Gary L. Phillips
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ORIGINAL

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

February 16, 2001

Ms. Magalie Roman Salas
Secretary
Federal Communications Comission
445 12th Street, SW
Washington, D.C. 20554

Re: **Ex Parte Presentation**
CC Docket 99-68
Inter-Carrier Compensation for ISP-Bound Traffic

Dear Ms. Salas:

On February 16, 2001, Don Cain and I met with Ryan Baron and Deena Shetler of Commissioner Tristani's Office to discuss SBC's position in the above referenced proceeding. The attached served as the basis of the discussion.

Respectfully Submitted,

Gary L Phillips

Attachment
cc: D. Shetler
R. Baron

No. of Copies rec'd 0+2
List A B C D E

David J. Hostetter
Executive Director
Federal Regulatory

SBC Telecommunications, Inc.
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Phone 202 326-8811
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February 14, 2001

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FEB 14 2001

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 12th Street, S.W.
Room No. TW-B204
Washington, DC 20554

RE: Notice of Ex Parte Presentation
CC Docket No. 96-98 Implementation of the Local Competition Provisions in the Telecommunications Act of 1996
CC Docket No. 99-68 Inter-Carrier Compensation for ISP-Bound Traffic

Dear Ms. Salas:

On Monday, February 12, 2001 Don Cain, Gary Phillips and I met with Jordan Goldstein from Commissioner Ness' office. The purpose of the meeting was to discuss SBC's position that CLECs recover their costs for ISP-bound traffic from the ISPs they serve. Our presentation started by pointing out that the federal compensation regime associated with the access charge exemption requires ISPs to pay for the switching ("termination") functionality through business line charges. The attached list of quotes from the Commission's access charge exemption order contains the language from the order and citation to support this point. The presentation also focused on the de minimis nature of the switching costs CLECs incur when they deliver Internet traffic to ISPs.

SBC believes that CLEC switching costs are significantly less than $.001 per MOU. Evidence to support this belief was presented during our meeting. We pointed out that SBC's comments in this proceeding included TELRIC cost study data for terminating switching that was originally filed in Texas Docket Nos. 21982. This data demonstrated that the unloaded TELRIC for the terminating switching associated with a digital switch was approximately $.00045 per minute of use (MOU) for an average Internet call. Even when TELRIC overhead costs are added to the $.00045 per MOU cost, the resulting total TELRIC terminating switching cost per MOU of $.0005 is still significantly less than $.001. We also presented a revenue/cost analysis to show that the ISDN PRI switching revenues that could be earned by serving CLEC ISP-bound MOUs in Texas far exceed the total TELRIC costs associated with the quantity of ISDN PRIs needed to serve these same CLEC ISP-bound minutes. We also provided the attached Morgan Stanley Dean Witter report, which estimates that CLECs incur a switching cost of approximately $.0001.

We discussed the most recent contracts SBC has negotiated with CLECs. Effective June 1, 2001, these contracts will apply a rate of $.001 to out of balance traffic. Out of balance traffic represents the MOUs that exceed a 3:1 exchange rate between carriers. In the majority of SBC's states, the out of balance traffic rate will decrease on June 1, 2002. The new rates in these states will be in the $.0002 to $.0009 range. While these recent contracts were the result of negotiations, they in no way represent a market-based conclusion. These contracts are simply stopgap measures to offset the regulatory uncertainty associated with this issue. Attached is a generic reciprocal compensation rate template that reflects the rates contained in these contracts that are available through the MFN process.

We are submitting an original and one copy of this memorandum in accordance with Section 1.1206 of the Commission's rules. Please stamp and return the copy to confirm your receipt. Should you have any questions, please contact me on (202) 326-8811.

Sincerely,

David Hostetler

Attachments

CC: J. Goldstein

Evidence that ESPs pay for interstate access:

- In cases where the surcharge [*721] is levied, no transport switching [**88] or other carrier access charges will be imposed for associated local exchange service. Customers instead will remain subject to business local exchange service charges for the line between the reseller or sharer switch, **enhanced service node** or PBX and the telephone company's local switch. In addition, **all switching functions will continue to be subsumed under the local business rate**. (In the Matter of MTS and WATS Market Structure, Memorandum Opinion and Order (CC Docket No. 78-72), 97 FCC 2d 682, at 720-721 (1983))

- ....there is some uncertainty as to whether these rules would apply to entities which may not be considered carriers, such as **enhanced service providers** and operators of sharing networks, but **which also use access service**. Our intent was to apply these carrier's carrier charges to interexchange carriers, and to all resellers and **enhanced service providers** other than those, such as hotels, who provide their communications service solely at their own premises, or where the service is intended for internal administrative purposes. (In the Matter of MTS and WATS Market Structure, Memorandum Opinion and Order (CC Docket No. 78-72), 97 FCC 2d 682, at 711 (1983))

- Among the variety of **users of access service** [**67] are facilities-based carriers, resellers (who use facilities provided by others), sharers, privately owned systems, **enhanced service providers**, and other private line and WATS customers, large and small, who "leak" traffic into the exchange..... A facilities-based carrier, reseller or **enhanced service [**68] provider** might terminate few calls at its own location and **thus would make relatively heavy interstate use of local exchange services and facilities to access its customers.** (In the Matter of MTS and WATS Market Structure, Memorandum Opinion and Order (CC Docket No. 78-72), 97 FCC 2d 682, at 711-712 (1983))

- Of the many entities that now use access service, some are currently paying relatively high carrier usage charges, through either the settlements/division of revenues process or ENFIA rates, while **others are obtaining exchange access at ordinary business local exchange service rates**... (In the Matter of MTS and WATS Market Structure, Memorandum Opinion and Order (CC Docket No. 78-72), 97 FCC 2d 682, at 712 (1983))

- In many cases, that local rate is flat, regardless of the amount of use on the line [**71] to satisfy its interstate calling needs. There, it could be argued that no charge whatsoever is assessed for interstate use of local services since the flat rate comprehends local service only. (In the Matter of MTS and WATS Market Structure, Memorandum Opinion and Order (CC Docket No. 78-72), 97 FCC 2d 682, at 713 (1983))

- Were we at the outset to impose full carrier usage charges on **enhanced service providers** and possibly sharers and a select few others who are **currently paying local business exchange service rates for their interstate access**, [**76] these entities would experience huge increases in their costs of operation which could affect their viability. (In the Matter of MTS and WATS Market Structure,

Memorandum Opinion and Order (CC Docket No. 78-72), 97 FCC 2d 682, at 715 (1983))

- Ideally, the surrogate private line WATS surcharge should be set at a level which yields overall revenues representative of the revenues forgone on account of **users obtaining access services at local telephone service rates.** In other words, the aggregate surcharge revenues serve as a **surrogate for the interstate access charges** which would be collected if leaky PBX usage could be quantified and identified as to source. (In the Matter of MTS and WATS Market Structure, Memorandum Opinion and Order (CC Docket No. 78-72), 97 FCC 2d 682, at 717 (1983))

- In addition to exchange carrier-provided private lines and WATS lines, **we shall allow exchange carriers to develop reasonable, nondiscriminatory surcharges on interconnected use of exchange services by carriers' publicly-offered interstate services using radio and other facilities (e.g. DTS), and privately-owned microwave relay systems, satellite transmission systems, and other interstate private facilities that would otherwise not be subject to either the surcharge or carriers access charges** (that is, that will not employ any end links obtained from the exchange carriers to which private line surcharges would apply). In such cases, [**82] we are prepared to consider carriers' proposals for a surcharge to the individual exchange telephone lines n66 which can be connected to such systems. (In the Matter of MTS and WATS Market Structure, Memorandum Opinion and Order (CC Docket No. 78-72), 97 FCC 2d 682, at 718 (1983) and Part 69.115(d))

- Rather, the surcharge is designed solely to compensate for the use of the local exchange. (In the Matter of MTS and WATS Market Structure, Memorandum Opinion and Order (CC Docket No. 78-72), 97 FCC 2d 682, at 719 (1983))

Revenues

Monthly MOU *(Note 1)*	1,106,672,602
Calendar Day MOU (Monthly MOU X 12 / 365)	36,383,756.78
Business Day MOU (Calendar Day MOU / .85)	42,804,420
Busy Hour MOU (Business Day MOU X .07)	2,996,309
Busy Hour Seconds (Busy Hour MOU X 60)	179,778,563
Busy Hour CCS (Busy Hour Seconds / 100) *(Note 2)*	1,797,786
Trunks Required to handle Busy Hour CCS *(Note 3)*	69,145.60
ISDN PRIs (Smart Trunks) Required *(Note 4)*	3,006
Average Texas Revenue per ISDN PRI *(Note 5)*	$450
Total Monthly Revenue from ISP (number of PRIs X revenue per PRI)	**$1, 352,849**

Costs

Monthly MOU	1,106,672,602
Monthly Messages *(Note 6)*	38,161,124
Estimated Terminating Switching Cost: *(Note 7)*	
$.000561 per message	$21,407
$.000484 per MOU	$535,705
Total Monthly Switching Cost to serve ISP	**$557,112**

Notes:
(1)-Actual CLEC-switched ISP Minutes of Use (MOU) from SBC studies (1999).
(2)-Series of calculations converts Monthly MOUs to Busy Hour CCS; the engineering assumptions used here parallel those used in the cost studies for tandem switching and transport reflected in the cost analysis portion of this document.
(3)-Trunks required to handle Busy Hour CCS (Assumes each trunk can carry 26 CCS)
(4)- 23 Trunks to make 1 ISDN PRI (T1)
(5)-Revenue is from rates for switching service elements only; does not include any revenues for transport (e.g. DS1 Local Distribution Channels) between the switch and the ISP premises, which would generally also be paid for by the ISP.
(6)-Calculated by dividing monthly MOU by 29 minutes average length of message
(7)-Source of Estimated Switching Cost is from SWBT testimony filed in Texas Docket No. 21982. This switching cost is comprised of the monthly cost for set-up and the monthly cost for usage; these cost estimates include overhead loadings.

Equity Research
North America

United States of America

Telecom - CLECs

Pac-West Telecomm

Reuters: PACW.O Bloomberg: PACW NASDAQ: PACW

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OUTPERFORM

Price (September 12, 2000):	$14.44
Price Target:	$25
52-Week Range:	$42-$10

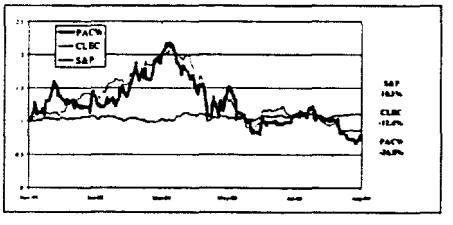
Initiating Coverage

September 19, 2000

Fully Funded but Not Fully Valued

- **Coverage initiated with an Outperform and Tier II rating**
  We believe that Pac-West represents one of the best risk/reward values in the CLEC space and it is our top Tier II play.
- **Unique retail strategy is key to value**
  Retail penetration is outpacing ISP growth, which diversifies revenues and reduces regulatory risk.
- **Company has liquidity and profitability**
  Pac-West is fully funded to free cash flow positive and is now generating 30%+ EBITDA margins.
- **Valuation is compelling**
  Pac-West is trading well below its peers despite its projected growth rate and good near-term visibility.

PACW Price Performance Since IPO (9/4/1999)



Source: FactSet and MSDW Research

FY ending Dec 31:	1998A	1999E	2000E	2001E
EPS ($)	–	(0.09)	0.15	0.28
CEPS ($)	–	0.16	0.74	1.20
Revenue ($ m)	–	68.2	136.2	182.0
EBITDA ($ m)	–	24.9	42.2	61.9
P/E	–	NM	101.8	50.9
P/CE	–	52.7	20.1	11.9
EV/EBITDA	–	24.2	14.4	9.0
EV/Rev	–	8.8	4.5	3.1
Market Cap ($m)	552.0			
Enterprise Value ($ m)	602.0			
Shares Outstanding (m)	38.7			

Q'rtly EPS	1998 actual	1999E curr	1999E prior	2000E curr	2000E prior
Q1	–	–	–	0.06	–
Q2	–	–	–	0.04	–
Q3	–	–	–	0.3E	–
Q4	–	–	–	0.01E	–

E = Morgan Stanley Dean Witter Research Estimate.

Company Description

Pac-West Telecomm is a provider of integrated telecommunications services to ISPs and small- and medium-sized businesses. ISPs collocate either at Pac-West's switching facilities, or subscribe to an integrated managed modem service. For small- and medium- sized business customers, Pac-West bundles telephone equipment, design, installation, and maintenance with local, long distance, and data services.

Fully Funded but Not Fully Valued

Summary and Investment Conclusion
We are initiating coverage of Pac-West Telecomm with an Outperform rating and a 12-month price target of $25.

We believe that Pac-West is well positioned to be a strong regional communications provider since it has the two components necessary for scalability: strong management and a fully funded business plan. We expect the company to post above-average top-line growth and profitability given its management, unique retail strategy, and its profitable ISP (Internet service provider) product offerings and distribution relationships.

The company's retail offerings include local, long distance, data, and equipment. We expect this revenue stream to grow substantially over the near term, outpacing its ISP channel and thus significantly reducing exposure to any regulatory overhangs. In addition, the company has a strong management team and is one of the few CLECs with a fully funded business plan. Pac-West is currently EBITDA positive (more than 30% margins) and is expected to be free cash flow positive by 2003.

In addition, we believe that the company's valuation is attractive and has been dragged down by recent concerns regarding the ISP distribution channel. We do not believe the stock's current price reflects the company's potential growth opportunities.

Pac-West's strong near-term visibility, high liquidity, and reasonable valuation make it one of the best risk/reward plays in the telecom sector, in our view, and our top Tier II pick.

Investment Positives

Strong management team and good near-term visibility. We believe the company's near-term targets are likely to be attained as Pac-West has a solid track record of meeting or beating Street expectations since it went public in late 1999.

Unique retail strategy. The company targets small- to medium-sized businesses by selling a bundle that includes telephone equipment, design, and maintenance with local, long distance, and data services. The company's retail distribution channel continues to outpace its strong ISP channel, reducing concentration and regulatory risk. This strategy provides a "sticky" customer base, with every customer taking an additional product besides local service. The typical contract length is 3–5 years.

EBITDA positive. The company is currently posting EBITDA margins in excess of 30%. We expect margins to remain high even with significant dilution from geographic and product expansion as the company continues to improve network efficiencies. We expect gross margins to improve as Pac-West enters into fiber IRU (indefeasible right of use) agreements, alleviating much of the third-party backhaul expense.

Minimal financing risk. Pac-West's current business plan is funded until the company becomes cash flow positive, which we estimate to be 2003.

Strong liquidity. Pac-West boasts a low leverage ratio, with its only debt financing being a $150 million senior credit facility. We believe this puts the company in a good fundamental and strategic position. Fundamentally, Pac-West has additional borrowing capacity for further expansion plans or acquisitions. The company is also a more attractive takeover candidate with a reduced debt overhang.

Attractive valuation. Pac-West is trading at 3.1 times 2001 revenue and 9.0 times 2001 EBITDA as compared to 4.2 times 2001 revenues and 40.5 times EBITDA for its peers. On a three-year EBITDA-to-growth basis, the stock is trading at 0.33 times versus 0.36 times for the CLECs as a group.

Please refer to important disclosures at the end of this report.

Exhibit 1
PACW Financing Status

($ 000's - except per share)	Pac-West
Total Cash on Hand	$134.9
Available Line of Credit	40.0
Total	$174.9
2H 2000	
EBITDA	$21.0
Capital Expenditures	(37.4)
Acquisitions	
Cash Interest	(10.1)
Working Capital	(4.0)
Cash Balance at 12/00	$144.4
FY 2001	
EBITDA	$61.9
Capital Expenditures	(106.7)
Cash Interest	(20.7)
Working Capital	(4.7)
Cash Balance at 12/01	$74.1

Source: MSDW Research

Investment Risks

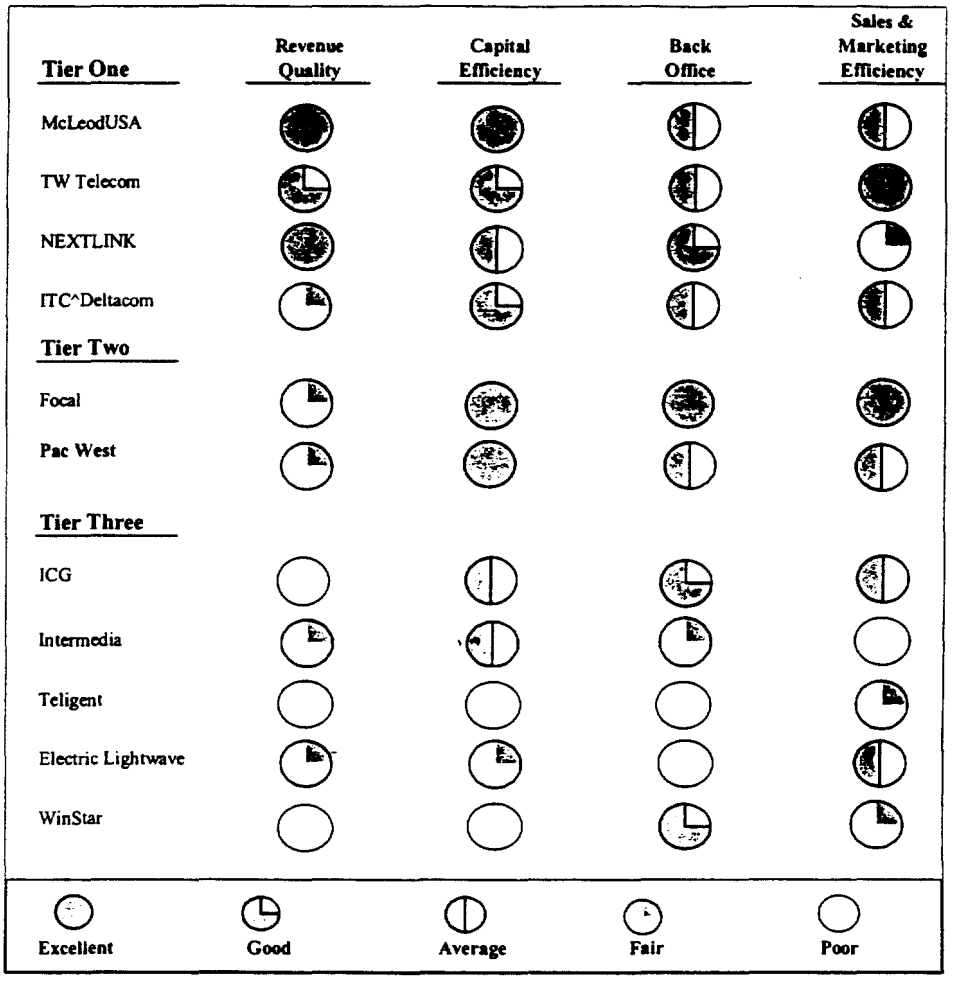
Pricing pressure in the ISP business. Pricing in the ISP distribution channel, for both port prices and usage-based reciprocal compensation, is declining rapidly. We estimate that reciprocal compensation rates have dropped from $0.007–0.008 per minute in late 1998 to $0.002 today. In addition, increased competition caused by low barriers to entry is reducing PRI (primary rate interface) port prices. Some CLECs are offering PRI ports at prices as low as $13–14 a month. We believe that Pac-West's ISP exposure is alleviated by the company's focus on growing its retail business, conservative accounting for reciprocal compensation, and the addition of value-added services, such as managed modems, for their ISP customers.

Provisioning capabilities. While Pac-West continues to provision lines at an increasing pace (the company added over 27,000 lines in 2Q), it is reliant on the ILECs for circuit delivery.

Regional focus. Pac-West primarily focuses on California and is branching into the neighboring states of Washington, Oregon, Colorado, Nevada, New Mexico, Texas, and Arizona. Being a regional CLEC limits the company's addressable market, particularly in relation to ISP customers. Most national ISPs want one telecommunications provider that is capable of delivering service across the country.

No clear data strategy. Pac-West provides Internet access and data switching but has not announced plans to expand its data platform by incorporating other value-added services such as web or applications hosting.

Exhibit 2
MSDW CLEC Tiering



Source: Company data, Morgan Stanley Dean Witter Research

Valuation

We have based our valuation of Pac-West on both a ten-year DCF model and a comparison of near-term trading multiples. In the DCF analysis we have conservative assumptions for market penetration, margins, growth rates, and discount rates. On a near-term trading multiple basis, Pac-West is trading at the low end of its peer group. We believe this has been caused by general market concern regarding the long-term viability of the ISP distribution channel and its exposure to regulatory risk. In our opinion, Pac-West's risk is mitigated by its increased retail focus, conservative treatment of usage-based fees, and addition of value-added services.

Exhibit 3

Pac-West DCF Assumptions

DCF Assumptions	
Growth in Perpetuity	7.5%
Cost of Debt	14.5%
Cost of Equity	17.5%
Discount Rate	14.0%
Implied EBITDA / Firm Value 2010	8.1x
Implied Net Income / Firm Value 2010	19.7x
% of Total Value in Terminal	77.5%
Addressable Local Business Lines 2010 (000s)	21,164
Local Business Access Lines 2010 (000s)	1,931
Penetration of Addressable Market 2010	9.1%
ISP Addressable Lines 2010 (000s)	7,556
ISP Lines 2010 (000s)	386
Penetration of ISP Market 2010	5.1%
10 Year Revenue CAGR	20.1%
2010 EBITDA Margin	40.2%

Source: Company data, Morgan Stanley Dean Witter Research

Exhibit 4

CLEC Trading Multiples (as of 9/18/2000)

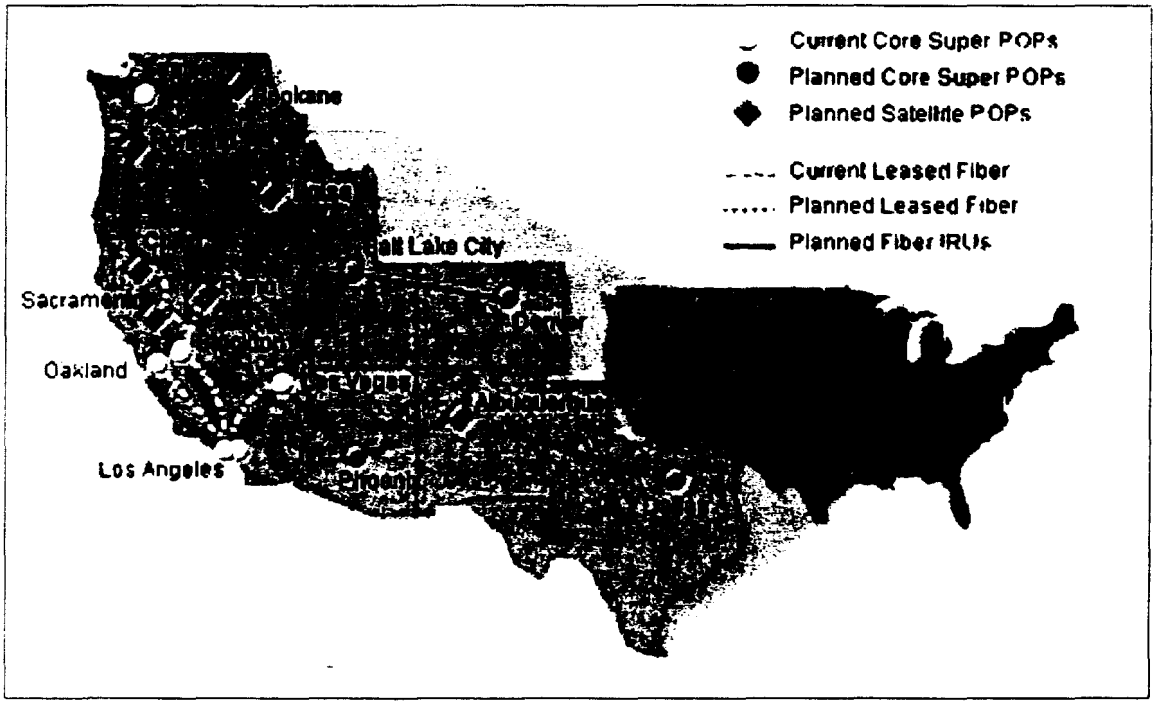
Near-Term Trading Multiples											
	ELIX	FCOM	ICGX	ICIX	ITCD	MCLD	NXLK	NXLK	TGNT	TWTC	WCII
Firm Value / 01E Revs.	3.0 x	4.4 x	2.7 x	4.5 x	2.4 x	6.8 x	9.6 x	3.3 x	4.4 x	10.8 x	4.3 x
Firm Value / 01E EBITDA	37.4 x	33.6 x	10.5 x	54.9 x	17.0 x	55.7 x	NM	9.8 x	NM	48.6 x	342.1 x
Firm Value / Gross Plant	1.3 x	5.1 x	1.3 x	2.5 x	2.1 x	5.5 x	6.9 x	3.4 x	3.1 x	6.8 x	1.6 x
3 Year Revenue to Growth	0.1 x	0.1 x	0.1 x	0.1 x	0.1 x	0.2 x	0.2 x	0.1 x	0.1 x	0.3 x	0.2 x
3 Year EBITDA to Growth	0.3 x	0.4 x	0.3 x	0.1 x	0.2 x	0.6 x	NM	0.3 x	0.3 x	0.8 x	NM

Source: Company data, Morgan Stanley Dean Witter Research

Please refer to important disclosures at the end of this report.

Network

Exhibit 5
Pac-West Coverage



Source: Company data

Pac-West Telecomm focuses on small- and medium size businesses and provides customized communications services. Pac-West uses a "smart-build" strategy, owning and building intelligent components of the network while leasing unbundled loops and transport lines from other carriers. This strategy allows Pac-West to expand into new markets with lower up-front capital expenditures and faster time-to-market. As traffic on Pac-West's network increases, it intends to purchase rights of use in high-capacity dark fiber transport lines to interconnect certain markets with an owned backbone network.

Pac-West is operational in six markets, including Los Angeles, San Francisco, and Stockton, California; Las Vegas, Nevada; Seattle and Tacoma, Washington; and Denver, Colorado. In addition to these markets, Pac-West has business lines in Phoenix, Arizona; Chico-Oroville and Sacramento, California; Boise-Nampa, Idaho; Albuquerque, New Mexico; Portland, Oregon; Reno, Nevada; Dallas-Ft. Worth, Texas; Salt Lake City-Ogden, Utah; and Spokane, Washington. Pac-West also expects to have statewide local coverage in each of its target markets by the end of 2000.

Pac-West leases most of its transmission facilities from IXCs, ILECs, and other CLECs. The company recently entered into a 20-year fiber IRU with Qwest for an OC-48, SONET ring in California. We expect the company to sign similar agreements for dark fiber in high-traffic regions.

Switch infrastructure. Pac-West's switch infrastructure is structured to minimize capital expense. The company installs Class 5 voice switches at "Super POP" locations and digital nodes at smaller LATA locations. Utilizing a tandem switch approach allows ISP customers to collocate equipment at the Super POP rather than in the smaller LATAs. For its commercial customer, Pac-West is able to provide local voice service using tandem switches by installing PBXs at the customer premise. Since the cost of the PBX is passed through to the customer, Pac-West is able to offer service with significantly lower capital expenditure than other telecom providers.

Products & Services

Pac-West Telecomm's service offerings range from local and long distance to DSL and ISP services:

Local services. Pac-West provides local dial-tone services, including operator services and access to third-party directory assistance.

Long distance services. Pac-West offers domestic and international long distance services. It can combine monthly recurring, local usage, and long distance charges into one invoice.

Specialized application services. Pac-West tailors products and services for small- to medium-sized businesses, for example, rated local calling, expanded local calling area, discounted long distance rates, and tailored trunking configurations.

ISP services. Pac-West provides collocation services at all of their switch locations (Los Angeles, Oakland, and Stockton, California; Las Vegas, Nevada; and Seattle, Washington). They receive monthly revenue from ISPs for the space occupied in the switch facilities. Recently, Pac-West has initiated a managed modem service, which consists of modem pools and dedicated circuits into the world-wide web.

Enhanced services. In addition to providing enhanced services such as conference calling, voicemail, and call transfer, Pac-West offers Internet access, data networking, and DSL services.

DSL (digital subscriber line) service. Pac-West uses Covad Communications to offer high-speed DSL (digital subscriber line) service to its customers. Covad's network supports ADSL, SDSL, and IDSL technologies.

Managed modems. The service provides access lines, modems, Internet access, routers, authentication service, dedicated point-to-point circuits for authentication, and technical support. For customers that choose to maintain their own modems, PACW's SuperPOP configuration allows all the calls from a region to collect in a common modem pool and then roll to an available modem. This process increases modem efficiency, and the number of subscribers that can be maintained by one modem.

Collocation facilities. Pac-West rents space and allows customers to install equipment in any of their SuperPOPs and connect directly to PACW's tandem switches. Allowing customers to collocate their equipment in a specific SuperPOP, rather than each LATA, reduces the customer's capital expenditures and maintenance expense.

Retail Strategy

Pac-West is building its "feet-on-the street" to grow its commercial business. The company currently has 104 salespeople and is targeting 120 people by year-end. Quota is based on the number of lines sold and is approximately 45 lines for the lowest level of account executive.

We forecast commercial revenue to be 19% of total revenue in 2000, growing to 80% by 2010. Pac-West's retail strategy keeps its customer base very "sticky". It provides all of the telecom service, including equipment design and maintenance, local, long distance, data, and Internet access. Pac-West installs a PBX in the customer premise, which is connected to the tandem or Super POP switch by a T-1. The average T-1 customer takes 22 voice lines for both local and long distance, with the remaining capacity dedicated to data and Internet access. For 2000, we modeled the monthly revenue per T-1 at approximately $1,300.

Customers are required to take the full bundle, which keeps them reliant on one telecom provider. The contracts are typically 3–5 years in length.

ISP Channel

Pac-West's ISP Business

Pac-West is shifting its focus toward its commercial customer base, but 70% of the company's revenue is still ISP-related. The ISP distribution channel has been under investor scrutiny recently, primarily due to rapid declines in reciprocal compensation rates and competitive pricing for PRI ports. While we do not believe that the current margins for the ISP business are sustainable, it is a profitable business today. In Pac-West's case, its ISP revenue allows the company to fund its growth initiatives and beef up its salesforce.

Pac-West's ISP revenue consists of monthly port rates, reciprocal compensation, and managed modem services. The company books reciprocal compensation at an industry average of $0.002 per minute. Thirty-percent of the company's ISP lines are taking a managed modem service, and we expect this number to rise in the future.

Overview of the ISP channel

In general, we view the ISP business as a growth opportunity, albeit one that is more price sensitive than commercial voice and data revenues.

- ISPs, particularly in the consumer space, are increasingly moving to full outsourcing, focusing on marketing and content.
- In our view, the primary beneficiaries of the growing wholesale ISP market are emerging carriers that are benefiting from segment growth as well as garnering share from the incumbents.
- Despite the introduction of broadband, as Internet demand surges, we believe the dial-up market will continue to grow —from an estimated $1.7 billion in 2000 to $1.9 billion in 2002.
- Value-added services and, potentially, voice could broaden this market opportunity significantly.
- Technology changes and general capital cost reductions are offsetting reciprocal compensation declines and near-term downward pricing trends. Soft-switch prices can be almost 70% cheaper than circuit-based technology.
- Supply constraints in local capacity have benefited CLECs focused on this segment in the near term. In the long term, market leaders will need to provide broadband and value-added services to maintain a share in the ISP market, in our view.

The ISP market has been critical to the growth of CLECs over the past several years. As those carriers have worked to develop retail sales channels, the ISP market has proven to be a source of growth. More than 40% of total added lines over the last two quarters have been ISP dial ports. Even after accounting for the steep decline in reciprocal compensation rates that has taken place over the past year, we believe this business remains very attractive. New soft-switch technology should help retain those margins over the next several years. Similarly, those CLECs with extensive local fiber networks have also benefited from the rising demand for Internet connectivity

Exhibit 6
Pac-West ISP Revenues

($ Millions)	1999	2000E	2001E	2002E	2003E	2004E	2005E	2006E	2007E	2008E	2009E	2010E
Assumptions												
Population												
Residential Lines	9,878	13,722	22,289	23,681	24,628	25,613	26,638	27,703	28,811	29,964	31,162	32,409
Total U.S. Residential Lines	123,911	128,008	132,184	136,436	140,764	145,165	149,640	154,185	158,799	163,551	168,445	173,486
Percentage Coverage	*8.0%*	*10.7%*	*16.9%*	*17.4%*	*17.5%*	*17.6%*	*17.8%*	*18.0%*	*18.1%*	*18.3%*	*18.5%*	*18.7%*
Total Dial-Up Users (inc. back up)	38,400	50,372	59,508	65,892	69,721	70,793	70,640	68,789	65,571	62,320	59,426	56,667
Growth		31.2%	18.1%	10.7%	5.8%	1.5%	-0.2%	-2.6%	-4.7%	-5.0%	-4.6%	-4.6%
Total Dial Ports	3,196	4,658	5,793	6,752	7,520	8,677	10,689	13,345	14,455	14,019	12,378	10,929
Total Target ISP Dial Ports	255	499	977	1,172	1,316	1,531	1,903	2,398	2,623	2,568	2,290	2,042
PACW ISP Lines	81,442	141,294	234,059	312,079	358,890	376,835	369,298	361,912	354,674	347,581	340,629	333,816
New Lines		59,852	92,765	78,020	46,812	17,945	(7,537)	(7,386)	(7,238)	(7,093)	(6,952)	(6,813)
Growth		*100.0%*	*65.7%*	*33.3%*	*15.0%*	*5.0%*	*-2.0%*	*-2.0%*	*-2.0%*	*-2.0%*	*-2.0%*	*-2.0%*
Average Lines		101,393	172,216	260,066	327,683	364,872	374,323	366,836	359,500	352,310	345,263	338,358
Market Share	32.0%	28.3%	24.0%	26.6%	27.3%	24.6%	19.4%	15.1%	13.5%	13.5%	14.9%	16.4%
Avg. Mnthly Mins of per Line (000s)	19.9	20.1	17.1	15.4	13.8	12.5	11.2	10.1	9.1	8.2	7.4	6.6
Total Minutes of Use (millions)		24,479	35,300	47,976	54,405	54,522	50,341	44,401	39,161	34,540	30,464	26,870
Product Selection												
PRI	81,442	98,906	93,624	109,228	107,667	94,209	73,860	54,287	35,467	17,379	0	0
% of Total ISP lines	*100.0%*	*70.0%*	*40.0%*	*35.0%*	*30.0%*	*25.0%*	*20.0%*	*15.0%*	*10.0%*	*5.0%*	*0.0%*	*0.0%*
Remote Access (Managed Modem)	0	42,388	140,435	202,851	251,223	282,626	295,439	307,625	319,207	330,202	340,629	333,816
% of Total ISP lines	*0.0%*	*30.0%*	*60.0%*	*65.0%*	*70.0%*	*75.0%*	*80.0%*	*85.0%*	*90.0%*	*95.0%*	*100.0%*	*100.0%*
Revenues												
Monthly Fee per PRI Line	$19.00	$19.00	19.5 $16.15	$13.73	$12.35	$11.12	$10.01	$9.01	$8.11	$7.30	$6.71	$6.17
Decline			*15.0%*	*15.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*	*10.0%*	*8.0%*	*8.0%*
Monthly Fee per RAS Line		$28.00	$23.80	$20.23	$19.22	$18.26	$17.34	$16.48	$15.65	$14.87	$14.13	$13.42
Decline	-		*15.0%*	*15.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*
Value-Added Services per Line				$0.00	$1.50	$3.00	$5.00	$7.00	$9.50	$12.00	$14.50	$17.00
						100.0%	66.7%	40.0%	35.7%	26.3%	20.8%	17.2%
Total Customer-Based Revenues	$0.0	$27.0	$40.3	$55.4	$72.5	$84.2	$92.7	$97.3	$104.2	$110.9	$117.6	$123.5
Total Reciprocal Compensation	$0.0	$47.7	$57.4	$58.5	$49.7	$44.9	$37.3	$29.6	$23.5	$18.6	$14.8	$11.7
Total Recip Comp per Min	$0.0020	$0.0020	$0.0016	$0.0012	$0.0009	$0.0008	$0.0007	$0.0007	$0.0006	$0.0005	$0.0005	$0.0004
Total ISP Revenues	$0.0	$74.8	$97.6	$113.9	$122.2	$129.1	$129.9	$126.9	$127.6	$129.6	$132.4	$135.3
Revenue Per Line/Mth		$61.44	$47.24	$36.50	$31.09	$29.48	$28.93	$28.83	$29.59	$30.65	$31.95	$33.31

Source: MSDW Research

Macro Trends Appear Positive

ISPs have historically outsourced components of their networks, a trend that has accelerated recently. Increasingly, ISPs are focused on providing content rather than underlying access and are turning to telecom service providers to carry the traffic. The emergence of free ISPs is likely to increase the pressure on consumer and small-business ISPs to cut costs by outsourcing as much of their networks as possible. Even modem banks, which ISPs once considered a core part of their businesses, are now being outsourced to local service providers. We believe that as more value-added products are introduced, there will be growing pressure on ISPs to find outsourcing partners that can provide these services.

Rumors that dial-up Internet access is dead are exaggerated, in our view. The demand for local connectivity is likely to overwhelm the supply of broadband connections over the next two years. We have seen several recent announcements indicating that Internet penetration, particularly at the consumer level, is likely to increase. Large corporations such as Delta Airlines and Ford have announced that they will offer subsidized Internet access to their employees. Free ISPs have announced unprecedented subscriber growth.

We believe that robust growth in dial-up connections will continue for the next two years before slowing and beginning to decline in 2004.

Please refer to important disclosures at the end of this report.

Service providers that can satisfy the need for capacity at key bottlenecks will be in the best position, in our opinion. Today, the local connectivity segment of the supply chain is the weakest link. Local capacity has not kept up with the explosion in backbone capacity. Broadband providers such as the DSL players and the cable companies are well positioned to capture share as broadband becomes more prevalent. However, the dial-up providers control a key bottleneck today.

We expect the ISP wholesale channel to grow with the addition of broadband and value-added services. Many of these services, such as unified messaging and voice, are already here today, although they are not yet a sales focus for most ISPs. We believe these services, combined with other future offerings, could more than double the wholesale ISP market. Service providers with significant market share and a direct relationship with the ISPs would be in the best position to benefit from this market expansion.

The supply of local capacity has not kept pace with the demand for Internet connectivity, shifting the competitive balance in favor of local providers and away from the backbone players. The increase in demand has created an opportunity for telecom service providers that have local capacity, both broadband and narrowband, to gain share in the wholesale ISP market.

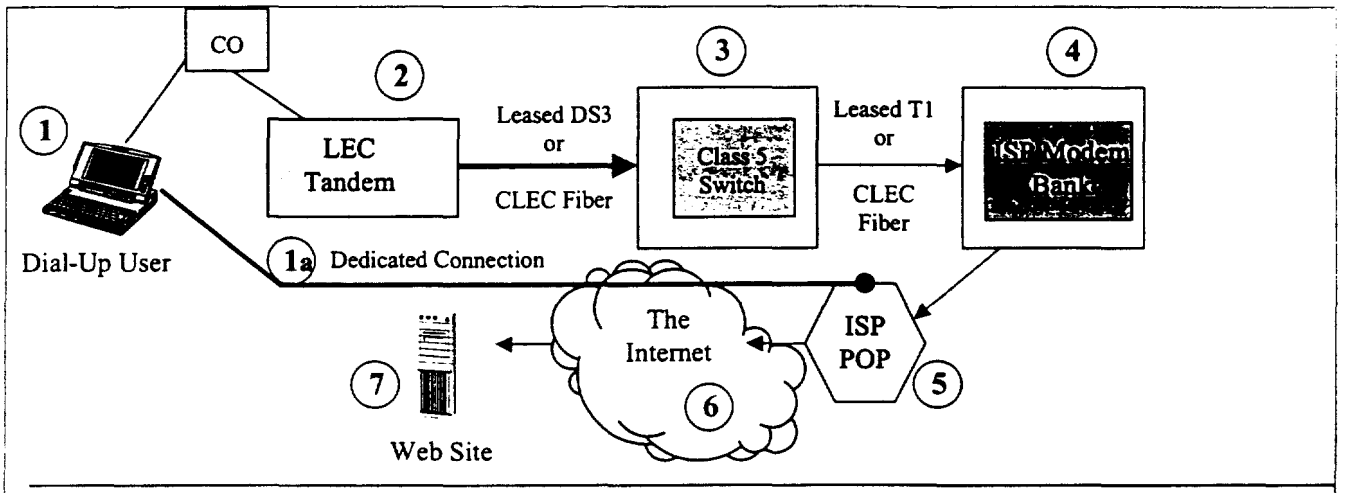
Given this positive environment, we believe CLECs will continue to grow their ISP dial ports for the next two years, gaining share in the ISP wholesale market. Investors who have been reluctant to credit them for their growth in this area should be relieved that the market will likely continue to grow rapidly and that the economics should remain intact.

The ISP Wholesale Market

The ISP wholesale market can be divided into two segments: local connectivity and the backbone. The wholesale value chain can be further subdivided into two markets by the capacity demand of the end user: a consumer and small-business opportunity and a medium- and large-business market.

Please refer to important disclosures at the end of this report.

Exhibit 7
Anatomy of an Internet Subscriber



1 Dial-Up User logs into his 56K modem connection. Connection time includes all minutes spent on line, not just those where one is actively querying the 'Net.

1a Large Business users generally access the Internet via a dedicated copper T1 or high speed fiber capacity. This connection is direct from the customer premise to the ISP POP.

2 A circuit is then opened between the customer site and the ILEC Tandem switch (via a local ILEC central office). The circuit is transported via a DS-3 circuit from the tandem to a local switch.

3 At the switch, which may be a Class 5 voice switch or a next-gen dedicated switch, the connection is passed to a modem bank. ISP customers are generally concentrated at 10 per dedicated switch port.

4 At the modem bank the call is converted into IP and given the appropriate IP address. The information request is then routed to the ISP POP.

5 The ISP point-of-presence (POP) is the local gateway to the Internet.

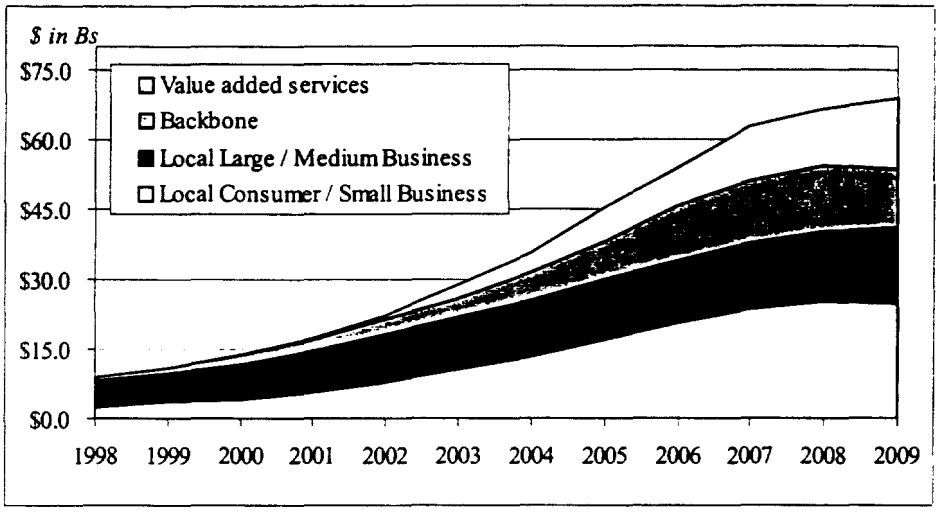
6 7 Once on the 'Net, the information request is then routed through various networks to the server hosting the requested web site. This is the backbone segment.

Source: MSDW Research

We estimate the total wholesale market at more than $11 billion in 1999. We believe it will grow at a compound annual growth rate (CAGR) of 26% over the next five years, reaching $36 billion in 2004. By 2009, we estimate the market will almost double again, to $69 billion.

Please refer to important disclosures at the end of this report.

Exhibit 8
Total ISP Wholesale Market, 1998 - 2009



Source: Morgan Stanley Dean Witter Research

Dial-Up Lives!

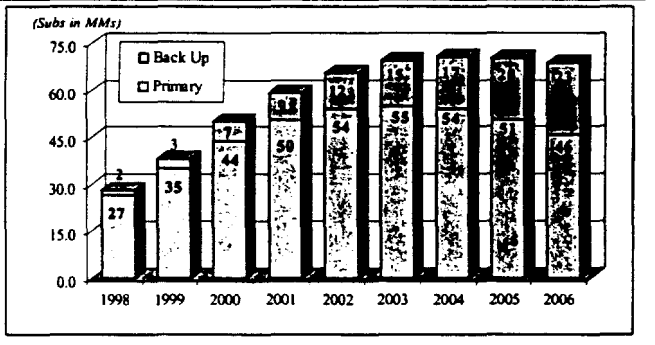
Rumors of the death of dial-up have been exaggerated, in our view. In 1999 the industry witnessed the first serious deployments of digital subscriber line (DSL) connectivity by the regional Bell operating companies (RBOCs) and through the nationwide buildout of NorthPoint and Covad. The cable companies also began to accelerate their rollout of cable modem services. Despite this recent push, these broadband connections have made only a small dent in what is still the primary means of connecting to the Internet — old-fashioned, narrowband, dial-up modems. The number of people connecting to the Internet here in North America continues to outstrip the available broadband access supply.

As indicated in the exhibit above, we believe the overall number of dial-up subscribers will continue to grow through 2004 before beginning to decline. However, we believe 2003 will be the peak year for consumers using dial-up as their primary means of Internet access.

In our view, several recent trends give credibility to our forecast:

- The emergence of free ISPs — NetZero added 1.98 million subscribers in its first year,
- Corporate subsidizing of the Internet,

Exhibit 9
Dial-Up Users, 1998 - 2006



Source: Morgan Stanley Dean Witter Research

- Declining PC prices,
- The proliferation of new applications, and
- Customers' inability to access broadband.

In short, we believe that Internet access will become nearly universal as growth in e-commerce and other web applications makes the Internet a part of everyday life. Furthermore, broadband access is likely to remain constrained by supply. Dial-up will probably remain the primary means of Internet access for the next several years as demand exceeds the supply of broadband alternatives such as DSL and cable modems.

Despite the growth in the number of ISP dial-up ports, we believe the dial-up market will grow at a CAGR of only 5%

Please refer to important disclosures at the end of this report.

in the next five years. The main culprit will be rapidly declining fixed monthly charges and a falling reciprocal compensation rate. With the advent of soft-switch technology, service providers can earn attractive returns even at fixed monthly port rates below $10, an analysis that leads us to believe that pricing is likely to rapidly decline to those levels as more providers roll it out. Reciprocal compensation rates fell sharply in 1999 as existing interconnection agreement expired and new agreements were struck. We believe that per-minute charges will continue to fall at greater than 20%, from $0.002 to $0.0015 per minute.

Exhibit 10

Overview of the Consumer and Small-Business ISP Wholesale Market Opportunity

Source: Morgan Stanley Dean Witter Research

The Local Link — CLECs and ILECs

The local service providers have approached the wholesale opportunity from the local portion of the value chain. CLECs, in particular, have been aggressive in selling local dial-up ports to ISPs. CLECs have been particularly well-positioned to take share in this market because they have the port capacity on their local switches, and the reciprocal compensation system has put them in an advantageous cost position vis-a-vis the incumbent local exchange companies (ILECs).

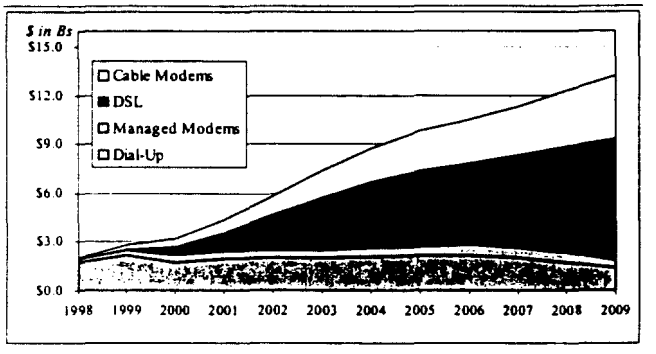
In order to reduce the cost of providing dial-up ports, CLECs have encouraged the ISPs to collocate their modem banks in the CLECs' switch facilities, eliminating the cost of transporting that traffic to another site. Some CLECs have begun to expand this collocation relationship to offer managed modem remote access services (RAS). In this case, the CLECs own and manage the modem bank in addition to providing dial-up port access.

Broadening the Service Offering: Gateways & Backbone

In order to strengthen their relationship with ISPs, service providers are likely to seek to broaden the services they offer. For the local players, offering collocation space and managed modem services helps remove costs from the dial-up port service offering (collocating modems enables a local provider to avoid paying transport costs between its local switch and the ISP modem bank) and frees up the ISP to concentrate on marketing its services and adding content to its site.

Exhibit 11

Consumer and Small-Business Local Access Wholesale Market



Source: Morgan Stanley Dean Witter Research

Broadening the range of products offered may not be the only reason to offer managed modem services. As the nearest local traffic concentration point for dial-up subscribers, collocation spaces may be an important component of offering value-added services.

Exhibit 10

Analysis of Incremental Managed Modem Services

Capital Assumptions	
PRI Only	
Switch Cost inc. install (000s)	$2,125
Cost per Port (25,000 ports)	$85
Depreciable Life	6 years
Mthly Switch Depreciation/Port	$1.18
Managed Modem Service	
Cost per RAS Modem	$3,000
per port modem cost	$120.00
Depreciable Life	3 years
Mthly Modem Depreciailon / Port	$3.33
Additional Power Cost per Port	$0
Depreciable Life	8 years
Mthly Power Depreciation / Port	$0.00
Total Capital per Port	**$85**
Total RAS Capital / Port	**120**
Total Capital	**$205**

Revenue Assumptions	
PRI Only	
Monthly Charge per PRI Line	$18.00
Monthly Minutes per Line	12,000
Assumes 40 min/day per ISP sub and 10 subs per Port	
Managed Modem Service	
Mthly Increm. RAS Rev. / Port	$8.00

Operating Cost Assumptions	
Operating Expenses	
Average T-1 Fill	90%
Monthly T-1 Charge	$175.00
Monthly DS-3 Charge	$2,500
DS 3 Trunc (per Line)	$3.72

Other Assumptions	
Tax Rate	40.0%
Discount Rate	12.0%
Total Average Life of Customer	2 years
Annual Churn	20%
Monthly Churn	1.7%

SG&A Expenses	
Customer Care / Billing per Port	$4.00
Base Salary per Rep	$50,000
Quota	$25,000
Commission % of Quota	20%
Additional SG&A per RAS Port	$0.50
Monthly Base	$4,167
Monthly Commission	5,000
Total	$9,167

Basic PRI Dial Port Service - Softswitch

	2000	2001	2002	2003
Recip Comp Rate	$0.0020	$0.0015	$0.0012	$0.0010
ISP Port (Access Line)	1	1	1	1
Fee per Line	$17.00	$12.75	$9.56	$7.65
Customer Revenues	$17.00	$12.75	$9.56	$7.65
Recip Comp Rev.	16.81	15.96	15.57	14.76
Total Revenue	**$33.81**	**$28.71**	**$25.13**	**$22.41**
Expenses				
Avg. T-1 Fill	90%	90%	90%	90%
Leased T-1s	0.05	0.05	0.05	0.05
Monthly T-1 Charge	$175.00	$157.50	$141.75	$127.58
Leased T-1 Expense	$8.10	$7.29	$6.56	$5.91
DS 3 Trunc (per Line)	3.72	3.35	3.01	2.71
Total	$11.82	$10.64	$9.58	$8.62
Gross Margin	**$21.99**	**$18.07**	**$15.56**	**$13.79**
% of Revenue	**65.0%**	**62.9%**	**61.9%**	**61.5%**
Customer Care and Billi	$4.00	$4.00	$4.00	$4.00
% of Revenue	11.8%	13.9%	15.9%	17.9%
EBITDA	$17.99	$14.07	$11.56	$9.79
% of Revenue	53.2%	49.0%	46.0%	43.7%
Depreciation / Port	$1.18	$1.18	$1.18	$1.18
EBT	$16.81	$12.89	$10.38	$8.61
Taxes	6.72	5.16	4.15	3.44
Net Income	$10.08	$7.73	$6.23	$5.16
Depreciation	1.18	1.18	1.18	1.18
Plus Capital Reuse	1.42	1.42	1.42	1.42
Free Cash Flow	**$12.68**	**$10.33**	**$8.82**	**$7.76**
Monthly IRR	13.5%	11.1%	9.5%	8.4%
Annual IRR	357.1%	252.1%	196.5%	162.0%
Total Payback Months	7.4	9.0	10.5	12.0
NPV per Sub - 3 yrs.	**$269**	**$209**	**$171**	**$144**

Managed Modem Service

	2000	2001	2002	2003
Recip Comp Rate	$0.0020	$0.0015	$0.0012	$0.0010
ISP Port (Access Line)	1	1	1	1
RAS Monthly Fee / Port	$9.00	$7.65	$6.50	$5.85
Incremental RAS Rev.	$9.00	$7.65	$6.50	$5.85
PRI Revenue	33.81	28.71	25.13	22.41
Total Revenue	**$42.81**	**$36.36**	**$31.64**	**$28.26**
Total Expenses	$11.82	$10.64	$9.58	$8.62
Gross Margin	**$30.99**	**$25.72**	**$22.06**	**$19.64**
% of Revenue	**72.4%**	**70.7%**	**69.7%**	**69.5%**
PRI SG&A	$4.00	$4.00	$4.00	$4.00
Incrmental SG&A	$0.50	0.50	0.50	0.50
Total	$4.50	$4.50	$4.50	$4.50
% of Revenue	10.5%	12.4%	14.2%	15.9%
EBITDA	$26.49	$21.22	$17.56	$15.14
% of Revenue	61.9%	58.4%	55.5%	53.6%
Depreciation				
PRI Port	$1.18	$1.18	$1.18	$1.18
Modem	3.33	3.33	3.33	3.33
Additional Power	—	—	—	—
Total Depreciation	$4.51	$4.51	$4.51	$4.51
EBT	$21.97	$16.71	$13.05	$10.63
Taxes	8.79	6.68	5.22	4.25
Net Income	$13.18	$10.02	$7.83	$6.38
Depreciation	4.51	4.51	4.51	4.51
Plus Capital Reuse	3.42	3.42	3.42	3.42
Free Cash Flow	**$21.11**	**$17.95**	**$15.76**	**$14.31**
Monthly IRR	9.8%	8.3%	7.3%	6.7%
Annual IRR	205.8%	161.1%	133.5%	116.6%
Total Payback Months	10.2	12.0	13.7	15.0
NPV per Sub - 3 yrs.	**$377**	**$296**	**$240**	**$203**

Source: Morgan Stanley Dean Witter Research

Management

Wallace W. Griffin, *President and CEO*

Mr. Griffin was appointed president, CEO, and a director of Pac-West when the company was recapitalized in September 1998. Prior to joining Pac-West, Mr. Griffin served as a group president for a number of Jones International companies from 1994 to 1997, including Jones Lightwave, Ltd., a competitive local exchange carrier (CLEC), and Jones Education Company, a leader in using technology to deliver education. Concurrently, he was co-owner of a consulting and business development company, Griffin Enterprises, Inc. From 1987 through 1992, Mr. Griffin served as the president and CEO of U S West Marketing Resources Group, where he managed the $1 billion publishing, media software, and advertising services division. Mr. Griffin has over 35 years experience in telecommunications, cable television, publishing, and advertising.

John K. La Rue, *Founder and Executive Vice President*

Mr. La Rue founded the company's predecessor (also known as Pac-West Telecomm, Inc.) in 1980 and served as its president from 1980 until September 16, 1996. Mr. La Rue is responsible for ensuring the profitable execution of the company's ten-state growth plan, working in close partnership with the company's executive team to develop new business processes, improve organizational efficiency, and ensure asset productivity. In addition, with over 31 years of experience in the telecommunications industry, Mr. La Rue plays a key role in the development of new technologies and service offerings. Mr. La Rue also serves on the company's board of directors.

Richard E. Bryson, *Chief Financial Officer*

Mr. Bryson has served as Pac-West's CFO since November 1998. From 1992 to 1998, Mr. Bryson worked at Bank of America as a managing director in the Telecommunications Group, providing emerging telecommunications companies with corporate finance and capital markets services. From 1989 to 1992, Mr. Bryson was president and founder of MBIC, a fund investing in growth companies. From 1980 to 1989, he worked at Citibank in Mezzanine Investments and Capital Markets.

Brian K. Johnson, *Senior Vice President and General Manager of Business Markets*

Mr. Johnson was appointed to his current position in June 1999. He joined Pac-West in September 1998 as vice president of sales. Mr. Johnson has over 15 years of experience in the telecommunications industry. Prior to joining Pac-West, he held several executive-level positions, including vice president and general manager of Winstar Telecommunications, overseeing CLEC operations in the San Francisco Bay Area, vice president and general manager for Metrocall Paging for the California and Nevada markets, director of sales for Comverse Technology, and major accounts manager for LA Cellular.

Dennis V. Meyer, *Vice President of Finance and Treasurer*

Mr. Meyer served as the chief financial officer and treasurer of Pac-West and its predecessor company from 1994 until 1998. In November of 1998, after the company's recapitalization, Mr. Meyer was appointed vice president of finance and treasurer. Prior to 1994, Mr. Meyer spent 12 years in public accounting with a national accounting firm. Mr. Meyer is a certified public accountant with over 20 years of experience as a senior financial officer of several manufacturing and regulated transportation companies. Mr. Meyer also served as an officer in the Air Artillery Branch of the U.S. Army.

Exhibit 11

PACW Quarterly Model

Quarterly Income Statement

Morgan Stanley Dean Witter - Peter J. Kennedy

$ in Millions (Unless Indicated)			2000					2001				
	4Q99A	1999A	1QA	2QA	3QE	4QE	2000E	1QE	2QE	3QE	4QE	2001E
Access Lines												
Access Lines In Service	105,100	105,100	124,094	151,957	166,957	186,957	186,957	211,957	244,457	284,957	334,457	334,457
Net Adds	17,100	56,600	18,947	27,863	15,000	20,000	81,810	25,000	32,500	40,500	49,500	147,500
Adj. Average Lines	93,700	76,800	114,574	138,026	159,457	176,957	147,253	199,457	228,207	264,707	309,707	250,520
Commercial Revenue												
Commercial Lines in Service	23,705	23,705	28,602	34,463	39,263	45,663	45,663	53,913	65,613	80,598	100,398	100,398
Commercial Lines Added			4,897	5,861	4,800	6,400	21,958	8,250	11,700	14,985	19,800	54,735
Adj. Average Commercial Lines			26,154	31,533	36,863	42,463	34,253	49,788	59,763	73,106	90,498	68,289
% of Net Adds			25.8%	21.0%	32.0%	32.0%	24.4%	33.0%	36.0%	37.0%	40.0%	30.0%
Avg Monthly Revenue per Seat			$67.93	$64.48	$62.00	$60.00	$63.60	$58.00	$57.42	$56.85	$56.28	$57.14
ISP Revenues												
ISP Lines in Service	81,442	81,442	95,442	117,494	127,694	141,294	141,294	158,044	178,844	204,359	234,059	234,059
ISP Lines Added			14,050	22,002	10,200	13,600	59,852	16,750	20,800	25,515	29,700	92,765
Adj. Average ISP Lines			88,467	106,493	122,594	134,494	120,494	149,669	168,444	191,602	219,209	193,827
%of Net Adds			74.2%	79.0%	68.0%	68.0%	75.6%	67.0%	64.0%	63.0%	60.0%	70.0%
Base Monthly Revenue per Line			$30.52	$29.11	$24.74	$22.27		$21.82	$21.39	$20.96	$20.54	
Reciprocal Comp Revenues	[illegible]		[illegible]	[illegible]	$13.3	$13.8		$14.4	$14.9	$14.5	$16.1	
Monthly Minutes per Line (000s)	19.2		23.5	19.9	19.0	18.1		17.9	17.3	16.8	16.3	
Reciprocal Compensation Rate	$0.0020		$0.0020	$0.0020	$0.0019	$0.0019		$0.0018	$0.0017	$0.0015	$0.0015	
Income Statement			2000					2001				
Revenues			1QA	2QA	3QE	4QE	2000E	1QE	2QE	3QE	4QE	2001E
ISP Revenue	$ 22.3	$ 48.4	$ 20.6	$ 22.0	$22.4	$22.8	$ 87.8	$24.2	$25.7	$26.5	$29.6	$ 106.1
Commercial Revenue	4.1	14.6	5.3	6.1	6.9	7.6	25.9	8.7	10.3	12.5	15.3	46.7
Napa Telecom	-	-	1.2	1.5	1.5	1.5	5.7	1.4	1.3	1.3	1.3	5.4
Dedicated Transport	1.9	5.2	3.7	4.0	4.3	4.7	16.8	5.1	5.6	6.2	6.8	23.8
Total Revenues	**28.3**	**68.2**	**30.8**	**33.7**	**35.1**	**36.6**	**136.2**	**39.4**	**43.0**	**46.6**	**53.0**	**182.0**
Sequential Revenue Growth			8.8%	9.4%	4.2%	4.4%	100%	7.5%	9.1%	8.3%	13.9%	34%
Operating Expenses	5.9	20.5	10.0	10.2	10.9	11.7	42.8	12.0	12.9	14.0	15.9	54.8
% of Rev	21.0%	30.0%	32.5%	30.2%	31.0%	32.0%	31.4%	30.5%	30.0%	30.0%	30.0%	30.1%
Gross Margin	22.4	47.7	20.8	23.5	24.2	24.9	93.4	27.4	30.1	32.6	37.1	127.2
% of Rev	79.0%	70.0%	67.5%	69.8%	69.0%	68.0%	68.6%	69.5%	70.0%	70.0%	70.0%	
SG&A	7.8	22.9	10.2	12.8	13.7	14.5	51.2	14.8	15.7	16.5	18.3	65.3
% of Rev	27.7%	33.5%	33.1%	38.1%	39.0%	39.5%	37.6%	37.5%	36.5%	35.5%	34.5%	35.9%
EBITDA	**14.5**	**24.9**	**10.6**	**10.7**	**10.5**	**10.4**	**42.2**	**12.6**	**14.4**	**16.1**	**18.8**	**61.9**
EBITDA Margin	51.3%	36.5%	34.4%	31.7%	30.0%	28.5%	31.0%	32.0%	33.5%	34.5%	35.5%	34.0%
Depreciation & Amortization	2.9	8.6	4.1	4.8	5.8	6.8	21.7	7.5	8.3	9.1	10.0	35.0
Operating Income	**11.6**	**16.2**	**6.5**	**5.8**	**4.7**	**3.6**	**20.6**	**5.1**	**6.1**	**6.9**	**8.8**	**26.9**
Net Interest Expense	(3.3)	(18.4)	(2.3)	(2.9)	(3.0)	(3.0)	(11.3)	(3.5)	(3.6)	(3.7)	(3.8)	(14.6)
Other Income/(Expense)	-	(0.1)	-	-	-	-	-	-	-	-	-	-
Income Before Taxes	8.3	(2.2)	4.1	2.897	1.7	0.6	9.3	1.6	2.5	3.2	5.0	12.3
Taxes	(0.8)	(1.0)	(1.8)	(1.3)	(0.5)	(0.2)	(3.8)	(0.5)	(0.8)	(1.0)	(1.5)	(3.7)
Net Income	**7.6**	**(3.2)**	**2.3**	**1.6**	**1.2**	**0.4**	**5.5**	**1.1**	**1.8**	**2.3**	**3.5**	**8.6**
Preferred Stock Dividends	-	(2.4)	-	-	-	-	-	-	-	-	-	-
Net Income to Common	7.6	(0.8)	2.3	1.647	1.2	0.4	5.5	1.1	1.8	2.3	3.5	8.6
Fully Diluted Shares Outstanding	31.7	20.1	37.5	37.5	37.6	37.6	37.5	37.7	37.7	37.8	37.8	37.7
Earnings per Share	**$0.24**	**($0.04)**	**$0.06**	**$0.04**	**$0.03**	**$0.01**	**$0.15**	**$0.03**	**$0.05**	**$0.06**	**$0.09**	**$0.23**
CEPS	$0.33	$0.27	$0.17	$0.17	$0.19	$0.19	$0.72	$0.23	$0.27	$0.30	$0.36	$1.16

Source: Company data, Morgan Stanley Dean Witter Research

Please refer to important disclosures at the end of this report.

Exhibit 12

PACW Annual Income Statement

$ in Millions (Unless Indicated)	1999	2000E	2001E	2002E	2003E	2004E	2005E	2006E	2007E	2008E	2009E	2010E
Revenue												
ISP Revenue	$48.4	$87.8	$106.1	$113.9	$122.2	$129.1	$129.9	$126.9	$127.6	$129.6	$132.4	$135.7
CLEC Revenue	14.6	25.9	46.7	94.3	150.1	210.6	276.6	343.7	413.0	487.5	568.5	660.0
NAPA Telecom	-	5.7	5.4	2.7	-	-	-	-	-	-	-	-
Dedicated Transport	5.2	16.8	23.8	26.2	28.8	31.7	34.9	38.4	42.2	46.4	51.1	56.2
Total Revenue	$68.2	$136.2	$182.0	$237.1	$301.2	$371.4	$441.5	$509.0	$582.9	$663.5	$752.0	$851.9
% Growth		*99.7%*	*33.6%*	*30.3%*	*27.0%*	*23.3%*	*18.9%*	*15.3%*	*14.5%*	*13.8%*	*13.3%*	*13.3%*
Total Operating Expenses	$20.5	$42.8	$54.8	$84.5	$108.7	$131.5	$153.5	$175.9	$200.6	$228.6	$260.6	$298.5
Gross Margin	47.7	93.4	127.2	152.6	192.5	239.9	287.9	333.1	382.3	435.0	491.3	553.5
% Gross Margin	*70.0%*	*68.6%*	*69.9%*	*64.4%*	*63.9%*	*64.6%*	*65.2%*	*65.5%*	*65.6%*	*65.6%*	*65.3%*	*65.0%*
SG&A	$22.9	$51.2	$65.3	$80.8	$93.6	$107.6	$120.6	$131.0	$146.5	$161.3	$181.0	$203.5
% of Revenue	*33.5%*	*37.6%*	*35.9%*	*34.1%*	*31.1%*	*29.0%*	*27.3%*	*25.7%*	*25.1%*	*24.3%*	*24.1%*	*23.9%*
EBITDA	$24.9	$42.2	$61.9	$71.8	$98.9	$132.3	$167.3	$202.2	$235.8	$273.7	$310.4	$350.0
% Margin	*36.5%*	*31.0%*	*34.0%*	*30.3%*	*32.8%*	*35.6%*	*37.9%*	*39.7%*	*40.5%*	*41.2%*	*41.3%*	*41.1%*
Depreciation	8.6	19.1	32.2	56.4	73.5	84.8	87.6	87.0	91.0	95.2	100.6	109.1
Total Amortization		2.6	2.8	2.8	2.8	2.8	2.1	0.2	-	-	-	-
Operating Income	$16.2	$20.6	$26.9	$12.6	$22.7	$44.7	$77.7	$115.0	$144.8	$178.5	$209.8	$240.8
Net Interest Expense	$18.4	$11.3	$18.6	$25.0	$32.2	$36.4	$37.3	$34.8	$29.5	$19.2	$0.4	($4.6)
Pre-Tax Income	(2.1)	9.3	14.6	(12.4)	(9.5)	8.3	40.4	80.2	115.3	159.3	209.4	245.4
Income Tax Expense	1.0	3.8	3.7	-	-	-	10.2	30.5	43.8	60.5	79.6	93.2
Other Income/(Expense)												
Net Income	($3.1)	$5.5	$10.9	($12.4)	($9.5)	$8.3	$30.2	$49.7	$71.5	$98.7	$129.8	$152.1
Preferred Dividends	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Net Income to Common	(3.1)	5.5	10.9	(12.4)	(9.5)	8.3	30.2	49.7	71.5	98.7	129.8	152.1
	-											
Shares Outstanding	35.4	36.8	38.3	39.8	41.4	43.1	44.8	46.6	48.4	50.4	52.4	54.5
Earnings per Share	($0.09)	$0.15	$0.28	($0.31)	($0.23)	$0.19	$0.67	$1.07	$1.48	$1.96	$2.48	$2.79
CEPS	$0.16	$0.74	$1.20	$1.18	$1.61	$2.23	$2.68	$2.94	$3.35	$3.85	$4.40	$4.80
Annual Capital Expenditure		$92	$107	$91	$99	$100	$100	$102	$108	$117	$126	$141
Gross Plant		$217	$324	$415	$513	$613	$713	$815	$923	$1,040	$1,166	$1,307
Revenue/Gross Plant		$0.63	$0.56	$0.57	$0.59	$0.61	$0.62	$0.62	$0.63	$0.64	$0.64	$0.65
ROI		2.6%	3.4%	NM	NM	1.4%	4.2%	6.1%	7.7%	9.5%	11.1%	11.6%

Source: Company data, Morgan Stanley Dean Witter Research

Exhibit 13

PACW Cash Flow Statement

$ in Millions (Unless Indicated)	2000E	2001E	2002E	2003E	2004E	2005E	2006E	2007E	2008E	2009E	2010E
Net Income	$5.5	$10.9	($12.4)	($9.5)	$8.3	$30.2	$49.7	$71.5	$98.7	$129.8	$152.1
Plus: Depreciation & Amortization	21.7	35.0	59.2	76.2	87.5	89.7	87.2	91.0	95.2	100.6	109.1
Less: Changes in Working Capital	(8.0)	(4.7)	(0.4)	(4.1)	(5.8)	(6.1)	(5.5)	(5.9)	(6.2)	(6.3)	(6.6)
Operating Cash Flow	**19.2**	**41.2**	**46.4**	**62.6**	**90.0**	**113.8**	**131.4**	**156.5**	**187.8**	**224.1**	**254.7**
Capital Expenditures	($92.5)	($106.7)	($90.9)	($98.6)	($100.3)	($99.9)	($101.9)	($108.1)	($117.0)	($125.6)	($141.3)
Acquisitions	($10.0)										
Investment Cash Flow	**(102.5)**	**(106.7)**	**(90.9)**	**(98.6)**	**(100.3)**	**(99.9)**	**(101.9)**	**(108.1)**	**(117.0)**	**(125.6)**	**(141.3)**
Plus: Non-Cash Comp											
Debt Repayments	-	-	-	-	-	-	-	-	-	(150.0)	-
Debt Drawdowns	-	-	-	-	-	-	-	-	-	-	-
Preferred Equity Raised/(Redeemed)	-	-	-	-	-	-	-	-	-	-	-
Common Equity Raised	-	-	-	-	-	-	-	-	-	-	-
Financing Cash Flow	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(150.0)**	**-**
Net Change in Cash	(83.3)	(65.6)	(44.5)	(36.0)	(10.2)	13.9	29.5	48.5	70.7	(51.4)	113.3
Minimum Cash Balance	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0
Beginning Cash Balance	$162.9	$79.6	$25.0	$25.0	$25.0	$25.0	$25.0	$25.0	$25.0	$85.9	$34.5
Net Cash Before Revolver	79.6	14.0	(19.5)	(11.0)	14.8	38.9	54.5	73.5	95.7	34.5	147.8
Revolver Drawdown	-	11.0	44.5	36.0	10.2	-	-	-	-	-	-
Revolver Payback	-	-	-	-	-	(13.9)	(29.5)	(48.5)	(9.8)	-	-
Cash Balance After Revolver	79.6	25.0	25.0	25.0	25.0	25.0	25.0	25.0	85.9	34.5	147.8

Source: Company data, Morgan Stanley Dean Witter Research

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SBC Reciprocal Compensation Rate Template

	TX	MI	IL	IN	WI	OH	CT	MO	KS	OK	AR
CLEC Rates-In Balance Traffic	0.00193	0.0011411	0.0041747	0.0042347	0.0045506	0.00408	0.002561	0.0025469	0.0021373	0.0036068	0.005003

CA	
Set Up	0.007
Duration	0.002539

NV	
Set Up	0.00311
Duration	0.002981

	TX	MI	IL	IN	WI	OH	CT	MO	KS	OK	AR	CA	NV
CLEC Rates-Out of Balance Traffic													
Year 1 (1/1/01 - 5/31/01)	0.001076	0.001004	0.001300	0.001300	0.001300	0.001300	0.001300	0.001300	0.001300	0.001300	0.001300	0.001300	0.001300
Year 2 (6/1/01 - 5/31/02)	0.001000	0.001000	0.001000	0.001000	0.001000	0.001000	0.001000	0.001000	0.001000	0.001000	0.001000	0.001000	0.001000
Year 3 (6/1/02 - 5/31/03)	0.000794	0.000262	0.001072	0.000307	0.000704	0.000660	0.001805	0.001514	0.000789	0.000956	0.001665	0.000670	0.001261