate that final two quarters of the year will show sequential improvement. We maintain our 1999 and outer year revenue and EBITDA forecasts.

Conclusion: We maintain our $24 price objective based on our 10-year discounted cash flow (DCF) model assuming a 15% discount rate, a 9 multiple on terminal year EBITDA, implying a 4.9% growth rate of perpetual free cash flow. We maintain our intermediate term Accumulate and long term Buy opinion.

Table 1: USN Communications Detailed Financial Forecast

	1997A	1Q98A	2Q98E	3Q98E	4Q98E	1998E	1999E	2000E	2001E	2002E	2003E	2004E	2005E	2006E	2007E
Revenues															
Direct Sales	47.2	27.5	39.9	58.6	89.7	215.6	392.3	502.1	603.3	690.5	776.1	861.1	942.9	1,024.7	1,107.5
Telemarketing	-	-	2.0	8.0	13.0	23.0	98.8	200.3	269.9	315.5	369.4	423.5	477.9	532.5	587.6
Agents	-	-	-	-	-	-	7.6	21.3	32.8	42.9	53.1	63.2	73.5	83.8	94.1
Enhanced	-	0.3	2.0	4.9	6.1	13.3	23.5	30.1	36.2	48.3	58.2	68.9	80.1	92.2	105.2
Core Revenues	47.2	27.8	43.9	71.5	108.8	251.9	522.2	753.8	942.1	1,097.1	1,256.8	1,416.7	1,574.4	1,733.2	1,894.4
CONTEL Revenues	-	4.6	12.8	14.7	16.6	48.6	63.2	76.7	87.7	98.7	110.3	122.5	136.2	151.3	168.3
Total Revenues	**47.2**	**32.4**	**56.7**	**86.2**	**125.3**	**300.6**	**585.4**	**830.5**	**1,029.8**	**1,195.9**	**1,367.1**	**1,539.3**	**1,710.5**	**1,884.6**	**2,062.7**
Expense															
Cost of Sales	41.3	26.6	44.9	65.5	91.5	228.5	417.2	571.5	700.3	802.7	917.9	1,033.8	1,133.2	1,248.4	1,366.3
Sales & Marketing	100.4	42.3	48.5	51.7	53.9	196.4	209.6	248.3	277.0	303.8	330.8	361.7	393.4	425.9	460.0
Depreciation/Amort.	3.5	2.2	1.2	1.4	2.1	6.9	10.0	14.2	18.6	19.7	22.1	23.2	24.4	25.6	30.4
Operating Profit	(97.9)	(38.7)	(37.9)	(32.5)	(22.1)	(131.2)	(51.4)	(3.5)	33.9	69.7	96.2	120.5	159.6	184.6	206.1
Interest Exp. net	11.9	5.5	9.6	12.1	14.5	41.7	59.3	53.1	41.4	30.0	18.3	2.0	-	-	-
Pretax Profit	(109.9)	(44.2)	(47.5)	(44.5)	(36.6)	(172.8)	(110.7)	(56.6)	(7.5)	39.7	77.9	118.5	159.6	184.6	206.1
Accumlt'd Pref'd Div.	2.2	0.6	-	-	-	-	-	-	-	-	-	-	-	-	-
Taxes	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Net Profit (loss)	(112.1)	(44.8)	(47.5)	(44.5)	(36.6)	(173.4)	(110.7)	(56.6)	(7.5)	39.7	77.9	118.5	159.6	184.6	206.1
EPS	$ (15.55)	$ (3.12)	$ (2.07)	$ (1.88)	$ (1.50)	$ (8.56)	$ (4.41)	$ (2.19)	$ (0.28)	$ 1.45	$ 2.75	$ 4.07	$ 5.32	$ 5.97	$ 6.47
Shares O/S	7.2	14.4	23.0	23.7	24.4	21.4	25.1	25.9	26.7	27.5	28.3	29.1	30.0	30.9	31.8
EBITDA	**(94.4)**	**(36.5)**	**(36.7)**	**(31.0)**	**(20.1)**	**(124.3)**	**(41.4)**	**10.7**	**52.5**	**89.5**	**118.3**	**143.7**	**183.9**	**210.2**	**236.4**
Cap Exp	15.0	5.4	5.0	5.0	5.0	20.0	21.0	22.1	23.2	24.3	25.5	26.8	28.1	29.5	31.0
Free Cash Flow	(111.7)					(120.2)	(62.7)	(11.8)	29.6	65.7	93.1	117.1	156.6	181.4	204.5
Access Lines (000s)	172	226	290	390	540	540	913	1,189	1,384	1,594	1,807	2,014	2,217	2,422	2,626
Margins															
Cost of Sales	87.4%	82.2%	79.2%	76.0%	73.0%	76.0%	71.3%	68.8%	68.0%	67.1%	67.1%	67.2%	66.2%	66.2%	66.2%
Sales & Marketing	212.7%	130.5%	85.5%	60.0%	43.0%	65.3%	35.8%	29.9%	26.9%	25.4%	24.2%	23.5%	23.0%	22.6%	22.3%
Depreciation/Amort.	7.4%	6.8%	2.1%	1.7%	1.6%	2.3%	1.7%	1.7%	1.8%	1.7%	1.6%	1.5%	1.4%	1.4%	1.5%
Interest Exp net	25.2%	16.9%	15.6%	13.5%	11.4%	13.9%	10.1%	6.4%	4.0%	2.5%	1.3%	0.1%	0.0%	0.0%	0.0%
Net Profit (loss)	NM	NM	NM	NM	NM	NM	NM	NM	NM	3.3%	5.7%	7.7%	9.3%	9.8%	10.0%
Y/Y Change															
Core Revenues															
Direct Sales	NA	NM	NA	NA	343.8%	356.9%	81.9%	28.0%	20.2%	14.4%	12.4%	10.9%	9.5%	8.7%	8.1%
Telemarketing	NA	NM	NA	NA	NM	NM	329.5%	102.8%	34.7%	16.9%	17.1%	14.6%	12.8%	11.4%	10.3%
Agents	NA	NM	NA	NA	NM	NM	NA	181.0%	53.9%	30.9%	23.7%	19.2%	16.2%	14.0%	12.4%
Enhanced	NA	NM	NA	NA	NM	NM	77.0%	28.0%	20.2%	33.5%	20.4%	18.3%	16.3%	15.1%	14.1%
Core Revenues	NA	NM	NA	NA	438.4%	433.8%	107.3%	44.4%	25.0%	16.5%	14.5%	12.7%	11.1%	10.1%	9.3%
CONTEL Revenues	NA	NM	NA	NA	NM	NM	29.9%	21.4%	14.4%	12.5%	11.8%	11.1%	11.1%	11.2%	11.2%
Total Revenues	NA	NM	NA	NA	NM	NM	94.7%	41.9%	24.0%	16.1%	14.3%	12.6%	11.1%	10.2%	9.5%
Operating Profit	NA	NM	NA	NA	NM	NM	NM	NM	NM	105.6%	38.0%	25.3%	32.4%	15.7%	11.6%
Net Profit	NA	NM	NA	NA	NM	NM	NM	NM	NM	NM	96.1%	52.1%	34.6%	15.7%	11.6%
EPS	NA	NM	NA	NA	NM	NM	NM	NM	NM	NM	90.4%	47.7%	30.7%	12.3%	8.4%
EBITDA	NA	NM	NA	NA	NM	NM	NM	NM	NM	70.3%	32.3%	21.5%	28.0%	14.3%	12.5%

Source Merrill Lynch estimates

Appendix

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Merrill Lynch

Comment

9 March 1998

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Advanced Radio Telecom Corp.

Moving Up The Value Chain, New Network Initiative Announced

ACCUMULATE

Reason for Report: Company Update, 4Q98 Results

Long Term ACCUMULATE

Price: **$13 7/8**

Estimates (Dec)	1996A	1997E	1998E
EPS:	d$3.80	d$2.26	d$1.36
P/E:	NM	NM	NM
EPS Change (YoY):		NM	NM
Consensus EPS: (First Call: 19-Feb-98)		d$2.65	d$2.61
Q4 EPS (Dec):	NA	d$0.51	
Cash Flow/Share:	d$4.33	d$2.25	d$1.83
Price/Cash Flow:	NM	NM	NM
Dividend Rate:	Nil	Nil	Nil
Dividend Yield:	Nil	Nil	Nil

Opinion & Financial Data

Investment Opinion:	D-2-2-9
Mkt. Value / Shares Outstanding (mn):	$290 / 20
Book Value/Share (-96):	$4.99
Price/Book Ratio:	2.9x
LT Liability % of Capital:	58.0%

Stock Data

52-Week Range:	$15 1/8-$5 3/4
Symbol / Exchange:	ARTT / OTC
Options:	None
Institutional Ownership-Spectrum:	5.4%
Brokers Covering (First Call):	4

ML Industry Weightings & Ratings**

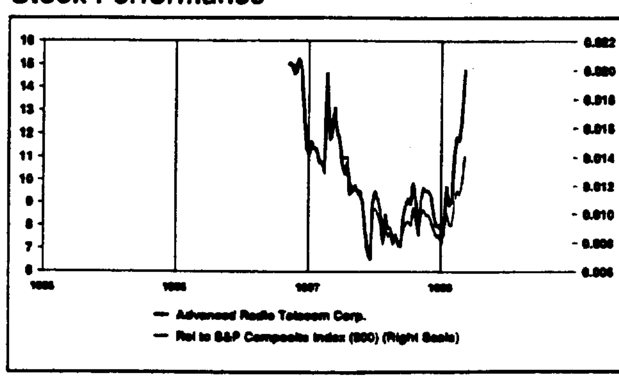
Strategy; Weighting Rel. to Mkt.:		
Income:	Overweight	(07-Mar-95)
Growth:	Underweight	(07-Mar-95)
Income & Growth:	Overweight	(07-Mar-95)
Capital Appreciation:	Overweight	(16-Jan-96)
Market Analysis: Technical Rating:	Above Average	(24-Dec-96)

**The views expressed are those of the macro department and do not necessarily coincide with those of the Fundamental analyst.
For full investment opinion definitions, see footnotes.

Investment Highlights:

- **ART announced a new strategic initiative that that calls for the deployment of a new data network in the top 100 US markets with an initial two markets scheduled for commercial service by end of 2Q98. Service will be supplied via a combination of its 38 GHz wireless local broadband licenses as well as leased local & long haul fiber "backbone".**
- **Strategy shift repositions ART from just a wholesale supplier of local broadband capacity to that of a data network company focused on end-user sales.**
- **ART is also actively pursuing a strategic relationship that will likely provide capital, brand name, access to a data-intensive customer base as well as a direct sales force.**
- **Company reported 4Q97 results that were below our previously published estimates. Sqt'l revenues were flat at $190,000 vs. 3Q (vs. our $300,000 forecast) as the installation of new senior management prompted a major corporate restructuring effort and a halt in wholesale service rollout activities.**
- **No change in our $16 private market value estimate for now as we await details on the new data network initiative.**

Stock Performance



Merrill Lynch & Co.
Global Securities Research & Economics Group
Global Fundamental Equity Research Department
435235/435200/435197/435100/435000

RC#20106814

Advanced Radio Telecom Announces New Strategic Initiative To Become The First Publicly Held Data CLEC:

After the market close on March 4, Advanced Radio Telecom (ART) announced an important new strategic initiative that repositions the company from a wholesale supplier of local broadband capacity to that of a data network company (i.e., a data CLEC), focused on direct end-user sales. Although many of the financial details have yet to be made public, we think that ART's newly installed senior management team led by CEO Henry "Harry" Hirsch and COO William Maxwell is off to a good start in its drive to enhance shareholder value.

New network initiative announced:

ART has announced its intention to begin deployment of wireless broadband metropolitan-area data networks in the top 100 US markets. Service will be provided via a combination of its own 38 GHz local radio licenses (to provide high bandwidth connectivity to end-user locations) as well as leased fiber "backbone" facilities, both for inter-connecting local radio hub/data switch sites and long haul capacity interconnecting the local city networks. Antici-pated services that will be offered to business customers include: High speed internet access (IAP) and services (ISP), private data networks (both on a local and national basis), video conferencing and over time, IP telephony and fax services. Sales will likely be accomplished via various channels, including direct and indirect (i.e., sales via other firms), reciprocal resale agreements with other telecom service companies and strategic relationships.

Network rollout plans:

Management plans to have two local networks deployed by the end of 2Q98 — Seattle and Washington, DC. These markets will serve as "prototypes" to prove the concept — both in terms of economics and customer demand (but not the technology which is all commercially available today). Over time, as ART expands its city rollout, the individual city networks will be interconnected via leased long haul facilities to form a high speed national data network.

Looking for a strategic relationship?:

In addition to rolling out its new network, the company according to a press release is also actively pursuing strategic relationships. Management stated the criteria for choosing a relationship could include: capital, access to a national brand, access to a large data-intensive customer base as well as a direct sales force. Possible relationships include all the usual telecom suspects such as CLECs, large long distance companies, new long distance companies building national networks as well as internet service providers, RBOCs and technology companies (i.e., computer equipment, software and/or networking companies).

Impacts of new network initiative

- **Impact on value?:**

Unknown for now as the company is not yet ready to discuss the key numbers — i.e., network economics, addressable market, sales force deployment etc. We understand that more details regarding the economics of this new strategic initiative will be forthcoming within the next few weeks. As a result, we are leaving our $16 private market value estimate unchanged for now. Our valuation methodology is based on our 10 year discounted cash flow (DCF) model, a 16% discount rate and an 8.0 multiple on terminal year EBITDA.

- **Strategic impact:**

We think this strategic shift is a good move for the new management team at ART as it repositions the company's focus from the wholesale market to one focused on the sale of services to end-users. As a result, ART will be the only pure-play publicly traded data CLEC in the industry today. In fact, ART's new data strategy — which leverages its ownership of local broadband capacity via its 38 GHz licenses — allows it to quickly leap frog many other firms looking to provide similar national data services but lacking local broadband capacity.

4Q97 results:

As expected, 4Q97 results showed virtually no improvement vs. 3Q with sequential service revenues actually flat at $190,000 vs. our last published estimate of $300,000. The installation of CEO Hirsch and his new senior management team a few months ago prompted a complete reappraisal of the company's strategy as well as a "top to bottom" corporate restructuring with a related halt in the company's wholesale service rollout activities.

6 February 1998

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Electric Lightwave, Inc.

Western US CLEC + LD Network Interconnecting Cities

ACCUMULATE

Reason for Report: Initial Opinion

Long Term ACCUMULATE

Price: $13.69

Estimates (DEC)	1996A	1997E	1998E
EPS:	NA	d$1.34	d$2.44
P/E:	NM	NM	NM
EPS Change (YoY):		NM	NM
Cash Flow/Share:	NA	d$3.27	d$6.95
Price/Cash Flow:	NM	NM	NM
Dividend Rate:	Nil	Nil	Nil
Dividend Yield:	Nil	Nil	Nil

Opinion & Financial Data

Investment Opinion:	D-2-2-9
Mkt. Value / Shares Outstanding (mn):	$736.7/51.7
Book Value/Share (Mmm-yy):	$5.14
Price/Book Ratio:	2.8
ROE 1996A Average:	NM
LT Liability % of Capital:	59%
Est. 5 Year EPS Growth:	NM

Stock Data

Range*:	16 3/8-12 3/8
Symbol / Exchange:	ELIX/OTC
Options:	NONE
Institutional Ownership-Spectrum:	NA

ML Industry Weightings & Ratings**

Strategy: Weighting Rel. to Mkt.:	
Income:	
Growth:	
Income & Growth:	
Capital Appreciation:	
Market Analysis: Technical Rating:	

**The views expressed are those of the macro department and do not necessarily coincide with those of the Fundamental analyst.
For full investment opinion definitions, see footnotes.
*Feom IPO 11/26/97

Investment Highlights:

- **Initiating coverage of Electric Lightwave Inc. (ELI) with an accumulate opinion (D-2-2-9).**
- **12-18 month price objective is $18 based on our 10 year DCF model, a 15% discount rate, and a 10.0x multiple on terminal year EBITDA.**

Fundamental Highlights:

- **By year-end '98, ELI will have local CLEC facilities built in 14 MSAs in the Western US. We est. that the mkt. addressable by ELI's local facilities will grow from $9.3B in '98 to $18.7 billion by '07, with ELI's share growing to 7.9% in '07 or just 1.2% of the total US market local mkt.**
- **ELI is connecting its markets with a 2,700 mile leased/owned long haul network to be completed by year end '98. By '07, we est. 28% of ELI's rev. will come from switched and dedicated LD sales.**
- **'98 revs. est. at $110MM, growing by 79% to $197MM in '99, reaching $2.0B in '07. We forecast EBITDA breakeven in 2H'00. By '07 we forecast EBITDA margins will reach 30.5% with a 70%/15%/15% blend of on-net, UNE & TSR local services.**
- **Partnerships with utilities companies provide capital expenditure savings and extend ELI's local & long haul network reach.**

We are initiating coverage on Electric Lightwave Inc. (ELI) with an intermediate and long term accumulate opinion (D-2-2-9). Our 12-18 month price objective is $18 or 31% upside from current prices. In our opinion, ELI is well positioned to compete in the highly lucrative local, LD voice and data markets in the western US through the use of its extensive local and long haul networks, comprehensive product set and strong sales force.

Company Description

ELI is a facilities-based competitive local exchange carrier (CLEC) providing local, LD voice and data services in six major market clusters or MSAs (metropolitan statistical areas) in the western United States: Portland, OR; Seattle, WA; Salt Lake City, UT; Sacramento, CA; Phoenix, AZ, and Las Vegas, NV. Prior to the 11/97 initial public offering, ELI was a subsidiary of Citizens Utilities Company, and Citizens has maintained an 85% ownership in the company.

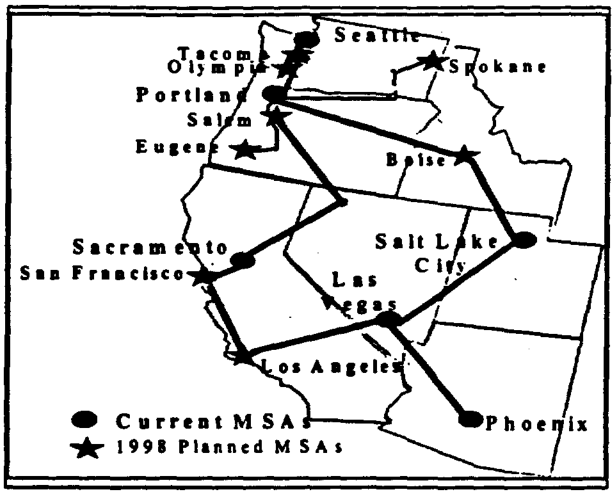
The Portland, OR based company's network includes 5 Nortel DMS 500 local/LD combination switches (one in each MSA), 1,007 miles of local fiber providing connectivity to 540 buildings, and 2,700 miles of long haul fiber connecting ELI's MSAs. The key to ELI's network strategy is the connection of its local markets via a owned/leased long haul network providing the opportunity for higher margins, quality control and pricing potential for both local and LD services within the western US.

ELI's local expansion plans call for constructing local networks in 8 additional MSAs in the western US during '98 including: Boise, ID; Spokane, WA; Tacoma, WA; Olympia, WA; Eugene, OR; Salem, OR; Los Angeles, CA; and San Francisco, CA, bringing the total number of MSAs served to 14. We estimate that ELI's current MSAs provide the ability to address $4.3 billion in local and data revenues in '97, an opportunity that will grow to $9.3 billion
(with the 8 additional markets and an assumed 5% annual growth rate for the base 6 MSAs) in '98, $11.5 billion in '99, reaching $18.7 billion in '07.

ELI is also moving quickly to connect its cities through both owned and leased long haul facilities. As shown in Chart 1 below, the company currently has long haul facilities in place connecting Phoenix to Las Vegas and Portland to Seattle, with connections running between Portland and Spokane, Salem, and Eugene expected to be in service by 2Q98. ELI's largest long haul route will be Portland to LA (via Boise, Salt Lake City, and Las Vegas) which should be in service by year-end '98.

ELI has cost effectively constructed its networks utilizing partnerships and joint builds. Through partnerships with utility companies, ELI has rights to 725 miles of local and long haul fiber. In addition, ELI has purchased 24 fiber optic strands of the Williams Company long haul network for its Portland to LA connection which should be available by year-end '98.

Chart 1: ELI Network



Source: Company documents

3 Key Value Drivers At ELI

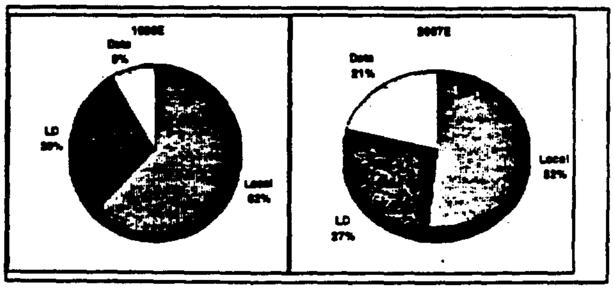
Value Driver #1. Attractive macro environment– expanded addressable market:

Regulatory and legislative changes on both the Federal and state levels have greatly expanded the nationwide market potentially addressable by new local competitors from $5 billion to $100 billion.

Value Driver #2. Strong top line growth forecast with a 10-year CAGR of 38%, driven by the sale of bundled services to small & medium-sized business customers:

We estimate that ELI will have revenues of $110.0 million for '98, growing by 79% to $196.5 million by '99, 68% to $329.9 million by '00, and reaching $2.0 billion in '07, with a 10 year CAGR of 38%. We forecast ELI's '98 EBITDA losses to be $50.7 million, with EBITDA breakeven occurring in 2H'00. We expect EBITDA to reach $621.9 million or 30.5% of revenues by '07. Our forecast assumes that ELI will use a mix of on-net, total service resale (TSR), and unbundled network elements (UNE) services in order to reach its customers. We estimate that ELI's traffic mix will shift from 81% on-net traffic in '98 down to 69% by '07 as the company moves from a predominately on-net strategy to more resale.

Chart 2: 1998E and 2007E Revenue Mix



Merrill Lynch estimates:

Key assumptions underlying our forecast are as follows:

Local Services:

1. **Industry context** – $100 billion local market growing 4.0-4.5% per annum through '07.

2. **Geographic coverage** – At year-end '97, ELI offered service to business customers in 6 MSAs constituting a local voice and data market addressable by existing facilities of $4.3 billion in '97. We estimate that expansion into 8 additional MSAs and continuing development of existing network infrastructure will enable ELI to target a $9.3 billion addressable market in '98, $11.5 billion in '99, reaching $18.7 billion in '07.

3. **Local and data market share**–We estimate that ELI will penetrate approximately 0.8% or $80.3 million of its addressable combined local and data market in '98, growing to 1.2% in '99 or $138.3 million, 1.8% in '00 or $264.0 million, reaching 7.9% or $1.5 billion by '07. These penetration rates are in line with our previous CLEC work which assumes that in addition to ELI, there will be two other local and data facilities-based and four UNE/TSR based competitors to the ILEC (incumbent local exchange carrier) in each market area, and in aggregate these new competitors will take a combined 28% local and data market share from the ILEC.

4. **LD market share** – Our estimates assume that ELI will penetrate approximately 0.4% or $29.7 million of the $4.2 billion addressable LD market within its MSAs in '98, growing to $561.1 million in '07 or 5.0% of ELI's $8.4 billion addressable LD market in '07.

Table 1 below outlines our key financial assumptions for ELI.

Table 1: Key Financial Assumptions

	1998	2000	2003	2007
Addressable Market Share				
Local	0.86%	1.79%	4.68%	7.91%
Long Distance	0.4%	0.7%	2.3%	5.0%
EBITDA Margin	-37.0%	-4.0%	14.8%	30.5%
Capital Expenditures	130.0	200.0	175.0	175.0
Free Cash Flow	(162.8)	(340.6)	(286.6)	125.4

Source: Merrill Lynch estimates

Value Driver #3. Strategic partnerships help to quickly boost network reach:

As discussed above, ELI's strategic relationships with electric utility companies in Portland and Salt Lake City have proven to be extremely beneficial by providing immediate access to local network facilities, buildings, and customers. We estimate that ELI has saved approximately $50 million in capital expenditures through these partnerships for the use of 725 miles of long haul fiber, assuming an estimated construction cost of $70,000 per fiber mile for aerial construction.

Strategic Assets — Takeover value of $18 per share:

Given the strategic value of ELI's network infrastructure, its in-place bundled service sales force and its customer base, one cannot rule out a possible bid for the company. If a transaction for ELI were to occur, we estimate that a buyer could offer $18 per share based on our 10 year DCF model. We think a potential buyer would be attracted by the significant time to market advantage of buying in-place local infrastructure, a customer base as well as "know how" that resides in-house. Potential buyers include large LD companies such as WorldCom/MCI, Sprint, AT&T as well as other large CLECs such as Intermedia, ICG, or NEXTLINK looking to quickly expand into new markets as well as augment the footprint of existing networks.

Attractive valuation

Our private market value for ELI is $18, or 31% upside. Our private market value estimate is based on our 10 year DCF (discounted cash flow) model. Key assumptions in our analysis (see table 2 below) include a 15% discount rate, a 10x multiple on terminal year EBITDA, a 7.3% perpetual growth rate of unlevered free cash flow, and a 10% "haircut" to private market value for majority stock ownership by Citizens Utilities. Our analytical approach on ELI is consistent with that employed in our earlier work on other CLECs, including 3 CLECs that have been taken over: Brooks and MFS by WorldCom and the pending acquisition of Teleport by AT&T. We use similar assumptions regarding terminal-year EBITDA multiples and local market penetration rates and free cash flow perpetual growth rates.

Table 2: ELI Valuation Summary

	Year End 1998E
Discount Rate	*15.0%*
Terminal Multiple	*10.0*
Implied Perpetual Growth of Unlevered Free Cash Flow	*7.3%*
+PV of Unlevered Free Cash Flow	($237)
+PV of Terminal Value	$1,768
=Enterprise Value	$1,531
xMajority Stockholder Discount	90%
=Enterprise Value Less Discount	$1,377.9
- Net Debt	$452
=Private Market Value - Equity	$926
Fully Diluted Shares Outstanding	52.7
=Per Share Private Market Value	$17.56

Source: Merrill Lynch estimates

Table 3: Electric Lightwave Detailed Financial Forecast

	1997E	1998E	1999E	2000E	2001E	2002E	2003E	2004E	2005E	2006E	2007E
Revenue											
Local Switched	9.0	19.8	43.6	87.1	156.8	250.9	376.4	526.9	674.4	775.6	837.6
Long Distance Switched	9.0	15.4	26.2	43.2	69.1	107.1	160.7	225.0	292.5	351.0	421.1
Data	8.7	17.6	35.2	66.9	107.0	155.2	201.7	256.2	320.2	393.9	433.3
Network Access											
Local	26.4	42.9	59.5	83.6	103.5	124.2	142.8	160.7	178.4	196.2	209.9
Long Haul	6.6	14.3	32.0	49.1	69.0	82.8	95.2	107.1	118.9	130.8	140.0
Total Network Access	33.0	57.2	91.5	132.7	172.5	207.0	238.1	267.8	297.3	327.0	349.9
Total Revenue	59.7	110.0	196.5	329.9	505.5	720.2	976.8	1,275.9	1,584.4	1,847.4	2,042.0
Expense											
Network Costs (COGS)	28.1	51.7	78.6	115.5	161.7	216.1	270.3	325.7	373.2	401.4	409.3
Operations/Engineering	13.7	31.9	49.1	79.2	121.3	172.9	234.4	306.2	380.3	443.4	490.1
Sales & Marketing	14.3	28.6	45.2	69.3	103.6	144.0	190.5	248.8	309.0	360.3	398.2
Admin General	19.7	38.5	55.0	69.3	85.9	108.0	127.0	127.6	118.8	110.8	122.5
Lease Payment	6.0	10.0	10.0	10.0	10.0	10.0	10.0	-	-	-	-
Dep. & Amort.	11.2	27.4	46.7	66.1	85.8	106.5	120.5	134.5	148.5	162.5	176.5
Interest exp. net	0.7	14.1	69.3	117.3	162.3	206.6	246.2	282.8	306.2	311.6	311.6
Net Profit (Loss)	(34.0)	(92.2)	(157.5)	(196.7)	(225.2)	(243.8)	(222.1)	(149.7)	(51.5)	57.5	133.9
EPS	$ (0.66)	$ (1.75)	$ (2.93)	$ (3.58)	$ (4.02)	$ (4.27)	$ (3.81)	$ (2.52)	$ (0.85)	$ 0.93	$ 2.12
Shares O/S	51.7	52.7	53.8	54.9	56.0	57.1	58.2	59.4	60.6	61.8	63.0
EBITDA	(22.1)	(50.7)	(41.4)	(13.3)	22.9	69.2	144.6	267.5	403.2	531.6	621.9
Cap Exp	130.0	270.0	250.0	200.0	200.0	175.0	175.0	175.0	175.0	175.0	175.0
Free Cash Flow	(162.8)	(349.8)	(370.7)	(340.6)	(349.4)	(322.3)	(286.6)	(200.2)	(87.9)	35.0	125.4
Net Debt	131	452	743	956	1,134	1,239	1,270	1,177	949	592	146
Margins											
Network Expense	*47.0%*	*47.0%*	*40.0%*	*35.0%*	*32.0%*	*30.0%*	*27.7%*	*25.5%*	*23.6%*	*21.7%*	*20.0%*
Operations/Engineering	*23.0%*	*29.0%*	*25.0%*	*24.0%*	*24.0%*	*24.0%*	*24.0%*	*24.0%*	*24.0%*	*24.0%*	*24.0%*
Sales & Marketing	*24.0%*	*26.0%*	*23.0%*	*21.0%*	*20.5%*	*20.0%*	*19.5%*	*19.5%*	*19.5%*	*19.5%*	*19.5%*
Admin General	*33.0%*	*35.0%*	*28.0%*	*21.0%*	*17.0%*	*15.0%*	*13.0%*	*10.0%*	*7.5%*	*6.0%*	*6.0%*
Lease Payment	*10.0%*	*9.1%*	*5.1%*	*3.0%*	*2.0%*	*1.4%*	*1.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Dep. & Amort.	*18.8%*	*24.9%*	*23.8%*	*20.0%*	*17.0%*	*14.8%*	*12.3%*	*10.5%*	*9.4%*	*8.8%*	*8.6%*
Interest exp, net	*1.2%*	*12.8%*	*35.3%*	*35.6%*	*32.1%*	*28.7%*	*25.2%*	*22.2%*	*19.3%*	*16.9%*	*15.3%*
Pretax Profit (loss)	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*3.1%*	*6.6%*
Net Profit (Loss)	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*3.1%*	*6.6%*
EBITDA %	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*25.4%*	*28.8%*	*30.5%*
Y/Y Change											
Local Revenues		*120.0%*	*120.0%*	*100.0%*	*80.0%*	*60.0%*	*50.0%*	*40.0%*	*2.08%*	*15.0%*	*8.0%*
Long Distance Revenues		*71.1%*	*70.0%*	*65.0%*	*60.0%*	*55.0%*	*5.00%*	*40.0%*	*30.0%*	*20.0%*	*20.0%*
Data Revenues		*102.3%*	*100.0%*	*90.0%*	*60.0%*	*45.0%*	*30.0%*	*27.0%*	*25.0%*	*23.0%*	*10.0%*
Local Network Access		*62.5%*	*38.7%*	*40.5%*	*23.8%*	*20.0%*	*15.0%*	*13.0%*	*11.0%*	*10.0%*	*7.0%*
Long Haul Network		*116.7%*	*124.0%*	*53.3%*	*40.5%*	*20.0%*	*15.0%*	*12.5%*	*11.0%*	*10.0%*	*7.0%*
Total Network Access		*73.3%*	*60.0%*	*45.0%*	*30.0%*	*20.0%*	*15.0%*	*12.5%*	*11.0%*	*10.0%*	*7.0%*
Total Revenue		*84.3%*	*78.6%*	*67.9%*	*53.2%*	*42.5%*	*35.6%*	*30.6%*	*24.2%*	*16.6%*	*10.5%*
Network Costs (COGS)		*84.3%*	*52.0%*	*46.9%*	*40.1%*	*33.6%*	*25.1%*	*20.5%*	*14.6%*	*7.6%*	*2.0%*
Operations/Engineering		*132.3%*	*54.0%*	*61.2%*	*53.2%*	*42.5%*	*35.6%*	*30.6%*	*24.2%*	*16.6%*	*10.5%*
Sales & Marketing		*99.6%*	*58.0%*	*53.3%*	*49.6%*	*39.0%*	*32.2%*	*30.6%*	*24.2%*	*16.6%*	*10.5%*
Admin General		*95.4%*	*42.9%*	*25.9%*	*24.0%*	*25.7%*	*17.5%*	*0.5%*	*-6.9%*	*-6.7%*	*10.5%*
Dep. & Amort.		*144.1%*	*70.6%*	*41.4%*	*29.8%*	*24.1%*	*13.1%*	*11.6%*	*10.4%*	*9.4%*	*8.6%*
Interest exp, net		*1872.0%*	*391.5%*	*69.3%*	*38.4%*	*27.3%*	*19.2%*	*14.9%*	*8.3%*	*1.8%*	*0.0%*
Net Profit (Loss)		*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*132.8%*
EPS			*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*128.2%*
Shares O/S		*2.0%*	*2.0%*	*2.0%*	*2.0%*	*2.0%*	*2.0%*	*2.0%*	*2.0%*	*2.0%*	*2.0%*
EBITDA		*NM*	*NM*	*NM*	*NM*	*202.9%*	*108.9%*	*85.0%*	*50.7%*	*31.8%*	*17.0%*

Source: Merrill Lynch estimates

12 May 1998

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e.spire Communications, Inc.

In.spiring CLEC Growth With A Data Twist ACCUMULATE

Reason for Report: Initial Opinion

Long Term BUY

Price: $18 1/2

Estimates (Dec)	1997A	1998E	1999E
EPS:	d$4.65	d$3.61	d$2.96
P/E:	NM	NM	NM
EPS Change (YoY):		NM	NM
Cash Flow/Share:	d$3.77	d$2.66	d$1.91
Price/Cash Flow:	NM	NM	NM
Dividend Rate:	Nil	Nil	Nil
Dividend Yield:	Nil	Nil	Nil

Opinion & Financial Data

Investment Opinion:	D-2-1-9
Mkt. Value / Shares Outstanding (mn):	$697 / 37.7
Book Value/Share (Mar-98):	-$2.74
Price/Book Ratio:	NM
LT Liability % of Capital:	77%
Est. 5 Year EPS Growth:	NM

Stock Data

52-Week Range:	$19 7/8 - $4 7/8
Symbol / Exchange:	ESPI/ OTC
Options:	None

ML Industry Weightings & Ratings**

Strategy: Weighting Rel. to Mkt.:		
Income:	Overweight	(07-Mar-95)
Growth:	Underweight	(07-Mar-95)
Income & Growth:	Overweight	(07-Mar-95)
Capital Appreciation:	Overweight	(16-Jan-96)
Market Analysis: Technical Rating:	Above Average	(24-Dec-96)

**The views expressed are those of the macro department and do not necessarily coincide with those of the Fundamental analyst.
For full investment opinion definitions, see footnotes.

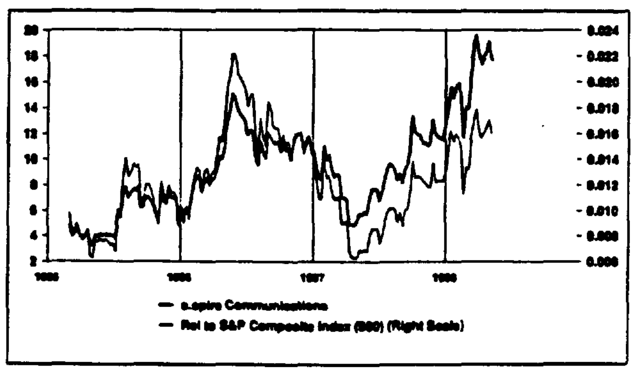
Investment Highlights:

- **We are initiating coverage of e.spire (formerly American Comm. Services) with an interm. term Accumulate & long term Buy opinion.**
- **12-18 mo. price objective is $28 or 51% upside based on the midpoint of our year-end '98 & '99 10 year DCF models, a 15% discount rate, and a 9.5x mult. on terminal year EBITDA.**

Fundamental Highlights:

- **Our forecast assumes that e.spire will have fiber rings built in 36 MSAs in the southern half of the US by year-end '98. We estimate that the size of the local market resident in MSAs where e.spire has local facilities will grow from $12.8Bn in '98 to $40.6Bn by '08, with e.spire's share growing to 6.8% in '08 or just 1.7% of the total US local market.**
- **'98 revs. estimated at $156MM, doubling in '99 to $325MM, reaching $3.2Bn in '08. By '08, we forecast EBITDA margins will reach 23.8% with a 17%/64%/19% blend of on-net, UNE & TSR local services.**
- **New management team -- led by CEO Jack Reich -- installed within the past 15 mos. and should help to accelerate e.spire's bundled service rollout efforts.**

Stock Performance



We are initiating coverage on e.spire Communications with an intermediate term Accumulate and long term Buy opinion. Our 12-18 month price objective is $28 or 51% upside from current prices.

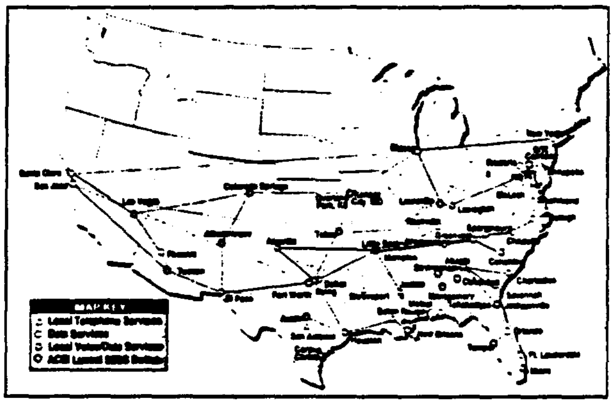
Company Description: e.spire Communications is a facilities-based competitive local exchange carrier (CLEC) providing local, long distance (LD), data and high speed internet services primarily to small & medium-sized business customers located in the southern half of the US. Currently, e.spire provides switched local telecom service in 37 MSAs (metropolitan statistical areas), 32 where it maintains competitive local fiber optic rings as well as an additional 5 MSAs where service is provided on a TSR (total service resale) basis using rented ILEC (incumbent local exchange carrier) local network facilities.

The Annapolis Junction, MD-based company's network at year-end '97 (see Chart 1) included 16 Lucent 5ESS combination local/LD telephone switches, 1,061 local fiber route miles, and network connectivity to 1,604 customer buildings. In addition, the company recently disclosed that during 1Q98, 22,500 new local access lines were added, bringing the corporate total to 57,605, or a sequential increase of 64%.

e.spire's network expansion plans call for the addition of: a) local fiber rings in 4-5 new MSAs per year (sufficient, by our estimation, to bring total MSA count to 50 by '02); and, b) the addition of 24 voice switches to raise the corporate total to 40. To a limited extent, e.spire has arrayed its local networks in "clusters" to take advantage of cost synergies of operating geographically-concentrated networks as well as to avail itself of regional LD traffic between key "communities of interest". Examples of these clusters include: Washington, DC/Baltimore/ Northern VA.; Dallas/Ft. Worth/Irving; and, Miami/Ft. Lauderdale. We estimate that the telecom market resident within the 36 MSAs where e.spire will have operational fiber rings by year-end '98 will total $12.8Bn in local and data revenues in '98. This market opportunity is then expected to grow to $15.7Bn in '99, $19.3Bn in '99, eventually reaching $40.6Bn by '08. The two key assumptions underlying our forecast are: a) total number of operational fiber rings grows to a total of 50 by '02; and, b) an assumed 5% annual growth in the market resident within the base 36 MSAs.

e.spire's selling strategy differs from that of solely pursuing voice traffic (both local and LD) from small and medium-sized business customers. Instead, e.spire was one of the first CLECs to offer its business customers a fully integrated suite of both voice AND data (including high speed internet) services. This full product line -- especially on the data side -- not only assists e.spire in the pursuit of new customers but, just as importantly, should assist in reducing customer churn over time. This product positioning was further enhanced via the acquisition last year of Cybergate. Cybergate, which was purchased for approximately $9MM in stock in early '97, is an internet service provider or ISP serving both the business and residential markets. We expect that this acquisition will provide e.spire with a number of important benefits including: a) the expansion of internet services offerings, and, b) providing an opportunity to cross-sell local, LD and other high speed data services to Cybergate's rapidly growing customer base of 44,500 (1Q98 sequential growth of 14%).

Chart 1: e.spire Network Map



Source: Merrill Lynch estimates

3 Key Value Drivers At e.spire

Value Driver #1. Attractive macro environment - expanded addressable market:

Regulatory and legislative changes on both the Federal and state levels have greatly expanded the nationwide market potentially addressable by new local competitors from what had been just the $5Bn special access/private line market segment to now the entire $107Bn local switched telecom market.

Value Driver #2: Strong top line growth forecast with a 10 year CAGR of 36%, driven by the sale of bundled telecom services -- including data and high speed internet -- to small and medium-sized business customers in the southern half of the US:

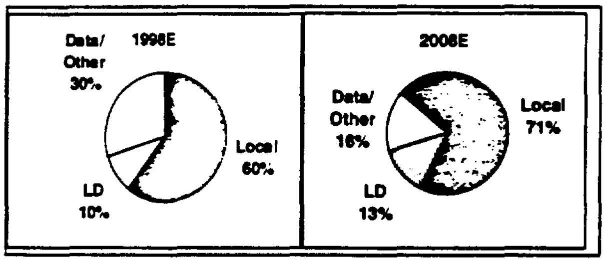
We estimate that in '98, e.spire's revenues will grow 164% y/y from $59MM in '97 to $156MM in '98, roughly double again in '99 to $325MM, grow 70% in '00 to $552MM, eventually reaching $3.2Bn by '08, with a 10 year CAGR of 36%. We forecast e.spire's '98 EBITDA losses to be $35MM, with EBITDA breakeven occurring during 1H'99. We expect EBITDA to eventually reach $772MM or 23.8% of revenues by '08. Our forecast model assumes that e.spire will utilize a mix of on-net (i.e., e.spire's "owned" last mile facilities), TSR, and unbundled network elements (UNE) services in order to reach its customers and that by '08, e.spire realizes EBITDA margins of 40% for on-net traffic, 25% for UNE and 10% for TSR. In addition, we estimate that e.spire's local traffic mix will shift away from a heavy dependence on TSR in '98 (54% of total with UNE's at 32% and on-net at 14%)

towards a network mix more heavily reliant on UNE's — 64% of total — with the balance almost evenly split between on-net and TSR by '08.

Key assumptions (detailed in Table 1 below) underlying our forecast are as follows:

4. **Industry context** - $107Bn local market growing 4.0-4.5% per annum through '08.
4. **Geographic coverage** – At year-end '97, e.spire offered service to business customers in 37 MSAs, a geographic area that contains a local voice and data market of $10.4Bn or roughly 10% of the US total. We estimate that the expansion of an additional 4-5 fiber rings in new MSAs per year through '02 to a total of 50, will increase the local telecom opportunity resident in e.spire's MSAs 23% to $12.8Bn in '98, 23% to $15.7Bn in '99, 23% to $19.3Bn in '00, eventually reaching $40.6Bn in '08.

Chart 2: 1998E and 2008E Revenue Mix



Source: Merrill Lynch estimates

4. **Local and data market share:** We estimate that during '98, e.spire will attain a 1.1% ($136MM) share of its local and data services resident within its MSAs. Our forecast calls for e.spire's market share to grow to 1.6% ($257MM) in '99, 2.2% ($432MM) in '00, reaching 6.8% ($2.8Bn) by '08. These market penetration rates are in line with our previously published CLEC work which assumes that, in addition to e.spire, there will be two other local/data facilities-based and four UNE/TSR-based competitors to the ILEC (incumbent local exchange carrier) in each market area, and in aggregate these new competitors will take a combined 29% local and data market share from the ILEC by '08.
4. **Long distance market share:** Our forecast assumes that e.spire will capture approximately 0.3% or $15MM of the $5.7Bn LD market available within its MSAs in '98, growing to $425MM or 2.5% of e.spire's $17.1Bn available LD market by '08.

Value Driver #3. New management in place helps to bolster confidence in long term growth prospects

Within the past 15 months, a new senior management team of experienced telecom executives was installed in an effort to reposition the company to better execute its bundled service product strategy -- both from an operations as well as sales & marketing perspective. The new management team is now led by: CEO Jack Reich (previously at Ameritech, MCI & AT&T); COO Ron Spears (Citizens Utilities and MCI division president); and, CFO Dave Piazza (MFS and AT&T).

Table 1: Key Financial Assumptions

	1998E	2000E	2004E	2008E
Avail. Business Lines* (Bn)	9.2	13.6	22.7	29.2
Monthly Revenue	$51.40	$50.30	$48.15	$46.05
Available Res. Lines* (Bn)	13.7	20.4	30.9	32.3
Monthly Revenue	$35.35	$36.05	$37.50	$39.05
Total Telephony Oppt'y (Bn)	$11.4	$17.0	$27.0	$31.2
Available Data Oppt'y* (Bn)	$1.4	$2.3	$5.1	$9.4
Local Available Market* (Bn)	$12.8	$19.3	$32.1	$40.6
Local Market Share	1.1%	2.2%	4.4%	6.8%
LD- Available Market* (Bn)	$5.7	$8.6	$14.2	$17.1
Long Distance Market Share	0.3%	1.3%	2.0%	2.5%
Combined Market Share	0.8%	1.9%	3.7%	5.6%
EBITDA Margin	-22.2%	9.0%	19.4%	23.8%
Capital Expenditures (MM)	$160.0	$200.0	$225.0	$250.0
Free Cash Flow (MM)	($245.0)	($235.3)	($4.0)	$430.6

Note: (numbers may not add due to rounding)
* - Estimated size of market available in the MSAs where e.spire sells service
Source: Merrill Lynch estimates

Strategic assets with estimated $28 takeover value: Given the strategic value of e.spire's network infrastructure, its in-place bundled service salesforce and its customer base, one cannot rule out a possible bid for the company. If a transaction for e.spire were to occur, we estimate that a buyer could offer $28 per share based on our 10 year discounted cash flow (DCF) model. We think a potential buyer would be attracted by the significant time to market advantage of buying in-place local infrastructure, a customer base as well as "know how" that resides in-house. Logical buyers could potentially include the large LD companies such as MCI/WorldCom, Sprint, AT&T as well as other large CLECs such as Intermedia, ICG, NEXTLINK or Electric Lightwave looking to quickly expand into new markets and augment the footprint of existing networks.

Attractive valuation: Our private market value estimate for e.spire is $28 or 51% upside. This 12-18 month price objective, based on our 10 year DCF model, assumes the midpoint of our year-end private market value estimates for '98 and '99. Key assumptions incorporated in our DCF analysis (see Table 2 below) include a 15% discount rate, a 9.5 multiple on terminal year EBITDA, and a 6.3-8.1% perpetual growth rate of unlevered free cash flow. Our analytical approach towards valuing shares of e.spire is consistent with our earlier work on other CLECs.

Table 2: e.spire Valuation Summary

(in millions except per share values)	YE 1998E	YE 1999E
Discount Rate	*15.0%*	*15.0%*
Terminal Multiple	*9.5x*	*9.5x*
Implied Perpetual Growth of Unlevered Free CF	*8.1%*	*6.3%*
+PV of Unlevered Free CF	($8)	$325
+PV of Terminal Value	$1,727	$2,084
=Enterprise Value	$1,719	$2,409
- Net Debt	($329)	($644)
=Private Market Value - Equity	$1,390	$1,765
Fully Diluted Shares Outstanding	54.8	58.0
=Per Share Private Market Value	$ 25.36	$ 30.42

Risks to our recommendation include:

1. Need for external funding — both debt and equity — to fund network deployment strategy.
2. Execution risk — can the current management team and back office systems handle the dynamic growth forecast for e.spire?

Table 3: e.spire Financial Forecast

	1997A	1Q98A	2Q98E	3Q98E	4Q98E	1998E	1999E	2000E	2001E	2002E	2003E	2004E	2005E	2006E	2007E	2008E
Switched Local		8.2	11.0	15.4	20.5	55.1	155.1	301.2	484.1	677.7	881.0	1.101.2	1.343.5	1.598.8	1.854.6	2.132.8
Long Distance		0.1	2.0	5.0	8.0	15.1	60.0	110.0	160.0	220.0	250.0	285.0	320.0	355.0	390.0	425.0
Switched Services		8.3	13.0	20.4	28.5	70.2	215.1	411.2	644.1	897.7	1,131.0	1,386.2	1,663.5	1,953.8	2.244.6	2.557.8
Dedicated		8.5	9.3	10.1	11.0	38.9	44.8	51.5	59.2	68.1	78.3	88.5	100.0	113.0	127.7	144.3
Data/Internet		9.3	10.0	10.7	11.4	41.5	57.5	79.4	107.1	139.3	178.3	224.6	280.7	345.3	421.3	514.0
Other		1.3	1.5	1.5	1.5	5.8	8.0	10.0	12.0	14.0	16.0	18.0	20.0	22.0	24.0	26.0
Total Revenues	59.0	27.5	33.8	42.7	52.4	156.4	325.4	552.1	822.4	1,119.1	1,403.6	1,717.3	2.064.3	2,434.1	2.817.6	3.242.1
Cost of service	48.8	19.3	22.0	23.5	28.0	92.7	169.2	281.6	415.3	559.5	698.3	852.0	1,021.8	1,202.5	1,389.1	1.595.1
SG&A	65.2	21.4	22.0	26.0	29.6	99.0	146.4	220.8	304.3	386.1	456.2	532.4	619.3	705.9	788.9	875.4
Depr & Amort	24.1	8.3	10.2	11.3	12.8	42.5	53.3	72.0	92.0	113.3	135.8	158.3	180.8	203.3	227.0	252.0
Operating Profit	(79.2)	(21.5)	(20.3)	(18.2)	(17.9)	(77.9)	(43.5)	(22.4)	10.8	60.2	113.3	174.7	242.4	322.5	412.6	519.6
Interest Exp (net)	32.9	10.6	12.5	13.0	13.5	49.6	70.0	85.0	97.5	120.0	120.0	112.0	108.0	100.0	90.0	91.0
Pretax Profit	(112.1)	(32.1)	(32.8)	(31.2)	(31.4)	(127.5)	(113.5)	(107.4)	(86.7)	(59.8)	(6.7)	62.7	134.4	222.5	322.6	428.6
Net Profit	(112.1)	(32.1)	(32.8)	(31.2)	(31.4)	(127.5)	(113.5)	(107.4)	(86.7)	(59.8)	(6.7)	62.7	134.4	222.5	322.6	428.6
Prfd Stk Div/Accr'tn	11.6	8.5	8.1	8.4	8.7	33.7	37.7	43.0	49.1	56.1	64.1	73.2	83.6	95.5	109.1	0.0
Net Income	(123.7)	(40.6)	(40.9)	(39.5)	(40.1)	(161.2)	(151.2)	(150.4)	(135.9)	(115.9)	(70.7)	(10.5)	50.8	127.0	213.4	428.6
EPS	($4.65)	($1.08)	($0.89)	($0.84)	($0.84)	($3.61)	($2.96)	($2.90)	($2.59)	($2.17)	($1.31)	($0.19)	$0.91	$2.24	$3.71	$7.35
Shares O/S	27.26	37.71	46.10	47.00	47.80	44.65	51.00	51.77	52.54	53.33	54.13	54.94	55.77	56.60	57.45	58.31
EBITDA	(55.1)	(11.6)	(10.1)	(6.8)	(5.2)	(35.4)	9.8	49.7	102.8	173.5	249.1	333.0	423.2	525.8	639.6	771.6
Lines in srvc. (000's)		57.6	83.6	113.6	148.6		348.6	598.6	923.6							
Cap Exp	149.4	40.0	45.0	45.0	30.0	160.0	175.0	200.0	200.0	225.0	225.0	225.0	225.0	225.0	250.0	250.0
Free cash flow		(63.8)	(67.6)	(64.8)	(48.7)	(245.0)	(235.2)	(235.3)	(194.7)	(171.5)	(95.9)	(4.0)	90.2	200.8	299.6	430.6
Margins																
Cost of service	82.8%	70.1%	65.0%	55.0%	53.5%	59.3%	52.0%	51.0%	50.5%	50.0%	49.8%	49.6%	49.5%	49.4%	49.3%	49.2%
SG&A	110.5%	78.0%	65.0%	61.0%	56.4%	63.3%	45.0%	40.0%	37.0%	34.5%	32.5%	31.0%	30.0%	29.0%	28.0%	27.0%
Depr & Amort	40.9%	30.0%	30.2%	26.5%	24.3%	27.2%	16.4%	13.0%	11.2%	10.1%	9.7%	9.2%	8.8%	8.4%	8.1%	7.8%
EBITDA	NM	NM	NM	NM	NM	NM	3.0%	9.0%	12.5%	15.5%	17.8%	19.4%	20.5%	21.6%	22.7%	23.8%
Y/Y Change																
Total Revenues		235.9%	190.9%	165.9%	126.4%	165.0%	108.1%	69.7%	49.0%	36.1%	25.4%	22.4%	20.2%	17.9%	15.8%	15.1%
Cost of service		122.1%	134.7%	120.6%	39.0%	89.9%	82.5%	66.4%	47.5%	34.7%	24.8%	22.0%	19.9%	17.7%	15.5%	14.8%
SG&A		51.4%	33.3%	39.6%	85.9%	51.8%	47.9%	50.8%	37.8%	26.9%	18.2%	16.7%	16.3%	14.0%	11.8%	11.0%
Shares O/S		380.2%	64.5%	29.7%	29.5%	63.8%	14.2%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%
EBITDA		NM	NM	NM	NM	NM	NM	409.0%	106.9%	68.7%	43.6%	33.7%	27.1%	24.2%	21.6%	20.6%

Source: Merrill Lynch estimates

[ESPI] MLPF&S was a manager of the most recent public offering of securities of this company within the last three years.
[ESPI] The securities of the company are not listed but trade over-the-counter in the United States. In the US, retail sales and/or distribution of this report may be made only in states where these securities are exempt from registration or have been qualified for sale. MLPF&S or its affiliates usually make a market in the securities of this company.

Opinion Key [X-a-b-c]: Investment Risk Rating(X): A - Low, B - Average, C - Above Average, D - High. Appreciation Potential Rating (a: Int. Term - 0-12 mo.; b: Long Term - >1 yr.): 1 - Buy, 2 - Accumulate, 3 - Neutral, 4 - Reduce, 5 - Sell, 6 - No Rating. Income Rating(c): 7 - Same/Higher, 8 - Same/Lower, 9 - No Cash Dividend.

16 March 1998

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ICG Communications, Inc.

New Data Initiative Announced, Raising Private Market Price Obj. To $42

ACCUMULATE*

Reason for Report: New Initiatives Announced

Long Term ACCUMULATE

Price: **$37 1/8**

12 Month Price Objective: $42

Estimates (Dec)	1997A	1998E	1999E
EPS:	d$9.75	d$6.34	d$6.39
P/E:	NM	NM	NM
EPS Change (YoY):		NM	NM
Consensus EPS: (First Call: 09-Mar-98)		d$6.42	d$5.42
Cash Flow/Share:	d$7.99	d$3.83	d$2.81
Price/Cash Flow:	NM	NM	NM
Dividend Rate:	Nil	Nil	Nil
Dividend Yield:	Nil	Nil	Nil

Opinion & Financial Data

Investment Opinion:	D-2-2-9
Mkt. Value / Shares Outstanding (mn):	$1.238 / 32
Book Value/Share (Sep-97):	-8.88
Price/Book Ratio:	NM

Stock Data

52-Week Range:	$39 7/8-$8 5/8
Symbol / Exchange:	ICGX / OTC
Options:	AMEX
Institutional Ownership-Spectrum:	91.3%
Brokers Covering (First Call):	13

ML Industry Weightings & Ratings**

Strategy: Weighting Rel. to Mkt.:		
Income:	Overweight	(07-Mar-95)
Growth:	Underweight	(07-Mar-95)
Income & Growth:	Overweight	(07-Mar-95)
Capital Appreciation:	Overweight	(16-Jan-96)
Market Analysis: Technical Rating:	Above Average	(24-Dec-96)

*Intermediate term opinion last changed on 18-Sep-97.
**The views expressed are those of the macro department and do not necessarily coincide with those of the Fundamental analyst.
For full investment opinion definitions, see footnotes.
Merrill Lynch or an affiliate has a proprietary investment in this company

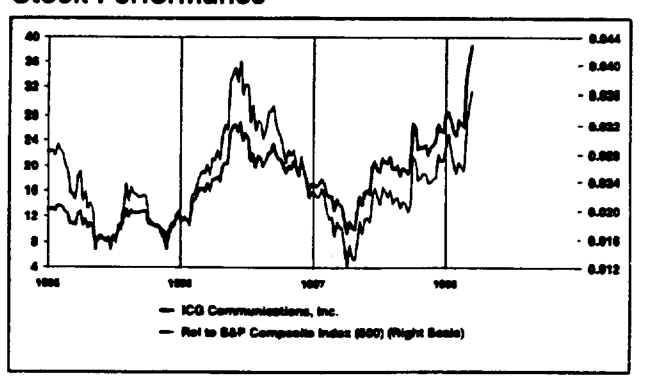
Merrill Lynch is currently acting as a financial advisor and has rendered a fairness opinion to Teleport Communications Group Inc. in connection with the proposed acquisition of it by AT&T Corporation, which was announced on January 8, 1998.

Teleport Communications Group Inc. has agreed to pay a fee to Merrill Lynch for its financial advisory services, a significant portion of which is contingent upon the consumation of the proposed transaction.

Investment Highlights:

- **Prior to the market open on March 11, ICG announced 2 "data oriented" products that helps to expand the company's breadth of product offerings.**
- **1) Flat rate IP (internet protocol) telephony offering at $0.059-$0.072 per minute bests recent product announcements of similar services by both Qwest and AT&T. ICG's extensive local infrastructure and internet backbone should allow for attractive margins.**
- **2) DSL (digital subscriber line) initiative will allow ICG to offer high speed internet access (at first) to business customers as well as a portion of NETCOM's 500,000 dial-up subscriber base. Over time, as DSL technology develops, ICG will expand high speed offering to include additional services.**
- **Raising our year-end '98 private market value estimate by $6 or 17% to $42, reflecting the forecasted impact from the new IP telephony product. Although we are not including DSL in our forecast, this new product could add an additional $3 to PMV.**
- **Reiterate Accumulate opinion for both the intermediate and long term.**

Stock Performance



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RC#20107537

Prior to the market open on March 11, ICG announced two new "data oriented" initiatives designed to both enhance the corporate product as well as leverage the data opportunity resident within its customer base.

IP Telephony:

ICG announced a flat rate, nation-wide LD product offering. This new product, which will be marketed to business customers as well as NETCOM's 500,000 dial-up internet subscribers in 166 markets by year-end '98, offers callers flat rate LD calling anywhere in the US. ICG will offer its IP telephony product for $0.059/min. for calls originating and terminating "on-net" (i.e., in cities with internet POP — point of presence — facilities) and $0.072/min. for calls terminating in "off net" cities (i.e., without internet POP facilities).

The economics of this new product look quite favorable for both the end user (i.e., a 49-58% discount vs. average LD rate of $0.14/min.) and ICG as detailed in Table 1 below. SG&A support should be minimal as product sales will be via the internet and out-bound telemarketing and billing options will include free billing by credit card or hard copy bill for which ICG will collect an additional fee of $1.70/month. Cap exp requirements related to this new product offering should be minimal as the service will be provided over existing internet backbone and local POP facilities, all of which have sufficient (or easily expandable) capacity to meet the demands of this product.

Table 1: IP Telephony Economics

	Typical LD Call	On-To-On-Net Call	On-To-Off-Net Call
Average LD Rate/Min.	$0.140	$0.140	$0.140
ICG Rate		$0.059	$0.072
% Discount		58%	49%
Cost to ICG (per minute)			
Originating Access	$0.025	$0.000	$0.000
Terminating Access	$0.025	$0.000	$0.025
Long Haul Transport	$0.015	$0.005	$0.005
Network Costs	$0.065	$0.005	$0.030
Gross Margin	$0.075	$0.054	$0.042
% of revenue	46%	92%	58%
Depreciation	$0.005	$0.002	$0.002
SG&A	$0.035	$0.011	$0.011
Operating Margin	$0.035	$0.041	$0.029
% of revenue	25%	70%	40%

Source: Company reports and Merrill Lynch estimates

Notably, this offer undercuts similar IP LD products recently announced by both Qwest at $0.075/min. and AT&T at $0.075-$0.090/min. and highlights the continuing escalation of the LD industry's competitive environment.

We are raising our private market value (PMV) estimate by $6 to reflect the impact from IP Telephony

based on the following key assumptions: 1) ICG can address 1/3 of the US LD market with this product; 2) ICG's LD share grows to 2% of its addressable market by '07; and, 3) revenues/minute and EBITDA margins, over time, decline due to competitive pressures.

DSL Initiative:

In addition to the IP product, ICG also unveiled a DSL (digital subscriber line) product, aimed at providing high-speed connectivity (i.e., 144Kbs to upwards of 9Mbs)to business as well as NETCOM dial up customers (both business and residential users). Initially, the service will provide just high speed internet access for the NETCOM ISP product. Over time, voice services will be added as DSL technology improves. This product will initially be available to customers served by the 45 ILEC central switching offices (COs) in which ICG is "co-located". This number is expected to grow to 100 COs by year-end '98 and 3-400 by year-end '99. Estimated economics of this product are shown in Table 2 below:

Table 2: Estimated DSL Economics Under Various Loop Price Assumptions

Average Revenue/Month	$75.00	$75.00	$75.00
Monthly loop rental cost	$14.00	$19.00	$25.00
Gross Margin	$61.00	$56.00	$50.00
% of revenue	81%	75%	67%
SG&A*	$13.33	$13.33	$13.33
Depreciation*	$14.58	$14.58	$14.58
Operating Profit	$33.09	$28.09	$22.09
% of revenue	44%	38%	30%

*Note: SG&A includes the impact from 1x $100/customer installation fees amortized over 4 years. Depreciation assumes capital costs of $500/CO port and $200 for customer DSL modem and 4 year straight line depreciation.
Source: Company reports and Merrill Lynch estimates

Possible Impact On PMV?

Although we are not incorporating the potential from DSL into our forecast at present pending further due diligence, we estimate that this new product could add an additional $3 to year-end '98 private market value based on the following assumptions: 1) percent of NETCOM's dial-up subscriber base that are served by CO's where ICG is co-located grows from 35% in '99 to 50% by '07; 2) 60% of lines in a CO are "serviceable" for DSL; 3) DSL penetration grows to 35% by '07; and, 4) $75/mo. average revenue declines 3%/yr.

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Intermedia Communications Inc

3 April 1998

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Stock Weakness Creates Excellent Buying Oppt'y, Upgrade To Buy/Buy

BUY*

Reason for Report: Opinion Upgrade

Long Term BUY

Price: $75 1/16
12 Month Price Objective: $105

Estimates (Dec)	1997A	1998E	1999E
EPS:	d$10.83	d$12.30	d$10.38
P/E:	NM	NM	NM
EPS Change (YoY):		NM	NM
Consensus EPS: (First Call: 01-Apr-98)		d$11.64	d$10.47
Q1 EPS (Mar):	d$1.89	d$4.16	
Cash Flow/Share:	d$7.64	d$4.88	d$0.44
Price/Cash Flow:	NM	NM	NM
Dividend Rate:	Nil	Nil	Nil
Dividend Yield:	Nil	Nil	Nil

Opinion & Financial Data

Investment Opinion:	D-1-1-9
Mkt. Value / Shares Outstanding (mn):	$13,463.3 / 174
Price/Book Ratio:	NM

Stock Data

52-Week Range:	$91 1/4-$15 1/2
Symbol / Exchange:	ICIX / OTC
Options:	Pacific
Brokers Covering (First Call):	14

ML Industry Weightings & Ratings**

Strategy: Weighting Rel. to Mkt.:		
Income:	Overweight	(07-Mar-95)
Growth:	Underweight	(07-Mar-95)
Income & Growth:	Overweight	(07-Mar-95)
Capital Appreciation:	Overweight	(16-Jan-96)
Market Analysis: Technical Rating:	Above Average	(24-Dec-96)

*Intermediate term opinion last changed on 31-Mar-98.
**The views expressed are those of the macro department and do not necessarily coincide with those of the Fundamental analyst.
For full investment opinion definitions, see footnotes.

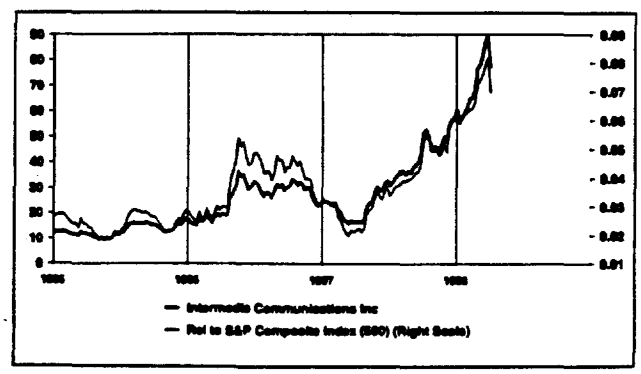
Investment Highlights:

- **Upgraded our intermediate term opinion to Buy following recent stock price weakness (down almost 15% in the past few days.).**
- **Reiterate 12 month private market value-based price objective of $105 or 40% upside.**

Fundamental Highlights:

- **Intermedia's stock has come under intense selling pressure over the past few days following heightened investor concern regarding 1Q and full year '98 forecast which we find unfounded.**
- **We reiterate confidence in our fundamental outlook. Recent discussions with management confirm reasonableness of our recently upwardly revised revenue and EBITDA forecast for both '98 and '99.**
- **Near term, key value drivers remain the strength of the core CLEC (competitive local exchange carrier) business, synergies expected from recently completed acquisitions as well as significant oppty's presented by data alliances with RBOCs such as US West with others possibly in the wings.**

Stock Performance



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RC#20109325

Table 1: Intermedia Communications – Financial Projections

($ in millions)	1997A	1Q98E	2Q98E	3Q98E	4Q98E	1998E	1999E	2000E	2001E	2002E	2003E	2004E	2005E	2006E	2007E
Revenue															
Local Network	42.0	24.4	29.0	33.9	39.7	127.0	215.0	325.0	475.0	657.9	878.3	1,141.7	1,450.0	1,798.0	2,157.6
Enhanced Data	57.8	19.0	24.6	31.5	39.9	115.0	279.0	348.8	418.5	489.6	563.1	647.6	738.2	834.2	934.3
Interexchange	113.2	44.3	59.8	79.0	101.9	285.0	360.0	444.6	533.5	634.9	746.0	857.9	986.6	1,134.6	1,304.7
Internet	28.8	20.1	22.3	25.0	28.5	95.9	210.0	252.0	296.1	340.5	391.6	450.3	506.6	564.9	621.4
Systems integration	6.1	26.0	29.7	33.7	37.8	127.2	137.0	150.0	165.0	180.0	194.4	208.8	219.2	230.2	241.7
Total Revenue	247.9	133.8	165.4	203.1	247.8	750.1	1,201.0	1,520.4	1,888.1	2,302.9	2,773.3	3,306.3	3,900.7	4,561.8	5,259.7
Expense															
Network Ops	164.5	69.0	84.4	101.1	119.0	373.5	609.5	741.4	893.3	1,032.5	1,217.1	1,418.2	1,642.2	1,893.2	2,156.5
Facil. admin & maint.	31.7	12.8	12.7	12.0	12.4	49.9	81.7	106.4	132.2	161.2	194.1	231.4	273.0	319.3	368.2
Cost of goods sold	3.0	1.8	2.1	2.5	3.0	9.3	13.9	19.7	28.3	34.5	41.6	49.6	58.5	68.4	78.9
SG&A	98.6	54.8	57.1	58.5	57.0	227.4	285.3	354.1	434.8	575.7	687.8	816.7	959.6	1,122.2	1,288.6
Dep & Amort.	53.6	35.4	38.9	43.7	44.8	162.8	222.2	266.0	323.2	371.3	429.4	482.6	535.7	594.4	649.4
Operating Profit	(103.5)	(40.1)	(29.7)	(14.7)	11.7	(72.8)	(11.6)	32.7	76.3	127.6	203.3	307.8	431.7	564.3	718.1
Interest Expense	(60.7)	(26.4)	(30.7)	(35.5)	(40.3)	(132.9)	(142.1)	(153.6)	(165.6)	(174.1)	(224.1)	(239.1)	(221.3)	(220.5)	(180.0)
Other Income	26.8	4.0	3.0	2.0	1.0	10.0	1.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pretax Income	(137.3)	(62.5)	(57.4)	(48.2)	(27.6)	(195.7)	(152.1)	(120.9)	(89.3)	(46.5)	(20.8)	68.7	210.4	343.8	538.1
Net Income	(137.3)	(62.5)	(57.4)	(48.2)	(27.6)	(195.7)	(152.1)	(120.9)	(89.3)	(46.5)	(20.8)	68.7	126.2	206.3	322.9
Prf'd Divs	43.7	17.8	18.3	18.7	19.2	74.0	80.0	88.0	96.8	104.0	105.0	105.0	105.0	105.0	105.0
Net Income - Common	(181.1)	(80.3)	(75.7)	(66.9)	(46.8)	(269.7)	(232.1)	(208.9)	(186.1)	(150.5)	(125.8)	(36.3)	21.2	101.3	217.9
EPS	($10.83)	($4.16)	($3.44)	($2.96)	($1.97)	($12.30)	($10.38)	($9.16)	($8.00)	($6.34)	($5.20)	($1.47)	$0.84	$3.94	$8.31
Shares O/S	16.7	19.3	22.0	22.6	23.8	21.9	22.4	22.8	23.3	23.7	24.2	24.7	25.2	25.7	26.2
EBITDA	(49.9)	(4.6)	9.1	29.0	56.5	90.0	210.6	298.7	399.5	498.9	632.7	790.4	967.4	1,158.7	
Cap Exp	272.0	90.0	95.0	95.0	95.0	375.0	475.0	410.0	425.0	425.0	425.0	425.0	425.0	435.0	445.0
Free Cash Flow	(360.7)	(125.8)	(129.8)	(130.8)	(139.1)	(412.9)	(409.9)	(284.9)	(211.1)	(120.2)	(36.4)	106.3	301.0	399.0	585.0
Margins															
Network Ops	66.3%	51.6%	51.0%	49.8%	48.0%	49.8%	50.7%	48.8%	47.3%	44.8%	43.9%	42.9%	42.1%	41.5%	41.0%
Facil. admin & maint.	12.8%	9.5%	7.7%	5.9%	5.0%	6.6%	6.8%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
Cost of goods sold	1.2%	1.3%	1.3%	1.2%	1.2%	1.2%	1.2%	1.3%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%
SG&A	39.8%	41.0%	34.5%	28.8%	23.0%	30.3%	23.8%	23.3%	23.0%	25.0%	24.8%	24.7%	24.6%	24.6%	24.5%
Dep & Amort.	21.6%	26.5%	23.5%	21.5%	18.1%	21.7%	18.5%	17.5%	17.1%	16.1%	15.5%	14.6%	13.7%	13.0%	12.3%
Operating Profit	-41.7%	-30.0%	-18.0%	-7.2%	4.7%	-9.7%	-1.0%	2.2%	4.0%	5.5%	7.3%	9.3%	11.1%	12.4%	13.7%
Interest Expense	-24.5%	-19.7%	-18.6%	-17.5%	-16.3%	-17.7%	-11.8%	-10.1%	-8.8%	-7.6%	-8.1%	-7.2%	-5.7%	-4.8%	-3.4%
Other Income	10.8%	3.0%	1.8%	1.0%	0.4%	1.3%	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Net Loss	-55.4%	-46.7%	-34.7%	-23.7%	-11.1%	-26.1%	-12.7%	-8.0%	-4.7%	-2.0%	-0.8%	2.1%	3.2%	4.5%	6.1%
EBITDA	-20.1%	-3.5%	5.5%	14.3%	22.8%	12.0%	17.5%	19.6%	21.2%	21.7%	22.8%	23.9%	24.8%	25.4%	26.0%
Y/Y % Change															
Local Network	210.3%	367.8%	243.9%	187.2%	140.4%	202.6%	69.3%	51.2%	46.2%	38.5%	33.5%	30.0%	27.0%	24.0%	20.0%
Enhanced Data	82.6%	67.8%	94.2%	84.8%	137.5%	98.8%	142.6%	25.0%	20.0%	17.0%	15.0%	15.0%	14.0%	13.0%	12.0%
Interexchange	112.9%	73.5%	115.9%	185.8%	215.6%	151.8%	26.3%	23.5%	20.0%	19.0%	17.5%	15.0%	15.0%	15.0%	15.0%
Internet				81.1%	90.3%	233.2%	118.9%	20.0%	17.5%	15.0%	15.0%	15.0%	12.5%	11.5%	10.0%
Systems integration	21.4%	NM	NM	NM	NM	NM	7.7%	9.5%	10.0%	9.1%	8.0%	7.4%	5.0%	5.0%	5.0%
Total Revenue	139.8%	204.4%	230.0%	185.0%	200.1%	202.6%	60.1%	26.6%	24.2%	22.0%	20.4%	19.2%	18.0%	17.0%	15.3%
Expense															
Facil.& line cost	138.0%	130.1%	126.4%	106.2%	147.0%	127.1%	63.2%	21.6%	20.5%	15.6%	17.9%	16.5%	15.8%	15.3%	13.9%
SG&A	316.4%	126.5%	120.0%	20.0%	20.9%	130.6%	25.5%	24.1%	22.8%	32.4%	19.5%	18.7%	17.5%	17.0%	14.8%
Dep & Amort.	-30.9%	39.1%	168.0%	392.5%	522.4%	203.6%	36.5%	19.7%	21.5%	14.9%	15.7%	12.4%	11.0%	11.0%	9.3%
Operating Profit	NM	NM	NM	NM	NM	NM	NM	NM	NM	67.2%	59.3%	51.4%	40.2%	30.7%	27.3%
Interest Expense	72.3%	138.1%	176.2%	100.7%	94.1%	119.1%	6.9%	8.1%	7.8%	5.1%	28.7%	6.7%	-7.4%	-0.4%	-18.4%
Net Income	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	63.4%	56.5%
EPS	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Shares O/S	19.2%	18.4%	33.1%	35.0%	37.8%	31.2%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
EBITDA	NM	NM	NM	NM	NM	NM	134.0%	41.8%	33.7%	24.9%	26.8%	24.9%	22.4%	19.8%	18.0%

Source: Merrill Lynch estimates

[ICIX] MLPF&S was a manager of the most recent public offering of securities of this company within the last three years.

[ICIX] The securities of the company are not listed but trade over-the-counter in the United States. In the US, retail sales and/or distribution of this report may be made only in states where these securities are exempt from registration or have been qualified for sale. MLPF&S or its affiliates usually make a market in the securities of this company.

Opinion Key [X-a-b-c]: Investment Risk Rating(X): A - Low, B - Average, C - Above Average, D - High. Appreciation Potential Rating (a. Int. Term - 0-12 mo.; b. Long Term - >1 yr.): 1 - Buy, 2 - Accumulate, 3 - Neutral, 4 - Reduce, 5 - Sell, 6 - No Rating. Income Rating(c): 7 - Same/Higher, 8 - Same/Lower, 9 - No Cash Dividend.

24 March 1998

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Intermedia Communications Inc

Data, Data, RBOC Data; Raising PMV To $105, Reiterate Long Term Buy

ACCUMULATE*

Reason for Report: Revised Price Objective

Long Term BUY

Price: **$89 1/8**

Estimates (Dec)	1997A	1998E	1999E
EPS:	d$10.83	d$12.47	d$10.52
P/E:	NM	NM	NM
EPS Change (YoY):		NM	NM
Consensus EPS: (First Call: 25-Feb-98)		d$10.33	d$9.15
Q4 EPS (Dec):			
Cash Flow/Share:	d$7.62	d$4.94	d$0.45
Price/Cash Flow:	NM	NM	NM
Dividend Rate:	Nil	Nil	Nil
Dividend Yield:	Nil	Nil	Nil

Opinion & Financial Data

Investment Opinion:	D-2-1-9
Mkt. Value / Shares Outstanding (mn):	$1,379.1 / 17
Book Value/Share (Mar-97):	NA
Price/Book Ratio:	NM
ROE 1997E Average:	NA
LT Liability % of Capital:	NA
Est. 5 Year EPS Growth:	NA

Stock Data

52-Week Range:	$84 3/4-$12 7/8
Symbol / Exchange:	ICIX / OTC
Options:	Pacific
Institutional Ownership-Spectrum:	90.6%
Brokers Covering (First Call):	14

ML Industry Weightings & Ratings**

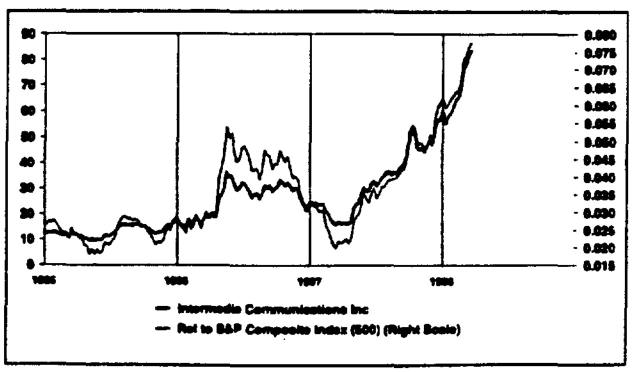
Strategy: Weighting Rel. to Mkt.:		
Income:	Overweight	(07-Mar-95)
Growth:	Underweight	(07-Mar-95)
Income & Growth:	Overweight	(07-Mar-95)
Capital Appreciation:	Overweight	(16-Jan-96)
Market Analysis: Technical Rating:	Above Average	(24-Dec-96)

*Intermediate term opinion last changed on 10-Jul-97.
**The views expressed are those of the macro department and do not necessarily coincide with those of the Fundamental analyst.
For full investment opinion definitions, see footnotes.

Investment Highlights:

- **Recent series of meetings with Intermedia's senior management team in both Tampa, FL. and NYC have prompted us to revise our near term and 10 year discounted cash flow forecast. Our recent meetings highlighted the strength of the core business, synergies from recently completed acquisitions as well as significant opportunity presented by data alliances with US West, etc.**
- **As a consequence, we are raising our '98 forecasts for revenue by 2% from $739 million to $750 million with no change to '98 EBITDA. In addition, we are raising our '99 forecasts for revenue and EBITDA by 9% from $1.1 billion to $1.2 billion and by 26% from $168 million to $211 million, respectively.**
- **We are increasing our 12 month private market value-based price objective by 48% from $71 to $105. Reiterate intermediate term Accumulate and long term Buy.**

Stock Performance



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Global Fundamental Equity Research Department

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RC#20108339

Revised 10 year forecast + RBOC data deals = Raising 12 month price objective to $105.

A recent series of meetings in both Tampa, FL. and NYC with Intermedia's senior management team over the past few weeks have led to a number of important revisions to our near term and 10 year discounted cash flow (DCF) model. Three key recent developments have prompted us to revisit many of our core modeling assumptions for Intermedia over the course of our 10 year DCF model:

1. Strong 4Q97 results reported on 2/25 give us confidence that the "core" Intermedia business model remains on track, fueled by continued strong data demand and benefits from the DIGEX acquisition and the continued rollout of switched local services.
2. Recently announced long haul network deal with Williams (1/15/98) enhances Intermedia's position and product offerings within the data market -- on a national scale -- with the addition of significant new data backbone capacity at favorable pricing.
3. RBOC data deals -- one down, a few more to go?: Intermedia's recently announced (1/29/98) alliance with US West for out-of-region frame relay and IP (internet protocol) data services. In accordance with these data deals, Intermedia will provide out-of-region origination and termination of data traffic plus inter-LATA data transport for US West's customers. This may indeed be just the first of a series of such deals with other RBOCs which will provide Intermedia with an important new revenue opportunity. In addition, we believe Intermedia will have the ability to utilize extra capacity within the last mile local loop connections required by the RBOC data deals to provide switched services (local, long distance and data) to other customers in the same building locations.

Revising Forecast: As shown in Table 1 below, we are making the following changes to our revenue and EBITDA forecast for both '98 and '99.

Table 1: Revised Forecast Model

	Revenue		EBITDA	
($ in millions)	**1998E**	**1999E**	**1998E**	**1999E**
Original Forecast	739	1,057	90	168
Y/Y % change		43%		87%
More optimism regarding revenue synergies w/ Shared Tech	11	20	0	21
Impact from RBOC data deals	0	124	0	22
New Forecast	750	1,201	90	211
Y/Y % change		60%		134%

Source: Merrill Lynch estimates

Outer year revenues and EBITDA have also increased with year 2007 revenue increasing by 10% from $4.8 billion to $5.3 billion and EBITDA increasing by 27% from $1.1 billion to $1.4 billion.

Conclusion: We are raising our 12 month private market value-based price objective from $71 to $105 to reflect our new 10 year DCF forecast model. Our new price objective reflects the average between our year-end '98 and year-end '99 private market values using a 15% discount rate, 9.5x terminal EBITDA multiple, and no public to private discount.

Table 2: Intermedia Communications Detailed Financial Forecast

	1997A	1Q98E	2Q98E	3Q98E	4Q98E	1998E	1999E	2000E	2001E	2002E	2003E	2004E	2005E	2006E	2007E
Revenue															
Local Network Svcs	42.0	24.4	29.0	33.9	39.7	127.0	215.0	325.0	475.0	657.9	878.3	1,141.7	1,450.0	1,798.0	2,157.6
Enhanced Data Svcs	57.8	19.0	24.6	31.5	39.9	115.0	279.0	348.8	418.5	489.6	563.1	647.6	738.2	834.2	934.3
Interexchange Svcs	113.2	44.3	59.8	79.0	101.9	285.0	360.0	444.6	533.5	634.9	746.0	857.9	986.6	1,134.6	1,304.7
Internet	28.8	20.1	22.3	25.0	28.5	95.9	210.0	252.0	296.1	340.5	391.6	450.3	506.6	564.9	621.4
Systems integration	6.1	26.0	29.7	33.7	37.8	127.2	137.0	150.0	165.0	180.0	194.4	208.8	219.2	230.2	241.7
Total Revenue	247.9	133.8	165.4	203.1	247.8	750.1	1,201.0	1,520.4	1,888.1	2,302.9	2,773.3	3,306.3	3,900.7	4,561.8	5,259.7
Expense															
Network Ops	164.5	69.0	84.4	101.1	119.0	373.5	609.5	741.4	893.3	1,032.5	1,217.1	1,418.2	1,642.2	1,893.2	2,156.5
Facil. admin & maint.	31.7	12.8	12.7	12.0	12.4	49.9	81.7	106.4	132.2	161.2	194.1	231.4	273.0	319.3	368.2
Cost of goods sold	3.0	1.8	2.1	2.5	3.0	9.3	13.9	19.7	28.3	34.5	41.6	49.6	58.5	68.4	78.9
SG&A	98.6	54.8	57.1	58.5	57.0	227.4	285.3	354.1	434.8	575.7	687.8	816.7	959.6	1,122.2	1,288.6
Dep & Amort.	53.6	35.4	38.9	43.7	44.8	162.8	222.2	266.0	323.2	371.3	429.4	482.6	535.7	594.4	649.4
Operating Profit	(103.5)	(40.1)	(29.7)	(14.7)	11.7	(72.8)	(11.6)	32.7	76.3	127.6	203.3	307.8	431.7	564.3	718.1
Interest Expense	(60.7)	(26.4)	(30.7)	(35.5)	(40.3)	(132.9)	(142.1)	(153.6)	(165.6)	(174.1)	(224.1)	(239.1)	(221.3)	(220.5)	(180.0)
Other Income	26.8	4.0	3.0	2.0	1.0	10.0	1.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pretax Income	(137.3)	(62.5)	(57.4)	(48.2)	(27.6)	(195.7)	(152.1)	(120.9)	(89.3)	(46.5)	(20.8)	68.7	210.4	343.8	538.1
Net Income	(137.3)	(62.5)	(57.4)	(48.2)	(27.6)	(195.7)	(152.1)	(120.9)	(89.3)	(46.5)	(20.8)	68.7	126.2	206.3	322.9
Prf'd Divs	43.7	17.8	18.3	18.7	19.2	74.0	80.0	88.0	96.8	104.0	105.0	105.0	105.0	105.0	105.0
Net Income - Common	(181.1)	(80.3)	(75.7)	(66.9)	(46.8)	(269.7)	(232.1)	(208.9)	(186.1)	(150.5)	(125.8)	(36.3)	21.2	101.3	217.9
EPS	($10.83)	($4.16)	($3.44)	($2.96)	($1.97)	($12.30)	($10.38)	($9.16)	($8.00)	($6.34)	($5.20)	($1.47)	$0.84	$3.94	$8.31
Shares O/S	16.7	19.3	22.0	22.6	23.8	21.9	22.4	22.8	23.3	23.7	24.2	24.7	25.2	25.7	26.2
EBITDA	(49.9)	(4.6)	9.1	29.0	56.5	90.0	210.6	298.7	399.5	498.9	632.7	790.4	967.4	1,158.7	1,367.5
Cap Exp	272.0	90.0	95.0	95.0	95.0	375.0	475.0	410.0	425.0	425.0	425.0	425.0	425.0	435.0	445.0
Free Cash Flow	(360.7)	(125.8)	(129.8)	(130.8)	(139.1)	(412.9)	(409.9)	(284.9)	(211.1)	(120.2)	(36.4)	106.3	301.0	399.0	585.0
Margins															
Network Ops	66.3%	51.6%	51.0%	49.8%	48.0%	49.8%	50.7%	48.8%	47.3%	44.8%	43.9%	42.9%	42.1%	41.5%	41.0%
Facil. admin & maint	12.8%	9.5%	7.7%	5.9%	5.0%	6.6%	6.8%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
Cost of goods sold	1.2%	1.3%	1.3%	1.2%	1.2%	1.2%	1.2%	1.3%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%
SG&A	39.8%	41.0%	34.5%	28.8%	23.0%	30.3%	23.8%	23.3%	23.0%	25.0%	24.8%	24.7%	24.6%	24.6%	24.5%
Dep & Amort	21.6%	26.5%	23.5%	21.5%	18.1%	21.7%	18.5%	17.5%	17.1%	16.1%	15.5%	14.6%	13.7%	13.0%	12.3%
Operating Profit	NM	NM	NM	NM	NM	NM	NM	2.2%	4.0%	5.5%	7.3%	9.3%	11.1%	12.4%	13.7%
Other Income	10.8%	3.0%	1.8%	1.0%	0.4%	1.3%	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Net Loss	NM	NM	NM	NM	NM	NM	NM	NM	NM	-2.0%	-0.8%	2.1%	3.2%	4.5%	6.1%
EBITDA	-20.1%	-3.5%	5.5%	14.3%	22.8%	12.0%	17.5%	19.6%	21.2%	21.7%	22.8%	23.9%	24.8%	25.4%	26.0%
Y/Y Change															
Local Network Svcs	210.3%	367.8%	243.9%	187.2%	140.4%	202.6%	69.3%	51.2%	46.2%	38.5%	33.5%	30.0%	27.0%	24.0%	20.0%
Enhanced Data Svcs	82.6%	67.8%	94.2%	84.8%	137.5%	98.8%	142.6%	25.0%	20.0%	17.0%	15.0%	15.0%	14.0%	13.0%	12.0%
Interexchange Svcs	112.9%	73.5%	115.9%	185.8%	215.6%	151.8%	26.3%	23.5%	20.0%	19.0%	17.5%	15.0%	15.0%	15.0%	15.0%
Internet	NA	NA	NA	81.1%	90.3%	233.2%	118.9%	20.0%	17.5%	15.0%	15.0%	15.0%	12.5%	11.5%	10.0%
Systems integration	NM	NM	NM	NM	NM	NM	7.7%	9.5%	10.0%	9.1%	8.0%	7.4%	5.0%	5.0%	5.0%
Total Revenue	139.8%	204.4%	230.0%	185.0%	200.1%	202.6%	60.1%	26.6%	24.2%	22.0%	20.4%	19.2%	18.0%	17.0%	15.3%
Expense															
Facil. admin. & maint	138.0%	130.1%	126.4%	106.2%	147.0%	127.1%	63.2%	21.6%	20.5%	15.6%	17.9%	16.5%	15.8%	15.3%	13.9%
SG&A	316.4%	126.5%	120.0%	20.0%	20.9%	130.6%	25.5%	24.1%	22.8%	32.4%	19.5%	18.7%	17.5%	17.0%	14.8%
Dep & Amort.	-30.9%	39.1%	168.0%	392.5%	522.4%	203.6%	36.5%	19.7%	21.5%	14.9%	15.7%	12.4%	11.0%	11.0%	9.3%
Operating Profit	NM	NM	NM	NM	NM	NM	NM	NM	NM	67.2%	59.3%	51.4%	40.2%	30.7%	27.3%
Interest Expense	72.3%	138.1%	176.2%	100.7%	94.1%	119.1%	6.9%	8.1%	7.8%	5.1%	28.7%	6.7%	-7.4%	-0.4%	-18.4%
Net Income	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	63.4%	56.5%
EPS	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Shares O/S	19.2%	18.4%	33.1%	35.0%	37.8%	31.2%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
EBITDA	NM	NM	NM	NM	NM	NM	134.0%	41.8%	33.7%	24.9%	26.8%	24.9%	22.4%	19.8%	18.0%

Source: Merrill Lynch estimates

9 February 1998

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RCN Corporation

Triple Play Residential CLEC: 3 Revenue Streams Yet Only 1 Construction Effort

ACCUMULATE

Reason for Report: Initiating Coverage

Long Term BUY

Price: **$44**

Estimates (Dec)	1997E	1998E	1999E
EPS:	d$2.50	d$5.81	d$7.45
P/E:	NM	NM	NM
EPS Change (YoY):		NM	NM
Cash Flow/Share:	d$0.59	d$3.71	d$4.38
Price/Cash Flow:	NM	NM	NM
Dividend Rate:	Nil	Nil	Nil
Dividend Yield:	Nil	Nil	Nil

Opinion & Financial Data

Investment Opinion:	D-2-1-9
Mkt. Value / Shares Outstanding (mn):	$1,223./27.8
Book Value/Share (Nov-97):	$13.46
Price/Book Ratio:	3.3x
LT Liability % of Capital:	58%
Est. 5 Year EPS Growth:	NM

Stock Data

Range (from 9/19/97):	$44 3/4-24 7/8
Symbol / Exchange:	RCNC/OTC
Options:	PSE
Institutional Ownership-Spectrum:	NA

ML Industry Weightings & Ratings**

Strategy: Weighting Rel. to Mkt.:		
Income:	Overweight	(07-Mar-95)
Growth:	Underweight	(07-Mar-95)
Income & Growth:	Overweight	(07-Mar-95)
Capital Appreciation:	Overweight	(16-Jan-96)
Market Analysis: Technical Rating:	Above Average	(24-Dec-96)

**The views expressed are those of the macro department and do not necessarily coincide with those of the Fundamental analyst.
For full investment opinion definitions, see footnotes.

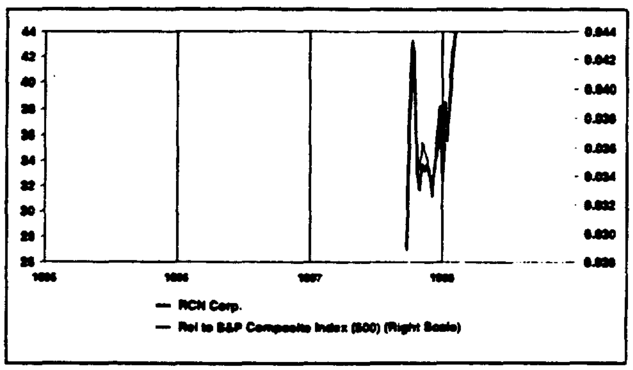
Investment Highlights:

- **Initiating coverage of RCN Corporation (RCN) with an intermediate term Accumulate and long term Buy opinion (D-2-1-9).**
- **Our 12-18 month price obj. of $70, 59% upside from current levels, is based on a sum of the parts private market valuation including RCN's US residential CLEC (RCN Telecom, $50/share), US cable props. ($16/share), & 40% share of a Mexican CLEC ($2/share). We think RCN will be attractive to the larger ind. players as vertical integration & consolidation continues.**

Fundamental Highlights:

- **RCN Telecom, a unit of RCN, is a facilities-based CLEC targeting high density residential areas within the NE corridor which we est. to have 25% of US access lines and 28% of US local revenues. Strong topline growth expected due to 3 fold rev. oppt'y (local and long distance voice, cable & internet) but just 1 construction effort.**
- **We est. '97 revs. of $124MM, growing by 74% to $216MM in '98, reaching $3.8B by '07. We est. '98 EBITDA losses of $32MM, with breakeven by 2H99, and '07 EBITDA margins of 41%.**
- **RCN Telecom's network is comprised of fiber to the node and "Siamese" copper and coaxial cable from the node to the home allowing scale economies and a triple revenue opp'ty.**

Stock Performance



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

435200/435197/435100/435000

RC#20104015

We are initiating coverage of RCN Corporation with an Accumulate/Buy rating. Our price objective is $70, or 59% upside. RCN's key value driver is its residential CLEC (competitive local exchange carrier) subsidiary, RCN Telecom, which is well positioned to capture a valuable slice of the residential telephony and cable TV (cable) market through product offerings including telephony, cable and internet services. RCN will focus its activities in high density urban and suburban areas with special emphasis placed on apartments or multiple dwelling units (MDUs). Service will be provided over RCN Telecom's own advanced fiber local network with Siamese coaxial cable (for cable and high speed internet) and copper wires (for voice).

Company Description: RCN Corp. has three separate entities: 1) RCN Telecom, a residential CLEC providing voice, cable and internet services to highly concentrated residential markets in the Northeast corridor including: the greater NY metropolitan area, Boston and Washington DC; 2) independent cable properties with 184,000 subscribers in NY, NJ, and PA; and, 3) 40% ownership of Megacable, the first Mexican CLEC venture to compete against Telmex, the incumbent local provider in Mexico.

1) **Residential CLEC (RCN Telecom):** The Princeton, NJ based company's RCN Telecom division is currently the sole facilities based competitor to the ILEC (incumbent local exchange carrier) concentrating on residential customers in its target markets. In order to maximize returns, RCN Telecom is focusing its network build in those neighborhoods with the highest density of single family homes and multiple dwelling units. Within the NE corridor, we estimate that there are approximately 25MM households. Of the homes and MDUs in the NE corridor, RCN has already built local facilities capable of serving 42,000. RCN's early success rate within the highest density MDUs has been very impressive with penetration rates running over 30% for cable and 20% for voice in the apartment buildings to which RCN has marketed.

   Rather than wait until a network is in place before selling services into a market, RCN Telecom also is entering into new markets through resale of the ILEC's local services and provision of dial-up internet services through RCN's recently acquired internet services providers (ISPs), Erol's, purchased for $85MM with $35MM in revenue and 292,000 dial up subscribers and Ultranet, purchased for $27MM with $9MM in revenue and over 30,000 dial up subscribers. These deals bring with them: 1) extensive internet backbone network infrastructure; 2) an in-place ISP sales and customer support infrastructure; and, 3) over 320,000 existing customers who now will be offered RCN's voice services given a high degree of geographic market overlap. These customers will be migrated onto RCN Telecom's facilities once built and marketed cable and higher speed internet as additional products.

   RCN Telecom has established joint ventures with utility companies and WorldCom for both local dark fiber leases and joint local construction providing capital expenditure savings and right of ways, speed to market, and the ability to leverage existing customer relationships. Through these partnerships and joint builds, RCN Telecom has a 400 route mile network with 2 local telephone switches (NYC and Boston) and connections to 500 buildings.

2) **US Cable Properties:** In addition to developing a residentially-based CLEC, RCN also derives revenues from independent cable properties located in NY, NJ, and PA. These facilities provide service to an estimated 184,000 subscribers (in addition to an approx. 45,000 wireless cable subscribers in NYC) with a penetration rate (excluding wireless) of 63% of units passed, in line with industry averages. RCN has extensive experience entering the market as a competitive cable company (in competition with the incumbent) as a result of its Allentown, PA property which was the first cable overbuild in the US and in which RCN now has an approximate 50% market share. Most of these properties will eventually be upgraded by RCN Telecom and will also be eligible for voice and high speed internet services.

3) **Megacable (Mexican CLEC):** RCN has a 40% ownership in Megacable, Mexico's second-largest cable provider with CLEC status in Mexico City, Monterey, and Guadalajara. Megacable has begun to offer internet service through cable modems in Guadalajara and plans to begin providing telephony services in Mexico City in 1Q98. Through Megacable, RCN will be offering the first local telephone alternative to Telmex, the formerly state-owned telephone monopoly.

RCN Telecom Value Drivers

Value Driver #1: Selling a bundled telecom package: RCN's strategy is to offer a competitively priced bundled service package including local and long distance voice, cable, and internet services — all on one bill — to residential customers with service to be provided via a state-of-the-art network with facilities construction concentrated in high density areas. Our forecast assumes that by '07: 1) RCN will have built facilities capable of furnishing its bundled service package to 33% of homes within its target markets; 2) on-net penetration rates (of built-to homes) will reach 25% for both voice and cable and 15% for internet; 3) the "average" customer will subscribe to 2.1 services from RCN; and, 4) total penetration of homes (adjusted for homes taking more than one service) will reach 11.3% (see Table 1 below).

An important side benefit from this "bundled" strategy is that the company should enjoy significant marketing, sales force and network efficiencies. As RCN will clearly be one of the first to market with such a comprehensive group of services, another key advantage should be realized — namely reduced customer churn. Nevertheless, we forecast annual customer churn rates of 15% in '98, growing to 18% in '99 through '07.

Voice services: RCN Telecom offers voice services provided over its own network and through resale of ILEC facilities prior to the building of facilities. We forecast RCN Telecom local sales, including both facilities-based and resale will penetrate 0.2% of homes in its markets in '98. 0.8% in '99, 1.8% in '00, increasing to 9.7% by '07. Of the customers subscribing to local service, we predict that 50% will also purchase RCN's long distance service in '98 increasing to 75% by '07. We forecast that per line revenues for local voice service will be $31 in '98 or an approx. 15-20% discount vs. ILEC pricing. Over the forecast period, we estimate that this discount will narrow to just 5% by '07. Long distance revenues per line are forecast to decline by 0.5% annually over the forecast period from the $20 level in '98. We also estimate revenues from small business customers located adjacent to RCN Telecom's network equal to 3% of residential voice revenues in '98, increasing to 10% from '01 to '07.

Cable services: RCN Telecom offers basic and premium cable services to customers over its advanced fiber network and existing wireless and coaxial networks. We estimate RCN Telecom cable sales will penetrate 0.1% of homes in its markets in '98, 0.4% in '99, 0.9% in '00, increasing to 8.2% by '07. We forecast that per subscriber monthly revenue for basic and premium services will average $36 in '98 (a 20% discount to average industry rates) increasing by 2% annually to $43 by '07.

Internet services: RCN Telecom offers its customers a choice between high speed internet access through cable modems for which it is charging $45 per mo. and lower cost dial-up service for $20 per mo. The high speed internet service will be delivered via cable modems and is up to 200x faster than dial up. We estimate RCN Telecom internet sales will penetrate 0.1% of homes in its markets in '98. 0.3% in '99. growing to 5.5% by '07.

Value Driver #2: Targeting high density, residential customers in the greater NY, Boston and Washington DC areas. RCN Telecom is targeting the greater NY, Boston. and DC metropolitan areas within the NE corridor, a corridor we estimate includes 25% of total homes in the US (25 million homes and 28% of total US local telecom revenues). Of the 25 million addressable homes within the NE corridor. RCN is "cherry picking" via a focused network deployment strategy and target marketing oriented towards the high density (with a concentration on MDUs), high usage neighborhoods. Marketing of RCN's services in high density areas is central to the company's economic model of selling multiple on-net services. To this point, we note the high density levels (measured in homes passed per linear mile) in key RCN Telecom markets such as Manhattan of 3.000. Boston of 1,000 and other markets targeted for construction by '00 averaging well over 150. These density statistics contrast sharply with national averages of 40-42 homes per passed mile (from cable industry statistics) and serve to highlight RCN's advantage.

Value Driver #3: Form strategic alliances to speed network development and customer acquisition. RCN Telecom has formed strategic partnerships with the main utility companies for both Boston and Washington DC and with WorldCom for access to local networks in NYC and Boston. Through the joint ventures, RCN Telecom has access to over 550 route miles of fiber and potential access (via joint marketing initiatives etc.) to 1.3 million utility customers. The joint venture partners should contribute approx. $150 million in capital over the next 3 years and will allow RCN Telecom to jointly pursue fiber builds thereby lowering network deployment costs.

Value Driver #4: Strong and credible management team: RCN Corps's executive team is led by Chairman and CEO, David McCourt, a current Director of WorldCom, past director of MFS and early CLEC industry pioneer. Also supporting RCN Corp.'s development efforts is its majority shareholder, Peter Kiewit Sons' Inc. (PKS), the founder of MFS Communmications. Through the experience with MFS, both Mr. McCourt and PKS are skilled in constructing facilities, targeting market share gains, and obtaining high values for shareholders upon sale of the company as evidenced by MFS' sale to WorldCom in '96 for $13B.

Financial Projections: We are estimating that RCN Telecom will take a combined 11.3% share of the total homes resident within its target markets by '07.

Table 1: Addressable Market Calculation

(In millions)		1998E	2001E	2004E	2007E
A	Total Homes In Market	25.3	26.0	26.8	27.6
B	Homes Passed By Network	0.3	2.5	5.8	9.1
C (B/A)	% Homes Built To	1.2%	9.9%	21.7%	32.9%
D (Ax3)	Potential Total Srvc Connects*	75.8	78.0	80.4	82.8
E (Bx3)	Potential On-Net Srvc Connects*	0.9	7.7	17.5	27.2
	Penetration of On-Net Service Connects				
F	Voice (on-net only)	10%	19%	24%	25%
G	Cable	10%	19%	24%	25%
H	Internet (on-net only)	4%	11%	14%	15%
	Resale Services As % of Total Connects				
I	Resale Voice	50%	45%	30%	15%
J	Resale Internet	50%	30%	16%	10%
	Implied Penetration of Total Homes**				
K (BxF/(1-I))/A	Voice (resale and on-net)	0.2%	2.8%	7.4%	9.7%
L (BxG)/A	Cable	0.1%	1.8%	5.2%	8.2%
M (BxH/(1-J))/A	Internet (resale and on-net)	0.1%	1.5%	3.6%	5.5%
N (assmpt.)	Avg. Connects Per Customer***	2.02	2.06	2.07	2.08
O (K+L+M)/N	Implied Penetration of Total Homes	0.2%	3.0%	7.8%	11.3%

* Assumes 3 potential services - voice, Cable, and internet

** Assumes churn rates for connections of 0% for '98, 15% for '01, and 18% for '04 and '07

*** Average connections per customer assumes 2 connections each (voice and cable) for all customers plus a fractional number of internet connections based upon penetration rates.

Source: Merrill Lynch estimates

Table 2 below details our financial forecast for RCN Corp. We forecast revenues for RCN Corp. of $124 million in '97, increasing by 74% in '98 to $216 million, reaching $3.8 billion by '07, with a 10 year CAGR of 41%. We estimate that RCN Telecom comprises 13% of total revenues in '98, increasing to 96% by '07.

We forecast RCN Corp. EBITDA losses of $36 million in '98, with EBITDA approx. breakeven in 2H99, reaching $1.6 billion or 41% of revenues by '07. Capital expenditures are estimated at $285 million for '98 with spending expected to ramp up to the $1 billion level by '01 and then holding that approximate pace for the balance of the forecast period. Capital expenditures are comprised of two components: 1) Fixed network deployment which we estimate at $900 per home passed in '98 dropping to $780 by '07 or a 1.5% average annual decline which we expect to be fueled by modest equipment purchasing efficiencies; and. 2) Variable costs to hook up a customer's service which we estimate at $250 per connection in '98, peaking at $300/connection in '00 with the introduction of high speed (and costly) internet modems and then declining 2.6% annually through '07 to $260/connection, aided by slight increases in average connections/home and equipment purchasing efficiencies.

Table 2: RCN Corp. Financial Forecast

	1998	1999	2002	2004	2007
Revenues	215.9	336.9	1,377.2	2,327.6	3,795.1
EBITDA	(35.7)	(3.2)	404.3	842.2	1,560.5
Margin	NM	NM	29.4%	36.2%	41.1%
Cap Exp	285.4	426.6	1,096.0	1,050.7	938.7
Free Cash Flow	(395.1)	(560.3)	(1,128.6)	(878.1)	(328.0)

Source. Merrill Lynch estimates

12-18 Month PMV Price Objective of $70: Our price objective (see Tables 3 & 4 below for derivation) is based on a sum of the parts valuation including: a) our 10-year DCF model for RCN Telecom, using a 15% discount rate, 10.0x terminal EBITDA multiple, no public to private discount and a 20% discount to reflect minority ownership in RCN Telecom by its partners; b) 11.0x '99 EBITDA of $43.2MM for the independent cable properties (our estimate of current private market valuation levels), and; c) 11.0x '99 EBITDA of $13MM (adjusted to account for 40% ownership) for Megacable, the Mexico CLEC venture. We use a private market value based price objective because we believe that RCN, along with many other CLECs, likely will become part of larger vertically integrated telecom companies over time as all the larger players move to offer an array of voice, internet, and entertainment services.

Table 3: Valuation of RCN's Largest Subsidiary: RCN Telecom

	YE '98	YE '99	YE '00
Discount rate	*15%*	*15%*	*15%*
Terminal Multiple	*10.0x*	*10.0x*	*10.0x*
	'99-'07	'00-'07	'01-'07
PV of unlevered FCF	($2,030)	($1,911)	($1,519)
PV of term value	4,277	4,919	5,657
JV Adjustment	80%	80%	80%
Enterprise Value	1,787	2,392	3,338
Net Debt	265	686	1,420
Private Market Value - Equity	1,522	1,705	1,917
Shares O/S - fully diluted	30.2	30.9	31.5
Private Mkt Value Per share	**$50.31**	**$55.28**	**$60.93**

Source: Merrill Lynch estimates

Table 4: Sum of the Parts Valuation - RCN Corp. Private Market Value

Per Share Value	YE '98	YE '99	YE '00
RCN Telecom	$50.31	$55.28	$60.93
Independent Cable	$15.70	$15.88	$15.99
Megacable (Mexican CLEC)	$1.89	$2.14	$2.24
Combined Per Share Valuation	**$67.90**	**$73.30**	**$79.16**

Source: Merrill Lynch estimates

Merrill Lynch is currently acting as a financial advisor and has rendered a fairness opinion to RCN Corporation in connection with its proposed acquisition of Erol's, which was announced on January 21, 1998. RCN Corporation has agreed to pay a fee to Merrill Lynch for its financial advisory services, a significant portion of which is contingent upon the consummation of the proposed transaction.
This research report is not intended to (1) provide voting advice, (2) serve as an endorsement of the proposed transaction, or (3) result in the procurement, withholding, or revocation of a proxy.

23 April 1998

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Teligent Inc.

Recent Weakness Creates Opportunity; Network Roll Out On Track — **ACCUMULATE***

Reason for Report: Company Update — **Long Term BUY**

Price: $30

Estimates (Dec)	1996A	1997A	1998E
EPS:	NA	NM	d$3.47
P/E:	NM	NM	NM
EPS Change (YoY):		NM	NM
Consensus EPS: (First Call: 12-Mar-98)		d$2.94	d$3.55
Cash Flow/Share:	NA	NM	d$3.29
Price/Cash Flow:	NM	NM	NM
Dividend Rate:	Nil	Nil	Nil
Dividend Yield:	Nil	Nil	Nil

Opinion & Financial Data

Investment Opinion:	D-2-1-9
Mkt. Value / Shares Outstanding (mn):	$1,620.0 / 54
Price/Book Ratio:	NM
LT Liability % of Capital:	57.0%

Stock Data

52-Week Range:	$35 3/8-$22 1/4
Symbol / Exchange:	TGNT / OTC
Options:	None
Institutional Ownership-Spectrum:	21.3%
Brokers Covering (First Call):	3

ML Industry Weightings & Ratings**

Strategy; Weighting Rel. to Mkt.:		
Income:	Overweight	(07-Mar-95)
Growth:	Underweight	(07-Mar-95)
Income & Growth:	Overweight	(07-Mar-95)
Capital Appreciation:	Overweight	(16-Jan-96)
Market Analysis: Technical Rating:	Above Average	(24-Dec-96)

*Intermediate term opinion last changed on 18-Dec-97.
**The views expressed are those of the macro department and do not necessarily coincide with those of the Fundamental analyst.
For full investment opinion definitions, see footnotes.

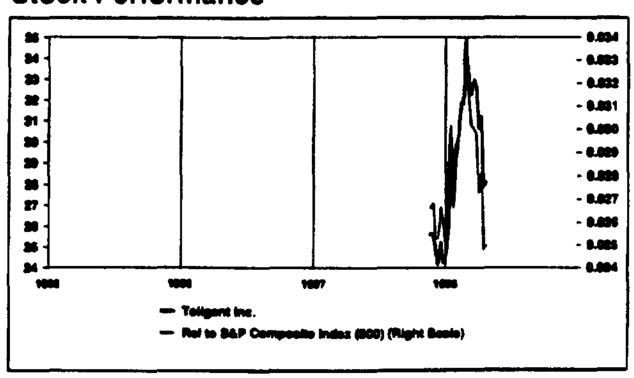
Investment Highlights:

- **Reiterating our intermediate term Accumulate and long term Buy opinion on Teligent.**
- **12-18 month private market value-based price objective remains at $37 or 23% upside from current prices. Our private market value estimate is based on our 10 year discounted cash flow (DCF) model, a 15% discount rate and 9.0 multiple on terminal year EBITDA, and no public market discount.**

Fundamental Highlights:

- **Network deployment efforts remain on track for 3 commercial networks in service by mid-year, with a total of 10 by year-end '98 and an additional 20 by year-end '99.**
- **Recent company announcements concerning progress towards commercial service rollout bolsters confidence that deployment schedule is on track.**

Stock Performance



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RC#20111345

Recent Stock Price Weakness Creates Attractive Buying Opportunity; Reiterate 12-18 Month Price Objective Of $37

Teligent's stock price as well as other CLECs (competitive local exchange carriers) have come under a good deal of pressure over the past month and a half. We think this stock price weakness can be traced to two main issues: a) profit taking in a group that has shown significant stock price outperformance year-to-date; and, b) recent heightening of investor concerns regarding the soon-to-be announced (beginning 4/28) 1Q98 results. Although there isn't much we can say about the first point, we do feel strongly that the underlying growth trends (i.e., line growth, revenue per line, and progress towards positive EBITDA) and most importantly -- value creation -- in the CLEC group is still very much intact.

Teligent's Network Build-Out Remains On Track.

For Teligent, specifically, the company's efforts toward commencement of commercial service by mid-'98 appear to be very much on track. In fact, we expect management to make this point in emphatic fashion during the 1Q98 update call with investors tentatively scheduled for the week of May 11. Our expectations for Teligent's commercial deployment schedule remain unchanged with 3 wireless local telephone and data networks up and running by mid-year, 10 in total by year-end '98 and an additional 20 in service by year-end '99.

Recent Developments Bolster Confidence

In mid-March (3/18), the company announced that it had begun to take delivery of "commercially available" point-to-mulitipoint digital wireless equipment from its lead equipment supplier, Northern Telecom. In addition, this equipment is currently being used to carry voice and data traffic for beta customers in the Los Angeles market. Lastly, we understand that Teligent is nearing completion of its Virginia-based network operations center. The weight of these recent developments bolsters our confidence that management will meet the anticipated network deployment schedule.

Conclusion: Recent Price Weakness Creates Opportunity, Reiterate Intermediate Term Accumulate Opinion.

In our opinion, recent price weakness in Teligent shares has created an attractive buying opportunity. We reiterate our 12-18 month price objective of $37 or 23% upside based on our 10 year discounted cash flow (DCF) model, a 15% discount rate, a 9.0 multiple on terminal year EBITDA and no public market discount.

[TGNT] MLPF&S was a manager of the most recent public offering of securities of this company within the last three years.

[TGNT] The securities of the company are not listed but trade over-the-counter in the United States. In the US, retail sales and/or distribution of this report may be made only in states where these securities are exempt from registration or have been qualified for sale. MLPF&S or its affiliates usually make a market in the securities of this company.

Opinion Key [X-a-b-c]: Investment Risk Rating(X): A - Low, B - Average, C - Above Average, D - High. Appreciation Potential Rating (a: Int. Term - 0-12 mo.; b: Long Term - >1 yr.): 1 - Buy, 2 - Accumulate, 3 - Neutral, 4 - Reduce, 5 - Sell, 6 - No Rating. Income Rating(c): 7 - Same/Higher, 8 - Same/Lower, 9 - No Cash Dividend.

13 March 1998

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Teligent Inc.

All Systems Go For Mid-Year Commercial Service Kickoff

Reason for Report: 4Q Update

ACCUMULATE*

Long Term BUY

Price: **$31 1/16**

12 Month Price Objective: $37

Estimates (Dec)	1996A	1997E	1998E
EPS:	NA	NA	d$3.47
P/E:	NM	NM	NM
EPS Change (YoY):		NM	NM
Cash Flow/Share:	NA	NA	d$3.29
Price/Cash Flow:	NM	NM	NM
Dividend Rate:	Nil	Nil	Nil
Dividend Yield:	Nil	Nil	Nil

Opinion & Financial Data

Investment Opinion:	D-2-1-9
Mkt. Value / Shares Outstanding (mn):	$1,677.4 / 54
Price/Book Ratio:	NM
LT Liability % of Capital:	57.0%

Stock Data

52-Week Range:	$35 3/8-$22 1/4
Symbol / Exchange:	TGNT / OTC
Options:	None
Institutional Ownership-Spectrum:	NA

ML Industry Weightings & Ratings**

Strategy: Weighting Rel. to Mkt.:		
Income:	Overweight	(07-Mar-95)
Growth:	Underweight	(07-Mar-95)
Income & Growth:	Overweight	(07-Mar-95)
Capital Appreciation:	Overweight	(16-Jan-96)
Market Analysis: Technical Rating:	Above Average	(24-Dec-96)

*Intermediate term opinion last changed on 18-Dec-97.
**The views expressed are those of the macro department and do not necessarily coincide with those of the Fundamental analyst.
For full investment opinion definitions, see footnotes.

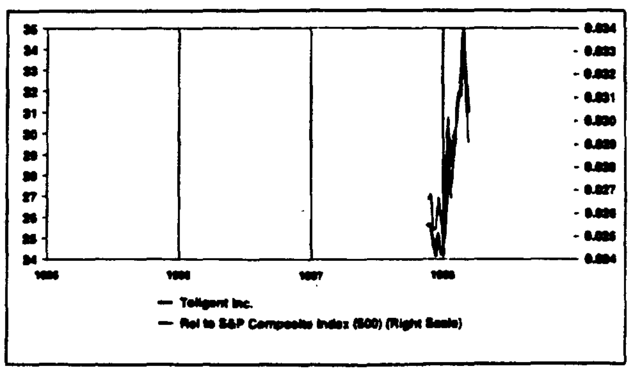
Investment Highlights:

- **Reiterating our intermediate term Accumulate and long term Buy opinion on Teligent.**
- **12 month private market value-based price objective remains at $37 or 19% upside from current prices. Our private market value estimate in based on our 10 year discounted cash flow (DCF) model, a 15% discount rate and 9.0 multiple on terminal year EBITDA, and no public market discount.**

Fundamental Highlights:

- **Management's 4Q97 conference call with investors confirmed that commercial rollout activities remain on track for 3 commercial networks to be in service by mid-year, with a total of 10 by year-end '98 and an additional 20 by year-end '99. Currently, network rollout activities are underway in 30 markets.**
- **Teligent has bowed out of the 28 GHz LMDS auctions but plans to be active in the 24 GHz auctions expected within 18 months in order to supplement its license holdings in 74 markets.**

Stock Performance



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RC#20107225

Teligent's 4Q Report & Analyst Call Confirms That Mid-Year Commercial Service Kickoff Is On Track; Reiterate Accumulate Opinion

After the market close on March 11, Teligent released 4Q results and hosted a call with analysts for the purpose of providing an update on activities related to the commercial rollout of the company's wireless CLEC (competitive local exchange carrier) services. The most important announcement in the quarterly release was confirmation that service rollout is indeed on track (i.e., 3 networks with commercial service by "mid-year", with a total of 10 networks commercial by year-end '98). To this end, management stated that "[b]y the end of 1998, we plan to have resources deployed in the thirty top markets, with AT LEAST (our emphasis) ten of those markets fully commercial." Additional key highlights of the quarter and the analyst call were as follows:

1. Construction/market development update: Activities designed to prepare for commercial service rollout are currently underway in 30 markets, in line with our expectations of 30 markets under commercial operation by year-end '99. Hub sites in the first 10 markets have been identified and efforts are currently underway to secure the necessary roof rights. 12 Nortel DMS-500 switches have been ordered, including those slated for the initial 10 markets. Five of these switches are currently in the process of installation. Lastly, construction of Teligent's network operations center (NOC) has begun in Northern Virginia.
2. Equipment update: The company expects to receive its first shipment of "commercial" point-to-multipoint wireless equipment from Nortel, its lead equipment vendor, within the next few weeks.
3. Staffing up: Year-end head count totaled 221 with approximately 200 staff members added so far in '98, the bulk of which comprise staff, operations and network deployment personnel. Management indicated that during 2Q98, hiring will begin to focus on sales and sales support personnel immediately in advance of commercial service rollout. By year-end '98, it is expected that Teligent will have 200 direct salespeople on staff.
4. Teligent bows out of 28 GHz LMDS auctions: Although the company had participated in the early phases of the LMDS auction, management disclosed that prices for the market licenses it targeted on an "opportunistic basis" had risen to a level that exceeded the value to Teligent. Thus, all bidding activity by the company has ceased. Management did indicate, however, that the company plans to participate in the anticipated spectrum auctions of additional 24 GHz spectrum which is expected to transpire within the next 18 months.
5. 4Q97 financial results: Teligent reported quarterly revenue of $397,000, of which approximately only $33,000 represented recurring revenues (related to Teligent's license perfection activities). The balance of the reported revenues — $364,000 — relate to spectrum management fees paid to Teligent by its partners in that portion of the 4Q prior to the completion of its IPO. We point out that neither of these two activities are directly related to Teligent's core business — wireless CLEC telecommunications services. Reported net loss for the quarter of $59 million included a $32 million non-cash expense for stock-based compensation.
6. Conclusion: Teligent's commercial service rollout activities appear to be on track for 3 commercial networks to be in service by mid-year, with at least an additional 7 in operation by year-end '98 and at least an additional 20 in operation by year-end '99. We reiterate both our intermediate term Accumulate and long term Buy opinion as well as our $37 private market value-based price objective or 19% upside. Our price objective is based on our 10 year discounted cash flow (DCF) model, a 15% discount rate and a 9.0 multiple on terminal year EBITDA, and no public market discount.

11 June 1998

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USN Communications Inc

New Initiatives Delayed, Lowering Estimates and Opinion

NEUTRAL

Reason for Report: Lowering Estimates & Opinion

Long Term
ACCUMULATE

Price: $9 3/8

Estimates (Dec)	1997A	1998E	1999E
EPS:	d$15.55	d$9.00	d$4.73
P/E:	NM	NM	NM
EPS Change (YoY):		NM	NM
Consensus EPS: (First Call: 29-May-98)		d$8.56	d$4.29
Q2 EPS (Jun):		D$1.99	
Cash Flow/Share:	d$15.06	d$8.24	d$4.01
Price/Cash Flow:	NM	NM	NM
Dividend Rate:	Nil	Nil	Nil
Dividend Yield:	Nil	Nil	Nil

Opinion & Financial Data

Investment Opinion:	D-2-1-9 to D-3-2-9
Mkt. Value / Shares Outstanding (mn):	$266.8 / 22
Book Value/Share (Sep-97):	d$1.94
Price/Book Ratio:	NM

Stock Data

52-Week Range:	$23-$10
Symbol / Exchange:	USNC / OTC
Options:	None
Institutional Ownership-Spectrum:	37.3%
Brokers Covering (First Call):	2

ML Industry Weightings & Ratings**

Strategy: Weighting Rel. to Mkt.:		
Income:	Overweight	(07-Mar-95)
Growth:	Underweight	(07-Mar-95)
Income & Growth:	Overweight	(07-Mar-95)
Capital Appreciation:	Overweight	(16-Jan-96)
Market Analysis: Technical Rating:	Above Average	(24-Dec-96)

**The views expressed are those of the macro department and do not necessarily coincide with those of the Fundamental analyst.
For full investment opinion definitions, see footnotes.

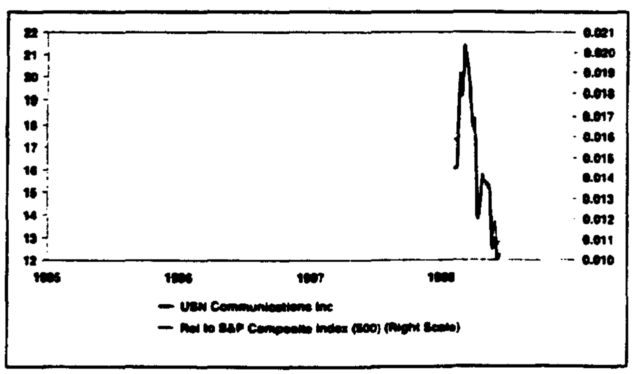
Investment Highlights:

- **We have reduced our 12 month private market based price objective from $24 to $18 due to slower than anticipated ramp up of important new initiatives.**
- **We have lowered our intermediate term opinion from Accumulate to Neutral and our long term opinion from Buy to Accumulate.**

Fundamental Highlights:

- **Due to delays in growth initiatives and lower than anticipated direct salesforce productivity, we are lowering full-year revenue estimates for 1998 from $301M to $238M and for 1999 from $572M to $449M.**
- **We are widening full-year EBITDA loss estimates for 1998 from $124M to $132M and for 1999 from $41M to $48M.**
- **We are decreasing our estimate of 2Q access line additions from 64,000 to 50,000 due to lower than expected direct salesforce productivity and delays in telemarketing sales rollout. In addition, we are lowering our full-year 1998 access line forecast from 540,000 to 426,000.**

Stock Performance



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RC#20116233

Due to slower than anticipated ramp up of telemarketing and direct sales productivity and enhanced services initiatives, we are lowering our 1998 and 1999 forecasts. As a result, we are reducing our private market value based price objective from $24 to $18 and lowering our intermediate term opinion from Accumulate to Neutral and our long term opinion from Buy to Accumulate. Revisions to our estimates are as follows:

1. **Access Lines:** Lower salesforce productivity (44 lines per month per salesperson vs. our estimate of 64 lines) has led us to decrease our est. of 2Q access line adds from 64,000 to 50,000. In addition, we are lowering our full-year '98 access line est. from 540,000 to 426,000.
2. **Churn:** We est. churn levels for 2Q to be 2.6%, a decrease from the 2.9% level seen in 1Q, but higher than our est. of 2.0%. We attribute the higher than anticipated churn to residual impact from previously announced billing issues during 1Q, and expect it to taper down to approx. 2.0% by year-end '98.
3. **Telemarketing Revenues:** As expected USN will have 90 telemarketing "chairs" in full service by the end of 2Q, however, the chairs will come into service much later in the quarter than anticipated due to time lags from training. In addition, lower than anticipated productivity per chair (e.g., 3 access lines sold per day per chair vs. the anticipated 5) will affect telemarketing revenue during 3Q and 4Q98, although we anticipate this will improve in 1999 with continued training.
4. **Enhanced Services Revenues:** Slower than anticipated enhanced services sales has resulted from: delays in rolling out cellular resale services to states outside of the Connecticut Telephone territory (CT, MA & RI); and lower than anticipated cross sales of voice features (i.e. caller ID, voice mail, fax and data lines) to existing customers.

Positive Trends

Despite the revisions to our forecast as detailed in Table 1, we do detect some positive trends including:

1. **Monthly Revenue Per Line:** A 6% increase in monthly revenue per line from an average of $49 during 1Q to $52 during 2Q.
2. **Geographic Expansion:** Deployment of 45 new salespeople in Maryland and Virginia which is estimated to grow to 75 by year-end 1998.
3. **Conservative Assumptions:** We have been purposefully conservative in our 10 year DCF model. We believe our assumptions for 2007 including: 25 lines sold per month per direct salesperson vs. 44 for 1998, 5 lines sold per telemarketing chair per day vs. 3 for 1998, and 11.5% EBITDA margin provide significant upside potential.

Conclusion

Although the stock remains attractive from a statistical standpoint as our private market value of $18 has a 92% upside potential, we believe the stock will mark time at current levels until positive impacts from new initiatives are reflected in the reported results. Our revised private market based price objective of $18 assumes a 15% discount rate, a 9x multiple on terminal year EBITDA growth and implies a 5.2% growth rate of perpetual free cash flow. We have lowered our intermediate term opinion from Accumulate to Neutral and our long term opinion from Buy to Accumulate.

Table 1: 1998 Revised Quarterly Forecast

	1Q98A	2Q98E	3Q98E	4Q98E	1998E
Revenues					
Direct Sales	27.5	37.0	50.0	65.0	179.5
Telemarketing	-	-	2.0	7.5	9.5
Agents	-	-	-	-	-
Enhanced	0.3	0.6	0.7	1.0	2.6
Core Revenues	27.8	37.6	52.7	73.5	191.6
CONTEL Revenues*	4.5	12.4	14.0	15.9	46.8
Total Revenues	32.3	50.0	66.7	89.4	238.4
EBITDA	(36.7)	(34.1)	(32.0)	(29.5)	(132.3)

* Includes 1 1/2 mos. of revenue for 1Q98 as CONTEL acquisition closed on 2/23
Source: Merril Lynch estimates

Table 2: USN Communications Detailed Financial Forecast

	1997A	1Q98A	2Q98E	3Q98E	4Q98E	1998E	1999E	2000E	2001E	2002E	2003E	2004E	2005E	2006E	2007E
Revenues															
Direct Sales	47.2	27.5	37.0	50.0	65.0	179.5	328.8	451.9	553.9	641.1	726.7	811.6	893.4	975.1	1,057.8
Telemarketing	-	-	-	2.0	7.5	9.5	37.9	79.8	105.6	120.6	143.1	166.4	190.5	215.6	241.6
Agents	-	-	-	-	-	-	6.2	17.4	26.7	35.6	44.9	54.5	64.5	74.9	85.7
Enhanced	-	0.3	0.6	0.7	1.0	2.6	13.2	22.6	33.2	44.9	54.5	64.9	75.9	87.8	100.5
Core Revenues	47.2	27.8	37.6	52.7	73.5	191.6	386.0	571.7	719.5	842.2	969.2	1,097.4	1,224.4	1,353.4	1,485.6
CONTEL Revenues	-	4.5	12.4	14.0	15.9	46.8	63.2	76.7	87.7	98.7	110.3	122.5	136.2	151.3	168.3
Total Revenues	47.2	32.3	50.0	66.7	89.4	238.4	449.2	648.4	807.2	940.9	1,079.5	1,220.0	1,360.5	1,504.7	1,653.9
Expenses															
Cost of Sales	41.3	26.6	39.6	50.7	65.2	182.2	320.2	446.2	548.9	631.5	724.8	819.4	901.3	996.8	1,095.5
Sales & Marketing	100.4	42.3	44.5	48.1	53.6	188.5	177.4	193.9	217.1	239.0	261.2	286.7	312.9	340.1	368.8
Dep. & Amort.	3.5	2.2	2.1	2.5	2.7	9.5	11.2	14.9	17.8	18.8	19.4	19.5	19.4	20.4	24.3
Operating Profit	(97.9)	(38.9)	(36.2)	(34.5)	(32.2)	(141.8)	(59.6)	(6.6)	23.4	51.6	74.0	94.4	126.9	147.4	165.2
Interest Exp. net	11.9	5.5	9.6	12.1	14.5	41.7	59.3	53.1	41.4	30.0	18.3	2.0	-	-	-
Pretax Profit	(109.9)	(44.3)	(45.9)	(46.6)	(46.7)	(183.5)	(118.9)	(59.7)	(18.0)	21.6	55.7	92.4	126.9	147.4	165.2
Accum.Preferred Div.	2.2	0.6	-	-	-	-	-	-	-	-	-	-	-	-	-
Taxes	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Net Profit (loss)	(112.1)	(44.9)	(45.9)	(46.6)	(46.7)	(184.0)	(118.9)	(59.7)	(18.0)	21.6	55.7	92.4	126.9	147.4	165.2
EPS	$ (15.55)	$ (3.13)	$ (1.99)	$ (1.97)	$ (1.91)	$ (9.00)	$ (4.73)	$ (2.31)	$ (0.67)	$ 0.79	$ 1.97	$ 3.17	$ 4.23	$ 4.77	$ 5.19
Shares O/S	7.2	14.4	23.0	23.7	24.4	21.4	25.1	25.9	26.7	27.5	28.3	29.1	30.0	30.9	31.8
EBITDA	(94.4)	(36.7)	(34.1)	(32.0)	(29.5)	(132.3)	(48.4)	8.3	41.2	70.4	93.4	113.9	146.3	167.8	189.6
Cap Exp	15.0	5.4	5.0	7.5	7.5	25.4	21.0	22.1	23.2	24.3	25.5	26.8	28.1	29.5	31.0
Free Cash Flow	(111.7)	*NM*	*NM*	*NM*	*NM*	(120.2)	(64.2)	(25.8)	5.9	33.7	54.9	73.6	104.5	124.2	142.9
Access Lines (000s)	172	226	276	346	426	426	717	941	1,094	1,261	1,432	1,595	1,756	1,918	2,080
Margins															
Cost of Sales	*87.4%*	*82.5%*	*79.2%*	*76.0%*	*73.0%*	*76.4%*	*71.3%*	*68.8%*	*68.0%*	*67.1%*	*67.1%*	*67.2%*	*66.2%*	*66.2%*	*66.2%*
Sales & Marketing	*212.7%*	*131.0%*	*89.0%*	*72.0%*	*60.0%*	*79.1%*	*39.5%*	*29.9%*	*26.9%*	*25.4%*	*24.2%*	*23.5%*	*23.0%*	*22.6%*	*22.3%*
Depreciation/Amort.	*7.4%*	*6.8%*	*2.1%*	*1.7%*	*1.6%*	*4.0%*	*2.5%*	*2.3%*	*2.2%*	*2.0%*	*1.8%*	*1.6%*	*1.4%*	*1.4%*	*1.5%*
Interest Exp. net	*25.2%*	*17.0%*	*15.6%*	*13.5%*	*11.4%*	*17.5%*	*10.1%*	*6.4%*	*4.0%*	*2.5%*	*1.3%*	*0.1%*	*0.0%*	*0.0%*	*0.0%*
Net Profit (loss)	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*2.3%*	*5.2%*	*7.6%*	*9.3%*	*9.8%*	*10.0%*
EBITDA	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*1.3%*	*5.1%*	*7.5%*	*8.7%*	*9.3%*	*10.8%*	*11.2%*	*11.5%*
Y/Y Change															
Core Revenues															
Direct Sales	*NA*	*NA*	*NA*	*NA*	*221.8%*	*280.3%*	*83.2%*	*37.4%*	*22.6%*	*15.7%*	*13.4%*	*11.7%*	*10.1%*	*9.1%*	*8.5%*
Telemarketing	*NA*	*NA*	*NA*	*NA*	*NM*	*NM*	*298.5%*	*110.8%*	*32.3%*	*14.2%*	*18.6%*	*16.3%*	*14.5%*	*13.2%*	*12.1%*
Agents	*NA*	*NA*	*NA*	*NA*	*NM*	*NM*	*NM*	*180.6%*	*53.6%*	*33.5%*	*26.1%*	*21.5%*	*18.4%*	*16.1%*	*14.4%*
Enhanced	*NA*	*NA*	*NA*	*NA*	*NM*	*NM*	*405.8%*	*71.8%*	*47.1%*	*35.0%*	*21.5%*	*19.1%*	*17.0%*	*15.6%*	*14.5%*
Core Revenues	*NA*	*NA*	*NA*	*NA*	*263.8%*	*305.9%*	*101.5%*	*48.1%*	*25.9%*	*17.1%*	*15.1%*	*13.2%*	*11.6%*	*10.5%*	*9.8%*
CONTEL Revenues	*NA*	*NA*	*NA*	*NA*	*NM*	*NM*	*34.9%*	*21.4%*	*14.4%*	*12.5%*	*11.8%*	*11.1%*	*11.1%*	*11.2%*	*11.2%*
Total Revenues	*NA*	*NA*	*NA*	*NA*	*NM*	*NM*	*88.4%*	*44.3%*	*24.5%*	*16.6%*	*14.7%*	*13.0%*	*11.5%*	*10.6%*	*9.9%*
Operating Profit	*NA*	*NA*	*NA*	*NA*	*NM*	*NM*	*NM*	*NM*	*NM*	*120.3%*	*43.5%*	*27.6%*	*34.4%*	*16.1%*	*12.1%*
Net Profit	*NA*	*NA*	*NA*	*NA*	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*158.2%*	*65.9%*	*37.3%*	*16.1%*	*12.1%*
EPS	*NA*	*NA*	*NA*	*NA*	*NM*	*NM*	*NM*	*NM*	*NM*	*NM*	*150.6%*	*61.1%*	*33.3%*	*12.8%*	*8.8%*
EBITDA	*NA*	*NA*	*NA*	*NA*	*NM*	*NM*	*NM*	*NM*	*NM*	*71.0%*	*32.7%*	*21.9%*	*28.4%*	*14.7%*	*12.9%*

Source: Merrill Lynch estimates.